

# **PENNSYLVANIA ACADEMY OF THE FINE ARTS**

***FINANCIAL STATEMENTS AND  
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS***

**JUNE 30, 2018**

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

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## **REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

**Board of Trustees  
Pennsylvania Academy of the Fine Arts  
Philadelphia, Pennsylvania**

We have audited the accompanying financial statements of Pennsylvania Academy of the Fine Arts (a nonprofit organization), which comprise the statement of financial position as of June 30, 2018, and the related statements of activities and changes in net assets 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 from material misstatement.

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

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

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pennsylvania Academy of the Fine Arts as of June 30, 2018, 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.

**Board of Trustees  
Pennsylvania Academy of the Fine Arts  
Philadelphia, Pennsylvania**

**Report on Summarized Comparative Information**

We have previously audited Pennsylvania Academy of the Fine Arts' 2017 financial statements, and our report dated October 26, 2017, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2017, is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Tait, Weller & Baker LLP*

**Philadelphia, Pennsylvania  
October 25, 2018**

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENTS OF FINANCIAL POSITION

June 30, 2018 And 2017

	<u>2018</u>	<u>2017</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 383,947	\$ 1,506,345
Accounts receivable, net	283,522	211,012
Prepaid expenses	385,099	370,239
Inventories	183,050	117,189
Pledges receivable (Notes 3 and 11)	<u>9,201,608</u>	<u>2,322,711</u>
<b>Total Current Assets</b>	<u>10,437,226</u>	<u>4,527,496</u>
<b>LONG-TERM ASSETS</b>		
Pledges receivable (Notes 3 and 11)	2,848,469	2,511,689
Other assets (Notes 4, 8 and 11)	127,870	122,036
Long term investments (Notes 4 and 7)	44,411,331	45,641,008
Property, buildings and equipment (Note 5)	52,228,293	50,810,291
Beneficial interest in perpetual trusts (Notes 4 and 6)	<u>10,343,994</u>	<u>10,057,807</u>
<b>Total Long-Term Assets</b>	<u>109,959,957</u>	<u>109,142,831</u>
<b>Total Assets</b>	<u>\$ 120,397,183</u>	<u>\$ 113,670,327</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Line of credit (Note 7)	\$ 8,055,000	\$ 6,230,000
Accounts payable	1,489,779	954,480
Accrued expenses	1,274,961	729,132
Bond payable (Note 8)	541,000	-
Deferred revenue	<u>1,374,513</u>	<u>1,082,096</u>
<b>Total Current Liabilities</b>	12,735,253	8,995,708
<b>LONG-TERM LIABILITIES</b>		
Bonds payable (Note 8)	20,263,545	20,796,727
Other liabilities (Notes 4 and 8)	<u>-</u>	<u>330,211</u>
<b>Total Liabilities</b>	<u>32,998,798</u>	<u>30,122,646</u>
<b>NET ASSETS</b>		
Unrestricted		
Undesignated	52,455,040	56,074,058
Board-designated (Note 10)	807,330	-
Temporarily restricted (Note 10)	5,185,956	1,161,507
Permanently restricted (Note 10)	<u>28,950,059</u>	<u>26,312,116</u>
<b>Total Net Assets</b>	<u>87,398,385</u>	<u>83,547,681</u>
<b>Total Liabilities and Net Assets</b>	<u>\$ 120,397,183</u>	<u>\$ 113,670,327</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2018 With Summarized Information For 2017

