

# **PENNSYLVANIA ACADEMY OF THE FINE ARTS**

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

**JUNE 30, 2016**

# 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, 2016, 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, 2016, 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' 2015 financial statements, and our report dated October 8, 2015, 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, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Tait, Weller & Baker LLP*

**Philadelphia, Pennsylvania  
October 27, 2016**

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENTS OF FINANCIAL POSITION

June 30, 2016 And 2015

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,850,001	\$ 6,170,971
Accounts receivable, net	328,095	230,858
Prepaid expenses	447,448	544,125
Inventories	93,018	95,352
Pledges receivable ( <i>Notes 3 and 11</i> )	<u>2,607,862</u>	<u>2,536,035</u>
<b>Total Current Assets</b>	<u>5,326,424</u>	<u>9,577,341</u>
<b>LONG-TERM ASSETS</b>		
Pledges receivable ( <i>Notes 3 and 11</i> )	3,379,382	2,304,195
Other assets ( <i>Note 11</i> )	138,623	154,235
Long term investments ( <i>Notes 4 and 7</i> )	42,528,374	40,151,026
Property, buildings and equipment ( <i>Note 5</i> )	49,754,832	46,044,431
Beneficial interest in perpetual trusts ( <i>Notes 4 and 6</i> )	<u>9,581,254</u>	<u>10,097,617</u>
<b>Total Long-Term Assets</b>	<u>105,382,465</u>	<u>98,751,504</u>
<b>Total Assets</b>	<u>\$ 110,708,889</u>	<u>\$ 108,328,845</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Line of credit ( <i>Note 7</i> )	\$ 5,180,000	\$ 580,000
Accounts payable	1,022,593	1,468,572
Accrued expenses	357,803	264,978
Deferred revenue	<u>2,200,706</u>	<u>1,260,710</u>
<b>Total Current Liabilities</b>	8,761,102	3,574,260
<b>LONG-TERM LIABILITIES</b>		
Bonds payable ( <i>Note 8</i> )	20,788,909	20,781,091
Other liabilities ( <i>Notes 4 and 8</i> )	<u>810,100</u>	<u>379,167</u>
<b>Total Liabilities</b>	<u>30,360,111</u>	<u>24,734,518</u>
<b>NET ASSETS</b>		
Unrestricted net assets	53,381,735	55,255,739
Temporarily restricted net assets ( <i>Note 10</i> )	1,722,592	2,574,552
Permanently restricted net assets ( <i>Note 10</i> )	<u>25,244,451</u>	<u>25,764,036</u>
<b>Total Net Assets</b>	<u>80,348,778</u>	<u>83,594,327</u>
<b>Total Liabilities and Net Assets</b>	<u>\$ 110,708,889</u>	<u>\$ 108,328,845</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2016 With Summarized Information For 2015

