

PENNSYLVANIA ACADEMY OF THE FINE ARTS

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

JUNE 30, 2014

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, 2014, 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, 2014, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**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' 2013 financial statements, and our report dated February 28, 2014, 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, 2013, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Tait, Weller & Baker LLP

**Philadelphia, Pennsylvania
November 24, 2014**

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENTS OF FINANCIAL POSITION

June 30, 2014 And 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (<i>Note 9</i>)	\$ 32,706,086	\$ 3,203,239
Accounts receivable, net	108,567	191,214
Prepaid expenses	456,071	272,781
Inventories	105,214	252,763
Pledges receivable (<i>Note 3</i>)	<u>1,201,520</u>	<u>578,690</u>
Total Current Assets	<u>34,577,458</u>	<u>4,498,687</u>
LONG-TERM ASSETS		
Pledges receivable (<i>Note 3</i>)	999,871	29,668
Other assets (<i>Note 12</i>)	615,856	651,867
Long term investments (<i>Notes 4 and 7</i>)	15,900,403	14,161,362
Property, buildings and equipment (<i>Note 5</i>)	45,133,017	46,026,605
Funds held by Trustee (<i>Note 9</i>)	700,695	710,757
Beneficial interest in perpetual trusts (<i>Notes 4 and 6</i>)	<u>9,833,828</u>	<u>8,988,997</u>
Total Long-Term Assets	<u>73,183,670</u>	<u>70,569,256</u>
Total Assets	<u>\$ 107,761,128</u>	<u>\$ 75,067,943</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Line of credit (<i>Note 7</i>)	\$ 2,200,000	\$ 1,700,000
Current maturities of note payable (<i>Note 8</i>)	-	85,127
Current maturities of long term debt (<i>Note 9</i>)	550,000	525,000
Accounts payable	806,615	645,518
Accrued expenses	337,212	256,689
Deferred revenue	<u>1,664,845</u>	<u>1,247,154</u>
Total Current Liabilities	5,558,672	4,459,488
LONG-TERM LIABILITIES		
Bonds payable (<i>Note 9</i>)	18,200,000	18,750,000
Other liabilities (<i>Notes 4 and 9</i>)	<u>160,996</u>	<u>327,647</u>
Total Liabilities	<u>23,919,668</u>	<u>23,537,135</u>
NET ASSETS		
Unrestricted net assets	57,116,793	26,729,548
Temporarily restricted net assets (<i>Note 11</i>)	1,295,297	388,908
Permanently restricted net assets (<i>Note 11</i>)	<u>25,429,370</u>	<u>24,412,352</u>
Total Net Assets	<u>83,841,460</u>	<u>51,530,808</u>
Total Liabilities and Net Assets	<u>\$ 107,761,128</u>	<u>\$ 75,067,943</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2014 With Summarized Information For 2013

