

Inner-City Arts

Financial Statements
and Other Audit Report

December 31, 2019 and 2018



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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Inner-City Arts
Los Angeles, California

We have audited the accompanying financial statements of Inner-City Arts (a California nonprofit corporation) (the "Organization"), which comprise the statements of financial position as of December 31, 2019 and 2018, and the related statements of activities, functional expenses, and 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.

Auditor's 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Inner-City Arts as of December 31, 2019 and 2018, 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.

Change in Accounting Principle

As described in Note 2 to the financial statements, the Organization has implemented Financial Accounting Standards Board Accounting Standards Update ("ASU") 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Made*. Our opinion is not modified with respect to this matter.

Emphasis of Matter

As discussed in Note 12 to the financial statements, on March 11, 2020, the World Health Organization declared the outbreak of the novel strain of coronavirus ("COVID-19") a global pandemic and recommended containment and mitigation measures worldwide. Potential impacts to the Organization include disruptions or restrictions on the Foundation's ability to operate its programs and on its employees' ability to work. The ultimate financial impact and duration of these events cannot be reasonably estimated at this time. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated August 25, 2020, on our consideration of the Organization's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control over financial reporting and compliance.



Armanino^{LLP}
Los Angeles, California

August 25, 2020

Inner-City Arts
Statements of Financial Position
December 31, 2019 and 2018

| | 2019 | 2018 |
|--|-------------------|-------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 590,003 | \$ 971,782 |
| Investments | 2,092,199 | 1,467,752 |
| Grants and accounts receivable | 459,752 | 336,086 |
| Pledges receivable | 365,560 | 317,293 |
| Prepaid expenses | 50,123 | 75,128 |
| Total current assets | 3,557,637 | 3,168,041 |
| Property and equipment, net | 10,388,917 | 10,588,658 |
| Long term assets | | |
| Board-designated investments | 1,000,000 | 1,000,000 |
| Donor-restricted endowment investments | 1,773,847 | 1,567,532 |
| Pledges receivable, net | 272,692 | 437,255 |
| Total long term assets | 3,046,539 | 3,004,787 |
| Total assets | \$ 16,993,093 | \$ 16,761,486 |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities | | |
| Accounts payable | \$ 47,671 | \$ 7,743 |
| Accrued expenses | 261,795 | 126,585 |
| Deferred revenue | 40,111 | 337,211 |
| Total current liabilities | 349,577 | 471,539 |
| Deferred revenue, net of current portion | 105,332 | 140,442 |
| Total liabilities | 454,909 | 611,981 |
| Net assets | | |
| Without donor restrictions | | |
| Undesignated | 1,688,170 | 1,248,358 |
| Board-designated | 1,000,000 | 1,000,000 |
| Investment in property and equipment | 10,388,917 | 10,588,658 |
| Total without donor restrictions | 13,077,087 | 12,837,016 |
| With donor restrictions | 3,461,097 | 3,312,489 |
| Total net assets | 16,538,184 | 16,149,505 |
| Total liabilities and net assets | \$ 16,993,093 | \$ 16,761,486 |

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

Inner-City Arts
Statement of Activities
For the Year Ended December 31, 2019

| | <u>Without Donor Restrictions</u> | <u>With Donor Restrictions</u> | <u>Total</u> |
|---|---------------------------------------|------------------------------------|----------------------|
| Revenue and support | | | |
| Contributions | \$ 1,879,084 | \$ 1,073,894 | \$ 2,952,978 |
| Special events (net of \$426,758 of direct benefit to donors) | 702,974 | - | 702,974 |
| Government grants | 449,543 | - | 449,543 |
| Fee income | 247,073 | - | 247,073 |
| In-kind contributions | 44,861 | - | 44,861 |
| Investment income, net | 366,318 | 232,688 | 599,006 |
| Rental income | 203,443 | - | 203,443 |
| Miscellaneous | 3,047 | - | 3,047 |
| Net assets released from restriction | <u>1,157,974</u> | <u>(1,157,974)</u> | <u>-</u> |
| Total revenue and support | <u>5,054,317</u> | <u>148,608</u> | <u>5,202,925</u> |
| Functional expenses | | | |
| Program services | <u>3,628,564</u> | <u>-</u> | <u>3,628,564</u> |
| Support services | | | |
| Management and general | 551,412 | - | 551,412 |
| Fundraising | <u>634,270</u> | <u>-</u> | <u>634,270</u> |
| Total support services | <u>1,185,682</u> | <u>-</u> | <u>1,185,682</u> |
| Total functional expenses | <u>4,814,246</u> | <u>-</u> | <u>4,814,246</u> |
| Change in net assets | 240,071 | 148,608 | 388,679 |
| Net assets, beginning of year | <u>12,837,016</u> | <u>3,312,489</u> | <u>16,149,505</u> |
| Net assets, end of year | <u>\$ 13,077,087</u> | <u>\$ 3,461,097</u> | <u>\$ 16,538,184</u> |

