

National Association for Music Education

**Financial Statements and
Independent Auditor's Report**

June 30, 2013 and 2012

National Association for Music Education

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Independent Auditor's Report

The Board of Directors
National Association for Music Education

We have audited the accompanying financial statements of National Association for Music Education (the Association or NAFME), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, functional expenses and cash flows for the year 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 audit. We conducted our audit 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 of 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 NAFME as of June 30, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Report on Comparative Information

The financial statements of NAFME as of June 30, 2012, were audited by Reznick Group, P.C. (Reznick) who report dated September 13, 2012 expressed an unmodified opinion on those statements. CohnReznick, L.L.P. is the current auditor as a result of a business combination between Reznick and J.H. Cohn, L.L.P. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012, is consistent, in all material respects, with the audited financial statements from which it is derived.

CohnReznick LLP

Bethesda, Maryland
October 22, 2013

National Association for Music Education
Statement of Financial Position
June 30, 2013 (with comparative totals for 2012)

	2013						2012
	Unrestricted			Temporary restricted	Permanently restricted	Total	
Assets	Unrestricted	Board designated	Total Unrestricted				
Current assets							
Cash and cash equivalents	\$ 182,789	\$ 264,708	\$ 447,497	\$ 2,021	\$ 135	\$ 449,653	\$ 442,033
Investments	-	4,045,482	4,045,482	9,000	75,000	4,129,482	4,126,864
Accounts receivable, net	329,906	4,982	334,888	-	-	334,888	252,435
Current portion of note receivable	19,992	-	19,992	-	-	19,992	19,992
Inventories, net	159,820	-	159,820	-	-	159,820	136,584
Prepaid expenses	110,618	-	110,618	-	-	110,618	(41,790)
Total current assets	803,125	4,315,172	5,118,297	11,021	75,135	5,204,453	4,936,118
Noncurrent assets							
Note receivable, net of current	1,682	-	1,682	-	-	1,682	5,855
Investments	-	339,178	339,178	-	-	339,178	779,000
Land, building and equipment, net	2,851,652	-	2,851,652	-	-	2,851,652	2,463,190
Work in process	-	-	-	-	-	-	319,423
Total assets	\$ 3,656,459	\$ 4,654,350	\$ 8,310,809	\$ 11,021	\$ 75,135	\$ 8,396,965	\$ 8,503,586
Liabilities and Net Assets							
Current liabilities							
Accounts payable and accrued expenses	\$ 755,098	\$ -	\$ 755,098	\$ -	\$ -	\$ 755,098	\$ 895,807
Deferred income	1,886,507	-	1,886,507	-	-	1,886,507	1,618,472
Total current liabilities	2,641,605	-	2,641,605	-	-	2,641,605	2,514,279
Commitments and contingencies	-	-	-	-	-	-	-
Net assets	1,014,854	4,654,350	5,669,204	11,021	75,135	5,755,360	5,989,307
Total liabilities and net assets	\$ 3,656,459	\$ 4,654,350	\$ 8,310,809	\$ 11,021	\$ 75,135	\$ 8,396,965	\$ 8,503,586

See notes to financial statements

National Association for Music Education

Statement of Activities

Year ended June 30, 2013 (with comparative totals for 2012)

	2013						2012
	Unrestricted			Temporarily restricted	Permanently restricted	Total	
	Unrestricted	Board designated	Total unrestricted				
Operating activities							
Revenue and support							
Membership dues	\$ 1,919,725	\$ -	\$ 1,919,725	\$ -	\$ -	\$ 1,919,725	\$ 1,813,129
Member contributions	1,458,662	-	1,458,662	-	-	1,458,662	1,794,944
Contributions/donations	59,340	-	59,340	2,500	-	61,840	1,086,553
Sponsorships	60,215	-	60,215	-	-	60,215	96,394
Royalty income	223,659	-	223,659	-	-	223,659	179,978
Sale of inventories	520,641	-	520,641	-	-	520,641	547,703
Meetings and conventions	86,259	-	86,259	-	-	86,259	203,403
Advertising	520,229	-	520,229	-	-	520,229	567,716
Investment income	7,107	472,844	479,951	2,170	-	482,121	123,508
Publication revenue	1,128,967	-	1,128,967	-	-	1,128,967	1,330,611
Rent revenue	101,703	-	101,703	-	-	101,703	67,500
Miscellaneous income	289,884	-	289,884	-	-	289,884	252,171
Net assets released from restrictions	20,205	-	20,205	(20,205)	-	-	-
Net assets released from designation	45,000	(45,000)	-	-	-	-	-
Total revenue and support	<u>6,441,596</u>	<u>427,844</u>	<u>6,869,440</u>	<u>(15,535)</u>	<u>-</u>	<u>6,853,905</u>	<u>8,063,610</u>
Expenses							
Program services:							
Membership	806,319	-	806,319	-	-	806,319	743,768
Periodicals	1,236,394	-	1,236,394	-	-	1,236,394	1,315,221
Meetings and conferences	442,697	-	442,697	-	-	442,697	496,034
Governance	812,072	-	812,072	-	-	812,072	785,305
Advocacy and public affairs	420,915	-	420,915	-	-	420,915	497,121
Miscellaneous programs	991,483	-	991,483	-	-	991,483	1,021,755
Scholarship and grant programs	2,506	-	2,506	-	-	2,506	1,003,029
Total program services	<u>4,712,386</u>	<u>-</u>	<u>4,712,386</u>	<u>-</u>	<u>-</u>	<u>4,712,386</u>	<u>5,862,233</u>
Supporting services:							
Management and general	1,781,219	36,277	1,817,496	-	-	1,817,496	1,830,945
Fundraising	551,070	-	551,070	-	-	551,070	589,110
Total supporting services	<u>2,332,289</u>	<u>36,277</u>	<u>2,368,566</u>	<u>-</u>	<u>-</u>	<u>2,368,566</u>	<u>2,420,055</u>
Total expenses	<u>7,044,675</u>	<u>36,277</u>	<u>7,080,952</u>	<u>-</u>	<u>-</u>	<u>7,080,952</u>	<u>8,282,288</u>
Changes in net assets before nonoperating activities	(603,079)	391,567	(211,512)	(15,535)	-	(227,047)	(218,678)
Provision for income tax	6,900	-	6,900	-	-	6,900	9,105
Changes in net assets	<u>(609,979)</u>	<u>391,567</u>	<u>(218,412)</u>	<u>(15,535)</u>	<u>-</u>	<u>(233,947)</u>	<u>(227,783)</u>
Net assets, beginning	1,624,833	4,262,783	5,887,616	26,556	75,135	5,989,307	6,217,090
Net assets, end of year	<u>\$ 1,014,854</u>	<u>\$ 4,654,350</u>	<u>\$ 5,669,204</u>	<u>\$ 11,021</u>	<u>\$ 75,135</u>	<u>\$ 5,755,360</u>	<u>\$ 5,989,307</u>

