BERKLEE COLLEGE OF MUSIC, INC.

Consolidated Financial Statements

May 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

KPMG LLP
Two Financial Center
60 South Street
Boston, MA 02111

Independent Auditors' Report

The Board of Trustees
Berklee College of Music, Inc.:

We have audited the accompanying consolidated financial statements of Berklee College of Music, Inc. which comprise the consolidated statements of financial position as of May 31, 2015 and 2014, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Berklee College of Music, Inc. as of May 31, 2015 and 2014, and the changes in their net assets and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

September 25, 2015

BERKLEE COLLEGE OF MUSIC, INC.

Consolidated Statements of Financial Position

May 31, 2015 and 2014

Assets		**2015**	**2014**
Cash and cash equivalents	$	41,231,881	27,383,685
Accounts receivable, net (note 7)		711,027	456,601
Contributions receivable (note 8)		12,800,045	5,817,513
Other assets		8,860,983	7,796,556
Loans receivable, net (note 7)		5,010,215	5,230,400
Deposits with bond trustees (note 6)		5,430,515	11,577,460
Long-term investments (notes 3 and 4)		327,745,268	321,453,450
Property, plant, improvements, and equipment, net (notes 5 and 6)		223,610,777	225,891,468
Total assets	$	625,400,711	605,607,133
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses	$	21,042,911	19,071,814
Student deposits and deferred liabilities		27,338,589	23,470,088
Accrued pension liabilities (note 9)		62,834,297	58,161,175
Bonds and notes payable (note 6)		258,098,352	264,904,778
Refundable advances – U.S. government grants		3,032,319	2,917,234
Total liabilities		372,346,468	368,525,089
Commitments and contingencies (note 10)			
Net assets:			
Unrestricted		186,123,265	178,344,598
Temporarily restricted (note 11)		31,843,809	34,421,544
Permanently restricted (note 11)		35,087,169	24,315,902
Total net assets		253,054,243	237,082,044
Total liabilities and net assets	$	625,400,711	605,607,133

See accompanying notes to consolidated financial statements.

BERKLEE COLLEGE OF MUSIC, INC.

Consolidated Statement of Activities

Year ended May 31, 2015

	Unrestricted	Temporarily restricted	Permanently restricted	2015 Total
Operating:				
Revenues:				
Student tuition and fees	$ 194,389,196	—	—	194,389,196
Less internally funded scholarship aid	(35,594,031)	—	—	(35,594,031)
Less externally funded scholarship aid	(5,921,960)	—	—	(5,921,960)
Net tuition and fees	152,873,205	—	—	152,873,205
Contributions	2,264,172	6,928,874	—	9,193,046
Federal and state grants and contracts	926,939	—	—	926,939
Investment return for operations (note 4)	11,425,615	1,552,373	—	12,977,988
Other income	1,365,636	—	—	1,365,636
Sales and service of auxiliary enterprises	49,956,959	—	—	49,956,959
Net assets released from restrictions	11,398,219	(11,398,219)	—	—
Total operating revenues	230,210,745	(2,916,972)	—	227,293,773
Expenses:				
Instruction	86,213,754	—	—	86,213,754
Academic support	12,126,213	—	—	12,126,213
Student and enrollment services	15,166,528	—	—	15,166,528
Institutional support and advancement	37,945,854	—	—	37,945,854
Auxiliary enterprises	27,768,774	—	—	27,768,774
Operation and maintenance of physical plant:				
Depreciation and amortization	12,386,228	—	—	12,386,228
Interest	12,175,427	—	—	12,175,427
Maintenance	16,964,246	—	—	16,964,246
Total operating expenses	220,747,024	—	—	220,747,024
Change in net assets from operating activities	9,463,721	(2,916,972)	—	6,546,749
Nonoperating:				
Investment return (note 3)	12,210,754	1,891,610	—	14,102,364
Investment return for operations (note 4)	(11,425,615)	(1,552,373)	—	(12,977,988)
Contributions for long-term items	48,889	—	10,771,267	10,820,156
Pension obligation changes other than net periodic costs (note 9)	(2,519,082)	—	—	(2,519,082)
Change in net assets from nonoperating activities	(1,685,054)	339,237	10,771,267	9,425,450
Change in net assets	7,778,667	(2,577,735)	10,771,267	15,972,199
Net assets at beginning of year	178,344,598	34,421,544	24,315,902	237,082,044
Net assets at end of year	$ 186,123,265	31,843,809	35,087,169	253,054,243

See accompanying notes to consolidated financial statements.

BERKLEE COLLEGE OF MUSIC, INC.