	2016			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2016	2015
<b>Program Revenues, Support Revenue and Investment Income</b>					
<b>Program Revenue</b>					
Tuition and fees, net of scholarships	\$ 6,684,360	\$ -	\$ -	\$ 6,684,360	\$ 5,882,258
Continuing and public education	827,386	-	-	827,386	833,064
Government grants	180,266	-	-	180,266	173,474
Museum admissions, collection rental and fees	356,405	-	-	356,405	403,887
Museum shop and art supply store, net	160,018	-	-	160,018	175,191
Facility rental and catering	485,717	-	-	485,717	290,820
Women's Board	307,455	-	-	307,455	296,002
Other income	64,791	-	-	64,791	245,585
<b>Total program revenue</b>	<b>9,066,398</b>	<b>-</b>	<b>-</b>	<b>9,066,398</b>	<b>8,300,281</b>
<b>Support Revenue</b>					
Fundraising and support revenues	3,631,703	3,338,973	16,778	6,987,454	8,777,072
Bequests	55,403	-	-	55,403	1,478,097
<b>Total support revenue</b>	<b>3,687,106</b>	<b>3,338,973</b>	<b>16,778</b>	<b>7,042,857</b>	<b>10,255,169</b>
<b>Investment Income</b>					
Endowment income designated for operations ( <i>Note 4</i> )	626,688	170,436	-	797,124	801,000
Income from outside trusts	488,902	-	-	488,902	755,385
<b>Total investment income</b>	<b>1,115,590</b>	<b>170,436</b>	<b>-</b>	<b>1,286,026</b>	<b>1,556,385</b>
<b>Net assets released from restrictions (<i>Note 10</i>)</b>	<b>4,361,369</b>	<b>(4,361,369)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total operating program, support and investment income</b>	<b>18,230,463</b>	<b>(851,960)</b>	<b>16,778</b>	<b>17,395,281</b>	<b>20,111,835</b>
<b>Program and Support Expenses</b>					
<b>Program Expenses</b>					
School	7,462,843	-	-	7,462,843	7,375,424
Continuing and public education	1,350,976	-	-	1,350,976	1,126,635
Women's Board	77,603	-	-	77,603	76,007
Museum and exhibition	3,308,181	-	-	3,308,181	3,253,032
<b>Total program expenses</b>	<b>12,199,603</b>	<b>-</b>	<b>-</b>	<b>12,199,603</b>	<b>11,831,098</b>
<b>Support Function Expenses</b>					
Management and general	1,639,938	-	-	1,639,938	1,583,024
Facility rental and catering	236,568	-	-	236,568	160,198
Development and fundraising	1,543,501	-	-	1,543,501	1,452,603
	3,420,007	-	-	3,420,007	3,195,825
<b>Total program and support expenses</b>	<b>15,619,610</b>	<b>-</b>	<b>-</b>	<b>15,619,610</b>	<b>15,026,923</b>
<b>Change in net assets before depreciation, gains (losses) and other income (expenses)</b>	<b>2,610,853</b>	<b>(851,960)</b>	<b>16,778</b>	<b>1,775,671</b>	<b>5,084,912</b>
<b>Depreciation and amortization</b>	<b>1,708,269</b>	<b>-</b>	<b>-</b>	<b>1,708,269</b>	<b>1,602,187</b>
<b>Change in net assets before gains (losses) and other income (expenses)</b>	<b>902,584</b>	<b>(851,960)</b>	<b>16,778</b>	<b>67,402</b>	<b>3,482,725</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, 2016 With Summarized Information For 2015

	2016			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2016	2015
<b>Gains (Losses) and Other Income (Expenses)</b>					
Investment return in excess (deficit) of amount designated for current operations (Notes 4 and 10)	(821,982)	-	-	(821,982)	(789,772)
Other investment income (Note 4)	103,188	-	-	103,188	23,926
Contribution of beneficial interest in perpetual trusts (Notes 4, 6 and 10)	-	-	-	-	647,476
Change in beneficial interest in perpetual trusts (Notes 4 and 10)	-	-	(516,363)	(516,363)	(383,687)
Change in market value of interest rate swap (Note 8)	(430,933)	-	-	(430,933)	(218,171)
Loss on financing (Note 8)	-	-	-	-	(446,984)
Proceeds from art sales	250,000	-	-	250,000	-
Collection items purchased but not capitalized	(1,896,861)	-	-	(1,896,861)	(2,562,646)
Transfer of net assets	20,000	-	(20,000)	-	-
<b>Total non-operating revenue, expenses and gain (losses)</b>	<u>(2,776,588)</u>	<u>-</u>	<u>(536,363)</u>	<u>(3,312,951)</u>	<u>(3,729,858)</u>
<b>Change in net assets</b>	(1,874,004)	(851,960)	(519,585)	(3,245,549)	(247,133)
<b>Net Assets</b>					
Beginning of year	<u>55,255,739</u>	<u>2,574,552</u>	<u>25,764,036</u>	<u>83,594,327</u>	<u>83,841,460</u>
<b>End of year</b>	<u>\$ 53,381,735</u>	<u>\$ 1,722,592</u>	<u>\$ 25,244,451</u>	<u>\$ 80,348,778</u>	<u>\$ 83,594,327</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## STATEMENTS OF CASH FLOWS