	2018			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2018	2017
<b>Program Revenues, Support Revenue and Investment Income</b>					
<b>Program Revenue</b>					
Tuition and fees, net of scholarships	\$ 6,511,078	\$ -	\$ -	\$ 6,511,078	\$ 6,735,682
Continuing and public education	770,484	-	-	770,484	800,978
Government grants	117,266	-	-	117,266	233,368
Museum admissions, collection rental and fees	292,984	-	-	292,984	701,048
Museum shop and art supply store, net	200,211	-	-	200,211	180,156
Facility rental and catering	468,671	-	-	468,671	727,518
Women's Board	362,970	-	-	362,970	309,000
Other income	147,444	-	-	147,444	28,108
<b>Total program revenue</b>	<b>8,871,108</b>	<b>-</b>	<b>-</b>	<b>8,871,108</b>	<b>9,715,858</b>
<b>Support Revenue</b>					
Fundraising and support revenues	4,418,191	8,080,785	2,351,756	14,850,732	7,493,460
Bequests	-	-	-	-	33,888
<b>Total support revenue</b>	<b>4,418,191</b>	<b>8,080,785</b>	<b>2,351,756</b>	<b>14,850,732</b>	<b>7,527,348</b>
<b>Investment Income</b>					
Endowment income designated for operations ( <i>Note 4</i> )	605,439	151,360	-	756,799	761,241
Income from outside trusts	444,345	-	-	444,345	400,975
<b>Total investment income</b>	<b>1,049,784</b>	<b>151,360</b>	<b>-</b>	<b>1,201,144</b>	<b>1,162,216</b>
<b>Net assets released from restrictions (<i>Note 10</i>)</b>	<b>4,213,978</b>	<b>(4,213,978)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total operating program, support and investment income</b>	<b>18,553,061</b>	<b>4,018,167</b>	<b>2,351,756</b>	<b>24,922,984</b>	<b>18,405,422</b>
<b>Program and Support Expenses</b>					
<b>Program Expenses</b>					
School	8,305,002	-	-	8,305,002	7,988,305
Continuing and public education	1,225,967	-	-	1,225,967	1,285,049
Women's Board	77,523	-	-	77,523	79,050
Museum and exhibition	2,400,208	-	-	2,400,208	3,273,103
<b>Total program expenses</b>	<b>12,008,700</b>	<b>-</b>	<b>-</b>	<b>12,008,700</b>	<b>12,625,507</b>
<b>Support Function Expenses</b>					
Management and general	1,895,186	-	-	1,895,186	1,979,220
Facility rental and catering	235,058	-	-	235,058	249,664
Development and fundraising	1,868,021	-	-	1,868,021	1,855,676
	3,998,265	-	-	3,998,265	4,084,560
<b>Total program and support expenses</b>	<b>16,006,965</b>	<b>-</b>	<b>-</b>	<b>16,006,965</b>	<b>16,710,067</b>
<b>Change in net assets before depreciation, gains (losses) and other income (expenses)</b>	<b>2,546,096</b>	<b>4,018,167</b>	<b>2,351,756</b>	<b>8,916,019</b>	<b>1,695,355</b>
<b>Depreciation and amortization</b>	<b>2,007,436</b>	<b>-</b>	<b>-</b>	<b>2,007,436</b>	<b>1,924,804</b>
<b>Change in net assets before gains (losses) and other income (expenses)</b>	<b>538,660</b>	<b>4,018,167</b>	<b>2,351,756</b>	<b>6,908,583</b>	<b>(229,449)</b>

The accompanying notes are an integral part of these statements.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS – (Continued)

Year Ended June 30, 2018 With Summarized Information For 2017

	2018			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2018	2017
<b>Gains (Losses) and Other Income (Expenses)</b>					
Investment return in excess of amount designated for current operations (Notes 4 and 10)	213,195	6,282	-	219,477	810,095
Other investment income (Note 4)	2,125,863	-	-	2,125,863	3,277,678
Change in beneficial interest in perpetual trusts (Notes 4 and 10)	-	-	286,187	286,187	476,552
Change in market value of interest rate swap (Notes 4 and 8)	353,607	-	-	353,607	479,889
Other Income	31,005	-	-	31,005	-
Collection items purchased but not capitalized	(6,074,018)	-	-	(6,074,018)	(1,615,862)
<b>Total non-operating revenue, expenses and gain (losses)</b>	<u>(3,350,348)</u>	<u>6,282</u>	<u>286,187</u>	<u>(3,057,879)</u>	<u>3,428,352</u>
<b>Change in net assets</b>	(2,811,688)	4,024,449	2,637,943	3,850,704	3,198,903
<b>Net Assets</b>					
Beginning of year	<u>56,074,058</u>	<u>1,161,507</u>	<u>26,312,116</u>	<u>83,547,681</u>	<u>80,348,778</u>
<b>End of year</b>	<u>\$ 53,262,370</u>	<u>\$ 5,185,956</u>	<u>\$ 28,950,059</u>	<u>\$ 87,398,385</u>	<u>\$ 83,547,681</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENTS OF CASH FLOWS

Years Ended June 30, 2018 And 2017

	<u>2018</u>	<u>2017</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ 3,850,704	\$ 3,198,903
<b>Adjustments to reconcile change in net assets to net cash (used for) provided by operating activities</b>		
Depreciation expense	1,999,618	1,916,986
Net unrealized appreciation on long-term investments	(238,691)	(4,048,462)
Net realized gains on long-term investments	(2,324,938)	(278,735)
Net unrealized appreciation on outside perpetual trusts	(286,187)	(476,552)
Accrued interest earned on note receivable	(2,438)	(3,413)
Forgiveness of note receivable	20,000	20,000
Change in market value of swap	(353,607)	(479,889)
Amortization of deferred bond cost	7,818	7,818
(Increase) decrease in assets		
Accounts receivable	(72,510)	117,083
Inventories	(65,861)	(24,172)
Pledges receivable	(7,215,677)	1,152,843
Prepaid expenses and other assets	(14,860)	77,209
Increase (decrease) in liabilities		
Accounts payable	535,299	(68,113)
Accrued expenses	545,829	371,329
Deferred revenue	<u>292,417</u>	<u>(1,118,609)</u>
<b>Net cash (used for) provided by operating activities</b>	<u>(3,323,084)</u>	<u>364,226</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(3,417,620)	(2,972,445)
Purchases of long-term investments	(8,254,869)	(3,001,943)
Proceeds from sale of long-term investments	<u>12,048,175</u>	<u>4,216,506</u>
<b>Net cash provided by (used for) investing activities</b>	<u>375,686</u>	<u>(1,757,882)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net proceeds from line of credit	<u>1,825,000</u>	<u>1,050,000</u>
<b>Net cash provided by financing activities</b>	<u>1,825,000</u>	<u>1,050,000</u>
<b>Net decrease in cash and cash equivalents</b>	(1,122,398)	(343,656)
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of year	<u>1,506,345</u>	<u>1,850,001</u>
<b>End of year</b>	<u>\$ 383,947</u>	<u>\$ 1,506,345</u>
<b>SUPPLEMENTAL INFORMATION</b>		
Cash paid for interest	<u>\$ 697,191</u>	<u>\$ 575,068</u>



# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## *NOTES TO FINANCIAL STATEMENTS*

**June 30, 2018 And 2017**

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### **(1) NATURE OF ORGANIZATION**

#### **NATURE OF ORGANIZATION**

Founded in 1805, the Pennsylvania Academy of the Fine Arts (“PAFA”) is the first and oldest art school and art museum in the United States. PAFA’s mission statement declares:

As the first art museum and school in the United States, PAFA celebrates the transformative power of art and art making.

PAFA inspires the public by expanding the stories of American art through its collections, exhibitions, and programs; and educates artists from around the world to be innovative makers and critical thinkers with a deep understanding of traditions and the ability to challenge conventions.

Through its world-class museum and school, PAFA nurtures and recognizes artists at every turn in their career.

The museum collects, preserves, exhibits and interprets works of American art, both historic and contemporary, for the benefit of public education. The museum is committed to expanding knowledge of, and appreciation for, American artists and their work.

The School of Fine Arts at PAFA offers four nationally and regionally accredited degree and certificate programs – a Bachelor of Fine Arts degree program, offering majors in painting, drawing, sculpting, illustration, and printmaking; a post-baccalaureate certificate program; a Master of Fine Arts degree program; and a second Master of Fine Arts degree program that combines three summers of intensive residency with two academic years of virtual classroom study. Students may also earn a Bachelor of Fine Arts Degree via a collaborative program with the University of Pennsylvania, dating back to 1929.

In addition, PAFA offers a wide array of public education programs, serving audiences ranging from young children to adults.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS

June 30, 2018 And 2017

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### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by PAFA are described below.

#### ***BASIS OF PRESENTATION***

##### ***CASH EQUIVALENTS***

PAFA considers highly liquid financial instruments purchased with an original maturity of three months or less to be cash equivalents.

##### ***CONCENTRATION OF CREDIT RISK***

PAFA occasionally maintains deposits in excess of federally insured limits. Accounting Standards Codification (“ASC”) 825, “*Financial Instruments*”, identifies these items as a concentration of credit risk requiring disclosure, regardless of the degree of risk. The risk is managed by monitoring the financial institutions in which deposits are made.

PAFA’s principal financial instruments subject to credit risk are its investments. The investments are managed by professional advisors subject to PAFA’s investment goals for total investment return, yield, and tolerance of investment risk and investment turnover. The degree and concentration of credit risk vary by the type of investment.

##### ***USE OF ESTIMATES***

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles 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.

##### ***INVESTMENTS***

PAFA records investments at fair market value. Fair value of investments is determined using quoted market prices of a national securities exchange. Unrealized and realized gains and losses on investments are recognized as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

##### ***PROPERTY, BUILDINGS AND EQUIPMENT***

Property, buildings and equipment are stated at cost or appraised value at the date of donation.

Maintenance, repairs and minor renewals are charged to expense. Major renewals, improvements or renovations which prolong the life of the assets are capitalized. The cost of current additions to exhibits, books and art literature is charged to expense. A portion of such cost may be reimbursed by designated contributed funds and income of certain endowment funds.

Depreciation is provided over the estimated useful lives of the assets using the straight-line method. Estimated useful lives are as follows:

Buildings	10 – 40 years
Building improvement	10 – 20 years
Equipment, furniture and fixtures	3 – 5 years

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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### ***FUNDS HELD IN TRUST BY OTHERS***

PAFA is the recipient/beneficiary of several irrevocable perpetual trust arrangements which are held by others. PAFA accounts for perpetual trusts held by third parties at the fair value of the assets.

