

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Financial Statements

Year ended June 30, 2014

(With Independent Auditors' Report Thereon)

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Financial Statements

Year ended June 30, 2014

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Mayer Hoffman McCann P.C.
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Board of Directors
Philharmonic Society of Orange County
Irvine, California

Independent Auditors' Report

We have audited the accompanying financial statements of Philharmonic Society of Orange County (a nonprofit organization), which comprise of the statement of financial position as of June 30, 2014 and the related statement of activities, 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.

Auditors' 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Philharmonic Society of Orange County as of June 30, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited the Philharmonic Society of Orange County's 2013 financial statements and we expressed an unmodified audit opinion on those audited financial statements in our report dated September 27, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2013 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Mayer Hoffman McPann P.C.

October 3, 2014
Irvine, California

THE PHILHARMONIC SOCIETY OF ORANGE COUNTY

Statement of Financial Position

June 30, 2014

(With comparative data for the prior year)

	<u>Totals</u>	
	<u>2014</u>	<u>2013</u>
<u>Assets</u>		
Cash and cash equivalents (note 2)	\$ 1,340,969	1,169,235
Contributions receivable (note 3)	522,572	871,073
Beneficial interest in trusts (note 4)	133,581	104,634
Prepaid expenses	83,530	219,623
Property and equipment, net (note 5)	23,367	34,517
Other assets (note 1q)	<u>498,031</u>	<u>457,727</u>
Total assets	<u>\$ 2,602,050</u>	<u>2,856,809</u>
<u>Liabilities and Net Assets</u>		
Liabilities:		
Accounts payable and accrued expenses	\$ 618,890	536,388
Deferred revenue	628,511	832,321
Line of credit (note 6)	500,000	700,000
Note payable (note 7)	<u>45,139</u>	<u>41,667</u>
Total liabilities	<u>1,792,540</u>	<u>2,110,376</u>
Net Assets (notes 11 and 12):		
Unrestricted	(452,663)	(797,494)
Temporarily restricted	693,953	975,707
Permanently restricted	<u>568,220</u>	<u>568,220</u>
	<u>809,510</u>	<u>746,433</u>
Total liabilities and net assets	<u>\$ 2,602,050</u>	<u>2,856,809</u>

See accompanying notes to financial statements.

THE PHILHARMONIC SOCIETY OF ORANGE COUNTY

Statement of Activities

Year ended June 30, 2014

(With comparative data for the prior year)

	Unrestricted	Temporarily	Permanently	Totals	
		Restricted	Restricted	2014	2013
Revenues:					
Concert ticket sales	\$ 1,091,548	-	-	1,091,548	1,087,120
Contributions	1,524,824	450,572	-	1,975,396	1,780,504
Special Events:					
Spring gala revenue	237,050	-	-	237,050	269,100
Direct expenses	(70,024)	-	-	(70,024)	(86,964)
Net support from spring gala	167,026	-	-	167,026	182,136
House of design revenue	408,364	-	-	408,364	330,752
Direct expenses	(155,894)	-	-	(155,894)	(161,181)
Net support from house of design	252,470	-	-	252,470	169,571
Cruise of lights revenue	178,342	-	-	178,342	191,485
Direct expenses	(75,992)	-	-	(75,992)	(87,254)
Net support from cruise of lights	102,350	-	-	102,350	104,231
Education and support groups	673,735	-	-	673,735	235,106
Investment income	2,549	-	-	2,549	1,720
Net assets released from donor restrictions (note 11)	732,326	(732,326)	-	-	-
Total revenues	4,546,828	(281,754)	-	4,265,074	3,560,388
Program Expenses:					
Concert production	1,636,093	-	-	1,636,093	1,398,059
Education	876,886	-	-	876,886	477,547
Fundraising	516,437	-	-	516,437	314,498
Marketing	663,422	-	-	663,422	518,070
General and administrative	509,159	-	-	509,159	635,373
Total expenses	4,201,997	-	-	4,201,997	3,343,547
Increase (decrease) in net assets	344,831	(281,754)	-	63,077	216,841
Net assets (deficit) at beginning of year	(797,494)	975,707	568,220	746,433	529,592
Net assets (deficit) at end of year	\$ (452,663)	693,953	568,220	809,510	746,433

See accompanying notes to financial statements.

