

PENNSYLVANIA ACADEMY OF THE FINE ARTS

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

JUNE 30, 2013

PENNSYLVANIA ACADEMY OF THE FINE ARTS

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

We have audited the accompanying financial statements of Pennsylvania Academy of Fine Arts (a nonprofit organization), which comprise the statement of financial position as of June 30, 2013, 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 Fine Arts as of June 30, 2013, 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 Fine Arts' 2012 financial statements, and our report dated December 13, 2012, 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, 2012, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Tait, Weller & Baker LLP

**Philadelphia, Pennsylvania
February 28, 2014**

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENTS OF FINANCIAL POSITION

June 30, 2013 And 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,203,239	\$ 3,329,421
Accounts receivable, net	191,214	468,425
Prepaid expenses	272,781	394,558
Inventories	252,763	296,970
Pledges receivable (<i>Note 3</i>)	<u>578,690</u>	<u>757,398</u>
Total Current Assets	<u>4,498,687</u>	<u>5,246,772</u>
LONG-TERM ASSETS		
Pledges receivable (<i>Note 3</i>)	29,668	133,350
Other assets (<i>Note 12</i>)	651,867	654,143
Long term investments (<i>Note 4</i>)	14,161,362	13,145,299
Property, buildings and equipment (<i>Note 5</i>)	46,026,605	47,385,932
Funds held by Trustee (<i>Note 9</i>)	710,757	763,044
Beneficial interest in perpetual trusts (<i>Notes 4 and 6</i>)	<u>8,988,997</u>	<u>8,590,981</u>
Total Long-Term Assets	<u>70,569,256</u>	<u>70,672,749</u>
Total Assets	<u>\$ 75,067,943</u>	<u>\$ 75,919,521</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Line of credit (<i>Note 7</i>)	\$ 1,700,000	\$ 975,000
Current maturities of note payable (<i>Note 8</i>)	85,127	81,749
Current maturities of long term debt (<i>Note 9</i>)	525,000	584,967
Accounts payable	645,518	1,161,109
Accrued expenses	256,689	311,628
Deferred revenue	<u>1,247,154</u>	<u>1,300,455</u>
Total Current Liabilities	4,459,488	4,414,908
LONG-TERM LIABILITIES		
Note payable (<i>Note 8</i>)	-	85,127
Bonds payable (<i>Note 9</i>)	18,750,000	19,275,000
Other liabilities (<i>Note 9</i>)	<u>327,647</u>	<u>541,561</u>
Total Liabilities	<u>23,537,135</u>	<u>24,316,596</u>
NET ASSETS		
Unrestricted net assets	26,729,548	27,163,388
Temporarily restricted net assets (<i>Note 11</i>)	388,908	526,000
Permanently restricted net assets (<i>Note 11</i>)	<u>24,412,352</u>	<u>23,913,537</u>
Total Net Assets	<u>51,530,808</u>	<u>51,602,925</u>
Total Liabilities and Net Assets	<u>\$ 75,067,943</u>	<u>\$ 75,919,521</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2013 With Summarized Information For 2012