See notes to financial statements

National Association for Music Education

Statement of Functional Expenses

Year ended June 30, 2013 (with comparative totals for 2012)

Expenses	Program expenses							Supporting services			Total - 2013	Total - 2012	
	Membership	Periodicals	Meetings and conferences	Governance	Advocacy and public affairs	Miscellaneous programs	Scholarship and grant programs	Total program	Management and general	Fundraising			Total supporting services
Salaries	\$ 352,256	\$ 165,579	\$ 109,715	\$ 232,272	\$ 250,094	\$ 240,892	\$ 310	\$ 1,351,118	\$ 896,809	\$ 218,837	\$ 1,115,646	\$ 2,466,764	\$ 2,456,048
Fringe benefits	83,904	39,705	26,448	55,619	58,999	57,941	79	322,695	215,542	52,731	268,273	590,968	623,837
Travel	3,025	252	48,342	239,971	14,788	20,709	-	327,087	54,804	52,588	107,392	434,479	344,230
Annual professional dues	390	-	145	-	812	676	-	2,023	1,585	1,204	2,789	4,812	3,484
Membership dues expenses	-	-	-	-	-	-	-	-	-	-	-	-	45,000
Meetings, conventions and conferences	-	-	68,878	134,429	2,200	1,991	-	207,498	2,760	31,747	34,507	242,005	215,875
Cost of goods sold	(172)	(9,946)	1,046	-	-	136,642	-	127,570	321	216	537	128,107	177,814
Professional services/consultants	-	-	2,714	28,790	-	51,136	-	82,640	139,897	59,220	199,117	281,757	395,772
Outside support	-	8,894	47,143	-	-	3,402	-	59,439	4,838	-	4,838	64,277	28,980
Production and printing	44,748	771,635	-	6,645	2,678	30,391	-	856,097	3,677	5,681	9,358	865,455	943,815
Membership promotion and retention	83,481	-	-	-	-	5,738	-	89,219	-	-	-	89,219	54,934
Promotion, printing and publicity	19,500	20,620	51,279	347	11,169	26,542	-	129,457	6,134	26,623	32,757	162,214	176,897
Postage and mailings	82,321	132,774	4,849	2,535	176	55,296	18	277,969	59,336	4,322	63,658	341,627	366,880
Telephone	-	-	-	-	-	-	-	-	-	468	468	468	5,847
State sales tax	-	-	-	-	-	-	-	-	-	-	-	-	2,557
Bad debts	-	3,668	-	-	-	571	-	4,239	-	-	-	4,239	2,049
Management fees	31,720	200	49,023	17,148	6,000	4,341	-	108,432	112,862	30,257	143,119	251,551	225,283
Awards, scholarships, and grants	-	-	-	-	-	18,577	2,000	20,577	878	594	1,472	22,049	1,222,247
Overhead	105,146	49,733	33,115	69,671	73,999	72,551	99	404,314	269,918	66,018	335,936	740,250	824,482
Other	-	53,280	-	24,645	-	264,087	-	342,012	48,135	564	48,699	390,711	166,257
Total expenses	\$ 806,319	\$ 1,236,394	\$ 442,697	\$ 812,072	\$ 420,915	\$ 991,483	\$ 2,506	\$ 4,712,386	\$ 1,817,496	\$ 551,070	\$ 2,368,566	\$ 7,080,952	\$ 8,282,288

See notes to financial statements

National Association for Music Education

Statement of Cash Flows

Year ended June 30, 2013 (with comparative totals for 2012)