	2014			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2014	2013
Program Revenues, Support Revenue and Investment Income					
Program Revenue					
Tuition and fees, net of scholarships	\$ 6,633,865	\$ -	\$ -	\$ 6,633,865	\$ 6,628,894
Continuing and public education	847,082	-	-	847,082	778,602
Government grants	90,973	-	-	90,973	93,796
Museum admissions, collection rental and fees	255,944	-	-	255,944	336,627
Museum shop and art supply store, net	25,399	-	-	25,399	201,267
Facility rental and catering	384,861	-	-	384,861	411,841
Women's Board	297,359	-	-	297,359	215,474
Other income	33,049	-	-	33,049	12,846
Total program revenue	8,568,532	-	-	8,568,532	8,679,347
Support Revenue					
Fundraising and support revenues	3,924,583	1,644,812	172,187	5,741,582	3,758,146
Bequests	247,483	-	-	247,483	13,500
Total support revenue	4,172,066	1,644,812	172,187	5,989,065	3,771,646
Investment Income					
Endowment income designated for operations (<i>Note 4</i>)	632,170	177,267	-	809,437	799,909
Income from outside trusts	424,872	-	-	424,872	404,933
Total investment income	1,057,042	177,267	-	1,234,309	1,204,842
Net assets released from restrictions (<i>Note 11</i>)	1,484,154	(1,484,154)	-	-	-
Total operating program, support and investment income	15,281,794	337,925	172,187	15,791,906	13,655,835
Program and Support Expenses					
Program Expenses					
School	7,224,038	-	-	7,224,038	6,651,049
Continuing and public education	1,026,365	-	-	1,026,365	1,124,641
Women's Board	102,089	-	-	102,089	84,589
Museum and exhibition	2,929,051	-	-	2,929,051	2,780,811
Total program expenses	11,281,543	-	-	11,281,543	10,641,090
Support Function Expenses					
Management and general	1,746,962	-	-	1,746,962	1,562,048
Facility rental and catering	199,612	-	-	199,612	172,565
Development and fundraising	1,301,420	-	-	1,301,420	1,120,761
	3,247,994	-	-	3,247,994	2,855,374
Total program and support expenses	14,529,537	-	-	14,529,537	13,496,464
Change in net assets before depreciation, gains (losses) and other income (expenses)	752,257	337,925	172,187	1,262,369	159,371
Depreciation and amortization	1,664,901	-	-	1,664,901	1,675,228
Change in net assets before gains (losses) and other income (expenses)	(912,644)	337,925	172,187	(402,532)	(1,515,857)

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, 2014 With Summarized Information For 2013

	2014			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2014	2013
Gains (Losses) and Other Income (Expenses)					
Investment return in excess (deficit) of amount designated for current operations (<i>Note 4</i>)	979,649	568,464	-	1,548,113	1,003,376
Change in beneficial interest in perpetual trusts	-	-	844,831	844,831	398,016
Change in market value of interest rate swap (<i>Note 9</i>)	166,652	-	-	166,652	213,914
Proceeds from art sales	30,700,000	-	-	30,700,000	8,700
Collection items purchased but not capitalized	(546,412)	-	-	(546,412)	(180,266)
Total non-operating revenue, expenses and gain (losses)	<u>31,299,889</u>	<u>568,464</u>	<u>844,831</u>	<u>32,713,184</u>	<u>1,443,740</u>
Change in net assets	30,387,245	906,389	1,017,018	32,310,652	(72,117)
Net Assets					
Beginning 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>
End of year	<u>\$ 57,116,793</u>	<u>\$ 1,295,297</u>	<u>\$ 25,429,370</u>	<u>\$ 83,841,460</u>	<u>\$ 51,530,808</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2014 And 2013

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 32,310,652	\$ (72,117)
Adjustments to reconcile change in net assets to net cash used for operating activities		
Depreciation and amortization expense	1,664,901	1,675,228
Net unrealized appreciation on long-term investments	(1,872,235)	(1,040,881)
Net realized gains on long-term investments	(139,204)	(336,994)
Net unrealized appreciation on outside perpetual trusts	(844,831)	(398,016)
Accrued interest earned on note receivable	(6,338)	(7,315)
Forgiveness of note receivable	20,000	20,000
Change in market value of swap	(166,651)	(213,914)
(Increase) decrease in assets		
Accounts receivable	82,647	277,211
Inventories	147,549	44,207
Pledges receivable	(1,593,033)	282,390
Prepaid expenses and other assets	(183,290)	121,777
Funds held by trustee	10,062	52,287
Increase (decrease) in liabilities		
Accounts payable	161,097	(515,591)
Accrued expenses	80,523	(54,939)
Deferred revenue	417,691	(53,301)
Net cash provided by (used for) operating activities	<u>30,089,540</u>	<u>(219,968)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(748,964)	(294,420)
Purchases of long-term investments	(3,103,270)	(3,234,377)
Proceeds from sale of long-term investments	3,375,668	3,596,189
Net cash (used for) provided by investing activities	<u>(476,566)</u>	<u>67,392</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of note payable	(85,127)	(81,749)
Payment of bond issuance costs	-	(31,890)
Net proceeds from line of credit	500,000	725,000
Repayment on bonds payable	(525,000)	(584,967)
Net cash (used for) provided by financing activities	<u>(110,127)</u>	<u>26,394</u>
Net increase (decrease) in cash and cash equivalents	29,502,847	(126,182)
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>3,203,239</u>	<u>3,329,421</u>
End of year	<u>\$ 32,706,086</u>	<u>\$ 3,203,239</u>
SUPPLEMENTAL INFORMATION		
Cash paid for interest	<u>\$ 614,891</u>	<u>\$ 706,788</u>