	2013			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2013	2012
Program Revenues, Support Revenue and Investment Income					
Program Revenue					
Tuition and fees, net of scholarships	\$ 6,628,894	\$ -	\$ -	\$ 6,628,894	\$ 6,843,987
Continuing and public education	778,602	-	-	778,602	768,237
Government grants	93,796	-	-	93,796	494,466
Museum admissions, collection rental and fees	336,627	-	-	336,627	394,942
Museum shop and art supply store, net	201,267	-	-	201,267	305,208
Facility rental and catering	411,841	-	-	411,841	486,771
Women's Board	215,474	-	-	215,474	711,878
Other income	12,846	-	-	12,846	62,283
Total program revenue	8,679,347	-	-	8,679,347	10,067,772
Support Revenue					
Fundraising and support revenues	3,340,691	316,656	100,799	3,758,146	4,019,189
Bequests	13,500	-	-	13,500	413,856
Total support revenue	3,354,191	316,656	100,799	3,771,646	4,433,045
Investment Income					
Endowment income designated for operations (<i>Note 4</i>)	624,729	175,180	-	799,909	800,173
Income from outside trusts	404,933	-	-	404,933	407,647
Total investment income	1,029,662	175,180	-	1,204,842	1,207,820
Net assets released from restrictions (<i>Note 11</i>)	628,928	(628,928)	-	-	-
Total operating program, support and investment income	13,692,128	(137,092)	100,799	13,655,835	15,708,637
Program and Support Expenses					
Program Expenses					
School	6,651,049	-	-	6,651,049	6,730,087
Continuing and public education	1,124,641	-	-	1,124,641	1,140,886
Women's Board	84,589	-	-	84,589	446,702
Museum and exhibition	2,780,811	-	-	2,780,811	3,507,035
Total program expenses	10,641,090	-	-	10,641,090	11,824,710
Support Function Expenses					
Management and general	1,562,048	-	-	1,562,048	1,570,241
Facility rental and catering	172,565	-	-	172,565	187,929
Development and fundraising	1,120,761	-	-	1,120,761	1,161,684
	2,855,374	-	-	2,855,374	2,919,854
Total program and support expenses	13,496,464	-	-	13,496,464	14,744,564
Change in net assets before depreciation, gains (losses) and other income (expenses)	195,664	(137,092)	100,799	159,371	964,073
Depreciation and amortization	1,675,228	-	-	1,675,228	1,720,196
Change in net assets before gains (losses) and other income (expenses)	(1,479,564)	(137,092)	100,799	(1,515,857)	(756,123)

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, 2013 With Summarized Information For 2012

	2013			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2013	2012
Gains (Losses) and Other Income (Expenses)					
Investment return in excess (deficit) of amount designated for current operations (<i>Note 4</i>)	1,003,376	-	-	1,003,376	(944,106)
Change in beneficial interest in perpetual trusts	-	-	398,016	398,016	(461,083)
Change in market value of interest rate swap (<i>Note 9</i>)	213,914	-	-	213,914	(162,903)
Other losses	-	-	-	-	(69,333)
Funds received for art acquisition	8,700	-	-	8,700	-
Collection items purchased but not capitalized	(180,266)	-	-	(180,266)	(2,201,563)
Total non-operating revenue, expenses and releases	<u>1,045,724</u>	<u>-</u>	<u>398,016</u>	<u>1,443,740</u>	<u>(3,838,988)</u>
Change in net assets	(433,840)	(137,092)	498,815	(72,117)	(4,595,111)
Net Assets					
Beginning of year	<u>27,163,388</u>	<u>526,000</u>	<u>23,913,537</u>	<u>51,602,925</u>	<u>56,198,036</u>
End of year	<u>\$ 26,729,548</u>	<u>\$ 388,908</u>	<u>\$ 24,412,352</u>	<u>\$ 51,530,808</u>	<u>\$ 51,602,925</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2013 And 2012

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (72,117)	\$ (4,595,111)
Adjustments to reconcile change in net assets to net cash used for operating activities		
Depreciation and amortization expense	1,675,228	1,720,196
Net unrealized (appreciation) depreciation on long-term investments	(1,040,881)	448,905
Net realized (gains) losses on long-term investments	(336,994)	78,032
Net unrealized (appreciation) depreciation on outside perpetual trusts	(398,016)	461,083
Accrued interest earned on note receivable	(7,315)	(8,288)
Forgiveness of note receivable	20,000	20,000
Change in market value of swap	(213,914)	162,903
(Increase) decrease in assets		
Accounts receivable	277,211	953,858
Inventories	44,207	9,595
Pledges receivable	282,390	37,842
Prepaid expenses and other assets	121,777	27,049
Funds held by trustee	52,287	(61,881)
Increase (decrease) in liabilities		
Accounts payable	(515,591)	(291,966)
Accrued expenses	(54,939)	(114,610)
Deferred revenue	(53,301)	(608,119)
Net cash used for operating activities	<u>(219,968)</u>	<u>(1,760,512)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(294,420)	(541,812)
Purchases of long-term investments	(3,234,377)	(3,003,165)
Proceeds from sale of long-term investments	<u>3,596,189</u>	<u>3,578,025</u>
Net cash provided by investing activities	<u>67,392</u>	<u>33,048</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of note payable	(81,749)	(78,517)
Issuance of note payable	-	245,393
Payment of bond issuance costs	(31,890)	-
Net proceeds from line of credit	725,000	975,000
Repayment on bonds payable	<u>(584,967)</u>	<u>(500,000)</u>
Net cash provided by financing activities	<u>26,394</u>	<u>641,876</u>
Net decrease in cash and cash equivalents	(126,182)	(1,085,588)
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>3,329,421</u>	<u>4,415,009</u>
End of year	<u>\$ 3,203,239</u>	<u>\$ 3,329,421</u>
SUPPLEMENTAL INFORMATION		
Cash paid for interest	<u>\$ 706,788</u>	<u>\$ 749,077</u>