Consolidated Statement of Activities

Year ended May 31, 2014

	Unrestricted	Temporarily restricted	Permanently restricted	2014 Total
Operating:				
Revenues:				
Student tuition and fees	$ 185,506,016	—	—	185,506,016
Less internally funded scholarship aid	(34,373,268)	—	—	(34,373,268)
Less externally funded scholarship aid	(2,754,321)	—	—	(2,754,321)
Net tuition and fees	148,378,427	—	—	148,378,427
Contributions	4,851,245	10,523,657	—	15,374,902
Federal and state grants and contracts	844,206	—	—	844,206
Investment return for operations (note 4)	10,236,051	1,306,797	—	11,542,848
Other income	664,337	—	—	664,337
Sales and service of auxiliary enterprises	40,416,020	—	—	40,416,020
Net assets released from restrictions	6,545,818	(6,545,818)	—	—
Total operating revenues	211,936,104	5,284,636	—	217,220,740
Expenses:				
Instruction	80,837,987	—	—	80,837,987
Academic support	12,452,012	—	—	12,452,012
Student and enrollment services	14,603,365	—	—	14,603,365
Institutional support and advancement	33,892,585	—	—	33,892,585
Auxiliary enterprises	22,805,354	—	—	22,805,354
Operation and maintenance of physical plant:				
Depreciation and amortization	10,453,090	—	—	10,453,090
Interest	9,868,720	—	—	9,868,720
Maintenance	16,644,268	—	—	16,644,268
Total operating expenses	201,557,381	—	—	201,557,381
Change in net assets from operating activities	10,378,723	5,284,636	—	15,663,359
Nonoperating:				
Investment return (note 3)	34,574,517	4,850,556	—	39,425,073
Investment return for operations (note 4)	(10,236,051)	(1,306,797)	—	(11,542,848)
Contributions for long-term items	33,895	—	720,377	754,272
Pension obligation changes other than net periodic costs (note 9)	(210,692)	—	—	(210,692)
Change in net assets from nonoperating activities	24,161,669	3,543,759	720,377	28,425,805
Change in net assets	34,540,392	8,828,395	720,377	44,089,164
Net assets at beginning of year	143,804,206	25,593,149	23,595,525	192,992,880
Net assets at end of year	$ 178,344,598	34,421,544	24,315,902	237,082,044

See accompanying notes to consolidated financial statements.

BERKLEE COLLEGE OF MUSIC, INC.

Consolidated Statements of Cash Flows

Years ended May 31, 2015 and 2014

		2015	2014
Cash flows from operating activities:			
Change in net assets	$	15,972,199	44,089,164
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		12,386,228	10,453,090
Realized and unrealized gains on investments, net		(14,102,364)	(39,425,073)
Pension obligation changes other than net periodic pension costs		2,519,082	210,692
Loss on disposal of equipment		44,222	165,285
Contributions for long-term investment		(5,865,006)	(912,671)
Disbursements and repayment of student loans		220,185	(40,343)
Change in current assets		(8,301,386)	(1,863,326)
Change in current liabilities		7,993,639	(3,355,225)
Net cash provided by operating activities		10,866,799	9,321,593
Cash flows from investing activities:			
Change in deposits with bond trustees		6,146,945	27,777,046
Purchase of property, plant, improvements, and equipment		(10,149,759)	(38,000,191)
Proceeds from sale and maturity of investments		78,304,039	88,473,799
Purchase of investments		(70,493,494)	(79,867,741)
Net cash provided by (used in) investing activities		3,807,731	(1,617,087)
Cash flows from financing activities:			
Payments on bonds and notes payable		(6,806,426)	(21,223,045)
Proceeds from bonds and notes payable		—	15,000,000
Contributions for long-term investment		5,865,006	912,671
Increase in refundable advances – U.S. government grants		115,086	103,563
Net cash used in financing activities		(826,334)	(5,206,811)
Net change in cash and cash equivalents		13,848,196	2,497,695
Cash and cash equivalents, beginning of year		27,383,685	24,885,990
Cash and cash equivalents, end of year	$	41,231,881	27,383,685
Supplemental data:			
Interest paid	$	12,216,883	12,391,019

See accompanying notes to consolidated financial statements.

(1) Background

Berklee College of Music, Inc. (the College) is a nonprofit co-educational institution of higher learning offering a bachelor of music degree as well as a four-year program leading to a professional diploma. Since it's founding in 1945, the College has become an international center for the education of career musicians, composers, arrangers, music educators, and other professionals in the world of modern music. The College also offers not-for-credit, for-credit courses and degrees online through its Berklee Online Program and master's degrees through its operations located in Valencia, Spain. Students were enrolled for the first time in the Valencia program during 2012. During the year ended May 31, 2014, the College formed a joint venture with Little Kids Rock to form Amp Up NYC, LLC for the purpose of teaching children in the New York City public school system to play modern band music.

(2) Summary of Significant Accounting Policies

(a) Basis of Statement Presentation

The accompanying consolidated financial statements are prepared in accordance with United States generally accepted accounting principles (GAAP). The consolidated financial statements, presented on the accrual basis of accounting, focus on the College as a whole, which includes its Valencia, Spain operations. Balances and transactions are presented based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes to net assets are classified as follows:

Permanently restricted net assets – Net assets subject to donor-imposed stipulations are maintained permanently by the College. Generally, the donors permit the College to use, for general or specific purposes, all or part of any income earned and any capital gains on related investments.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations to be met by actions of the College and/or the passage of time.

Unrestricted net assets – Net assets not subject to donor-imposed stipulations.

Unless limited by donor restrictions or law, revenues and expenses, gains or losses on investments, and changes in other assets or liabilities are reported on the consolidated statements of activities as increases and decreases in unrestricted net assets. Net assets released from restrictions, for which the donor purpose has been met or the stipulated time period has elapsed, are reported as reclassifications between applicable net asset classes.

Contributions and unconditional promises to give are recognized as revenue in the period received. Promises to give that are expected to be collected after the consolidated statement of financial position date are reported as contribution revenue in temporarily restricted net assets. Promises to give that require the corpus to be maintained permanently are reported as contributions for long-term items in permanently restricted net assets. Contributions of land, buildings, or equipment are reported as unrestricted nonoperating support unless the donor places restrictions on their use.