The accompanying notes are an integral part of these statements.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 And 2013

(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, 2014 And 2013

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, 2014 and 2013, the Academy had donated accessions with approximate appraised values totaling \$660,555 and \$1,016,895, respectively. Collection items purchased but not capitalized totaled \$546,412 and \$180,266 during the years ended June 30, 2014 and 2013, respectively. In addition, the Academy received \$30,700,000 and \$8,700 for the sale of art works during the year ended June 30, 2014 and 2013, respectively.

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 (2011 – 2013) or is expected to be taken in the current year.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

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 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, 2013, from which the summarized information was derived.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

(3) PLEDGES RECEIVABLE

Current pledges receivable consist of the following at June 30:

	<u>2014</u>	<u>2013</u>
Capital Campaign pledges receivable	\$ 1,805,003	\$ 371,219
Major Gifts pledges receivable	<u>396,388</u>	<u>237,139</u>
Total Pledges Receivable	<u>\$ 2,201,391</u>	<u>\$ 608,358</u>

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

	<u>2014</u>	<u>2013</u>
Pledges receivable Capital Campaign:		
Past due and due within a year	\$ 1,016,570	\$ 535,831
Due between one and five years	<u>955,000</u>	<u>20,000</u>
Pledges receivable, gross	1,971,570	555,831
Less allowance for uncollectibles and discount	<u>(166,567)</u>	<u>(184,612)</u>
Pledges receivable Capital Campaign, net	<u>\$ 1,805,003</u>	<u>\$ 371,219</u>
Pledges receivable Major Gifts:		
Due within a year	\$ 334,250	\$ 227,250
Due between one and three years	<u>63,000</u>	<u>10,000</u>
Pledges receivable, gross	397,250	237,250
Less discount	<u>(862)</u>	<u>(111)</u>
Pledges receivable Major Gifts, net	<u>\$ 396,388</u>	<u>\$ 237,139</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

(4) INVESTMENTS

Investments consist of the following at June 30:

	2014			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Permanently Restricted				
Money Market Funds	\$ 159,935	\$ -	\$ -	\$ 159,935
Common Stocks	4,297,200	2,244,083	-	6,541,283
Corporate Bonds	76,298	9,012	-	85,310
Mutual Funds	<u>7,993,972</u>	<u>1,119,903</u>	<u>-</u>	<u>9,113,875</u>
	<u>\$ 12,527,405</u>	<u>\$ 3,372,998</u>	<u>\$ -</u>	<u>\$ 15,900,403</u>
	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>

The change in unrealized gain was \$1,872,235 and \$1,040,081 in 2014 and 2013, respectively.

For the years ended June 30, 2014 and 2013, the Board approved a 5.75% and 6.00% 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, 2014 Total</u>	<u>June 30, 2013 Total</u>
Interest and dividends (net of fees of \$65,968 and \$61,972, respectively)	\$ 346,111	\$ -	\$ 346,111	\$ 425,410
Net realized and unrealized gains	<u>1,265,708</u>	<u>745,731</u>	<u>2,011,439</u>	<u>1,377,875</u>
Return on long-term investments	1,611,819	745,731	2,357,550	1,803,205
Investment return designated for current operations	<u>632,170</u>	<u>177,267</u>	<u>809,437</u>	<u>799,909</u>
Investment return in excess of amounts designated for current operations	<u>\$ 979,649</u>	<u>\$ 568,464</u>	<u>\$ 1,548,113</u>	<u>\$ 1,003,376</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

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, 2014 and 2013 are as follows:

	2014			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Money Market Funds	\$ 159,935	\$ -	\$ -	\$ 159,935
Common Stocks	6,541,283	-	-	6,541,283
Corporate Bonds	-	85,310	-	85,310
Mutual Funds	9,113,875	-	-	9,113,875
	<u>\$ 15,815,093</u>	<u>\$ 85,310</u>	<u>\$ -</u>	<u>\$ 15,900,403</u>
Beneficial Interest in Perpetual Trust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,833,828</u>	<u>\$ 9,833,828</u>
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ (160,996)</u>	<u>\$ -</u>	<u>\$ (160,996)</u>
	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	7,909,743	-	-	7,909,743
	<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>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

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, 2014 or 2013.