The accompanying notes are an integral part of these statements.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 And 2012

(1) NATURE OF ORGANIZATION

The Pennsylvania Academy of the Fine Arts (the “*Academy*”) is the first and oldest American art school and museum in the United States. The Academy’s mission is to combine studio instruction and direct contact with historic and contemporary art objects. 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 education program has five divisions – a four-year certificate program, offering majors in painting, drawing, sculpting and printmaking; a degree granting program leading to a Bachelor of Fine Arts; a post baccalaureate program; a degree granting program leading to a Master of Fine Arts; and active continuing and public education programs. Students may also earn a Bachelor of Fine Arts Degree via a collaborative program with the University of Pennsylvania.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the Academy are described below.

BASIS OF PRESENTATION

CASH EQUIVALENTS

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

CONCENTRATION OF CREDIT RISK

The Academy 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.

The Academy’s principal financial instruments subject to credit risk are its investments. The investments are managed by professional advisors subject to the Academy’s investment goals for total investment return, yield, 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

The Academy 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.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

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

FUNDS HELD IN TRUST BY OTHERS

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

WORKS OF ART

The Academy maintains a collection of rare American art that is held for public exhibition. The collection is kept under curatorial care and is subject to the Academy's policy that requires the proceeds from the sales of accessioned collection items to be used only to acquire other items for collection. The Academy does not recognize the contributions of donated collection items, as its collections are not capitalized. During the year ended June 30, 2013 and 2012, the Academy had donated accessions with approximate appraised values totaling \$1,016,895 and \$1,736,200, respectively. Collection items purchased but not capitalized totaled \$180,266 and \$2,201,563 during the years ended June 30, 2013 and 2012, respectively. In addition, the Academy received \$8,700 for art acquisition during the year ended June 30, 2013.

INCOME TAXES

The Academy 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.

The Academy 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 (2010 – 2012) or is expected to be taken in the current year.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

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 includes the revenues and expenses associated with the principal mission of the Academy.

Temporarily restricted net assets include gifts which are subject to donor-imposed restrictions. The Academy'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.

CONTRIBUTIONS

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

The Academy 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. 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 the Academy'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 the Academy's financial statements for the year ended June 30, 2012, from which the summarized information was derived.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

(3) PLEDGES RECEIVABLE

Current pledges receivable consist of the following at June 30:

	<u>2013</u>	<u>2012</u>
Capital Campaign pledges receivable	\$ 371,219	\$ 469,476
Major Gifts pledges receivable	<u>237,139</u>	<u>421,272</u>
Total Pledges Receivable	<u>\$ 608,358</u>	<u>\$ 890,748</u>

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

	<u>2013</u>	<u>2012</u>
Pledges receivable Capital Campaign:		
Past due and due within a year	\$ 535,831	\$ 679,831
Due between one and five years	<u>20,000</u>	<u>75,000</u>
Pledges receivable, gross	555,831	754,831
Less allowance for uncollectibles and discount	<u>(184,612)</u>	<u>(285,355)</u>
Pledges receivable Capital Campaign, net	<u>\$ 371,219</u>	<u>\$ 469,476</u>
Pledges receivable Major Gifts:		
Due within a year	\$ 227,250	\$ 361,958
Due between one and three years	<u>10,000</u>	<u>60,000</u>
Pledges receivable, gross	237,250	421,958
Less discount	<u>(111)</u>	<u>(686)</u>
Pledges receivable Major Gifts, net	<u>\$ 237,139</u>	<u>\$ 421,272</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