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities		
Change in net assets	\$ (233,947)	\$ (227,783)
Adjustments to reconcile changes in net assets to net cash used in operating activities:		
Loss on disposal of fixed assets	-	8,809
Bad debt expense	4,239	2,049
Depreciation	212,377	181,526
Realized gain on investments	(74,504)	(153,117)
Unrealized (gain) loss on investments	(223,380)	201,429
Changes in assets (increase) decrease in:		
Accounts receivable	(86,692)	(74,283)
Inventories	(23,236)	25,324
Prepaid expenses and other	(152,408)	36,300
Changes in liabilities increase (decrease) in:		
Accounts payable and accrued expenses	(140,709)	313,704
Deferred income	268,035	(350,897)
	<u>(450,225)</u>	<u>(36,939)</u>
Net cash used in operating activities		
Cash flows from investing activities		
Purchases of property and equipment	(281,416)	(605,848)
Proceeds from sales of investments	3,539,418	3,431,927
Purchase of investment securities	(2,804,330)	(3,065,392)
Loan advances	(20,000)	(20,000)
Proceeds from payment of loan advances	24,173	19,992
	<u>457,845</u>	<u>(239,321)</u>
Net cash provided by (used in) investing activities		
Net increase (decrease) in cash and cash equivalents	7,620	(276,260)
Cash and cash equivalents, beginning of year	<u>442,033</u>	<u>718,293</u>
Cash and cash equivalents, end of year	<u>\$ 449,653</u>	<u>\$ 442,033</u>
Significant noncash investing activities		
Disposal of fully depreciated property and equipment	<u>\$ -</u>	<u>\$ 131,444</u>
Construction in progress transferred to property and equipment	<u>\$ 319,423</u>	<u>\$ -</u>

See notes to financial statements

National Association for Music Education

Notes To Financial Statements

June 30, 2013 and 2012

Note 1 - Organization and Purpose

Nature of Operations

The National Association for Music Education (the Association or NAFME), a non-profit corporation located in Reston, Virginia, was organized April 12, 1907, under the laws of the state of Iowa for the specific purpose of the advancement of music education.

NAFME serves as leader and spokesperson for music education in the United States. Its members are engaged in music teaching or other music education work at institutional levels from preschool through college and university. The goals of NAFME include:

- Comprehensive music programs in all schools.
- Involvement of people of all ages in learning music.
- High-quality preparation of teachers.
- Use of the most effective techniques and resources in music instruction.

NAFME's significant programmatic areas include:

Membership

The NAFME membership program is involved in producing and mailing membership promotion materials, mailing membership notices to the Association's more than 135,000 members (including active, retired, pre-service music teachers and honor students), collection and tracking of national, state and student chapter dues, and maintaining all membership records and data. Other important functions include the distribution of membership information and management of services designed to be of benefit to members.

Music Educators Journal/Teaching Music - Periodicals

Magazines published alternately each month, for a total of 10 times per year, dealing with all aspects of music and music education for the classroom, elementary through the university level. *Music Educators Journal* is a peer-reviewed publication and is published through Sage Publications: *Teaching Music* focuses on practical teaching information and news about the field and is published through In Tune publications.

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Meetings and Conventions

NAfME meetings and conventions are produced to furnish in-service and pre-service professional development for music educators, to allow for the exchange of ideas among members and other teachers, and to facilitate the growth of knowledge of central issues to music education among professionals. The two principal association conventions are the NAfME National In-Service Conference and the Biennial Music Educators National Conference:

- NAfME National In-Service Conference is an annual event designed to provide members with opportunities for music education advocacy, intensive professional development and performances.
- The Biennial Music Educators National Conference is designed with a special focus on research in music education and music teacher education. This meeting is held in the spring of each even-numbered year.

The Association also sponsors or cosponsors other meetings designed to meet particular needs among the profession or to facilitate the business of the Association. These meetings, which may be held in one geographic location or may be mediated through online “webinars,” include:

- Meetings of the NAfME National Assembly (officers from the Federated State Associations, the geographic divisions of the Association, and NAfME Societies and Councils).
- Meetings of the National Executive Board.
- Meetings and conventions held independently by the Federated State Associations, but to which NAfME sends Board Officers.
- Meetings and conventions held by the geographic divisions of the Association, hosted by a Federated State Association, and cosponsored by NAfME.
- Informational seminars on a variety of special topics (e.g., nonprofit tax requirements and budgeting, copyright issues) for specific subgroups of the Association or specific groups served by the Association.

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Governance

Governance covers the activities of the National Executive Board, its subdivision, including but not limited to Councils, Societies, Committees and Task Forces as well as the National Officers work in fulfilling their responsibilities for the management, oversight, policies and actions of the Association. Most work is normally carried out through meetings, conferences, events, and other deliberations. This also includes the operation of the National Assembly, the Division Executive Boards, the relationship with federated state associations, and individual members.

Advocacy and Public Affairs

NAfME serves as the national voice for music education, providing, and seeking support for music programs at the federal, state, and local levels by advocating on Capitol Hill to protect sequential, standards-based school music for our nation's students. NAfME works in a variety of coalitions, strengthening music education's public policy profile and increasing capacity for achieving the advocacy goals of our members. Most notably through the Music Education Policy Roundtable, an 18-member group coalition of music education advocacy organizations, NAfME pushes its federal legislative agenda and promotes the cause to influential elected officials. Most importantly, NAfME provides assistance to music educators on the ground by supplementing their grassroots advocacy efforts with resources and support.