### ***WORKS OF ART***

PAFA maintains a collection of rare American art that is held for public exhibition. The collection is kept under curatorial care and is subject to PAFA's policy that requires the proceeds from the sales of accessioned collection items to be used only to acquire other items for collection. PAFA does not recognize the contributions of donated collection items, as its collections are not capitalized. During the year ended June 30, 2018 and 2017, PAFA had donated accessions with approximate appraised values totaling \$451,100 and \$610,500, respectively. Collection items purchased but not capitalized totaled \$6,074,018 and \$1,615,862 during the years ended June 30, 2018 and 2017, respectively.

### ***INCOME TAXES***

PAFA has been granted tax-exempt status as a nonprofit organization under Section 501(c)(3) of the Internal Revenue Code, which is not a private foundation under Section 509(a) of the Code, and files a Form 990 (Return of Organization Exempt from Income Tax) annually for information purposes. Accordingly, no provision for income taxes is provided in the accompanying financial statements.

PAFA has reviewed its tax positions and has concluded that no liability for unrecognized tax benefits should be recorded related to uncertain tax positions taken on federal and state tax returns for the open tax years (2014 – 2016) or is expected to be taken in the current 2017 tax year.

### ***NET ASSETS***

Net assets are classified as unrestricted, temporarily restricted or permanently restricted in accordance with donor-imposed restrictions. Each of these three classes of net assets are displayed in the financial statements and the amounts of changes in each of those classes of net assets are displayed in the statements of operations and changes in net assets.

***Unrestricted net assets*** include the revenues and expenses associated with the principal mission of PAFA.

***Temporarily restricted net assets*** include gifts which are subject to donor-imposed restrictions. PAFA's temporarily restricted net assets are intended, by the donors, to be used for lecture series, library resources, medal and awards programs, and other purposes.

***Permanently restricted net assets*** include gifts, trusts and bequests which require, by donor restriction, that the corpus be invested in perpetuity and only the income be made available for program operations in accordance with donor restrictions.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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### **CONTRIBUTIONS**

Pledges from donors for unrestricted and restricted contributions are recorded as revenue in the year received.

PAFA reports contributions of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, except if the restriction is met in the same year the contribution is received, then PAFA classifies the contribution as unrestricted. When a donor 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”*.

### **ALLOCATION OF FUNCTIONAL EXPENSES**

The costs of providing PAFA’s programs have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the various programs.

### **PRIOR YEAR 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. Accordingly, such information should be read in conjunction with PAFA’s financial statements for the year ended June 30, 2017, from which the summarized information was derived.

### **RECLASSIFICATION**

Certain account balances in the 2017 financial statements have been reclassified to conform to the 2018 financial statement presentation.

### **NEW ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED**

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, Presentation of Financial Statements of Not-for-Profit Entities (Topic 958), intended to improve financial reporting for not-for-profit entities. The ASU will reduce the current three classes of net assets into two: with and without donor restrictions. The change in each of the classes of net assets must be reported on the Statement of Activities and Change in Net Assets. The ASU also requires various enhanced disclosures around topics such as board designations, liquidity, functional classification of expenses, investment expenses, donor restrictions, and underwater endowments. The ASU is effective for years beginning after December 15, 2017. Early adoption is permitted. The ASU should be applied on a retrospective basis in the year the ASU is first applied. While the ASU will change the presentation of PAFA’s financial statements, it is not expected to alter PAFA’s reported financial position. PAFA plans to adopt the new ASU at the required implementation date.

In 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The ASU changes the accounting treatment for operating leases by recognizing a lease asset and lease liability at the present value of the lease payments in the statement of financial position and disclosing key information about leasing arrangements. The ASU is effective for private entities for fiscal years beginning after December 31, 2019. Early adoption is permitted. The ASU should be applied at the beginning of the earliest period presented using a modified retrospective approach. PAFA plans to adopt the new ASU at the required implementation date.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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### (3) PLEDGES RECEIVABLE

Pledges receivable consist of the following at June 30:

	<u>2018</u>	<u>2017</u>
Capital Campaign pledges receivable	\$ 6,925,734	\$ 3,358,371
Major Gifts pledges receivable	2,975,343	1,126,029
Endowment pledge receivable	<u>2,149,000</u>	<u>350,000</u>
Total pledges receivable	12,050,077	4,834,400
Less: current portion	<u>(9,201,608)</u>	<u>(2,322,711)</u>
Pledges receivable – long-term	<u>\$ 2,848,469</u>	<u>\$ 2,511,689</u>

PAFA had pledges receivable relating to the capital campaign and major gifts as of June 30 as follows:

	<u>2018</u>	<u>2017</u>
Pledges receivable Capital Campaign:		
Past due and due within a year	\$ 5,178,390	\$ 1,670,871
Due between one and five years	<u>1,922,420</u>	<u>1,814,845</u>
Pledges receivable, gross	7,100,810	3,485,716
Less: allowance for uncollectibles and discount	<u>(175,076)</u>	<u>(127,345)</u>
Pledges receivable Capital Campaign, net	<u>\$ 6,925,734</u>	<u>\$ 3,358,371</u>
Pledges receivable Major Gifts:		
Due within a year	\$ 2,673,218	\$ 678,438
Due between one and four years	<u>405,665</u>	<u>540,000</u>
Pledges receivable, gross	3,078,883	1,218,438
Less: allowance for uncollectibles and discount	<u>(103,540)</u>	<u>(92,409)</u>
Pledges receivable Major Gifts, net	<u>\$ 2,975,343</u>	<u>\$ 1,126,029</u>
Pledges receivable Endowment:		
Due within a year	\$ 1,350,000	\$ 150,000
Due between one and four years	<u>850,000</u>	<u>200,000</u>
Pledges receivable, gross	2,200,000	350,000
Less: discount	<u>(51,000)</u>	<u>-</u>
Pledges receivable Endowment, net	<u>\$ 2,149,000</u>	<u>\$ 350,000</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

### (4) INVESTMENTS

Investments consist of the following at June 30:

	<b>2018</b>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Money Market Funds	\$ 3,888,361	\$ -	\$ -	\$ 3,888,361
Common Stocks	10,089,722	3,348,468	-	13,438,190
Mutual Funds/Exchange Traded Funds	22,334,634	3,310,157	-	25,644,791
Pooled Investment Fund - Private Equity/Hedge Fund	<u>1,316,079</u>	<u>123,910</u>	<u>-</u>	<u>1,439,989</u>
	<u>\$ 37,628,796</u>	<u>\$ 6,782,535</u>	<u>\$ -</u>	<u>\$ 44,411,331</u>

  

	<b>2017</b>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Money Market Funds	\$ 791,799	\$ -	\$ -	\$ 791,799
Common Stocks	11,461,453	4,010,074	-	15,471,527
Mutual Funds/Exchange Traded Funds	25,663,711	2,406,804	-	28,070,515
Pooled Investment Fund - Private Equity/Hedge Fund	<u>1,180,201</u>	<u>126,966</u>	<u>-</u>	<u>1,307,167</u>
	<u>\$ 39,097,164</u>	<u>\$ 6,543,844</u>	<u>\$ -</u>	<u>\$ 45,641,008</u>

PAFA has a hedge fund investment, BBH Wealth Strategies, LLC REMS Group Series, of \$1,041,989 and \$1,079,611 as of June 30, 2018 and 2017, respectively. The fair value of this investment is based on the net asset value of the Series and is furnished by its management. The investment objective of the Series is to achieve long-term capital growth and current income by investing in a portfolio of common-stock, publicly-traded real estate securities that may include real estate investment trust (REIT) companies (including equity, mortgage and hybrid REITS), real estate operating companies, real estate service companies that are publicly traded but have not elected REIT status, other publicly traded companies whose primary business is the real estate industry and preferred equity securities of any of the foregoing. As of June 30, 2018, PAFA has no outstanding commitment for further investment into this Series. Investors of the Series are eligible for redemptions at month-end with 30 days prior notification.

In addition, PAFA has an investment in a private equity pooled investment fund, BBH Wealth Strategies Unit Trust – Barings Loan Sub-Trust of \$398,550 and \$227,556 as of June 30, 2018 and 2017, respectively. The fair value of this investment is based on the net asset value of the Fund as furnished by the Fund's management. After an initial lock-up period of three years from the date of investment (February 2017), PAFA is eligible for redemptions annually on December 31.

Investments as of June 30, 2018 and 2017, include unrestricted investments of \$27,130,655 and \$30,004,792, respectively, which are invested separately from those investments for the permanently restricted endowment. Other investment income of \$2,125,863 and \$3,277,678 for the years ended June 30, 2018 and 2017, respectively, represents the net investment income on these unrestricted investments. As of June 30, 2018, PAFA has no additional commitment for further investment to the Fund.

The change in unrealized gain was \$238,691 and \$4,048,462 in 2018 and 2017, respectively.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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For the years ended June 30, 2018 and 2017, the Board approved a 5% spending rate, respectively, to its net assets to ensure preservation and growth of the corpus and to provide for a constant stream of income. The spending rate is based on the average net asset balance for the previous three years. If investment income during the year is in excess of the spending rate, the balance is reinvested. If investment income is not sufficient, the balance is provided from previously reinvested amounts. The following schedule summarizes the investment return of the endowment funds and its classification in the statement of activities:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>June 30, 2018 Total</u>	<u>June 30, 2017 Total</u>
Interest and dividends (net of fees of \$70,954 and \$65,990, respectively)	\$ 326,199	\$ -	\$ 326,199	\$ 321,417
Net realized and unrealized gains	<u>492,435</u>	<u>157,642</u>	<u>650,077</u>	<u>1,249,919</u>
Return on long-term investments	818,634	157,642	976,276	1,571,336
Investment return designated for current operations	<u>605,439</u>	<u>151,360</u>	<u>756,799</u>	<u>761,241</u>
Investment return in excess of amounts designated for current operations	<u>\$ 213,195</u>	<u>\$ 6,282</u>	<u>\$ 219,477</u>	<u>\$ 810,095</u>

PAFA utilized various methods to measure the fair value of its investments on a recurring basis. Generally accepted accounting principles establish a hierarchy that prioritizes inputs to valuation methods. The three levels of inputs are described below:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that PAFA has the ability to access.