(4) INVESTMENTS

Investments consist of the following at June 30:

	2013			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Permanently Restricted				
Money Market Funds	\$ 151,494	\$ -	\$ -	\$ 151,494
Common Stocks	4,569,753	1,391,087	-	5,960,840
Corporate Bonds	129,635	9,650	-	139,285
Mutual Funds	<u>7,809,717</u>	<u>100,026</u>	<u>-</u>	<u>7,909,743</u>
	<u>\$ 12,660,599</u>	<u>\$ 1,500,763</u>	<u>\$ -</u>	<u>\$ 14,161,362</u>
	2012			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Permanently Restricted				
Money Market Funds	\$ 193,284	\$ -	\$ -	\$ 193,284
Common Stocks	4,825,891	823,091	-	5,648,982
Corporate Bonds	179,609	15,216	-	194,825
Mutual Funds	<u>7,486,633</u>	<u>-</u>	<u>378,425</u>	<u>7,108,208</u>
	<u>\$ 12,685,417</u>	<u>\$ 838,307</u>	<u>\$ 378,425</u>	<u>\$ 13,145,299</u>

The change in unrealized gain (loss) was \$1,040,081 and \$(448,905) in 2013 and 2012, respectively.

For the years ended June 30, 2013 and 2012, the Board approved a 6.00% and 6.25% 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, 2013 Total</u>	<u>June 30, 2012 Total</u>
Interest and dividends (net of fees of \$61,972 and \$74,082, respectively)	\$ 425,410	\$ -	\$ 425,410	\$ 383,004
Net realized and unrealized gains (losses)	<u>1,202,695</u>	<u>175,180</u>	<u>1,377,875</u>	<u>(526,937)</u>
Return on long-term investments	1,628,105	175,180	1,803,205	(143,933)
Investment return designated for current operations	<u>624,729</u>	<u>175,180</u>	<u>799,909</u>	<u>800,173</u>
Investment return in excess (deficit) of amounts designated for current operations	<u>\$ 1,003,376</u>	<u>\$ -</u>	<u>\$ 1,003,376</u>	<u>\$ (944,106)</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

The Academy 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 the Organization 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 the Academy’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.

The summary of inputs used to value the Academy’s assets and liabilities that are carried at fair value as of June 30, 2013 and 2012 are as follows:

	2013			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Money Market Funds	\$ 151,494	\$ -	\$ -	\$ 151,494
Common Stocks	5,960,840	-	-	5,960,840
Corporate Bonds	-	139,285	-	139,285
Mutual Funds	<u>7,909,743</u>	<u>-</u>	<u>-</u>	<u>7,909,743</u>
	<u>\$ 14,022,077</u>	<u>\$ 139,285</u>	<u>\$ -</u>	<u>\$ 14,161,362</u>
Beneficial Interest in Perpetual Trust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,988,997</u>	<u>\$ 8,988,997</u>
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ (327,647)</u>	<u>\$ -</u>	<u>\$ (327,647)</u>
	2012			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Money Market Funds	\$ 193,284	\$ -	\$ -	\$ 193,284
Common Stocks	5,648,982	-	-	5,648,982
Corporate Bonds	-	194,825	-	194,825
Mutual Funds	<u>7,108,208</u>	<u>-</u>	<u>-</u>	<u>7,108,208</u>
	<u>\$ 12,950,474</u>	<u>\$ 194,825</u>	<u>\$ -</u>	<u>\$ 13,145,299</u>
Beneficial Interest in Perpetual Trust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,590,981</u>	<u>\$ 8,590,981</u>
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ (541,561)</u>	<u>\$ -</u>	<u>\$ (541,561)</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

The Beneficial Interest in Perpetual Trust is measured at the estimated cash flows which involve unobservable inputs. As a result, the present value technique is a Level 3 input.

There were no transfers between Level 1 and Level 2 during the years ended June 30, 2013 or 2012.