Scholarship and Grant Programs

NAfME administers scholarship programs that support and advance the mission to encourage the study and making of music by all; these include the Shannon Kelly Kane Fund and the Harley Scholarship fund. The Shannon Kelly Kane Fund provides two \$1,000 scholarships annually and Harley Scholarship Fund provides one scholarship. Four grants are awarded annually as part of the NAfME Tri-M Music Honor Society Chapter of the Year program. Grants are to be used for musically enriching experience that benefits the school/chapter. Two \$1,000 grants are awarded to the Chapter of the Year in the Senior and Junior Division; Runner-Ups are awarded \$800 for Senior Division and \$400 for Junior Division. Criteria for selection are on the Tri-M website. NAfME also, from time to time, provides small grants for music education related research. These grants are distributed and monitored by the Society for Research in Music Education. In addition, NAfME entered into a partnership with Fox/Glee for the purpose of awarding a total of \$1,000,000 in grants to 73 schools across the USA. Grant awards ranged from \$10,000 to \$50,000. The funding for these grants was provided completely by Fox/Glee.

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Miscellaneous Programs

NAfME's other programs include: book publications, contests and competitions, resource development, cultural and community partnerships, electronic communications, information resources, Music in Our Schools Month (MIOSM), production and promotion, research publications and other periodicals, resource shops and the world's largest concert.

Tri-M

Tri-M is an international music honor society for middle school and high school students. Its focus is to encourage music educators to recognize and motivate musical and personal achievement in their students.

Note 2 - Summary of Significant Accounting Policies and Other Matters

Basis of Accounting

The financial statements have been prepared using the accrual basis of accounting. Revenue, other than contributions, is recognized when earned; expenses are recorded when the obligation is incurred. Contributions are recorded as unrestricted, temporarily restricted or permanently restricted support depending upon the existence and/or nature of any donor imposed restrictions. All donor-restricted contributions are reported initially as an increase in temporarily restricted net assets and then reclassified to unrestricted net assets when restrictions have been met.

Basis of Presentation

These financial statements present net assets, revenue, expenses, gains and losses based on the existence of donor-imposed restrictions. Accordingly, net assets and the changes therein are classified as follows:

- Unrestricted - Net assets that are not subject to donor-imposed stipulations. Revenues from sources other than contributions and investment income are reported as increases in unrestricted net assets.
- Temporarily Restricted - Temporarily restricted net assets are subject to donor-imposed stipulations that may or will be met by the actions of the Association and/or passage of time.
- Permanently Restricted - Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained permanently by the

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Association. Generally, the investment income is temporarily restricted until appropriated for expenditure.

The Association conforms to Statements of Financial Accounting Standards for the "Transfer of Assets to a Not-for-profit Organization or Charitable Trust That Raises or Holds Contributions for Others." This establishes standards for transactions in which an entity (the donor) makes a contribution by transferring assets to a not-for-profit organization or charitable trust (the recipient organization) who in accepting the assets from the donor agrees to use those assets on behalf, or transfer those assets to, another specified beneficiary. The standards require that the recipient organization recognize the fair value of the assets received from the donor. The Association accepts member dues from various members and agrees to transfer those assets to respective states.

Comparative Financial Information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, the Association considers all highly liquid investments, purchased with a maturity of three months or less to be cash equivalents.

Concentration of Credit Risk

The Association maintains its cash, cash equivalents and investment balances in several accounts at multiple banks that are insured by the Federal Deposit Insurance Corporation (FDIC) or the Security Investor Protection Corporation (SIPC). Certificates of deposit are placed with a bank's Certificate of Deposit Registry Service (CDARS) and are fully insured by the FDIC. At times, these balances may exceed the federal insurance limits; however, the Association has not experienced any losses with respect to its bank balances in excess of government provided insurance. As of June 30, 2013, management believes that no significant concentration of credit risk exists with respect to these cash, cash equivalents and investment balances.

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Investments

Investments with readily determinable fair values are reflected at fair market value. Income is recognized from interest and dividends as earned. The Association maintains separate investment accounts for its endowment and similar funds. Realized and unrealized gains and losses from securities in the investment accounts are allocated to the individual endowment's fund based on the relationship of the fair value of each endowment fund to the total fair value of the investment accounts, as adjusted for additions to or deductions from these accounts. Investments in certificates of deposits and private equity with no readily determinable fair value are reported at cost.

Investment income classified as operating revenue consist of interest and dividend income on investments and any gains approved by the board of directors for use in operations (Note 4). All other realized and unrealized gains or losses are classified as Board designated activity.

The Association reports its investments in a commodity fund at fair value as determined by the investment managers. This valuation is reviewed and approved by management on a yearly basis.

Financial Risk

The Association invests in a professionally managed portfolio that contains U.S. equity securities, mutual funds, fixed income securities, alternative investments and certificates of deposits. Such investments are exposed to various risks such as interest rate market volatility and credit risks. Due to the level of risk associated with such investments and the level of uncertainty related to the changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term could materially affect investment balance and the amounts reported in the financial statements.

Inventories

Inventories consist of specialty items and publications, and are valued at the lower of cost or market. Cost is determined on a first-in, first-out basis net of obsolescence. Allowance for obsolete inventory at June 30, 2013 and 2012 was \$20,283 and \$31,958, respectively.

The Association contracts with a third party to publish, market, sell and distribute the Association's book publications. The Association receives an agreed upon royalty percentage of all revenues received on book and publication sales.