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

Inner-City Arts
Statement of Activities
For the Year Ended December 31, 2018

| | <u>Without Donor Restrictions</u> | <u>With Donor Restrictions</u> | <u>Total</u> |
|---|---------------------------------------|------------------------------------|----------------------|
| Revenue and support | | | |
| Contributions | \$ 1,023,554 | \$ 1,919,612 | \$ 2,943,166 |
| Special events (net of \$450,806 of direct benefit to donors) | 761,562 | - | 761,562 |
| Government grants | 468,813 | - | 468,813 |
| Fee income | 281,559 | - | 281,559 |
| In-kind contributions | 8,561 | - | 8,561 |
| Investment income, net | (97,166) | (40,873) | (138,039) |
| Rental income | 27,236 | - | 27,236 |
| Miscellaneous | 217 | - | 217 |
| Net assets released from restriction | <u>1,450,826</u> | <u>(1,450,826)</u> | <u>-</u> |
| Total revenue and support | <u>3,925,162</u> | <u>427,913</u> | <u>4,353,075</u> |
| Functional expenses | | | |
| Program services | <u>4,072,243</u> | <u>-</u> | <u>4,072,243</u> |
| Support services | | | |
| Management and general | 554,028 | - | 554,028 |
| Fundraising | <u>848,116</u> | <u>-</u> | <u>848,116</u> |
| Total support services | <u>1,402,144</u> | <u>-</u> | <u>1,402,144</u> |
| Total functional expenses | <u>5,474,387</u> | <u>-</u> | <u>5,474,387</u> |
| Change in net assets | (1,549,225) | 427,913 | (1,121,312) |
| Net assets, beginning of year | <u>14,386,241</u> | <u>2,884,576</u> | <u>17,270,817</u> |
| Net assets, end of year | <u>\$ 12,837,016</u> | <u>\$ 3,312,489</u> | <u>\$ 16,149,505</u> |

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

Inner-City Arts
Statement of Functional Expenses
For the Year Ended December 31, 2019

| | <u>Program Services</u> | <u>Management and General</u> | <u>Fundraising</u> | <u>Total</u> |
|---|-----------------------------|-----------------------------------|--------------------|---------------------|
| Personnel expenses | | | | |
| Salaries and wages | \$ 2,158,863 | \$ 368,313 | \$ 469,485 | \$ 2,996,661 |
| Payroll taxes | 174,504 | 26,530 | 36,984 | 238,018 |
| Employee benefits | <u>250,862</u> | <u>24,409</u> | <u>28,647</u> | <u>303,918</u> |
| Total personnel expenses | 2,584,229 | 419,252 | 535,116 | 3,538,597 |
| Depreciation | 376,903 | 14,288 | 11,186 | 402,377 |
| Services and professional fees | 94,194 | 34,587 | 49,136 | 177,917 |
| Facility and occupancy | 233,592 | 13,138 | 15,039 | 261,769 |
| Supplies and travel | 82,900 | 13,601 | 4,982 | 101,483 |
| Independent artists and art class services | 69,093 | - | - | 69,093 |
| Class transportation | 108,583 | 674 | 884 | 110,141 |
| Advertising and promotion | 2,204 | 8,271 | 2,487 | 12,962 |
| Insurance | 20,226 | 646 | 645 | 21,517 |
| Postage and printing | 4,423 | 3,758 | 5,978 | 14,159 |
| Program events and awards | 51,834 | - | - | 51,834 |
| Dues and subscriptions | - | 5,583 | 7,485 | 13,068 |
| Bad debt expense | - | 25,510 | - | 25,510 |
| Conferences, conventions and meetings | 383 | 12,104 | 1,332 | 13,819 |
| Direct benefit costs | <u>-</u> | <u>-</u> | <u>426,758</u> | <u>426,758</u> |
| Total expenses | 3,628,564 | 551,412 | 1,061,028 | 5,241,004 |
| Less: expenses included with revenues on the statement of activities | | | | |
| Direct benefit costs | <u>-</u> | <u>-</u> | <u>(426,758)</u> | <u>(426,758)</u> |
| | <u>\$ 3,628,564</u> | <u>\$ 551,412</u> | <u>\$ 634,270</u> | <u>\$ 4,814,246</u> |