Level 2 – Observable inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These inputs may include quoted prices for the identical instrument on an inactive market, prices for similar instruments, interest rates, prepayment speeds, credit risk, yield curves, default rates and similar data.

Level 3 – Unobservable inputs for the asset or liability, to the extent relevant observable inputs are not available, representing PAFA's own assumptions about the assumptions a market participant would use in valuing the asset or liability, and would be based on the best information available.

The inputs methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.





# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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### (5) PROPERTY, BUILDINGS AND EQUIPMENT

A summary of property, buildings and equipment as of June 30 is as follows:

	<u>2018</u>	<u>2017</u>
Land, buildings and improvements	\$ 68,319,131	\$ 68,410,257
Furniture, fixtures and equipment	<u>5,123,722</u>	<u>4,871,687</u>
	73,442,853	73,281,944
Less accumulated depreciation	<u>(25,345,833)</u>	<u>(23,346,215)</u>
	48,097,020	49,935,729
Construction in progress	<u>4,131,273</u>	<u>874,562</u>
	<u>\$ 52,228,293</u>	<u>\$ 50,810,291</u>

Conditional asset retirement obligations (“*AROs*”) that meet the definition of liabilities should be recognized when incurred if their fair value can be reasonably estimated. As of June 30, 2018, PAFA was unable to determine the extent of any remediation AROs that would be required in the future.

Depreciation expense was \$1,999,618 and \$1,916,986 for years ended June 30, 2018 and 2017, respectively.

### (6) BENEFICIAL INTEREST IN PERPETUAL TRUSTS

The beneficial interest in perpetual trusts of \$10,343,994 and \$10,057,807 at June 30, 2018 and 2017, respectively, includes PAFA’s respective share of the fair value of the total funds held in trust by others for which PAFA is the recipient of all or a percentage of the income.

### (7) LINE OF CREDIT

PAFA has two revolving lines of credit for \$10,000,000. The lines of credit, \$7,500,000 for capital projects and \$2,500,000 for working capital, are collateralized by certain marketable securities held by a financial institution and expire July 31, 2019. Interest on the line of credit is payable monthly at a variable percentage based upon the J.P. Morgan Chase Guaranty Prime Rate minus 1.40% (3.60% and 2.85% as of June 30, 2018 and 2017, respectively). At June 30, 2018 and 2017, the outstanding balance on the lines of credit was \$8,055,000 and \$6,230,000, respectively. Interest expense on the lines of credit was \$206,625 and \$128,508 for the years ended June 30, 2018 and 2017, respectively.

### (8) LONG-TERM DEBT

On June 25, 2015, PAFA borrowed \$21,000,000 through the issuance of tax-exempt Revenue Bonds, Series 2015A through the Philadelphia Authority for Industrial Development, the proceeds of which were used to refinance its 2010 Bonds and any obligations owed to PNC Bank, N.A. as letter of credit provider on the 2010 Bonds, a portion of the outstanding credit line with Haverford Trust, and to finance the costs of issuance. The Bryn Mawr Trust Company purchased the Bonds from the Authority.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

**June 30, 2018 And 2017**

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The tax-exempt Bonds will mature on June 25, 2043 and may be prepaid in whole or in part at any time. The tax-exempt interest rates are variable and are adjustable monthly by The Bryn Mawr Trust Company. The floating rate per annum is the sum of LIBOR plus 1.30% multiplied by sixty-seven percent (effective rate as of June 30, 2018 and 2017 was 2.20% and 1.58%, respectively). Interest is paid monthly on the outstanding principal. Bonds payable of \$20,804,545 and \$20,796,727 as of June 30, 2018 and 2017 reflects bonds payable of \$21,000,000 net of unamortized deferred financing expenses of \$195,455 and \$203,273, respectively. Deferred financing expenses are being amortized on a straight-line basis over the life of the Bonds.

In connection with the issuance of the 2015 Bonds, PAFA entered into an interest rate swap agreement with the Bryn Mawr Trust Company. The swap agreement requires PAFA to pay a fixed interest rate of 2.62% on a notional balance of \$12,600,000 while receiving a variable interest rate equal to the rate paid for the Bond. The purpose of the swap agreement is to hedge against increases in the variable interest rates on the 2015 Bonds. The market value of the swap was \$23,396 in favor of PAFA as of June 30, 2018 and is included in other assets in the statement of financial position. The market value of the swap was \$330,211 in favor of the bank as of June 30, 2017 and is included in other liabilities in the statement of financial position.