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Accounts Receivable

Accounts receivable are reported net of an allowance for doubtful accounts. Management's estimate of the allowance is based on historical collection experience and a review of the current status of accounts receivable. Receivables are charged to allowance when deemed uncollectible. It is reasonably possible that management's estimate of the allowance will change. Allowance for doubtful accounts at June 30, 2013 and 2012 was \$10,000.

Property and Equipment and Depreciation

Property and equipment are recorded at cost. Expenditures for maintenance and repairs are charged to expenses as incurred while major renewals and betterments are capitalized. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related cost and accumulated depreciation. The resulting gain and losses are reflected in the statement of operations. Depreciation is computed on a straight-line basis over the estimated useful lives of each asset. The Association capitalizes all property and equipment purchased with a cost of \$500 or more. Depreciation expense for the years ended June 30, 2013 and 2012 was \$212,377 and \$181,526, respectively, and is included in overhead expenses on the statement of functional expenses.

Work in Process

Projects in process consist of various projects and are stated at cost of \$0 and \$319,423 at June 30, 2013 and 2012, respectively.

Impairment of Long-Lived Assets

The Association reviews its long-lived assets for impairment whenever events and changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the fair value is less than the carrying value of an asset, an impairment loss is recognized for the difference. The Association did not record an impairment loss during the years ended June 30, 2013 and 2012.

Revenue Recognition

Membership Revenue

Membership dues and subscription fees are recognized as revenue over the period of membership. Membership revenue related to future periods is recorded as deferred revenue in the accompanying statement of financial position.

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

Contributions

Contributions received are recorded as permanently restricted, temporary restricted or unrestricted revenue, depending on the existence and/or nature of any donor restrictions. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted for specific purposes are reported as temporarily restricted support that increases those net asset classes.

Non-cash and in-kind contributions are recorded as revenue at fair value of the items contributed.

There were no promises to give, non-cash contributions, and in-kind contributions received during the years ended June 30, 2013 and 2012.

Fair Value of Financial Instruments

The Association has adopted the Fair Value Measurement topic of the Financial Accounting Standards Board (FASB), Accounting Standards Codification (ASC or Codification).

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practical to estimate that value:

Cash and cash equivalents: Cash and cash equivalents, are carried at cost, which approximates fair value.

Investments: For securities held for investments purposes, fair values are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Alternative investments are reported at estimated fair values, the valuation of which is discussed further in Note 11. The private equity investments are recorded at cost. The fair value is not readily determinable.

Inventories: Fair value is based on lower of cost or market.

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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant

National Association for Music Education

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June 30, 2013 and 2012

estimates include allowance for uncollectible receivables, and inventory obsolescence.

Functional Allocation of Expenses

The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities. Direct costs associated with identifiable expenses are charged to program and supporting services. Accordingly, certain costs have been allocated among the departments, programs and supporting services benefited.

Income Taxes

The Association is exempt from federal income taxes under the provision of Section 501(c)(3) of the Internal Revenue Code (IRC). The Association is subject to income taxes on revenue generated from other sources unrelated to its exempt purpose. The Association is required to file and does file tax returns with the IRS and other taxing authorities.

Federal and state income tax expense for the years ended June 30, 2013 and 2012 was \$6,900 and \$9,105, respectively, in connection with advertising income. Income tax returns filed by the Association are subject to examination by the Internal Revenue Service for a period of three years. While no other tax returns are currently being examined by the Internal Revenue Service, tax years since 2009 remain open.

Rental income

Rental income is recognized as rent becomes due from tenants related to property owned by NAFME. Rental payments received in advance are deferred until earned. All leases between the Association and the tenants of the property are operating leases.

Advertising

Advertising costs are charged to activities when incurred. Advertising expense during the years ended June 30, 2013 and 2012 was \$227,155 and \$319,889, respectively.

Reclassification

Certain reclassifications have been made to the 2012 balances to conform to the 2013 presentation.

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

Note 3 - Cash and Cash Equivalents

Cash and cash equivalents consist of the following as of June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Unrestricted:		
Operating		
Checking accounts and petty cash	\$ 417,699	\$ 260,154
Money Market accounts	15,132	134,710
Operating investments	-	716
Cash equivalents held in investment accounts	<u>14,666</u>	<u>28,762</u>
	<u>447,497</u>	<u>424,342</u>
Temporarily and Permanently restricted:		
Caitlin Scholarship Fund	-	-
Harley Scholarship Fund	2,021	2,482
Kane Scholarship Fund	135	11,925
Mrs. America Scholarship Fund	<u>-</u>	<u>3,284</u>
	<u>2,156</u>	<u>17,691</u>
Total cash and cash equivalents	<u>\$ 449,653</u>	<u>\$ 442,033</u>

Note 4 - Investments

Investments consist of the following as of June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Certificates of deposits (at cost)	\$ 84,000	\$ 529,000
Mutual funds	3,734,176	3,547,467
Corporate bonds	311,306	343,143
Equity securities	339,178	250,000
Commodity fund	<u>-</u>	<u>236,254</u>
Total investments	<u>\$ 4,468,660</u>	<u>\$ 4,905,864</u>

The Associations endowment consists of three individual funds established for a variety of purposes. These endowments include donor-restricted endowment funds and a fund designated by the Association to function as an endowment. As required

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

by GAAP, net assets associated with endowment funds, including funds designated by the Association to function as an endowment, are classified based on the existence of donor imposed restrictions.