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

	<u>2014</u>	<u>2013</u>
Beneficial Interest in Perpetual Trust:		
Balance, July 1	\$ 8,988,997	\$ 8,590,981
Unrealized gains	<u>844,831</u>	<u>398,016</u>
Balance, June 30	<u>\$ 9,833,828</u>	<u>\$ 8,988,997</u>

(5) PROPERTY, BUILDINGS AND EQUIPMENT

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

	<u>2014</u>	<u>2013</u>
Land, buildings and improvements	\$ 59,891,992	\$ 59,556,216
Furniture, fixtures and equipment	<u>2,863,575</u>	<u>2,774,085</u>
	62,755,567	62,330,301
Less accumulated depreciation	<u>(18,126,591)</u>	<u>(16,484,039)</u>
	44,628,976	45,846,262
Construction in progress	<u>504,041</u>	<u>180,343</u>
	<u>\$ 45,133,017</u>	<u>\$ 46,026,605</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, 2014, 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 \$9,833,828 and \$8,988,997 at June 30, 2014 and 2013, 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, 2014 And 2013

(7) LINE OF CREDIT

On June 27, 2014, the Academy increased its revolving line of credit from \$2,500,000 to \$7,500,000 to provide bridge financing for capital projects. The line of credit is collateralized by certain marketable securities held by a financial institution. Interest on the line of credit is payable on a monthly basis at a variable percentage based upon the J.P. Morgan Chase Guaranty Prime Rate minus 1.25% (2% as of June 30, 2014). Prior to the amendment to the line of credit on June 27, 2014 and during the year ended June 30, 2013, the interest rate was 4.00%. At June 30, 2014 and 2013, the outstanding balance on this line of credit was \$2,200,000 and \$1,700,000, respectively. Interest expense on this line of credit was \$70,349 and \$51,777 for the years ended June 30, 2014 and 2013, respectively.

(8) NOTE PAYABLE

In connection with the purchase of 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 on the note payable was \$85,127 as of June 30, 2013. This note payable was repaid during 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 tax-exempt 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 interest rates are variable and are adjustable monthly by PNC Bank. Interest is paid monthly. The monthly tax exempt interest rates ranged from 1.94% to 1.97% and 1.97% to 2.17% for the years ended June 30, 2014 and 2013, respectively, and was 1.94% and 1.97% as of June 30, 2014 and 2013, 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 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.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

In connection with the Bonds, the Academy must maintain certain financial covenants regarding debt service coverage and certain levels of cash. A Debt Service Reserve Fund with a minimum of \$700,000 in cash is required. Funds in the Debt Service Reserve Fund may be withdrawn by the Trustee to make principal or interest payments for the 2010 Bonds in the event that the other funds available for that purpose are inadequate. The Academy failed to meet the Bond's debt service ratio covenant as of June 30, 2014 and 2013. On November 24, 2014, the Bank issued a waiver related to noncompliance with the Board's debt service ratio covenant as of June 30, 2014. 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 the 2013 waiver, the Bank also waived requirements regarding the timely submission of financial statements and other information.

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%. In conjunction with the taxable bond being repaid in 2013, the corresponding interest rate swap expired. In addition, the three year interest rate swap of \$3,282,000 expired on April 1, 2013. 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 3.3155%. Effective February 1, 2014, the interest rate increased to a rate of 3.5155%. This rate will continue in effect until the swap matures on April 1, 2015. 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 \$160,996 and \$327,647 in favor of the bank as of June 30, 2014 and 2013, respectively, and is included in other liabilities in the statement of financial position.