Years Ended June 30, 2016 And 2015

	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in net assets	\$ (3,245,549)	\$ (247,133)
<b>Adjustments to reconcile change in net assets to net cash (used for) provided by operating activities</b>		
Depreciation expense	1,700,451	1,602,187
Net unrealized depreciation (appreciation) on long-term investments	(130,546)	1,008,162
Net realized gains on long-term investments	632,159	(549,623)
Contribution of beneficial interest in perpetual trusts	-	(647,476)
Net unrealized depreciation (appreciation) on outside perpetual trusts	516,363	383,687
Accrued interest earned on note receivable	(4,388)	(5,363)
Forgiveness of note receivable	20,000	20,000
Loss on financing	-	446,984
Change in market value of swap	430,933	218,171
Amortization of deferred bond cost	7,818	-
(Increase) decrease in assets		
Accounts receivable	(97,237)	(122,291)
Inventories	2,334	9,862
Pledges receivable	(1,147,014)	(2,638,839)
Prepaid expenses and other assets	96,677	(88,054)
Funds held by trustee	-	700,695
Increase (decrease) in liabilities		
Accounts payable	(445,979)	661,957
Accrued expenses	92,825	(72,234)
Deferred revenue	<u>939,996</u>	<u>(404,135)</u>
<b>Net cash (used for) provided by operating activities</b>	<u>(631,157)</u>	<u>276,557</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(5,410,852)	(2,513,601)
Purchases of long-term investments	(7,859,741)	(27,599,553)
Proceeds from sale of long-term investments	<u>4,980,780</u>	<u>2,890,391</u>
<b>Net cash used for investing activities</b>	<u>(8,289,813)</u>	<u>(27,222,763)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payment of bond issuance costs	-	(218,909)
Net proceeds/(repayments) from line of credit	4,600,000	(1,620,000)
Issuance of long-term debt	-	21,000,000
Repayment on bonds payable	<u>-</u>	<u>(18,750,000)</u>
<b>Net cash provided by financing activities</b>	<u>4,600,000</u>	<u>411,091</u>
<b>Net decrease in cash and cash equivalents</b>	(4,320,970)	(26,535,115)
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of year	<u>6,170,971</u>	<u>32,706,086</u>
<b>End of year</b>	<u>\$ 1,850,001</u>	<u>\$ 6,170,971</u>
<b>SUPPLEMENTAL INFORMATION</b>		
Cash paid for interest	<u>\$ 470,357</u>	<u>\$ 665,627</u>



# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS

June 30, 2016 And 2015

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### (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, 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***

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, 2016 And 2015

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### ***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, 2016 and 2015, the Academy had donated accessions with approximate appraised values totaling \$357,300 and \$883,200, respectively. Collection items purchased but not capitalized totaled \$1,896,861 and \$2,562,646 during the years ended June 30, 2016 and 2015, respectively. In addition, the Academy received \$250,000 for the sale of art works during the year ended June 30, 2016.

### ***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 (2012 – 2014) or is expected to be taken in the current 2015 tax year.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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### **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, 2015, from which the summarized information was derived.

### **RECLASSIFICATION**

Certain account balances in the 2015 financial statements have been reclassified to conform to the 2016 financial statement presentation.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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### NEW ACCOUNTING STANDARDS

In April 2015, the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Topic 835-30): Simplifying the Presentation of Debt Issuance Costs*. This ASU was issued as a result of feedback received relating to the different balance sheet presentation requirements for debt issuance costs and debt discounts and premiums. To simplify presentation of debt issuance costs, the amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. ASU 2015-03 is effective for the Academy's fiscal year beginning July 1, 2016; early adoption was permitted for financial statements that have not been previously issued. The Academy elected to adopt the guidance for the fiscal year beginning July 1, 2015. The guidance is retrospective and the adoption of ASU 2015-03 did not have a significant impact on the Academy's financial position or results of operations. The adoption of ASU 2015-03 caused long-term debt and deferred financing expenses previously reported in other assets in the June 30, 2015 statement of financial position to decrease by \$218,909.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU was issued to address the diversity in practice relating to how certain investments measured at net asset value are categorized in the fair value hierarchy. The amendments in ASU 2015-07 remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. ASU 2015-07 also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. ASU 2015-07 is effective for the Academy's fiscal year beginning July 1, 2016; early adoption is permitted. The Academy elected to adopt the guidance for the fiscal year beginning July 1, 2015. The guidance is retrospective, and the adoption of this ASU impacted disclosures related to investments.