The following summarizes the investment return and its classification in the statement of activities for the years ended June 30, 2013 and 2012:

Investment income

	2013			2012
	Operating	Board designated	Total	
Investment income	\$ 9,983	\$ 174,254	\$ 184,237	\$ 171,820
Realized gain (loss)	(706)	75,210	74,504	153,117
Unrealized gain (loss)	-	223,380	223,380	(201,429)
Total	<u>\$ 9,277</u>	<u>\$ 472,844</u>	<u>\$ 482,121</u>	<u>\$ 123,508</u>

Interpretation of Relevant Law

The Virginia General Assembly issued the Virginia Uniform Prudent Management of Institutional Funds Act (UPMIFA). Unless there are explicit donor instructions, this law gives the Boards of non-profit organizations the flexibility to determine appropriate use of endowment principal and related investment income. In accordance with UPMIFA, NAFME Board should consider the following factors in determining a prudent use of investment income and endowment principal:

1. The duration and preservation of the fund
2. The purposes of Association and the donor restriction endowment fund
3. General economic conditions
4. The possible effect of inflation or deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Association
7. The investment policy of the Association

The Board of the Association continually reviews its policy regarding the use of endowment funds, and makes necessary modifications to the Investment Policy.

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

The changes in endowment net assets for the years ended June 30, 2013 and 2012, and the endowment net assets at June 30, 2013 and 2012 were as follows:

	2013			2012
	Temporarily restricted	Permanently restricted	Total	
Endowment net assets beginning of the year	\$ 26,556	\$ 75,135	\$ 101,691	\$ 136,838
Investment net income	2,170	-	2,170	2,790
Contributions	2,500	-	2,500	1,006,536
Uses	<u>(20,205)</u>	<u>-</u>	<u>(20,205)</u>	<u>(1,044,473)</u>
Endowment net assets end of year	<u>\$ 11,021</u>	<u>\$ 75,135</u>	<u>\$ 86,156</u>	<u>\$ 101,691</u>

As of June 30, 2013 and 2012, amounts classified as permanently restricted net assets are permanently restricted either by explicit donor stipulations or by UPMIFA, and amounts classified as temporarily restricted net assets are subject to purpose restrictions and net earnings from permanently restricted funds.

Return Objectives and Spending Policy

The Association has adopted investment and spending policies for donor-restricted endowment assets that attempt to generate a series of cash withdrawals that grow with inflation to programs supported by its endowment while seeking to maintain the purchasing power of the donor restricted endowment assets. Donor-restricted endowment assets include those assets of donor restricted funds that that the Association must hold in perpetuity or for donor-specified period(s). Under this policy, the Association accepts a low level of risk in investment return.

The investment policy approves appropriation of the endowment funds income for the donor designated purpose in the year(s) when sufficient accumulated investment income is realized to make a meaningful scholarship or grant.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, the Association relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized/unrealized) and current yield (interest/dividends). The Association targets a diversified asset allocation in order to satisfy its cash withdrawal and long-term rate-of-return objectives.

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Note 5 - Restricted and Board Designated Assets

Temporarily Restricted

Net assets were released from restriction by satisfying the program restrictions. Temporary restricted net assets consist of the following at June 30, 2013:

	2012	Additions	Investment gains (losses)	Restrictions accomplished	2013
Harly scholarship fund	\$ 8,336	\$ -	\$ 456	\$ -	\$ 8,792
Mrs. America scholarship fund	18,205	-	-	(18,205)	-
Shannon Kane scholarship fund	15	2,500	1,714	(2,000)	2,229
Total	\$ 26,556	\$ 2,500	\$ 2,170	\$ (20,205)	\$ 11,021

In December 2012, the Mrs. America scholarship fund was released from temporary restriction. Per the endowment agreement, this fund was required to have a minimum of \$30,000 within one year in order for funds to be disbursed. This requirement was not met, therefore, the fund was released on October 25, 2012.

Permanently Restricted

Permanently restricted net assets represent donor-restricted contributions in which the donor has stipulated that the principal be maintained intact. Unless otherwise stated by the donor, investment income is recorded into temporary restricted net assets to be used for specific purposes.

Permanently restricted net assets consist of the following at June 30, 2013:

	2012	Additions	2013
Endowments:			
Kane scholarship fund	\$ 65,395	\$ -	\$ 65,395
Harley scholarship fund	9,740	-	9,740
Total	\$ 75,135	\$ -	\$ 75,135

Permanently restricted net assets consist of funds to support various music related scholarships and grants.

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

Board Designated

Funds designated by the board represent the portion of unrestricted funds that have been set aside for specific purposes. The Finance committee requires that NAFME maintain a reserve account equaling or exceeding one-half of the annual operating budget, and is to be used as designated by the board. In 1999, the National Executive Board approved an annual \$45,000 transfer of funds from the reserve account to the NAFME operating account to alleviate current life member expenses.