THE PHILHARMONIC SOCIETY OF ORANGE COUNTY
Statement of Cash Flows
Year ended June 30, 2014

(With comparative data for the prior year)

	2014	2013
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 63,077	216,841
Adjustments to increase (decrease) net assets to net cash provided by (used for) operating activities:		
Depreciation and amortization	13,249	14,910
Loss on disposal of capital assets	1,392	-
(Increases) decreases due to changes in assets:		
Accounts receivable	-	5,924
Contributions receivable	348,501	(231,061)
Beneficial interest in trusts	(28,947)	(4,037)
Prepaid expenses	136,093	(165,137)
Other assets	(40,304)	(35,706)
Increases (decreases) due to changes in liabilities:		
Accounts payable and accrued expenses	82,502	59,468
Deferred revenue	(203,810)	152,354
Total adjustments	308,676	(203,285)
Net cash provided by (used for) operating activities	371,753	13,556
Cash flows from investing activities:		
Purchase of equipment	(3,491)	(3,569)
Net cash provided by (used for) investing activities	(3,491)	(3,569)
Cash flows from financing activities:		
Proceeds of borrowings	858,333	950,000
Repayment of borrowings	(1,054,861)	(1,010,000)
Net cash provided by (used for) financing activities	(196,528)	(60,000)
Net increase (decrease) in cash and cash equivalents	171,734	(50,013)
Cash and cash equivalents at beginning of year	1,169,235	1,219,248
Cash and cash equivalents at end of year	\$ 1,340,969	1,169,235
 <u>Supplemental disclosure cash flow information:</u>		
Cash paid during the year for interest	\$ 41,142	56,530

There were no significant non-cash investing and financing activities for the years ended June 30, 2014 and 2013.

See accompanying notes to financial statements.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(1) Summary of Significant Accounting Policies

(a) Organization and Background

The accompanying financial statements include the accounts of the Philharmonic Society of Orange County (the "Society") and activities of the Philharmonic Committees, and the Scholarship and Endowment Funds.

The principal activities of the Philharmonic committees include coordination and monitoring of fundraising activities of 19 committees, and providing musical activities and education for the youth of Orange County.

(b) Basis of Accounting

The financial statements of the Philharmonic Society of Orange County have been prepared on the accrual basis of accounting. Under this method of accounting, revenues are recognized when earned and expenses are recognized when incurred.

(c) Financial Statement Presentation – Net Assets

The Society's financial statements are presented in accordance with Accounting Standards Codification (ASC) 958-205, *Financial Statements of Not-for-Profit Organizations* for net assets. Accordingly, the net assets of the Society are reported in each of the following three classes: (a) unrestricted net assets, (b) temporarily restricted net assets, and (c) permanently restricted net assets.

(a) *Unrestricted net assets* are those that are not subject to donor-imposed stipulations. The Society currently shows a negative unrestricted fund balance.

(b) *Temporarily restricted net assets* are those stipulated by donors for specific operating purposes that require passage of time or the occurrence of a specific event.

(c) *Permanently restricted net assets* are those stipulated by donors that the corpus be invested in perpetuity while permitting the Society to use or expend part or all of the income derived from the donated assets.

(d) Contributions Received

The Society also follows ASC 958-605, *Accounting for Contributions Received and Contributions Made*. In accordance with ASC 958-605, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(d) Contributions Received, (Continued)

Unconditional promises to give are recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Unconditional promises to give and beneficial interest in trusts are recorded at fair value. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is received. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions.