Contributions of assets other than cash are recorded at their estimated fair value at the date of the gift.

(b) Operations

The consolidated statement of activities reports the change in net assets from operating and nonoperating activities. Operating revenues and expenses are attributable to the College's academic programs and auxiliary enterprises. Tuition revenue is reported net of a discount awarded to students from various sources including college financial aid, scholarships from endowment funds, and/or state and federal grants. Nonoperating activities are attributable to the return on investments, contributions of capital assets, contributions to the permanent endowment, gains or losses on capital asset sales or disposals, and nonrecurring changes in accounting principles.

Expenses associated with the operation and maintenance of plant assets, including depreciation and interest expense, are disclosed separately on the consolidated statement of activities. Note 12 presents the impact had these expenses been allocated, based on actual square footage utilized, to operating expenses for Instruction, Academic support, Student and enrollment services, Institutional support and advancement, and Auxiliary enterprises. Expenses associated with fundraising activities were $3,009,067 and $2,886,194 in 2015 and 2014, respectively, and are included in Institutional support and advancement.

(c) Cash Equivalents

Cash equivalents represent money market funds and short-term instruments with maturities at date of purchase of three months or less.

(d) Long-Term Investments

Investments are reported at estimated fair value. If an investment is held directly by the College and an active market with quoted prices exists, the College reports the fair value as the market price.

The College also holds shares or units in nonmarketable securities including alternative investments such as private equity, venture capital, hedge funds, and real asset strategies. Such alternative investment funds may hold securities or other financial instruments for which a ready market exists and are priced accordingly. In addition, such funds may hold assets that require the estimation of fair values in the absence of readily determinable market values. Such valuations are determined by fund managers and generally consider variables such as operating results, comparable earnings multiples, projected cash flows, recent sales prices, and other pertinent information, and may reflect discounts for the illiquid nature of certain investments held.

For investments that do not have a readily determinable fair value, the fair value of those investments is the net asset value (NAV) per share or its equivalent as a practical expedient.

Investments are generally redeemable or may be liquidated at NAV under the original terms of the subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the fund agreements. Due to the nature of the investments held by these funds, changes in market conditions, the economic environment, or liquidity provisions may significantly impact the NAV of the funds and, consequently, the fair value of the College's interests in the funds. Although certain investments may be sold in secondary market transactions, subject to meeting certain requirements of the governing documents of the funds, the secondary market is not active and individual transactions

(Continued)

are not necessarily observable. It is, therefore, reasonably possible that if the College were to sell its interest in a fund in the secondary market, the sale could occur at an amount materially different from the reported value.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820), Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. The ASU eliminates the requirement to categorize investments in the fair value hierarchy if their fair value is measured at net asset value per share (or its equivalent) using the practical expedient in the FASB's fair value measurement guidance. The ASU is effective for fiscal years beginning after December 15, 2015, with early adoption permitted and applied retrospectively. Management has elected to adopt the ASU early.

(e) Fair Value Measurements

GAAP defines fair value and establishes a framework for measuring and disclosing fair value measurements. Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. GAAP establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels:

- Level 1 - quoted prices in active markets accessible at the measurement date for assets or liabilities
- Level 2 – observable prices based on inputs not quoted in active markets but corroborated by market data.
- Level 3 – unobservable inputs are used when little or no market data is available.

(f) Property, Plant, Improvements, and Equipment

Property, plant, improvements, and equipment are stated at cost. Depreciation, including amortization of leasehold improvements and library books, is computed using the straight-line method over the related assets' estimated useful economic lives. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized. The cost of maintenance and repairs is charged to expense as incurred. Interest on debt obtained for construction purposes is capitalized during the construction phase.

If the College determines a conditional asset retirement obligation exists, it assesses whether or not the amount of the obligation can be reasonably estimated. If the obligation can be reasonably estimated, the College records the present value of the obligation, the corresponding cost is capitalized, and the liability is accreted to fair value each reporting period until settled. Depreciation of the cost is recognized over the life of the related asset.

(g) Bond Issuance Costs

Bond issuance costs are amortized using the effective interest method over the life of the associated bond issue.

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(h) Student Deposits and Deferred Revenue

Student deposits along with advance payments for tuition, room and board, and fees related to the summer and fall semesters have been deferred and will be reported as unrestricted revenue in the year in which the revenue is earned.

(i) Tax Status

The College is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code), and is generally exempt from taxes pursuant to Section 501(a) of the Code. The College believes it has taken no significant uncertain tax positions.

(j) Foreign Currency Translation

The College's accounting records, for Valencia, Spain, are maintained in the functional currency of U.S. dollars. The cumulative adjustment from foreign currency translation at May 31, 2015 and 2014 included in Institutional Support was a net gain of $602,283 and $200,294, respectively.

The foreign currency equivalents used to translate Euros into U.S. dollars are as follows:

	U.S. dollar to one euro 2015	U.S. dollar to one euro 2014
Revenues and expenses at the monthly average rate:		
The annual average rate for the fiscal year ended May 31	1.23:1	1.35:1
Assets, liabilities, and net assets at the current rate as of May 31	1.21:1	1.36:1

(k) Self-Funded Insurance

Effective January 1, 2014, the College entered into a self-funding medical insurance program, open to most employees and certain of their family members, in order to manage rising health insurance costs over the long-term. A stop loss policy is in effect, which limits the College's annual loss per claimant to $150,000 and 125% of expected claims, as calculated by the program's actuary on an aggregate basis. The College's expense under the self-insured medical plan amounted to $7,095,822 for 2015 and the estimated unpaid claims liability, included in accrued expenses at May 31, 2015, amounted to $1,274,500.