Interest expense on the tax exempt bonds was \$577,982 and \$635,523 for the years ended June 30, 2014 and 2013, respectively.

Redemption payments required under the Bond Agreements are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2015	\$ 550,000
2016	575,000
2017	610,000
2018	640,000
2019	670,000
2020 and thereafter	<u>15,705,000</u>
	<u>\$ 18,750,000</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, 2014 and 2013, the Academy contributed approximately \$171,000 and \$142,000, respectively, to the plan.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

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.

(11) NET ASSETS

Temporarily restricted net assets at June 30, 2014 and 2013 are available for the following purposes:

	<u>2014</u>	<u>2013</u>
Building fund, net of discount	\$ 35,904	\$ 273,908
Campus Master Plan – Capital Campaign	580,929	-
Major gifts-time restriction	47,000	50,000
Faculty development	25,000	25,000
Scholarships	38,000	40,000
Cumulative gain on endowment	<u>568,464</u>	<u>-</u>
	<u>\$ 1,295,297</u>	<u>\$ 388,908</u>

Permanently restricted net assets at June 30, 2014 and 2013 are available for the following purposes:

	<u>2014</u>	<u>2013</u>
Operations	\$ 4,664,406	\$ 4,664,406
Art acquisitions and conservation	3,349,691	3,349,691
Museum operations	926,168	926,168
School scholarships and prizes	5,345,299	5,173,112
School – other	1,309,978	1,309,978
Beneficial interest in perpetual trusts	<u>9,833,828</u>	<u>8,988,997</u>
	<u>\$ 25,429,370</u>	<u>\$ 24,412,352</u>

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

Purpose and time restrictions accomplished:

	<u>2014</u>	<u>2013</u>
Capital campaign	\$ -	\$ 170,000
Acquisition of art	177,267	175,180
Building fund	162,252	87,748
Campus Master Plan – Capital Campaign	1,077,135	-
Major gifts-time restriction	47,500	141,000
Faculty development	-	25,000
Scholarships	<u>20,000</u>	<u>30,000</u>
	<u>\$ 1,484,154</u>	<u>\$ 628,928</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

Endowment net asset composition by type of fund as of June 30, 2014 and 2013:

	2014			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor restricted endowment funds	\$ -	\$ 568,464	\$ 25,429,370	\$ 25,997,834

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

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, 2014, 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 as of June 30, 2013, were charged to unrestricted net assets.

Changes in endowment net assets for the years ended June 30, 2014 and 2013:

	2014			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ (979,649)	\$ -	\$ 24,412,352	\$ 23,432,703
Investment income, net	346,111	-	-	346,111
Realized and unrealized gains	1,265,708	745,731	-	2,011,439
Contributions	-	-	172,188	172,188
Endowment income designated for current operations	(632,170)	(177,267)	-	(809,437)
Change in beneficial interest in perpetual trust	-	-	844,830	844,830
	<u>\$ -</u>	<u>\$ 568,464</u>	<u>\$ 25,429,370</u>	<u>\$ 25,997,834</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

	2013			<u>Total</u>
	<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	1,202,696	175,180	-	1,377,876
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>

(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 \$38,318,000 and \$16,948,000 as of June 30, 2014 and 2013, respectively. The Academy was charged investment fees by the investment company. The fee was approximately for \$66,000 and \$62,000 for the years ended June 30, 2014 and 2013, respectively. In addition, this Trust Company provides a line of credit for the Academy; interest expense during the years ended June 30, 2014 and 2013 for this line of credit was approximately \$70,000 and \$52,000, 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, 2014 and 2013, the balance on the loan, including accrued interest, is \$168,872 and \$182,534, respectively, and is included in other assets in the statement of financial position. Accrued interest income was \$6,338 and \$7,315 for the years ended June 30, 2014 and 2013, 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 \$409,770 and \$483,440 as of June 30, 2014 and 2013, respectively, in pledges for capital campaign and other purposes from several board members and their foundations.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2014 And 2013

(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:

2015	\$ 266,425
2016	70,867
2017	<u>35,771</u>
Total	<u>\$ 373,063</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.

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, November 24, 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.