(e) Accounting for Endowment Funds

The State of California enacted UPMIFA effective January 1, 2009, the provisions of which apply to endowment funds existing on or established after that date. Based on the Society's interpretation of UPMIFA, the Society has interpreted the law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment fund absent explicit donor stipulations to the contrary. As a result of this interpretation, the Society classifies permanently restricted endowment net assets at the original value of the gift donated to the permanent endowment. Remaining assets that have been restricted due to Society actions and not as a result of donor restrictions are classified as unrestricted net assets to be used upon Board approval.

(f) Investments

The Society follows ASC 958-320, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Under ASC 958-320, the Society is required to report investments in certain equity securities and all debt services at fair value. Net appreciation (depreciation) in the fair value of investments, which consists of the realized and unrealized gains or losses on those investments, is shown in the statement of activities.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(g) Fair Value Measurements

ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 - Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

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

(h) Property and Equipment

Property and equipment are stated at historical cost or fair market value at the date of donation, if donated. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Depreciation is computed using the straight-line method over estimated useful lives of the assets that are five years for equipment and the life of the lease for leaseholds. When property is sold or abandoned, the related cost and accumulated depreciation or amortization is removed from the accounts and any gain or loss is reflected in operations.

(i) Impairment of Long-Lived Assets

The Society adopted the provisions of ASC 360-10, *Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of*. The standard requires that management review long-lived and certain identifiable assets for impairment whenever events or changes in circumstances indicate the carrying value of such assets may not be recoverable. The standard specifies the measurement procedures to determine the amount of adjustment, if any, required to reduce such assets to an appropriate value for financial statement purposes.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(j) Vacation and Sick Time

Accrued vacation time is included in accrued expenses. Unused sick time is not paid to employees upon termination. As a result, no liability for sick time has been included in the accompanying financial statements.

(k) Revenue and Expense Recognition

Deferred revenue consists of advance ticket sales for future concerts. Costs and expenses directly related to future concerts are recorded as prepaid expenses. Ticket sales are recorded as revenue when a concert is performed and the related prepaid costs are charged to expense.

Income from the Philharmonic Committees, included as support groups and special events, is recognized in the year in which it is earned. The income is reported net of the related fundraising costs and expenses which approximated \$380,526 for the year ended June 30, 2014.

(l) Donated Services

A substantial number of volunteers, directors and officers have donated their time and talent to the Society. No amounts are shown in the accompanying financial statements to reflect the value of these donated services. Services donated by professionals (as defined) are accounted for by the Society based upon the fair market value of the services rendered.

(m) Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Society considers all unrestricted highly liquid investments with an initial maturity of three months or less to be cash equivalents.

(n) Use of Estimates

The preparation of these financial statements requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amount of assets, liabilities, revenues, and expenses, as well as any contingent assets and liabilities. Actual results could differ from those estimates. Management also determines the accounting principles to be used in the preparation of financial statements.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(1) Summary of Significant Accounting Policies, (Continued)

(o) Income Tax Status

The Society qualifies as a tax-exempt organization under Section 501(c)(3) as described in Sections 509(a)(1) and 170(b)(1)(A)(vi) of the Internal Revenue Code (the "Code") and, accordingly, there is no provision for income taxes. In addition, the Society qualifies for the charitable contribution deduction under Section 170 of the Code and has been classified as an organization that is not a private foundation. Income determined to be unrelated business taxable income (UBTI) would be taxable. The Society evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax filings, and discussions with outside experts.

The Society's federal Return of Organization Exempt from Income Tax (Form 990) for the fiscal years ended 2011, 2012 and 2013 are subject to IRS examination, generally for three years after filing. As of the date of this report, the Society's fiscal year 2014 return had not yet been filed.

(p) Expense Allocation

The costs of providing the various programs and other activities have been summarized on a functional basis in the "Statement of Activities". Accordingly, certain costs have been allocated among the program and supporting services benefited.