The changes in investments measured at fair value for which the Academy used Level 3 inputs to determine fair value are as follows:

	<u>2013</u>	<u>2012</u>
Beneficial Interest in Perpetual Trust:		
Balance, July 1	\$ 8,590,981	\$ 9,408,881
Unrealized gains (losses)	398,016	(461,083)
Termination of Trust	<u>-</u>	<u>(356,817)</u>
Balance, June 30	<u>\$ 8,988,997</u>	<u>\$ 8,590,981</u>

(5) PROPERTY, BUILDINGS AND EQUIPMENT

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

	<u>2013</u>	<u>2012</u>
Land, buildings and improvements	\$ 59,556,216	\$ 59,516,216
Furniture, fixtures and equipment	<u>2,774,085</u>	<u>2,700,008</u>
	62,330,301	62,216,224
Less accumulated depreciation	<u>(16,484,039)</u>	<u>(14,830,292)</u>
	45,846,262	47,385,932
Construction in progress	<u>180,343</u>	<u>-</u>
	<u>\$ 46,026,605</u>	<u>\$ 47,385,932</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, 2013, the Academy was unable to determine the extent of any remediation AROs that would be required in the future.

(6) BENEFICIAL INTEREST IN PERPETUAL TRUSTS

The beneficial interest in perpetual trusts of \$8,988,997 and \$8,590,981 at June 30, 2013 and 2012, respectively, includes the Academy’s respective share of the fair value of the total funds held in trust by others for which the Academy is the recipient of all or a percentage of the income.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

(7) LINE OF CREDIT

The Academy has a revolving line of credit in the amount of \$2,500,000. The line of credit is collateralized by certain marketable securities held in custody by the bank. The line of credit expires on July 31, 2014. Interest on the line of credit is payable on a monthly basis at a variable percentage based upon the Morgan Guaranty Prime Rate. The interest rate at June 30, 2013 and 2012 was 4.00%. At June 30, 2013 and 2012, the outstanding balance on this line of credit was \$1,700,000 and \$975,000, respectively. Interest expense on this line of credit was \$51,777 and \$52,961 for the years ended June 30, 2013 and 2012, respectively.

(8) NOTE PAYABLE

In connection with the purchase of new accounting software, the Academy entered into a 36-month term note payable on July 1, 2011, with monthly payments of \$7,251 and an interest rate of 4.00%. The outstanding balance of \$85,127 is due to be repaid during the year ended June 30, 2014.

(9) LONG-TERM DEBT

2010 Bonds

On March 5, 2010, the Academy borrowed \$19,773,000 through the issuance of tax-exempt Revenue Bonds, Series 2010A through the Philadelphia Authority for Industrial Development, the proceeds of which were used to refinance its 2004 Bonds and any obligations owed to Wachovia Bank, N.A. as letter of credit provider on the 2004 Bonds, the East Norriton Industrial Development Authority's Revenue Bond Series 2007, and a 2008 Term loan with Wachovia Bank, N.A., and to finance the costs of issuance. The Academy also borrowed \$1,227,000 through the issuance of Taxable Revenue Bonds, Series 2010B through the Philadelphia Authority for Industrial Development, the proceeds of which were used to finance Swap Termination Payments. PNC Bank, N.A. purchased the Bonds from the Authority.

The Bonds and Notes are dated March 5, 2010 and will mature on July 1, 2034 and may be prepaid in whole or in part at any time. The tax exempt and taxable interest rates are variable and are adjustable monthly by PNC Bank. Interest is paid monthly. The monthly tax exempt interest rates ranged from 1.97% to 2.17% and 2.13% to 2.21% for the years ended June 30, 2013 and 2012, respectively, and was 1.97% and 2.17% as of June 30, 2013 and 2012, respectively. On March 8, 2013, the Academy and PNC Bank amended the Loan Documents effective on January 1, 2013, to lower the tax exempt interest rates by 25 basis points, to be a floating rate per annum equal to the sum of Libor plus two and three-quarters percent (2.75%) multiplied by sixty-seven percent. The monthly taxable interest rate ranged from 3.19% to 3.30% for the year ended June 30, 2012, and was 3.24% as of June 30, 2012. The balance of the taxable debt was paid in full on July 3, 2012. Deferred financing expenses in the amount of \$507,597 are being amortized on a straight-line basis over the life of the Bonds; the net amount is included under other long term assets. In connection with the Bonds, the Academy must maintain certain financial covenants regarding debt service coverage and certain levels of cash. The Academy failed to meet the Bond's debt service ratio covenant as of June 30, 2013. On February 26, 2014, the Bank issued a waiver regarding the noncompliance of the debt service ratio as of June 30, 2013 and December 31, 2013, respectively. In conjunction with this waiver, the Bank also waived requirements regarding the timely submission of financial statements and other information.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