Activity in board designated net assets during the years ended June 30, 2013 and 2012, respectively, consist of the following:

	<u>2013</u>	<u>2012</u>
Board designated net assets beginning of the year	\$ 4,262,783	\$ 4,234,649
Investment income	472,844	95,120
Uses	<u>(81,277)</u>	<u>(66,986)</u>
Board designated net assets end of year	<u>\$ 4,654,350</u>	<u>\$ 4,262,783</u>

**As of June 30, 2013 and 2012, amounts related to Uses includes \$36,277 and \$21,986, respectively, in management fees' expense in addition to a \$45,000 draw each year from the board designated net assets for the costs of life member dues' expense.*

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

Note 6 - Land, Building and Equipment

The following is a summary of land, building and equipment as of June 30, 2013 and 2012:

<u>Asset Category</u>	<u>Estimated life</u>	<u>2013</u>	<u>2012</u>
Land		\$ 1,069,089	\$ 1,069,089
Building and improvements	10 - 40 years	2,323,736	2,233,765
Furniture and equipment	3 - 7 years	1,991,426	1,480,558
		5,384,251	4,783,412
Accumulated depreciation		(2,532,599)	(2,320,222)
Property and equipment, net		<u>\$ 2,851,652</u>	<u>\$ 2,463,190</u>

Note 7 - Pension Plans and Retirement Benefits

The Association has a defined contribution retirement plan covering all employees who work over 1,000 hours in the plan year following one month of service. On an annual basis, the Association contributes 7% of participants' eligible compensation to the defined contribution retirement. For the years ended June 30, 2013 and 2012, net amounts contributed after forfeitures were \$149,133 and \$179,730.

The Association sponsors a 403(b) plan for eligible employees. Employees are eligible to participate in the plan upon their date of hire. Participants may contribute a portion of their eligible compensation to the plan, subject to limits approved by the Internal Revenue Service. Participants are immediately vested in their own contributions. The Association does not make matching contributions to the 403(b) plan.

Accrued Vacation and Sick Leave

Depending on length of service and other factors, the Association's employees are entitled to paid vacation time. At June 30, 2013 and 2012, the accrued vacation leave was \$261,187 and \$252,775, respectively, and is included in accounts payable and accrued expenses in the statement of financial position at June 30, 2013 and 2012.

Effective July 1, 2009, employees in good standing are entitled to be paid sick leave upon employment termination, depending on meeting certain age and years of service requirements. At June 30, 2013 and 2012, accrued sick leave was \$106,736

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

and \$81,003, respectively, and is included in accounts payable and accrued expenses in the statement of financial position at June 30, 2013 and 2012.

Note 8 - Operating Leases

The Association has various leases for automobiles and equipment which are classified as operating leases. Total rent expense for all operating leases for the years ended June 30, 2013 and 2012 was \$101,177 and \$81,735, respectively.

Future minimum lease payments under the non-cancelable operating leases with initial or remaining terms of one year or more are as follows:

June 30, 2014	\$	122,076
2015		95,217
2016		<u>10,009</u>
Total	\$	<u><u>227,302</u></u>

Note 9 – Lease Commitments

NAfME leases office space to National Art Education Association and Metronome Software LLC in addition to leasing parking spaces to Access Bank. No security deposits were received for these leases. In 2013 and 2012, total revenue from tenants was \$101,703 and \$67,500, respectively.

Future minimum lease payments and sublease receipts are as follows:

June 30, 2014	\$	86,674
2015		79,845
2016		<u>13,749</u>
Total	\$	<u><u>180,268</u></u>

**The lease with Access Bank is on a month to month basis and can be terminated by either party at anytime. Future least payments include amounts for Access Bank.*

Note 10 - Note Receivable

Effective June 25, 2010, the Association made available an interest-free line of credit to a member of the Federated State Association of Music Educators National Conference up to a total amount of \$75,000. The term of the agreement is for two years and may be extended upon the written agreement of both parties. As of June

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

30, 2013 and 2012, the balance drawn and receivable was \$21,674 and \$25,847, respectively.

Future minimum principal payments under the terms of the agreement are as follows:

June 30, 2014	\$	19,992
2015		<u>1,682</u>
Total	\$	<u><u>21,674</u></u>

Note 11 - Fair Value Measurement

The Association has adopted the Fair Value Measurements topic of the Codification. The guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels. The following summarizes the three levels of inputs and hierarchy of fair value the Association uses when measuring fair value:

1. Level 1 inputs - quoted prices (unadjusted) in active markets for identical assets or liabilities that the Association has the ability to access;
2. Level 2 inputs - quoted prices for similar assets and liabilities in active markets, as well as interest rates and yield curves that are observable at commonly quoted intervals; and
3. Level 3 inputs - unobservable inputs for the asset or liability that are typically based on an entity's own assumptions as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the fair value measurement will fall within the lowest level input that is significant to the fair value measurement in its entirety. Management's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

The following table presents the fair value of assets measured on a recurring basis at June 30, 2013 and 2012:

Description	Fair value measurements as of June 30, 2013 using			Balance at June 30, 2013
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Mutual Funds:				
Closed end Mutual Funds	\$ 3,734,176	\$ -	\$ -	\$ 3,734,176
Fixed Income securities:				
Corporate bonds	311,306	-	-	311,306
Alternative Investments				
Commodity fund	-	-	-	-
Equity securities	-	-	339,178	339,178
Total Assets	\$ 4,045,482	\$ -	\$ 339,178	\$ 4,384,660
Description	Fair value measurements as of June 30, 2012 using			Balance at June 30, 2012
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Mutual Funds:				
Closed end Mutual Funds	\$ 3,547,467	\$ -	\$ -	\$ 3,547,467
Fixed Income securities:				
US Treasury bonds	-	-	-	-
Corporate bonds	343,143	-	-	343,143
Total fixed income securities	-	-	-	-
Alternative Investments				
Commodity fund	-	236,254	-	236,254
Convertible note	-	250,000	-	250,000
Total Assets	\$ 3,890,610	\$ 486,254	\$ -	\$ 4,376,864