(l) Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP 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.

(m) Reclassifications

Certain prior year balances have been reclassified to conform to current year presentation.

(3) Long-Term Investments

The College's investments at fair value are summarized as follows at May 31:

		2015	2014
Money market funds	$	24,271,589	27,128,105
U.S. equity funds		31,462,991	33,604,162
International equity funds		82,815,594	71,422,488
Fixed income funds		—	6,609,472
Alternative investments		189,195,094	182,689,223
Total	$	327,745,268	321,453,450

Total return on long-term investments consisted of the following for the years ended May 31:

		2015	2014
Investment return:			
Interest and dividends	$	68	179,027
Unrealized gain		6,552,717	19,477,429
Realized gain		7,549,579	19,768,617
Total return on investments	$	14,102,364	39,425,073

The following tables summarize the College's investments by major category in the fair value hierarchy as of May 31, 2015 and 2014, as well as related strategy, liquidity, and funding commitments:

	Fiscal year ended May 31, 2015		Redemption or	Days'	Related unfunded
	Level 1	**Total**	**liquidation**	**notice**	**commitment**
Long-term investment strategies:					
Investments at fair value:					
Cash and cash equivalents	24,271,589	24,271,589	Daily	N/A	None
Traditional equity index funds	7,858,577	7,858,577	Daily	1	None
Investments at net asset value:					
Domestic equities:					
Large cap long/short funds		23,604,414	Quarterly	60	None
Global (excluding U.S.) equities:					
Developed markets		75,524,995	Various (1)	6 and 30	None
Emerging Markets		7,290,599	Quarterly	90	None
Hedged equity funds of funds:					
Multiple strategies		12,111,126	Quarterly	45	None
Private equity and venture capital funds		33,350,469	Illiquid (2)	N/A	5,122,720
Real assets:					
Commodities oil and energy		2,171,963	Illiquid (3)	N/A	635,981
Private real estate		9,350,520	Illiquid	N/A	8,334,205
Direct hedge equity/ multiple strategies		81,701,679	Various (4)	90	None
Direct absolute return/ multiple strategies		50,509,337	Various (5)	45 and 90	None
Total	$ 32,130,166	327,745,268			

(1) Funds with monthly redemption = $42,957,764, quarterly redemption = $28,171,577, illiquid =$4,395,654
(2) These funds are expected to liquidate within 1-8 years and total $33,350,469
(3) Variety of benchmarks and limitations on withdrawals; dissolutions from 2015 to 2018
(4) Funds with semi-annual redemption = $13,484,526, annual redemption $29,108,222, illiquid $13,791,832, Locked up $9,089,900, Rolling 3 year 90 days notice $16,227,199
(5) Funds with annual redemption $50,486,410, illiquid $22,927

	Fiscal year ended May 31, 2014		Redemption		Related
	Level 1	Total	or liquidation	Days' notice	unfunded commitment
Long-term investment strategies:					
Investments at fair value:					
Cash and cash equivalents	27,128,105	27,128,105	Daily	N/A	None
Fixed income	6,609,472	6,609,472	Daily	1	None
Traditional equity index funds	9,025,232	9,025,232	Daily	1	None
Investments at net asset value:					
Domestic equities:					
Large cap long/short funds		24,578,930	Quarterly	60	None
Global (excluding U.S.) equities:					
Developed markets		71,422,488	Various (1)	6, 30, N/A	None
Hedged equity funds of funds:					
Multiple strategies		58,119,588	Various (2)	45, 30, N/A	None
Private equity and venture capital funds		48,061,006	Illiquid (3)	N/A	5,503,950
Real assets:					
Commodities oil and energy		6,802,045	Illiquid (4)	N/A	5,112,425
Private real estate		629,212	Illiquid	N/A	6,780,416
Direct hedge equity/ multiple strategies		44,789,171	Illiquid (5)	90	None
Direct absolute return/ multiple strategies		24,288,201	Various (6)	45 and 90	None
Total	$ 42,762,809	321,453,450			

(1) Funds with monthly redemption = $41,493,206, quarterly redemption = $26,058,590, illiquid =$3,870,692

(2) Funds with annual redemption $27,965,384, quarterly redemption total $11,225,475, Illiquid $12,882,126, Locked up $6,046,603

(3) These funds are expected to liquidate within 1-8 years

(4) Variety of benchmarks and limitations on withdrawals; dissolutions from 2015 to 2018

(5) Funds illiquid - $30,411,391, Rolling 3 years 90 days $14,377,780

(6) Funds with annual redemption $24,265,052, illiquid $23,149

No investments at fair value are considered to be Level 2 or Level 3 investments in the fair value hierarchy at May 31, 2015 or 2014, respectively.

Alternative investments are redeemable with the fund at NAV under the original terms of the partnership agreement and/or subscription agreements and operations of underlying funds. All alternative investment fund redemptions require written notice prior to the redemption period. The long-term investments' fair values as of May 31, 2015 are classified below by redemption period:

		Investment fair values
Investments redemption period:		
Daily	$	32,130,166
Monthly		42,957,764
Quarterly		87,403,914
Semi-Annually		13,484,526
Annually		79,594,633
Locked up or illiquid		72,174,265
Total as of May 31, 2015	$	327,745,268

The investments categorized as locked up are those funds that are locked up based on subscription agreements until liquidation, such as private equity and real asset funds.