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

Inner-City Arts
Statement of Functional Expenses
For the Year Ended December 31, 2018

| | <u>Program Services</u> | <u>Management and General</u> | <u>Fundraising</u> | <u>Total</u> |
|---|-----------------------------|-----------------------------------|--------------------|---------------------|
| Personnel expenses | | | | |
| Salaries and wages | \$ 2,410,644 | \$ 399,947 | \$ 538,255 | \$ 3,348,846 |
| Payroll taxes | 210,085 | 29,224 | 44,926 | 284,235 |
| Employee benefits | <u>226,168</u> | <u>36,118</u> | <u>31,806</u> | <u>294,092</u> |
| Total personnel expenses | 2,846,897 | 465,289 | 614,987 | 3,927,173 |
| Depreciation | 376,414 | 13,492 | 11,740 | 401,646 |
| Services and professional fees | 137,089 | 25,059 | 179,829 | 341,977 |
| Facility and occupancy | 198,209 | 12,215 | 10,573 | 220,997 |
| Supplies and travel | 74,414 | 11,392 | 2,923 | 88,729 |
| Independent artists and art class services | 137,199 | - | - | 137,199 |
| Class transportation | 79,991 | 92 | 511 | 80,594 |
| Advertising and promotion | 2,513 | 14,096 | 10,225 | 26,834 |
| Insurance | 26,044 | 831 | 831 | 27,706 |
| Postage and printing | 9,841 | 3,939 | 10,313 | 24,093 |
| Program events and awards | 120,721 | - | - | 120,721 |
| Dues and subscriptions | 5,002 | 6,669 | 6,148 | 17,819 |
| Bad debt expense | 57,385 | - | - | 57,385 |
| Conferences, conventions and meetings | 524 | 954 | 36 | 1,514 |
| Direct benefit costs | <u>-</u> | <u>-</u> | <u>450,806</u> | <u>450,806</u> |
| Total expenses | 4,072,243 | 554,028 | 1,298,922 | 5,925,193 |
| Less: expenses included with revenues on the statement of activities | | | | |
| Direct benefit costs | <u>-</u> | <u>-</u> | <u>(450,806)</u> | <u>(450,806)</u> |
| | <u>\$ 4,072,243</u> | <u>\$ 554,028</u> | <u>\$ 848,116</u> | <u>\$ 5,474,387</u> |

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

Inner-City Arts
Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018

| | <u>2019</u> | <u>2018</u> |
|--|-------------------|-------------------|
| Cash flows from operating activities | | |
| Change in net assets | \$ 388,679 | \$ (1,121,312) |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities | | |
| Depreciation | 402,377 | 401,646 |
| Reinvested interest and dividends | (99,848) | (84,814) |
| Unrealized and realized (gains) losses on investments | (499,158) | 222,853 |
| Contributions for endowment | (10,000) | (135,000) |
| Discount on pledges receivable | - | 86,568 |
| Changes in operating assets and liabilities | | |
| Grants and accounts receivable | (123,666) | (24,579) |
| Pledges receivable | 116,296 | (267,916) |
| Prepaid expenses | 25,005 | (8,062) |
| Accounts payable | 39,928 | (54,557) |
| Accrued expenses | 135,210 | 35,435 |
| Deferred revenue | (332,210) | 261,989 |
| Net cash provided by (used in) operating activities | <u>42,613</u> | <u>(687,749)</u> |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (202,636) | (45,488) |
| Purchases of investments | (772,957) | (2,376,664) |
| Proceeds from sales of investments | 541,201 | 3,145,104 |
| Net cash provided by (used in) investing activities | <u>(434,392)</u> | <u>722,952</u> |
| Cash flows from financing activities | | |
| Contributions for endowment | <u>10,000</u> | <u>135,000</u> |
| Net cash provided by financing activities | <u>10,000</u> | <u>135,000</u> |
| Net increase (decrease) in cash and cash equivalents | (381,779) | 170,203 |
| Cash and cash equivalents, beginning of year | <u>971,782</u> | <u>801,579</u> |
| Cash and cash equivalents, end of year | <u>\$ 590,003</u> | <u>\$ 971,782</u> |

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

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

1. NATURE OF OPERATIONS

Inner-City Arts (or the "Organization") was incorporated on September 6, 1989, under the California nonprofit public benefit corporation law. Inner-City Arts has been granted tax-exempt status under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3).

Inner-City Arts serves students enrolled in public elementary, middle, and high schools located within 7 miles of the high-poverty Skid Row area of Los Angeles. Throughout its history, Inner-City Arts have provided diverse and professional experiences in the arts that serve to enhance learning outcomes among those most under-resourced children with limited English proficiency enrolled in schools where students struggle to meet minimum standards of literacy and academic achievement. What began as primarily a visual arts program has now grown to serve more than 15,000 children and youth, educators, school community, and family members each year, offering a broad spectrum of experiences in the visual and performing arts. Inner-City Arts operates in partnership with a city school district to bus children from inner-city schools during their instructional day, as well as offering programs during out of school hours. Inner-City Arts relies primarily on gifts from foundations, corporations, public funds, fundraising events, and individuals to fund the ongoing operation of its programs.

Inner-City Arts' students are among the nation's most at risk of failure to achieve in school, facing severe challenges manifesting from conditions of poverty. A high proportion of its students struggle to meet minimum standards of academic achievement, impaired in part by language barriers and the effects of living in poverty. The more than 70 elementary, middle and high schools (primarily within the Los Angeles Unified School District's (LAUSD) Educational Service Centers-East, South and Central) served by Inner-City Arts reflect a combined enrollment of more than 56,000 that is 78% Latino, 12% African American, and 10% Asian American. Of the total population, 77% are classified as having limited English proficiency, and 100% are enrolled in Title I schools that participate in the free/reduced lunch program, coming from households that earn an income that is at or below the poverty level.