PAFA must maintain certain financial covenants in accordance with the 2015 Bond agreement:

- a. Maintain unencumbered liquidity at least equal to \$21,000,000 tested semi-annually
- b. Maintain unrestricted net assets at least equal to \$28,500,000

Total interest expense on the tax-exempt bonds, 2015 issue, was \$494,937 and \$449,346 for the years ended June 30, 2018 and 2017, respectively.

Redemption payments required under the Bond Agreements are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2019	\$ 541,000
2020	606,000
2021	621,000
2022	640,000
2023	656,000
Thereafter	<u>17,936,000</u>
Bond Payable at June 30, 2018, gross	21,000,000
Deferred Financing Expenses	<u>(195,455)</u>
Bond Payable at June 30, 2018, Net	20,804,545
Less current maturities	<u>(541,000)</u>
	<u>\$ 20,263,545</u>
Bond Payable at June 30, 2017	21,000,000
Deferred Financing Expenses	<u>(203,273)</u>
Bond Payable at June 30, 2017, Net	<u>\$ 20,796,727</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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### (9) RETIREMENT PLANS

PAFA has a defined contribution plan covering employees over the age of 21 who work 1,000 hours or more in a calendar year. Under this plan, employees can contribute to the plan immediately, not to exceed the limits imposed by IRC 402(g). Effective after ninety days of employment, PAFA matches up to 4% for each employee contribution. During the years ended June 30, 2018 and 2017, PAFA contributed approximately \$193,000 and \$191,000, respectively, to the plan.

PAFA also has a defined benefit pension plan covering certain former employees. Benefits under the plan are based on employees' years of service and compensation. The related assets and liabilities of this plan are not material to the financial statements.

### (10) NET ASSETS

Temporarily restricted net assets at June 30, 2018 and 2017 are available for the following purposes:

	<u>2018</u>	<u>2017</u>
Building fund	\$ 25,000	\$ 25,000
Campus Master Plan – Capital Campaign, net of discount	3,272,493	127,835
Major gifts-time restriction	1,456,770	211,000
Scholarships	425,411	797,672
Accumulated appreciation (net realized and unrealized gains) from permanently restricted endowment	<u>6,282</u>	<u>-</u>
	<u>\$5,185,956</u>	<u>\$1,161,507</u>

Permanently restricted net assets at June 30, 2018 and 2017 are available for the following purposes:

	<u>2018</u>	<u>2017</u>
Operations	\$ 5,064,406	\$ 5,064,406
Art acquisitions and conservation	3,349,691	3,349,691
Museum operations	929,868	926,168
School scholarships and prizes	7,952,121	5,604,065
School – other	1,309,979	1,309,979
Beneficial interest in perpetual trusts	<u>10,343,994</u>	<u>10,057,807</u>
	<u>\$28,950,059</u>	<u>\$26,312,116</u>

Net assets were released from donor restrictions by satisfying the restricted purpose during the year ended June 30, 2018, as follows:

Purpose and time restrictions accomplished:

	<u>2018</u>
Acquisition of art	\$ 151,360
Campus Master Plan – Capital Campaign	3,256,710
Major gifts-time restriction	433,647
Scholarships	<u>372,261</u>
	<u>\$4,213,978</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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Endowment net asset composition by type of fund as of June 30, 2018 and 2017:

	<u>2018</u>			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Donor restricted endowment funds	\$ -	\$ 6,282	\$ 28,950,059	\$ 28,956,341
Funds functioning as endowment funds	<u>807,330</u>	<u>-</u>	<u>-</u>	<u>807,330</u>
Total Fund	<u>\$ 807,330</u>	<u>\$ 6,282</u>	<u>\$ 28,950,059</u>	<u>\$ 29,763,671</u>

	<u>2017</u>			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Donor restricted endowment funds	<u>\$(213,195)</u>	<u>\$ -</u>	<u>\$ 26,312,116</u>	<u>\$ 26,098,921</u>

PAFA classifies the original value of gifts received with donor stipulations that require them to be held in perpetuity as permanently restricted net assets. Commonwealth of Pennsylvania law stipulates that realized and unrealized gains on endowment assets may be expended for the purposes stipulated by the donors only to the extent that the total of such expenditures, including dividends and interest and less fees, do not exceed 7% of the average of the three most recent fiscal years' fair values of the permanently restricted endowment assets. Realized and unrealized gains in excess of the annual limitation would be included in the statements of activities as increases in the temporarily restricted net assets. Such temporarily restricted amounts may be released to unrestricted net assets in future years based on authorization by PAFA only to the extent of the 7% limitation applicable to the year in which they are to be released.