(4) Endowment

The College's endowment consists of approximately 170 individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board of Trustees (the Board) to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

(a) Relevant Law and Balances

The College is subject to UPMIFA as adopted by the Commonwealth of Massachusetts. Under UPMIFA, the Board has discretion to determine appropriate expenditures of a donor-restricted endowment fund in accordance with a robust set of guidelines about what constitutes prudent spending. UPMIFA permits the College to appropriate for expenditure or accumulate so much of an endowment fund as the College determines to be prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Seven criteria are to be used to guide the College in its yearly expenditure decisions: 1) duration and preservation of the endowment fund; 2) the purposes of the College and the endowment fund; 3) general economic conditions; 4) effect of inflation or deflation; 5) the expected total return from income and the appreciation of investments; 6) other resources of the College; and 7) the investment policy of the College.

Although UPMIFA offers short-term spending flexibility, the explicit consideration of the preservation of funds among factors for prudent spending suggests that a donor-restricted endowment fund is still perpetual in nature. Under UPMIFA, the Board is permitted to determine and continue a prudent payout amount, even if the market value of the fund is below historic dollar value. There is an expectation that, over time, the permanently restricted amount will remain intact. This perspective is aligned with the accounting standards definition that permanently restricted funds are those that must be held in perpetuity even though the historic dollar value may be dipped into on a temporary basis.

The College classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets, until appropriated for spending by the Board.

Endowment funds consisted of the following at May 31, 2015:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$ —	11,419,000	29,851,592	41,270,592
Board-designated endowment funds	286,474,676	—	—	286,474,676
Total endowed funds	$ 286,474,676	11,419,000	29,851,592	327,745,268

Endowment funds consisted of the following at May 31, 2014:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	$ —	11,079,763	23,986,586	35,066,349
Board-designated endowment funds	286,387,101	—	—	286,387,101
Total endowed funds	$ 286,387,101	11,079,763	23,986,586	321,453,450

Changes in endowment funds for the year ended May 31, 2015 are as follows:

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment funds, June 1, 2014	$	286,387,101	11,079,763	23,986,586	321,453,450
Investment return:					
Investment gain		68	—	—	68
Net appreciation		12,210,686	1,891,610	—	14,102,296
Total investment return		12,210,754	1,891,610	—	14,102,364
Contributions		—	—	5,865,006	5,865,006
Appropriation of endowment assets for expenditure		(11,425,615)	(1,552,373)	—	(12,977,988)
Transfers from board-designated funds		(697,564)	—	—	(697,564)
Endowment funds, May 31, 2015	$	286,474,676	11,419,000	29,851,592	327,745,268

Changes in endowment funds for the year ended May 31, 2014 are as follows:

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment funds, June 1, 2013	$	260,024,695	7,535,825	23,073,915	290,634,435
Investment return:					
Investment income		157,544	21,483	—	179,027
Net appreciation		34,416,973	4,829,073	—	39,246,046
Total investment return		34,574,517	4,850,556	—	39,425,073
Contributions		—	—	912,671	912,671
Reclassification of contributions		(179)	179	—	—
Appropriation of endowment assets for expenditure		(10,236,051)	(1,306,797)	—	(11,542,848)
Transfers to board-designated funds		2,024,119	—	—	2,024,119
Endowment funds, May 31, 2014	$	286,387,101	11,079,763	23,986,586	321,453,450

(b) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below their original contributed value. No deficiencies of this nature are reported as reductions in unrestricted net assets as of May 31, 2015 and 2014. These deficiencies result from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

(c) Return Objectives and Risk Parameters

The College has adopted investment and spending policies for endowment assets that are intended to ensure a total return (yield plus capital appreciation) necessary to at least preserve, but expected to enhance (in real dollar terms) endowment assets, while providing a dependable source of income for current operations and scholarships. Endowment assets include those assets of donor-restricted funds that the College must hold in perpetuity or for a donor-specified period as well as board-designated funds.

To satisfy its long-term rate-of-return objectives, the College relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The College targets a diversified asset allocation that places emphasis on investments in equities, fixed income and alternative investments to achieve its long-term return objectives within prudent risk constraints.

(d) Spending Policy and How the Investment Objectives Relate to Spending Policy

State law permits the spending of gains on endowment funds over a stipulated period of time. State law allows the Board to appropriate all of the income and a specified percentage of the net appreciation as is prudent considering the College's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Under the College's current endowment spending policy, which is within the guidelines specified under state law, 5% of the average of the fair value of qualifying endowment investments at the end of the previous three years is authorized for appropriation. The authorized appropriation amounted to $12,977,988 in 2015 and $11,542,848 in 2014. In establishing this policy, the College considered the expected return on its endowment. Accordingly, the College expects the current spending policy to allow its endowment to maintain its purchasing power by growing at a rate equal to planned payouts. Additional real growth will be provided through new gifts and any excess investment return.