Inner-City Arts offers instructional day programs, after-school, weekend and summer programs to Kindergarten through 12th-grade students and young adults. Core instructional day classes reflect the foundational program offering at Inner-City Arts, providing elementary and middle school students learning in the visual and performing arts over multi-week sessions held at the Inner-City Arts campus. This foundational program is taught by professional teaching artists and is designed to engage students in their own creativity, strengthen language development, develop critical thinking skills, promote literacy, and improve learning outcomes overall.

Inner-City Arts' Work of Art is a college and career exploration program designed to prepare teens with the skills, training, and real-world experience necessary to prepare them for employment and college life beyond high school. The pilot program with eight students began in 2013. Now established with year-round activities, Work of Art enrolled a total of 50 students in 2019, produced 22 graduates, with 10 of the graduates enrolling in a 4-year college or university and 7 enrolling in community college.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

1. NATURE OF OPERATIONS (continued)

The Inner-City Arts Professional Development Institute provides training to in-service and pre-service teachers and educators and served over 1,369 participants in 2019. The in-service components of the program serve teachers from primarily Los Angeles County. The pre-service component of the program provides two accredited courses for UCLA graduate students receiving their teaching credential and M.A. degree. This program supports the essential role that teachers play in their students' ability to think, learn, and achieve, creating classrooms where learning is enhanced in all core subjects. The program exposes teachers to new ways of thinking about creativity and the arts and also provides new approaches to student learning in all core subject areas. All instruction in the program is aligned with current research on brain-based teaching strategies (as delineated in the growing field of neuroeducation), the strands of the California Content Standards for the Visual and Performing Arts (VAPA), and best practices in stand-alone arts instruction, as well as arts-integrated approaches. Teachers' capacity to create successful learning environments is increased as they gain tools to provide learning-centered education.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting and financial statement presentation

The financial statements are reported according to the existence or absence of donor-imposed restrictions. Accordingly, balances and transactions are reported in the following classes of net assets:

- *Net assets without donor restrictions, general* - Net assets not subject to donor-imposed stipulations.
- *Net assets without donor restrictions, board-designated* - Net assets designated by the Organization's Board of Directors as reserves for future use.
- *Net assets without donor restrictions, investment in property and equipment* - Net assets the Organization currently has invested in property and equipment, net of accumulated depreciation and amortization.
- *Net assets with donor restrictions* - Net assets subject to donor-imposed stipulations that will be met by actions of the Organization, and/or the passage of time, or are maintained in perpetuity by the Organization. When the donor-imposed stipulation ends or the Organization satisfies an action, the Organization reclassifies net assets with donor restrictions to net assets without donor restrictions. Donor-imposed stipulations which are met in the same reporting period are reported as without donor restrictions.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Change in accounting principle

The Organization has implemented Financial Accounting Standards Board ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Made* ("ASU 2018-08"). That standard clarifies guidance about whether funds received from contracts and grants are contributions or exchange transactions. The standard further provides that when both a barrier to be overcome and a right of return or right of release exist, a donor-imposed condition exists and contribution revenue should not be recognized until the barrier has been overcome or has been met. A probability assessment about whether the recipient is likely to meet the stipulation is not a factor when determining whether an agreement is a barrier. The Organization has implemented the standard on a modified prospective basis, meaning that it has been applied to all arrangements that were not completed as of January 1, 2019, or were entered into after that date. The implementation of ASU 2018-08 had no impact on the financial statements for the year ended December 31, 2019.

Cash and cash equivalents

Inner-City Arts has defined cash and cash equivalents as cash in banks and other financial instruments with an original maturity date of three months or less. The carrying value of cash and cash equivalents at December 31, 2019 and 2018 approximates its fair value. Inner-City Arts did not have any cash equivalents at December 31, 2019 or 2018.

Investments

Investments in marketable securities with readily determinable fair values and all investments in debt securities are recorded at their fair values in the statements of financial position. Realized and unrealized gains and losses are included in the statements of activities.

Fair value measurements

Inner-City Arts follows an accounting standard which defines fair value for those assets (and liabilities) that are re-measured and reported at fair value at each reporting period. This standard establishes a single authoritative definition of fair value, sets out a framework for measuring fair value based on inputs used, and requires additional disclosures about fair value measurements. The statement applies to fair value measurements already required or permitted by existing standards.

- *Level 1* - utilize quoted prices (unadjusted) in active markets for identical assets (or liabilities).
- *Level 2* - utilize data points that are observable such as quoted prices, interest rates and yield curves.
- *Level 3* - unobservable data points for the asset (or liability) and include situations where there is little, if any, market activity for the asset (or liability).