Note 12 - Alternative Investment Valuation

The non-discretionary portion of NAFME's managed investment portfolio includes alternative investments partnerships. NAFME's objective as part of its alternative investments strategy is to mitigate risk and enhance diversification of the overall investment portfolio. Management believes that in an attempt to gain enhanced diversification, focusing on absolute return, that these alternative investments will

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

reduce their overall portfolio investment risk and volatility and offer potential for returns that are not correlated to the traditional markets of stock and bonds. NAFME has established an investment policy and procedures statement with a maximum allowable alternative investment exposure of 15% of their overall investment portfolio. The managed futures component of the alternative investments include trading in commodities such as energy, metals, crops, livestock, currencies and financial markets. The management of commodity funds are carried out by registered commodity trading advisors.

Commodity Funds

The commodity fund engages in the speculative trading futures, options on futures and forward contracts on a wide range of commodities. Such contracts meet the definition of a derivative as noted in the ASC guidance for derivatives and hedging. There are no credit related contingent features embedded in these derivative contracts.

Senior Secured Convertible Note

On June 8, 2012, NAFME entered into a senior secured convertible promissory note agreement with Acceptd LLC (Maker) in the total amount of \$250,000. The note bears interest at 7.5% compounded annually and matures on June 8, 2017, at which time all unpaid interest and principal are due. If this Note remains outstanding upon closing of any venture capital, institutional or other equity security financing by the Maker, according to the terms set forth in the agreement, NAFME may elect to convert all outstanding principal and accrued interest into common stock at the time of such financing.

As of June 30, 2012, total principal advanced and receivable was \$250,000. For the years ended June 30, 2013 and 2012, interest of \$14,178 and \$0 was accrued on the initial investment. As of March 2013, this note was converted to equity. In addition to the note conversion, NAFME made a purchase of \$75,000 for additional shares of Series A preferred stock, for a total investment value of \$339,178 as of June 30, 2013. The investment is recorded at cost given there is no readily determinable fair value.

Note 13 - Related Party

Give a Note Foundation

The Give a Note Foundation (the Foundation) is a related party of NAFME. The Foundation was formed by the leadership of the Association as a separate corporation and filed their 1023 with the IRS. The Foundation's primary purpose is

National Association for Music Education

Notes to Financial Statements - Continued

June 30, 2013 and 2012

to support the work of NAFME by providing a source of funding to encourage the study of music education; encourage public and private financial support for the advancement of music education; support research activities aimed at educating people about the benefits of music; and providing grant support for activities that strengthen music education. Although economic interest exists between NAFME and the Foundation, the Foundation maintains a board that is independent from that of NAFME. As of and for the year ended June 30, 2013, the statement of financial position and the statement of activities for the Foundation consist of the following:

Give a Note Foundation

**Statements of Financial Position
June 30, 2013**

Assets

	<u>2013</u>
Current assets	
Cash	\$ 101,144
Contribution receivable, net	19,813
Investments	35,031
Prepaid expenses	<u>2,605</u>
 Total assets	 <u><u>\$ 158,593</u></u>

Liabilities and Net Assets

Liabilities	
Accounts payable and accrued expenses	<u>\$ -</u>
 Total liabilities	 <u>-</u>
 Net assets - unrestricted	 <u>158,593</u>
 Total net assets	 <u><u>\$ 158,593</u></u>

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

**Statements of Activities
Year ended June 30, 2013**

	<u>2013</u>
Revenue	
Contributions and donations	\$ 66,477
In-kind goods and services	185,898
	<u>252,375</u>
Total revenue	
Expenses	
Program expenses	13,849
Management and general	119,306
Fundraising	62,365
	<u>195,520</u>
Total operating expenses	
	<u>56,855</u>
Change in net assets before other changes	
Other changes	
Unrealized gain on investments	8,948
	<u>8,948</u>
Total other changes	
	<u>65,803</u>
Change in net assets	
Net assets, beginning of year	92,790
	<u>158,593</u>
Net assets, end of year	<u>\$ 158,593</u>

Cost Sharing Agreement

On April 23, 2012, NAFME entered into a cost sharing agreement with the Foundation, whereby the Foundation may share use of certain office equipment, facilities and staff service. According to the terms of the Agreement, the Foundation shall reimburse NAFME, for such costs, on a monthly basis, except for the first two years, whereby NAFME has agreed to forgive all related costs incurred by the Foundation. For the years ended June 30, 2013, and 2012, total donated costs were \$185,898 and \$199,893, respectively.

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Notes to Financial Statements - Continued

June 30, 2013 and 2012

Note 14 - Subsequent Events

Events that occur after the balance sheet date but before the financial statements were available to be issued must be evaluated for recognition or disclosure. The effects of subsequent events that provide evidence about conditions that existed at the balance sheet date are recognized in the accompanying financial statements. Subsequent events which provide evidence about conditions that existed after the balance sheet date require disclosure in the accompanying notes. Management evaluated the activity of the Association through October 22, 2013 and concluded that no subsequent events have occurred that would require disclosure in the financial statements.