As of June 30, 2017, PAFA had not designated any unrestricted net assets to function as an endowment. However, cumulative losses on the permanently restricted endowment of \$213,195 as of June 30, 2017, were charged to unrestricted net assets.

During 2018, PAFA executed an asset transfer agreement in which PAFA received \$807,330, equipment and print inventory. Under the agreement, PAFA agreed to administer these quasi-endowment funds known as the Brodsky Center (the "Center") funds. The Center was originally established to promote the art of printmaking through the use of its printing equipment. PAFA has agreed to spend the investment earnings from these quasi-endowment funds in compliance with its Board of Trustees' policy with respect to all of its endowment funds.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

Changes in endowment net assets for the years ended June 30, 2017 and 2016:

	2018			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ (213,195)	\$ -	\$ 26,312,116	\$ 26,098,921
Investment income, net	326,199	-	-	326,199
Realized and unrealized gains	492,435	157,642	-	650,077
Contributions	807,330	-	2,351,756	3,159,086
Endowment income designated for current operations	(605,439)	(151,360)	-	(756,799)
Change in beneficial interest in perpetual trust	-	-	286,187	286,187
	<u>\$ 807,330</u>	<u>\$ 6,282</u>	<u>\$ 28,950,059</u>	<u>\$ 29,763,671</u>

  

	2017			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ (1,023,290)	\$ -	\$ 25,244,451	\$ 24,221,161
Investment income, net	321,417	-	-	321,417
Realized and unrealized gains	1,097,671	152,248	-	1,249,919
Contributions	-	-	591,113	591,113
Endowment income designated for current operations	(608,993)	(152,248)	-	(761,241)
Change in beneficial interest in perpetual trust	-	-	476,552	476,552
	<u>\$ (213,195)</u>	<u>\$ -</u>	<u>\$ 26,312,116</u>	<u>\$ 26,098,921</u>

### (11) RELATED PARTY TRANSACTIONS

PAFA had the following related party transactions:

- ♦ PAFA uses the services of a Trust Company where three Board members are paid Directors. Assets under management with this investment company totaled approximately \$17,280,700 and \$15,636,000 as of June 30, 2018 and 2017, respectively. PAFA was charged investment fees by the investment company. The fee was approximately for \$71,000 and \$66,000 for the years ended June 30, 2018 and 2017, respectively. In addition, this Trust Company provides a line of credit for PAFA; interest expense during the years ended June 30, 2018 and 2017 for this line of credit was approximately \$206,600 and \$128,500, respectively.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2018 And 2017

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- ♦ PAFA has an employment agreement with its President whereby PAFA paid \$200,000 during fiscal year 2009 to assist in acquiring a residence. As of June 30, 2018 and 2017, the balance on the note receivable for purchase of this residence, including accrued interest, is \$104,474 and \$122,036, respectively, and is included in other assets in the statement of financial position. PAFA has an equity interest in the property. Accrued interest income was \$2,438 and \$3,413 for the years ended June 30, 2018 and 2017, respectively.
- ♦ PAFA receives the income from a beneficial trust held by a third party, of which one of the Trustees of that beneficial trust is a Board member of PAFA.
- ♦ PAFA has approximately \$1,683,000 and \$2,691,000 as of June 30, 2018 and 2017, respectively, in pledges for capital campaign and other purposes from several board members and their foundations.
- ♦ A Board member of PAFA is President of the financial institution which provided PAFA the 2015 Bond debt.

## (12) COMMITMENTS AND CONTINGENCIES

### *OPERATING LEASES*

PAFA leases certain office equipment and student housing apartments under lease agreements which expire at various dates through fiscal year 2024. In accordance with the student housing apartments lease, PAFA has a termination right commencing with the lease year ending July 31, 2019 and each lease year end thereafter subject to six months advance written notice and applicable termination penalty.

Future minimum rental payments required under these non-cancellable operating leases are as follows:

2019	\$ 678,416
2020	745,929
2021	754,477
2022	713,520
2023	720,098
Thereafter	<u>59,898</u>
Total	<u>\$3,672,338</u>

### *LITIGATION*

PAFA is involved in certain litigation arising out of the conduct of its business. In the opinion of management and legal counsel, the resolution of such matters will not have a material adverse effect on PAFA's financial position.

### *GRANTS*

Financial assistance from the federal and state governments in the form of grants and student aid/loans are subject to audit by the granting entity. An audit could result in claims for disallowed costs or noncompliance with regulations. In the opinion of management, any such liability, if any, will not have a material adverse effect on PAFA's financial position.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## *NOTES TO FINANCIAL STATEMENTS – (Continued)*

**June 30, 2018 And 2017**

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### **(13) SUBSEQUENT EVENTS**

Subsequent events after the statement of financial position date through the date that the financial statements were available for issuance, October 25, 2018 have been evaluated in the preparation of the financial statements and management has determined that there are no subsequent events that would require disclosure or adjustment in the financial statements.