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Grants and accounts receivable

Grants and accounts receivable are recorded when billed or accrued and represent claims against third parties that will be settled in cash. The carrying value of receivables, net of the allowance for doubtful accounts, if any, represents their estimated net realizable value. The allowance for doubtful accounts, if any, is estimated based on historical collection trends, type of customer, the age of outstanding receivables and existing economic conditions. If events or changes in circumstances indicate that specific receivable balances may be impaired, further consideration is given to the collectability of those balances and the allowance is adjusted accordingly. Past due receivable balances are written-off when internal collection efforts have been unsuccessful in collecting the amount due. As of December 31, 2019 and 2018, all grants and accounts receivable were deemed collectible; therefore, no allowance for doubtful accounts has been provided.

Pledges receivable

Pledges receivable are unconditional promises to give and are discounted to present value utilizing risk-free interest rates for similar assets with a similar cash flow period. As of December 31, 2019 and 2018, the discount rates range from 3.64% to 4.83% and are recognized as revenues in the period received. Unconditional promises are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional.

Property and equipment

Depreciation of property and equipment is computed using the straight-line method over the following estimated useful lives:

| | |
|-----------------------------------|---------------|
| Buildings | 39 years |
| Building improvements | 36 - 39 years |
| Furniture, fixtures and equipment | 3 -12 years |

Long-lived assets

Inner-City Arts evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss is recognized when the sum of the undiscounted future cash flows is less than the carrying amount of the asset, in which case a write-down is recorded to reduce the related asset to its estimated value. No such impairment losses have been recognized during the years ended December 31, 2019 and 2018.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Concentrations of credit risk

Inner-City Arts' operating cash accounts are held with high-credit, quality financial institutions. At times, such cash accounts may be in excess of the Federal Deposit Insurance Corporation's (FDIC) insurance limit. Inner-City Arts has not incurred losses related to these cash accounts.

Inner-City Arts holds investments in the form of certificates of deposit, U.S. and international equities index funds, and fixed income bonds. Market values of such investments are routinely reviewed by the Finance Committee.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain long-term investments, it is reasonably possible that changes in the values of these investments will occur in the near-term and that such changes could materially affect those amounts reported in the financial statements.

At December 31, 2019 and 2018, three donors accounted for 61% and 64% of the pledges receivable balance, respectively. During the years ended December 31, 2019 and 2018, one donor accounted for 17% and 12% of the Organization's contribution revenue, respectively. The Organization continually monitors its receivables and establishes allowances as considered appropriate.

In-kind contributions

Contributions of donated non-cash assets are recorded at fair value in the period received. Contributions of donated services that create or enhance non-financial assets or that require specialized skills which are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation, are recorded at fair value in the period received. For the years ended December 31, 2019 and 2018 in-kind contributions consisting of materials and facility use totaled \$44,861 and \$8,561, respectively.

Revenue recognition

Contributions, including unconditional promises to give, are recognized as support in the period received. Contributions, including unconditional promises to give, are recorded as net assets with donor restrictions depending on the existence and/or nature of any restrictions and are then reclassified to net assets without donor restrictions upon satisfaction of any restrictions through the net assets released from restriction. Contributions and unconditional promises to give that are expected to be collected or paid in future years are discounted using a net present value technique, unless management determines the discount amount is insignificant.

Contributions that are considered conditional promises to give which contain barriers and a right of return or right of release are not recognized until the conditions on which they depend are met, at which time, the gift is recognized as either contribution revenue with or without donor restrictions.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

The Organization generates revenue from providing services for children through cost reimbursement government funded programs. The revenue generated from these services is included within government grants in the statement of activities. These government grants meet the criteria to be classified as conditional contributions under Generally Accepted Accounting Principles ("GAAP") revenue recognition for nonprofit organizations as they contain barriers related to the incurrence of qualifying expenditures and a right of return or release. The Organization has elected a simultaneous release option to account for these grants. Therefore, they are recorded as government grants without donor restrictions upon satisfaction of the barriers. In the event amounts are received and have not been earned, the Organization records such amounts as deferred revenue until earned. At December 31, 2019 the Organization had zero conditional contributions related to open government grants.

Deferred revenue

Grant funds received as part of an exchange transaction are recorded as deferred revenue and recognized as they are earned. Conditional contributions received in advanced are recorded as deferred revenue and recognized as they are earned.

Functional expenses

The costs of providing Inner-City Arts' programs and other activities have been presented in the statements of functional expenses. During the years, such costs are accumulated into separate groupings as either direct or indirect. Indirect or shared costs are allocated among program and support services by a method that best measures the relative degree of benefit. Inner-City Arts uses salary dollars, headcount, and square footage to allocate indirect costs.

Income tax status

Inner-City Arts is exempt from taxation under Internal Revenue Code Section 501(c)(3) and California Revenue and Taxation Code Section 23701d.