### (3) PLEDGES RECEIVABLE

Current pledges receivable consist of the following at June 30:

	<u>2016</u>	<u>2015</u>
Capital Campaign pledges receivable	\$ 3,967,432	\$ 3,010,487
Major Gifts pledges receivable	<u>2,019,812</u>	<u>1,829,743</u>
Total Pledges Receivable	<u>\$ 5,987,244</u>	<u>\$ 4,840,230</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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

	<u>2016</u>	<u>2015</u>
Pledges receivable Capital Campaign:		
Past due and due within a year	\$ 1,605,741	\$ 1,742,528
Due between one and five years	<u>2,526,000</u>	<u>1,434,000</u>
Pledges receivable, gross	4,131,741	3,176,528
Less allowance for uncollectibles and discount	<u>(164,309)</u>	<u>(166,041)</u>
Pledges receivable Capital Campaign, net	<u>\$ 3,967,432</u>	<u>\$ 3,010,487</u>
Pledges receivable Major Gifts:		
Due within a year	\$ 1,167,090	\$ 982,690
Due between one and three years	<u>925,000</u>	<u>925,000</u>
Pledges receivable, gross	2,092,090	1,907,690
Less allowance for uncollectibles and discount	<u>(72,278)</u>	<u>(77,947)</u>
Pledges receivable Major Gifts, net	<u>\$ 2,019,812</u>	<u>\$ 1,829,743</u>

#### (4) INVESTMENTS

Investments consist of the following at June 30:

	<u>2016</u>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Money Market Funds	\$ 1,433,589	\$ -	\$ -	\$ 1,433,589
Common Stocks	22,763,129	2,264,444	-	25,027,573
Corporate Bonds	75,981	1,219	-	77,200
Mutual Funds	14,772,606	156,807	-	14,929,413
Pooled Investment Fund/Hedge Fund	<u>987,687</u>	<u>72,912</u>	<u>-</u>	<u>1,060,599</u>
	<u>\$ 40,032,992</u>	<u>\$ 2,495,382</u>	<u>\$ -</u>	<u>\$ 42,528,374</u>
	<u>2015</u>			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Money Market Funds	\$ 5,211,886	\$ -	\$ -	\$ 5,211,886
Common Stocks	17,200,151	1,805,848	-	19,005,999
Corporate Bonds	76,298	4,828	-	81,126
Mutual Funds	15,048,439	563,919	-	15,612,358
Pooled Investment Fund/Hedge Fund	<u>249,416</u>	<u>-</u>	<u>(9,759)</u>	<u>239,657</u>
	<u>\$ 37,786,190</u>	<u>\$ 2,374,595</u>	<u>\$ (9,759)</u>	<u>\$ 40,151,026</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

**June 30, 2016 And 2015**

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The Academy has a hedge fund investment, BBH Wealth Strategies, LLC REMS Group Series, of \$1,060,599 and \$239,657 as of June 30, 2016 and 2015, 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, 2016, The Academy 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.

Investments as of June 30, 2016 and 2015, include unrestricted investments of \$27,881,978 and \$25,025,683, respectively, which are invested separately from those investments for the permanently restricted endowment. Other investment income of \$103,188 and \$23,926 for the years ended June 30, 2016 and 2015, respectively, represents the net investment income on these unrestricted investments.

The change in unrealized gain/(loss) was \$130,546 and \$(1,008,162) in 2016 and 2015, respectively.