On June 17, 2010, the Academy entered into an interest rate swap agreement with PNC Bank in three separate amounts. The taxable amount of \$727,000 bears interest at a fixed rate of 3.86%, a three year swap on \$3,382,000 of the tax exempt bonds bears interest at a fixed rate of 2.94% and a five year swap on \$16,391,000 of the tax exempt bonds bears interest at a fixed rate of 3.51%. On March 8, 2013, the Academy and PNC Bank amended the five year swap agreement applicable to the tax exempt bonds to reflect a lower interest rate, equal to 3.3034%. The purpose of the Swap Agreement is to hedge against increases in the variable interest rates on the 2010 Bonds. The market value of the swap was \$327,647 and \$541,561 in favor of the bank as of June 30, 2013 and 2012, respectively, and is included in other liabilities in the statement of financial position.

Interest expense on the tax exempt bonds was \$635,523 and \$687,355 for the years ended June 30, 2013 and 2012, respectively. Interest on the taxable bonds was \$16 and \$11,753 for the years ended June 30, 2013 and 2012, respectively.

In connection with the issuance of the 2010 Bonds, a Debt Service Reserve Fund has been created which requires \$700,000 or some other amount that PNC Bank and the Academy would mutually agree upon in future periods. Funds in the Debt Reserve Service Reserve Fund may be withdrawn by the Trustee to make the principal or interest payment of the 2010 Bonds in the event that the other funds available for that purpose are inadequate.

Redemption payments required under the Bond Agreements are as follows:

<u>Year ending June 30,</u>	<u>Amount</u>
2014	\$ 525,000
2015	550,000
2016	575,000
2017	610,000
2018	640,000
2019 and thereafter	<u>16,375,000</u>
	<u>\$ 19,275,000</u>

(10) RETIREMENT PLANS

The Academy 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, the Academy matches up to 4% for each employee contribution. During the years ended June 30, 2013 and 2012, the Academy contributed approximately \$160,000 and \$170,000, respectively, to the plan.

The Academy 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.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

(11) NET ASSETS

Temporarily restricted net assets at June 30, 2013 and 2012 are available for the following purposes:

	<u>2013</u>	<u>2012</u>
Building fund	\$273,908	\$ 270,000
Major gifts-time restriction	50,000	176,000
Faculty development	25,000	50,000
Scholarships	<u>40,000</u>	<u>30,000</u>
	<u>\$388,908</u>	<u>\$ 526,000</u>

Permanently restricted net assets at June 30, 2013 and 2012 are available for the following purposes:

	<u>2013</u>	<u>2012</u>
Operations	\$ 4,664,406	\$ 4,664,406
Art acquisitions and conservation	3,349,691	3,349,691
Museum operations	926,168	925,168
School scholarships and prizes	5,173,112	5,073,313
School – other	1,309,978	1,309,978
Beneficial interest in perpetual trusts	<u>8,988,997</u>	<u>8,590,981</u>
	<u>\$ 24,412,352</u>	<u>\$ 23,913,537</u>

Net assets were released from donor restrictions by satisfying the restricted purpose, as follows:

Purpose and time restrictions accomplished:

	<u>2013</u>	<u>2012</u>
Capital campaign	\$ 170,000	\$ 1,136,980
Acquisition of art	175,180	180,238
Building fund	87,748	-
Major gifts – time restriction	141,000	-
Faculty development	25,000	-
Scholarships	<u>30,000</u>	<u>-</u>
	<u>\$ 628,928</u>	<u>\$ 1,317,218</u>

During the year ended June 30, 2012, permanently restricted net assets of \$356,817 were released due to the termination of one perpetual trust.