(5) Property, Plant, Improvements, and Equipment

Property, plant, improvements, and equipment consisted of the following at May 31:

	2015	2014	Estimated useful life
Land	$ 21,248,852	20,808,650	—
Buildings	150,813,844	150,094,976	40 years
Improvements	129,453,963	123,972,559	15 – 20 years
Furniture and equipment	41,125,951	43,417,158	3 – 10 years
Library books	2,807,314	2,644,499	10 years
Construction in progress	2,641,255	1,592,267	—
	348,091,179	342,530,109	
Less accumulated depreciation	(124,480,402)	(116,638,641)	
	$ 223,610,777	225,891,468	

Total depreciation expense was $12,305,973 and $10,384,594 in 2015 and 2014, respectively.

Interest on debt obtained for construction purposes is capitalized during the construction phase. Total capitalized interest was $2,511,799 in 2014.

(6) Bonds and Notes Payable

Bonds and Notes payable consisted of the following at May 31:

	2015	2014
(a) MDFA Revenue Bonds, Berklee College of Music Series 2011, dated September 22, 2011 (including unamortized premium of $4,996,259 and $4,950,944 in 2015 and 2014, respectively)	$ 90,414,683	92,100,943
(b) MHEFA Revenue Bonds, Berklee College of Music Series 2007A, dated August 8, 2007 (including unamortized premium of $3,516,376 in 2015 and $3,478,835 in 2014)	155,308,669	158,928,835
(c) MDFA Revenue Bonds, Berklee College of Music Series 2013, Dated August 1, 2013	12,375,000	13,875,000
Bonds payable	258,098,352	264,904,778

(a) MDFA Revenue Bonds, Berklee College of Music Issue, Series 2011

On September 22, 2011, the College issued $90,000,000 Revenue Bonds, Series 2011 (the Series 2011 bonds) from the Massachusetts Development Finance Agency (MDFA). The College used some of the proceeds from the Series 2011 bonds to finance and refinance the acquisition, design, and construction of several real estate projects located primarily on Massachusetts Avenue. The Series 2011 bonds bear interest at rates ranging from 2.00% to 5.00% and are due in varying installments of $141,900 to $4,358,725 until October 1, 2041. Principal payments began on October 1, 2012. Proceeds from these bonds had been fully spent as of May 31, 2014.

(b) MHEFA Revenue Bonds, Berklee College of Music Issue, Series 2007A

On August 8, 2007, the College issued $173,510,000 Revenue Bonds, Series 2007A (the Series 2007A bonds) from the Massachusetts Health and Education Facilities Authority (MHEFA). The Series 2007A bonds bear interest at rates ranging from 3.88% to 5.00% and are due in varying installments of $271,000 to $8,393,493 until October 1, 2037. Principal payments began in October 2008. Proceeds from these bonds had been fully spent as of May 31, 2012.

(c) MDFA Revenue Bonds, Berklee College of Music Issue, Series 2013

On August 1, 2013, the College issued $15,000,000 Revenue Bonds, Series 2013 (the Series 2013 bonds) from the Massachusetts Development Finance Agency. The Series 2013 bonds bear interest at a fixed rate of 2.14% and are due in varying installments until August 1, 2023. Included in deposits with bond trustees at May 31, 2015 was $5,430,515 for project funds. The fair value of investments held by the bond trustees are based on market quoted information in an active market, and are categorized as Level 1 for purposes of valuation disclosure.

Scheduled long-term maturities of existing indebtedness at May 31, 2015 in each of the next five years and in the aggregate thereafter are as follows:

		Amount
Year ending May 31:		
2016	$	6,700,000
2017		6,945,000
2018		7,205,000
2019		7,495,000
2020		7,795,000
Thereafter		213,860,000
		250,000,000
Plus unamortized bond premium		8,098,352
	$	258,098,352

The College's bonds trade periodically in a limited market. Utilizing available market pricing information provided by a third party, the College determined that the estimated fair value of its total

(Continued)

indebtedness at May 31, 2015 was $257,302,657 related to these bonds. Because the fair value of the bonds is based predominantly on observable inputs that are corroborated by market data, it is categorized as Level 2 for purposes of valuation disclosure.

(d) Notes Payable

In February 2008, the College entered into an uncollateralized loan with a bank in the amount of $17,290,000 (the note payable). The outstanding principal balance must be repaid on or before March 1, 2015. Interest was paid monthly, and the loan bore interest at a seven-day market rate plus 25 basis points (0.448% at May 31, 2013). This note payable was paid in full on September 3, 2013.

(e) Revolving Credit Facility

The College established a three-year revolving line of credit facility with JP Morgan Chase in the amount of $30,000,000 on June 3, 2013. Advances on this facility can be made as a Base Rate loan, a money market loan, or a LIBOR loan and interest will apply based on the commercial base rate, the money market rate in effect for the first day, and the adjusted LIBOR for the period, respectively. A nonusage facility fee of 0.10% per annum will apply. There were no outstanding borrowings under this facility at May 31, 2015.

(f) Interest Expense and Amortization Costs

Interest expense on bonds and notes payable, net of capitalized interest, was $12,175,427 and $9,868,720 in 2015 and 2014, respectively. Amortization of bond issue costs was not significant in both 2015 and 2014, respectively.

(7) Allowances for Uncollectible Accounts and Loans Receivable

Accounts receivable, arising from student tuition and fees, are presented net of an allowance for uncollectible accounts of $1,011,730 and $661,575 at May 31, 2015 and 2014, respectively.

Loans receivable, primarily from the federal Perkins loan program, are net of an allowance for uncollectible accounts of $1,000,000, at May 31, 2015 and 2014.