Inner-City Arts' current accounting policy is to evaluate uncertain tax positions. Accordingly, a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. Management evaluated Inner-City Arts' tax positions and concluded that Inner-City Arts had maintained its tax-exempt status and had taken no uncertain tax positions that require adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the financial statements. Inner-City Arts is no longer subject to tax examinations by Federal and State tax authorities for tax years before 2015.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues and expenses as of the date and for the period presented. Actual results could differ from these estimates.

Subsequent events

Inner-City Arts has evaluated events and transactions occurring subsequent to the statement of financial position date of December 31, 2019 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through August 25, 2020, the date these financial statements were available to be issued. See Note 12.

3. PLEDGES RECEIVABLE

Future collections of pledges receivable are expected as follows:

Year ending December 31,

| | | |
|--------------------------------------|----|--------------------------|
| 2020 | \$ | 365,560 |
| 2021 | | 90,000 |
| 2022 | | 85,000 |
| 2023 | | 60,000 |
| 2024 | | 35,000 |
| Thereafter | | <u>105,000</u> |
| | | 740,560 |
| Less: discount on pledges receivable | | <u>(102,308)</u> |
| Pledges receivable, net of discount | | 638,252 |
| Current portion | | <u>(365,560)</u> |
| | | <u><u>\$ 272,692</u></u> |

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

4. INVESTMENTS AND FAIR VALUE MEASUREMENTS

The following table sets forth by level, within the fair value hierarchy, the Organization's investments at fair value as of December 31, 2019:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Fair Value</u> |
|-------------------------|---------------------|-------------------|----------------|---------------------|
| Money market funds | \$ 921,660 | \$ - | \$ - | \$ 921,660 |
| Certificates of deposit | - | 445,000 | - | 445,000 |
| U.S. equities | 2,064,231 | - | - | 2,064,231 |
| International equities | 179,432 | - | - | 179,432 |
| Fixed income | <u>1,255,723</u> | <u>-</u> | <u>-</u> | <u>1,255,723</u> |
| | <u>\$ 4,421,046</u> | <u>\$ 445,000</u> | <u>\$ -</u> | <u>\$ 4,866,046</u> |

The following table sets forth by level, within the fair value hierarchy, the Organization's investments at fair value as of December 31, 2018:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Fair Value</u> |
|-------------------------|---------------------|-------------------|----------------|---------------------|
| Money market funds | \$ 642,300 | \$ - | \$ - | \$ 642,300 |
| Certificates of deposit | - | 445,000 | - | 445,000 |
| U.S. equities | 1,632,619 | - | - | 1,632,619 |
| International equities | 151,887 | - | - | 151,887 |
| Fixed income | <u>1,163,478</u> | <u>-</u> | <u>-</u> | <u>1,163,478</u> |
| | <u>\$ 3,590,284</u> | <u>\$ 445,000</u> | <u>\$ -</u> | <u>\$ 4,035,284</u> |

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

| | <u>2019</u> | <u>2018</u> |
|-----------------------------------|----------------------|----------------------|
| Land | \$ 1,623,072 | \$ 1,623,072 |
| Buildings | 12,430,895 | 12,430,895 |
| Building improvements | 1,000,389 | 903,096 |
| Furniture, fixtures and equipment | <u>517,142</u> | <u>411,356</u> |
| | 15,571,498 | 15,368,419 |
| Accumulated depreciation | <u>(5,182,581)</u> | <u>(4,779,761)</u> |
| | <u>\$ 10,388,917</u> | <u>\$ 10,588,658</u> |

Depreciation expense for the years ended December 31, 2019 and 2018 was \$402,377 and \$401,646, respectively.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

6. ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

| | 2019 | 2018 |
|----------------------------|------------|------------|
| Accrued expenses | \$ 3,326 | \$ 5,254 |
| Accrued salaries and wages | 140,327 | 6,113 |
| Accrued vacation | 118,142 | 115,218 |
| | \$ 261,795 | \$ 126,585 |

7. COMMITMENTS AND CONTINGENCIES

Inner-City Arts leases a parking facility located in Los Angeles under a non-cancelable operating lease which expires in November 2023 for approximately \$6,200 per month.

Inner-City Arts leases office equipment under various non-cancelable operating leases. The leases require monthly payments ranging from \$20 to \$386 and expire on various dates through May 2023.

The scheduled minimum lease payments under the lease terms are as follows:

| Year ending December 31, | Equipment | Parking Facility | Total |
|--------------------------|-----------|------------------|------------|
| 2020 | \$ 5,168 | \$ 74,318 | \$ 79,486 |
| 2021 | 1,308 | 78,032 | 79,340 |
| 2022 | 1,308 | 81,591 | 82,899 |
| 2023 | 461 | 78,210 | 78,671 |
| | \$ 8,245 | \$ 312,151 | \$ 320,396 |

Total rent expense under all operating leases in effect during the years ended December 31, 2019 and 2018 was \$76,724 and \$66,117, respectively.