(q) Life Insurance Policy

The Society has a life insurance policy on the President/Artistic Director. The cash surrender of the life insurance policy less any outstanding loans against the policy have been reflected in the accompanying financial statement as Other Assets. The net cash surrender balance of the life insurance policy at June 30, 2014 is \$466,395. In accordance with the contract, the entire balance has vested as of June 30, 2014 and will be paid to the president upon retirement. A liability equal to the entire amount of the policy has been included in accounts payable and accrued liabilities on the accompanying financial statements

(r) Comparative Data

The amounts shown for the year ended June 30, 2013 in the accompanying financial statements are included to provide a basis for comparison with 2014 and present summarized totals only. Accordingly, the 2013 totals are not intended to present all information necessary for a fair presentation in conformity with accounting principles generally accepted in the United States of America. Such information should be read in conjunction with the Society's financial statements for the year ended June 30, 2013, from which the information was derived.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(2) Cash Equivalents and Investments

Cash and investments held by the Society are reported in the accompanying financial statements as follows at June 30, 2014:

Deposits	\$ 719,185
Money market accounts	53,567
Certificates of deposit	<u>568,217</u>
Total	<u>\$ 1,340,969</u>

The investments above are categorized as Level 1 for fair value reporting.

(3) Contributions Receivable

Contributions receivable represent unconditional promises to give which will be collected in future periods. All contributions not expected to be collected in less than one year have been discounted to their present value using a risk adjusted interest rate of 5%. Contributions receivable as of June 30, 2014 are as follows:

Contributions receivable:	
Due in one year	\$ 345,437
Due in more than one year	228,995
Less:	
Reserve for doubtful accounts	(26,996)
Present value discount on contributions	<u>(24,864)</u>
Total	<u>\$ 522,572</u>

Changes in contributions receivable for the year ended June 30, 2014 were as follows:

Fair value at beginning of year	\$ 871,073
New pledges	383,825
Payments received	(728,026)
Change in allowance for doubtful accounts	314
Change in discount	<u>(4,614)</u>
Fair value at end of year	<u>\$ 522,572</u>

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(4) Beneficial Interest in Trusts

Beneficial interest in trusts represents two agreements naming the Society as beneficiaries. The present value is calculated based on average life expectancy of the donor and discounted to present value using a risk adjusted interest rate of 4%. Beneficial interest in trusts as of June 30, 2014 are as follows:

Beneficial interest in trust	\$ 263,140
Less:	
Present value discount on beneficial interest in trust	<u>(129,559)</u>
Total	<u>\$ 133,581</u>

Beneficial interest in trusts are recorded at fair value using Level 3 inputs. Changes in fair value of contributions receivable for the year ended June 30, 2014 was as follows:

Fair value at beginning of year	\$ 104,634
Change in fair value of trust assets	50,900
Change in present value discount	<u>(21,953)</u>
Fair value at end of year	<u>\$ 133,581</u>

(5) Property and Equipment

Property and equipment consist of the following at June 30, 2014:

Office equipment	\$ 152,721
Leasehold improvements	6,248
Music mobile	<u>51,284</u>
Subtotal	210,253
Less: Accumulated depreciation	<u>(186,886)</u>
Total	<u>\$ 23,367</u>

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(6) Line of Credit

The Society entered into two secured lines of credit with American Business Bank for the amounts of \$500,000 and \$250,000 that mature on November 3, 2014 and November 3, 2014, respectively. Interest is payable monthly at a rate of 5%. The interest rates may be changed by the bank to the American Business Bank Referenced Rate plus 1%. However, the rates will never be less than 5%. The lines of credit are secured by inventory, accounts receivable, intangibles, equipment, and specific property. The outstanding lines of credit payable at June 30, 2014 were \$500,000 and \$0, respectively.

(7) Note Payable

The Society entered into a \$108,333 note payable with American Business Bank in November 2013. Principal of \$9,072 and accrued interest are payable monthly on the last day of each month with the final payment due on November 12, 2014. Interest accrues at the American Business Bank Referenced Rate plus 1%. However, the rate will never be less than 5%. The note is secured by inventory, accounts receivable, intangibles, equipment, and specific property. The outstanding balance of the note payable at June 30, 2014 was \$45,139.