(8) Contributions Receivable

Contributions receivable consisted of the following at May 31:

		2015	2014
Unconditional promises expected to be collected in:			
Less than one year	$	4,899,561	3,608,858
One year to five years		9,895,827	3,043,588
		14,795,388	6,652,446
Less allowance for uncollectible pledges		(1,479,284)	(664,990)
		13,316,104	5,987,456
Less present value discount		(516,059)	(169,943)
	$	12,800,045	5,817,513

The present value of estimated future cash flows is measured utilizing a discount rate equivalent to Treasury yields of similar maturity (3-year, 5-year, and 10-year rates) based on the anticipated pledge fulfillment date. The rates utilized to calculate the discount ranged from 0.52% to 3.05% in 2015 and 2014.

In fiscal year 2012, the College was informed that it was one of the named beneficiaries of a testamentary trust. The College received $1,717,188 and $2,640,000 in 2015 and 2014, respectively. Included in the May 31, 2014 unconditional promises to be collected in less than one year was the final anticipated distribution of $1,360,000.

(9) Retirement Plans

The College offers a defined-contribution plan to substantially all employees. Through December 31, 2011, this plan provided for investments through the Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF), as well as The Standard. Beginning January 1, 2012, this plan provided for investments through the TIAA and CREF, as well as Transamerica Retirement Services (formerly known as Diversified Retirement Corporation). The College matches all savings in a pay period up to 3% of pay for full-time employees hired before January 1, 2012, up to 6% of pay for full-time employees hired January 1, 2012 or later, and up to 50% of 10% of pay for eligible part-time employees who are eligible for medical benefits under the College’s healthcare program. All eligible, full-time employees hired after January 1, 2012 also receive an additional 3% of pay. The College contributed $3,185,504 and $3,149,628, respectively, for the years ended May 31, 2015 and 2014.

The College also sponsors a noncontributory, defined-benefit pension plan (the pension plan) that covers substantially all those full-time employees that were hired prior to January 1, 2012. The pension plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service with the College and their compensation rates near retirement. Guidance under GAAP requires the retirement benefit plan’s funding deficit or surplus to be recognized in the sponsoring employer’s statement of financial position and plan assets and benefit obligations to be measured as of the date of the College's fiscal year-end. The College froze the pension plan to new membership as of January 1, 2012. Notwithstanding, certain part-time faculty members active at December 31, 2011, who achieve full-time status after December 31, 2011 will be enrolled in the pension plan.

Pension expense for the years ended May 31 includes the following components:

		2015	2014
Service cost of the current period	$	6,123,249	5,929,172
Interest cost on the projected benefit obligation		5,272,784	5,035,619
Expected return on assets held in the plan		(5,879,594)	(5,622,840)
Recognition of net actuarial loss		3,272,757	3,210,944
Pension expense	$	8,789,196	8,552,895

The following sets forth the change in benefit obligation, change in plan assets, and funded status of the plan and the amounts shown in the accompanying consolidated statements of net assets at May 31:

		2015	2014
Change in benefit obligation:			
Benefit obligation at beginning of year	$	142,426,169	131,058,772
Service cost		6,123,249	5,929,172
Interest cost		5,272,784	5,035,619
Actuarial loss		3,244,265	7,738,322
Benefits paid		(4,728,338)	(7,335,716)
Benefit obligation at end of year		152,338,129	142,426,169
Change in plan assets:			
Fair value of plan assets at beginning of year		86,225,560	76,782,062
Actual return on plan assets		3,332,020	9,939,533
Employer contributions		6,496,893	6,839,681
Benefits paid		(4,728,338)	(7,335,716)
Fair value of assets held in the plan		91,326,135	86,225,560
Pension liability at end of year	$	(61,011,994)	(56,200,609)

Pension expense was computed based on a weighted average discount rate of 3.75% for 2015 and 3.85% for 2014, expected long-term rate of return on assets of 7.00% for 2015 and 2014, and future personnel expense increases of 3% for 2015 and 2014.

(Continued)

The discount rate used in determining the actuarial present value of the projected benefit obligation in 2015 and 2014 was 3.75% and 3.85%, respectively.

The benefits expected to be paid after May 31, 2015 are as follows:

Years ending May 31:		
2016	$	11,907,041
2017		8,501,774
2018		9,183,626
2019		9,525,541
2020		9,870,779
2021–2025		51,129,103

The expected long-term rate of return on assets was determined by considering the current and expected asset allocations, as well as historical and expected returns on the categories of plan assets.

The College's asset allocations and investment policy guidelines as of the measurement date are as follows:

	Target allocation	Plan assets at May 31	
		2015	2014
Equity securities	55%	47%	46%
Debt securities	15	12	13
Real estate	—	4	3
Other	30	37	38

The investment strategy of the pension plan is designed to maximize total return (income plus capital change) while preserving the capital values of the funds, protecting the funds from inflation, and providing liquidity as needed for plan benefits. The objective is to provide a rate of return that meets or exceeds the expected long-term rate of return on plan assets. Equity and fixed income managers will be expected to achieve an annualized total rate of return over a three-to five-year period, which exceeds an appropriate market index rate of return by 1.50% and 0.75% points compounded annually, net of costs and fees, respectively.