Inner-City Arts' grants and contracts are subject to inspection and audit by the appropriate governmental funding agency. The purpose is to determine whether program funds were used in accordance with their respective guidelines and regulations. The potential exists for disallowance of previously funded program costs. The ultimate liability, if any, which may result from these governmental audits cannot be reasonably estimated and, accordingly, Inner-City Arts has no provision for the possible disallowance of program costs on its financial statements.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

8. RETIREMENT PLAN

Inner-City Arts established a 403(b) plan, and full-time employees are eligible to participate in the plan. Eligible employees may make a salary reduction election under the plan. Inner-City Arts did not contribute to the plan for the years ended December 31, 2019 and 2018.

9. NET ASSETS

Net assets consisted of the following:

| | 2019 | 2018 |
|---|----------------------|----------------------|
| Net assets without donor restrictions | | |
| Undesignated | \$ 1,688,170 | \$ 1,248,358 |
| Board-designated | 1,000,000 | 1,000,000 |
| Investment in property and equipment | <u>10,388,917</u> | <u>10,588,658</u> |
| Total net assets without donor restrictions | <u>13,077,087</u> | <u>12,837,016</u> |
| Net assets with donor restrictions: | | |
| Restricted for a specified purpose | | |
| Animation | - | 50,000 |
| Learning & Achieving Through the Arts | 145,417 | 182,916 |
| Dance Academy | 428,664 | 271,572 |
| Busing | 89,500 | 44,500 |
| Creativity Lab | 76,866 | 76,866 |
| Performing, Visual & Media Arts | 167,083 | 235,417 |
| Programs - Individually under \$25,000 | 27,970 | 27,970 |
| Teacher Professional Development | <u>12,500</u> | <u>91,667</u> |
| | <u>948,000</u> | <u>980,908</u> |
| Time-restricted, including pledges receivable | <u>739,250</u> | <u>701,185</u> |
| Donor-restricted endowment | <u>1,773,847</u> | <u>1,630,396</u> |
| Total net assets with donor restrictions | <u>3,461,097</u> | <u>3,312,489</u> |
| Total net assets | <u>\$ 16,538,184</u> | <u>\$ 16,149,505</u> |

10. ENDOWMENT

The Organization's endowment consists of several individual funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

10. ENDOWMENT (continued)

Interpretation of relevant law

The Organization's Board of Directors has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization classifies as donor-restricted net assets (a) the original value of gifts donated to the donor-restricted endowment, (b) the original value of subsequent gifts to the donor-restricted endowment, and (c) accumulations to the donor-restricted endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

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

- (1) The duration and preservation of the fund
- (2) The purposes of the Organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Organization
- (7) The investment policies of the Organization

Return objectives and risk parameters

The primary long-term financial objective for Inner-City Arts' endowments is to preserve the real purchasing power of endowment assets and income after accounting for endowment spending, inflation and costs of portfolio management. The endowments are also managed to optimize the long run total rate of return on invested assets, assuming a prudent level of risk. The goal for this rate of return is one that funds Inner-City Arts' existing spending policy and allows sufficient reinvestment to grow the endowment principal at a rate that is based on inflation as measured by the Consumer Price Index. Over the short-term, Inner-City Arts seeks to obtain a return for each element of the endowment portfolio that would match or exceed each of the returns for the broader capital markets in which assets are invested.

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 UPMIFA requires the Organization to retain as a fund of perpetual duration. There were no such deficiencies as of December 31, 2019 or 2018.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

10. ENDOWMENT (continued)

Spending policy

Inner-City Arts will only incur costs that are reasonable in relation to the assets, the purposes of the Organization, and the skills available to Inner-City Arts.

The appropriation for expenditure in any year of an amount greater than 7% of the fair market value of an endowment fund calculated on the basis of market values determined at least quarterly and averaged over a period of not less than three years immediately preceding the year in which the appropriation for expenditure is made creates a rebuttable presumption of imprudence. To show prudence, the decision-making process on expenditure in any year greater than 7% will be documented.

Endowment composition

Endowment net asset composition by type of fund as of December 31, 2019 is as follows:

| | With Donor Restrictions | | |
|-----------|-------------------------|--|--------------|
| | Original Gift Amount | Accumulated Gains (Losses) and Other | Total |
| Endowment | \$ 1,702,532 | \$ 71,315 | \$ 1,773,847 |

Endowment net asset composition by type of fund as of December 31, 2018 is as follows:

| | With Donor Restrictions | | |
|-----------|-------------------------|--|--------------|
| | Original Gift Amount | Accumulated Gains (Losses) and Other | Total |
| Endowment | \$ 1,692,532 | \$ (62,136) | \$ 1,630,396 |

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

10. ENDOWMENT (continued)

Endowment composition (continued)