(8) Related Party Transaction

The Society paid for contract musical services of an employee in the amount of \$800 for the fiscal year ended June 30, 2014.

(9) Committee Activities

Other Activities noted below are recorded in *Education and Support Groups* revenue and *Education* expenses on the accompanying Statement of Activities. For the year ended June 30, 2014, Committee Activities included the following:

	<u>House of Design</u>	<u>Cruise of Lights</u>	<u>Other Activities</u>	<u>Total</u>
Revenues	\$408,364	178,342	405,032	991,738
Expenses	<u>155,894</u>	<u>75,992</u>	<u>379,326</u>	<u>611,212</u>
	<u>\$252,470</u>	<u>102,350</u>	<u>25,706</u>	<u>380,526</u>

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(10) Commitments

The Society contracts for the services of various orchestras and performers for the upcoming concert sessions. Contractual commitments were \$1,170,500 at June 30, 2014.

The Society's 2014/2015 concert series will be performed at the Renee and Henry Segerstrom Concert Hall and the Irvine Barclay Theater. The Society has entered into limited use license agreements with the Concert Hall and the Barclay Theater. Pursuant to the agreements, the Society is committed to pay various fees for use of the facilities, the greater of \$2,500 or 10% of gross ticket revenues to the Concert Hall, and the greater of \$1,450 or 15% of gross ticket revenues (not to exceed \$3,500) to the Barclay Theater.

The Society is obligated under a lease on its administrative facilities to December 31, 2015. The lease agreement requires monthly lease payments of \$5,850 per month. In 2013 the Society entered into a 5 year lease agreement for office equipment. The lease will expire in December 2018 and requires monthly payments of \$899. In August 2013 the Society entered into a 6 year lease for office equipment. The lease expires in November 2019 and requires monthly payments of \$288.

The following is a schedule of future minimum lease payments as of June 30, 2014:

<u>Year ended June 30:</u>	
2015	\$ 78,594
2016	43,494
2017	14,244
2018	14,244
2019	<u>1,440</u>
Total	<u>\$ 152,016</u>

Rental expense for the year ended June 30, 2014 was \$64,467.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(11) Temporarily and Permanently Restricted Net Assets

Temporarily and permanently restricted net assets at June 30, 2014 are summarized as follows:

Temporarily restricted:

Beneficial interest in trust	\$ 133,581
Program restriction	37,800
Time restriction for contributions receivable	<u>522,572</u>

Total temporarily restricted net assets \$ 693,953

Permanently restricted:

Endowment fund	\$ 390,216
Educational scholarships	<u>178,004</u>

Total permanently restricted net assets \$ 568,220

Net assets released from donor restriction in the amount of \$732,326 were due to the passage of time.

(12) Unrestricted Net Asset Deficit

The Society has an unrestricted net asset deficit at June 30, 2014 of \$452,663. The deficit unrestricted net assets balance is a result of approximately \$800,000 in losses suffered in the year ended June 30, 2007 related to the opening of the new Segerstrom Concert Hall. Additionally, the Society relies on its lines of credit that expire throughout 2014. If the line of credit is not renewed by the bank, management would have difficulty paying its bills on time.

The Society has had positive net income for the past two years. During fiscal year 2014 a multi-faceted development campaign that included a matching \$1 million 60th Anniversary Challenge grant with new and increased annual gifts, and asking long-time supporters to consider special anniversary gifts, legacy or endowment gifts helped the Society come closer to the realization of a positive unrestricted net asset balance. These efforts are all important steps toward solidifying the Society's cash position and building both short term reserves and long-term assets.

PHILHARMONIC SOCIETY OF ORANGE COUNTY

Notes to Financial Statements

Year ended June 30, 2014

(Continued)

(13) Subsequent Events

On June 30, 2014 the President and Artistic Director retired. In July 2014 the Society cancelled the life insurance policy discussed in footnote 1q and paid the balance to the retired President. In July 2014 the Society also hired a new President and Artistic Director.