Endowment net asset composition by type of fund as of June 30, 2013 and 2012:

	<u>2013</u>			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	<u>\$ (979,649)</u>	<u>\$ -</u>	<u>\$24,412,352</u>	<u>\$ 23,432,703</u>

	<u>2012</u>			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowment funds	<u>\$(1,983,025)</u>	<u>\$ -</u>	<u>\$23,913,537</u>	<u>\$21,930,512</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

The Academy 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 the Academy only to the extent of the 7% limitation applicable to the year in which they are to be released.

As of June 30, 2013, the Academy has not designated any unrestricted net assets to function as an endowment. However, cumulative losses on the permanently restricted endowment of \$979,649 and \$1,983,025 as of June 30, 2013 and 2012, respectively, have been charged to the unrestricted net assets.

Changes in endowment net assets for the years ended June 30, 2013 and 2012:

	2013			Total
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, beginning of year	\$ (1,983,025)	\$ -	\$ 23,913,537	\$ 21,930,512
Investment income, net	425,410	-	-	425,410
Realized and unrealized gains	1,202,695	175,180	-	1,377,875
Contributions	-	-	100,799	100,799
Endowment income designated for current operations	(624,729)	(175,180)	-	(799,909)
Change in beneficial interest in perpetual trust	-	-	398,016	398,016
Release of restriction – perpetual trust	-	-	-	-
	<u>\$ (979,649)</u>	<u>\$ -</u>	<u>\$ 24,412,352</u>	<u>\$ 23,432,703</u>

	2012			Total
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, beginning of year	\$ (1,038,919)	\$ -	\$ 24,728,063	\$ 23,689,144
Investment income, net	383,004	-	-	383,004
Realized and unrealized losses	(702,175)	175,238	-	(526,937)
Contributions	-	-	3,374	3,374
Endowment income designated for current operations	(624,935)	(175,238)	-	(800,173)
Change in beneficial interest in perpetual trust	-	-	(461,083)	(461,083)
Release of restriction – perpetual trust	-	-	(356,817)	(356,817)
	<u>\$ (1,983,025)</u>	<u>\$ -</u>	<u>\$ 23,913,537</u>	<u>\$ 21,930,512</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

(12) RELATED PARTY TRANSACTIONS

The Academy had the following related party transactions:

- ♦ The Academy uses the services of a Trust Company where a Board member of the Academy is an officer and three Board members are paid Directors. Assets under management with this investment company totaled approximately \$16,948,000 and \$15,757,000 as of June 30, 2013 and 2012, respectively. The Academy is charged a .4% fee for this service. The fee was approximately \$55,000 for 2013 and \$67,000 for 2012. In addition, this Trust Company provides a line of credit for the Academy; interest expense during the years ended June 30, 2013 and 2012 for this line of credit was approximately \$52,000 and \$53,000, respectively.
- ♦ The Academy has an employment agreement with its President whereby the Academy paid \$200,000 during fiscal year 2009 to assist in acquiring a residence. The payment is treated as an asset of the endowment. The Academy has an equity interest in the property. As of June 30, 2013 and 2012, the balance on the loan, including accrued interest, is \$182,534 and \$195,221, respectively, and is included in other assets in the statement of financial position. Accrued interest income was \$7,315 and \$8,288 for the years ended June 30, 2013 and 2012, respectively.
- ♦ The Academy 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 the Academy.
- ♦ The Academy has \$558,440 and \$682,898 as of June 30, 2013 and 2012, respectively, in pledges for capital campaign and other purposes from several board members and their foundations.

(13) COMMITMENTS AND CONTINGENCIES

OPERATING LEASES

The Academy leases certain office equipment under lease agreements which expire at various dates through fiscal year 2017.

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

2014	\$ 67,572
2015	58,654
2016	53,657
2017	<u>35,771</u>
Total	<u>\$ 215,654</u>

LITIGATION

The Academy 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 the Academy's financial position.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2013 And 2012

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 the Academy's financial position.

(14) SUBSEQUENT EVENTS

Subsequent events after the balance sheet date through the date that the financial statements were available for issuance, February 28, 2014 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.