Other changes in pension liability recognized in unrestricted net assets in fiscal years 2015 and 2014 were as follows:

		2015	2014
Net (gain) loss	$	2,519,082	210,692
Amortization of prior service costs		—	—
Total	$	2,519,082	210,692

The investment strategy of the noncontributory retirement plan is to allocate assets among investment classes that will provide for stability and growth of plan assets in varying market environments. To that end, the plan has adopted policies that require each asset class to be diversified and that multiple managers with differing styles of management are employed. On a quarterly basis, the plan reviews progress toward achieving its and individual managers' performance objectives.

The value of the College's defined-benefit pension plan assets by asset class are as follows at May 31, 2015:

	2015	
	Level 1	**Total**
Investments at fair value:		
Cash and fixed income	$ 10,910,460	10,910,460
Domestic equities	6,408,730	6,408,730
International equities	8,130,710	8,130,710
Investments at net asset value:		
Domestic equities		12,990,727
International equities		18,981,663
Hedge funds		26,156,745
Real assets		5,095,620
Private equity and venture capital		2,651,480
	$ 25,449,900	91,326,135

The value of the College's defined-benefit pension plan assets by asset class are as follows at May 31, 2014:

	2014	
	Level 1	**Total**
Investments at fair value:		
Cash and fixed income	$ 14,035,653	14,035,653
Domestic equities	6,298,599	6,298,599
International equities	9,629,421	9,629,421
Investments at net asset value:		
Domestic equities		8,076,093
International equities		18,989,860
Hedge funds		20,810,607
Real assets		4,137,965
Private equity and venture capital		4,247,362
	$ 29,963,673	86,225,560

No investments at fair value are considered to be Level 2 or Level 3 investments in the fair value hierarchy at May 31, 2015 and 2014, respectively.

(10) Lease Commitments

The College leases space in various buildings for its operations. The following is a schedule of future minimum lease payments under operating leases as of May 31:

	Amount
Fiscal year:	
2016	$ 3,954,412
2017	2,427,722
2018	2,164,435
2019	2,007,700
2020	1,238,410
Thereafter	336,363

Rental expense was $4,435,424 in 2015 and $3,184,325 in 2014.

(Continued)

The College owns several buildings in which there are commercial tenants. The following is a schedule of future minimum rental income under operating leases as of May 31:

		Amount
Fiscal year:		
2016	$	969,378
2017		913,022
2018		888,117
2019		758,196
2020		627,243
Thereafter		1,242,521

Rental income was $1,576,417 in 2015 and $1,616,780 in 2014.

(11) Restricted Net Assets

Temporarily restricted net assets consist of the following at May 31:

		2015	2014
Unspent gifts:			
Instruction	$	1,853,408	2,319,266
Institutional support		1,320,228	1,832,059
Student aid		4,305,326	7,738,629
Facilities		697,885	—
Capital campaign programs		4,727,310	7,187,635
		12,904,157	19,077,589
Unappropriated gains from permanently restricted net assets		11,419,000	11,079,763
Outstanding pledges		7,520,652	4,264,192
	$	31,843,809	34,421,544

The College classifies unspent gains from permanently restricted funds as temporarily restricted until it appropriates and spends such sums in accordance with the terms of the underlying endowment funds, at which time, they will be reclassified to unrestricted revenues.

Permanently restricted net assets consist of the following at May 31:

		2015	2014
Student aid	$	21,221,418	18,368,421
Instruction		5,617,767	4,108,467
Institutional support		3,012,407	1,509,698
Outstanding pledges		5,235,577	329,316
	$	35,087,169	24,315,902

(12) Functional Expenses

Following summary presents the effect on functional expenses had the direct and indirect cost components been allocated to the functional expenses for the years ended May 31, 2015 and 2014:

		May 31, 2015				
			Indirect costs			
		Direct costs	Maintenance	Depreciation and amortization	Interest expense	Total expenses
Expenses:						
Education and general:						
Instruction	$	86,213,754	9,777,666	4,815,543	6,163,991	106,970,954
Academic support		12,126,213	477,612	235,225	301,094	13,140,144
Student and enrollment services		15,166,528	282,606	139,185	178,159	15,766,478
Institutional support and advancement		37,945,854	3,601,149	1,773,581	2,270,220	45,590,804
Auxiliary enterprises		27,768,774	2,825,213	5,422,694	3,261,963	39,278,644
Total operating expenses	$	179,221,123	16,964,246	12,386,228	12,175,427	220,747,024

		May 31, 2014				
			Indirect costs			
		Direct costs	Maintenance	Depreciation and amortization	Interest expense	Total expenses
Expenses:						
Education and general:						
Instruction	$	80,837,987	9,556,390	4,063,974	5,001,502	99,459,853
Academic support		12,452,012	466,803	198,514	244,309	13,361,638
Student and enrollment services		14,603,365	276,210	117,462	144,560	15,141,597
Institutional support and advancement		33,892,585	3,519,652	1,496,776	1,842,071	40,751,084
Auxiliary enterprises		22,805,354	2,825,213	4,576,364	2,636,278	32,843,209
Total operating expenses	$	164,591,303	16,644,268	10,453,090	9,868,720	201,557,381

(13) Subsequent Events

In June 2015, the College signed a memorandum of understanding (MOU) with The Boston Conservatory to explore a merger of the two institutions.

For purposes of determining the effects of subsequent events on these consolidated financial statements, management has evaluated events subsequent to May 31, 2015 and through September 25, 2015, the date on which the consolidated financial statements were issued.