Changes in endowment net assets for the years ended December 31, 2019 and 2018 is as follows:

| | With Donor Restrictions | | |
|-------------------------------|-------------------------|---|--------------|
| | Original Gift Amount | Accumulated Gains (Losses) and Other | Total |
| Balance, January 1, 2018 | \$ 1,557,532 | \$ 77,974 | \$ 1,635,506 |
| Investment income (loss) | - | (40,873) | (40,873) |
| Contributions | 135,000 | - | 135,000 |
| Appropriation for expenditure | - | (99,237) | (99,237) |
| Balance, December 31, 2018 | \$ 1,692,532 | \$ (62,136) | \$ 1,630,396 |
| Investment income (loss) | \$ - | \$ 232,688 | \$ 232,688 |
| Contributions | 10,000 | - | 10,000 |
| Appropriation for expenditure | - | (99,237) | (99,237) |
| Balance, December 31, 2019 | \$ 1,702,532 | \$ 71,315 | \$ 1,773,847 |

Donor-restricted endowment funds at December 31, 2019 and 2018 included \$0 and \$125,000 of pledges receivable, respectively.

11. LIQUIDITY AND FUNDS AVAILABLE

As part of Inner-City Arts liquidity management, it structures its financial assets to be available as its general expenditures, liabilities, and other obligations come due. To meet liquidity needs, Inner-City Arts has cash and investments, which consist of certificates of deposit, equity securities and fixed income securities that are separate from the investments related to the Board-designated investments and endowment investments. These investments are considered short-term as there are no preventative lockups or restrictions and can be readily liquidated to pay for operating needs. Additionally, grants and accounts receivable consist primarily of amounts due from third parties that have been historically collected within 60 days of the year-end. Pledges receivable that are considered current will be collected from donors within one year from the date of the statement of financial position.

Quarterly, the Finance Committee of the Board of Directors reviews Inner-City Arts' statement of financial position sheet and discusses what may be a reasonable cash position to maintain.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

11. LIQUIDITY AND FUNDS AVAILABLE (continued)

The following is a quantitative disclosure which describes assets that are available within one year of December 31, 2019 to fund general expenditures and other obligations when they become due:

| | 2019 | 2018 |
|--|--------------|--------------|
| Financial assets | | |
| Cash and cash equivalents | \$ 590,003 | \$ 971,872 |
| Grants and accounts receivable | 459,752 | 336,086 |
| Pledges receivable | 740,560 | 754,548 |
| Investments | 2,092,199 | 1,467,752 |
| Board-designated investments | 1,000,000 | 1,000,000 |
| Donor-restricted endowment investments | 1,773,847 | 1,567,532 |
| | 6,656,361 | 6,097,790 |
| Less: amounts unavailable for general expenditure within one year | | |
| Board-designated investments (see Note 2) | (1,000,000) | (1,000,000) |
| Donor-restricted endowment investments (see Note 10) | (1,773,847) | (1,567,532) |
| Pledges receivable due past one year (see Note 3) | (272,692) | (437,255) |
| Net assets subject to expenditure for specified purpose (see Note 9) | (948,000) | (980,908) |
| | (3,994,539) | (3,985,695) |
| Financial assets available to meet cash needs for general expenditures within one year | \$ 2,661,822 | \$ 2,112,095 |

Inner-City Arts has financial assets available at December 31, 2019 to cover approximately six months of operating expenses based on the 2020 monthly budgeted run rate for all program and support services expense of approximately \$410,000, excluding depreciation.

It is highly probable that net assets with time and purpose restrictions of \$1,415,868 (Note 9) at December 31, 2019 (excluding long-term pledges receivable of \$272,692 and endowment net assets of \$1,773,847) will be released within one year given Inner-City Arts has budgeted total program service expense of approximately \$3,490,000 for 2020.

Inner-City Arts
Notes to Financial Statements
December 31, 2019 and 2018

12. SUBSEQUENT EVENTS

In December 2019, an outbreak of a novel strain of coronavirus ("COVID-19") originated in Wuhan, China and on March 11, 2020, the World Health Organization characterized COVID-19 a global pandemic and recommended containment and mitigation measures worldwide. The COVID-19 outbreak in the United States has caused business disruption through mandated and voluntary closings of businesses and shelter-in-place orders. In response, the U.S. Government enacted the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which includes significant provisions to provide relief and assistance to affected organizations. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration of the closings and shelter-in-place orders and the ultimate impact of the CARES Act and other governmental initiatives.

In May 2020, Organization was approved for the Paycheck Protection Program ("PPP") loan under the U.S. Small Business Administration ("SBA") in the amount of \$682,155. The SBA will forgive the loan if employees are kept on payroll for either eight or twenty-four weeks and the funds are used for payroll, rent, mortgage interest, or utilities. The loan has a maturity of two years and an interest rate of 1%. Organization expects the entirety of this loan amount to be forgiven.

OTHER AUDIT REPORT

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Inner-City Arts
Los Angeles, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Inner-City Arts (a California nonprofit corporation) (the "Organization"), which comprise the statement of financial position as of December 31, 2019, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated August 25, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies.

Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Armanino^{LLP}
Los Angeles, California

August 25, 2020