For the years ended June 30, 2016 and 2015, the Board approved a 5.25% and 5.50% 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, 2016 Total</u>	<u>June 30, 2015 Total</u>
Interest and dividends (net of fees of \$62,922 and \$68,875, respectively)	\$ 301,535	\$ -	\$ 301,535	\$ 358,544
Net realized and unrealized (losses) gains	<u>(496,829)</u>	<u>170,436</u>	<u>(326,393)</u>	<u>(347,316)</u>
Return on long-term investments	(195,294)	170,436	(24,858)	11,228
Investment return designated for current operations	<u>626,688</u>	<u>170,436</u>	<u>797,124</u>	<u>801,000</u>
Investment return in excess of amounts designated for current operations	<u>\$ (821,982)</u>	<u>\$ -</u>	<u>\$ (821,982)</u>	<u>\$ (789,772)</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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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 Academy 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, 2016 and 2015 are as follows:

	2016			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Investments</b>				
Money Market Funds	\$ 1,433,589	\$ -	\$ -	\$ 1,433,589
Common Stocks	25,027,573	-	-	25,027,573
Corporate Bonds	-	77,200	-	77,200
Mutual Funds	<u>14,929,413</u>	<u>-</u>	<u>-</u>	<u>14,929,413</u>
	<u>\$ 41,390,575</u>	<u>\$ 77,200</u>	<u>\$ -</u>	41,467,775
Alternative Investments reported at Net Asset Value				<u>1,060,599</u>
				<u>\$ 42,528,374</u>
Beneficial Interest in Perpetual Trust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,581,254</u>	<u>\$ 9,581,254</u>
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ (810,100)</u>	<u>\$ -</u>	<u>\$ (810,100)</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

	<b>2015</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>Investments</b>				
Money Market Funds	\$ 5,211,886	\$ -	\$ -	\$ 5,211,886
Common Stocks	19,005,999	-	-	19,005,999
Corporate Bonds	-	81,126	-	81,126
Mutual Funds	15,612,358	-	-	15,612,358
	<u>\$ 39,830,243</u>	<u>\$ 81,126</u>	<u>\$ -</u>	39,911,369
Alternative Investments reported at Net Asset Value				<u>239,657</u>
				<u>\$ 40,151,026</u>
Beneficial Interest in Perpetual Trust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,097,617</u>	<u>\$ 10,097,617</u>
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ (379,167)</u>	<u>\$ -</u>	<u>\$ (379,167)</u>

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, 2016 or 2015.

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

	<b>Beneficial Interest In Perpetual Trust</b>	
	<b>2016</b>	<b>2015</b>
Balance, July 1	\$ 10,097,617	\$ 9,833,828
Contribution	-	647,476
Unrealized gains / (losses)	<u>(516,363)</u>	<u>(383,687)</u>
Balance, June 30	<u>\$ 9,581,254</u>	<u>\$ 10,097,617</u>

### (5) PROPERTY, BUILDINGS AND EQUIPMENT

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

	<b>2016</b>	<b>2015</b>
Land, buildings and improvements	\$ 64,429,418	\$ 60,566,464
Furniture, fixtures and equipment	<u>4,517,481</u>	<u>3,720,695</u>
	68,946,899	64,287,159
Less accumulated depreciation	<u>(21,429,229)</u>	<u>(19,728,778)</u>
	47,517,670	44,558,381
Construction in progress	<u>2,237,162</u>	<u>1,486,050</u>
	<u>\$ 49,754,832</u>	<u>\$ 46,044,431</u>



# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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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, 2016, the Academy was unable to determine the extent of any remediation *AROs* that would be required in the future.

Depreciation expense was \$1,700,451 and \$1,602,187 for years ended June 30, 2016 and 2015, respectively.

### (6) BENEFICIAL INTEREST IN PERPETUAL TRUSTS

The beneficial interest in perpetual trusts of \$9,581,254 and \$10,097,617 at June 30, 2016 and 2015, 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.

Six beneficiaries who have a beneficial interest in a trust had filed a motion to the Orphan’s Court of Pennsylvania disputing the beneficial interest of the seventh beneficiary. The Court ruled in favor of the six beneficiaries increasing each of the beneficiaries’ beneficial interest to a 1/6 share in the Trust. The increase in the beneficial interest is reflected as a contribution of beneficial interest in perpetual trusts of \$647,476 during 2015.

### (7) LINE OF CREDIT

On June 1, 2015, the Academy increased its revolving lines of credit from \$7,500,000 to \$10,000,000 to provide additional bridge financing for capital projects. 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, 2017. 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 1.40% (2.10% and 1.85% as of June 30, 2016 and 2015, respectively). Prior to the execution of the lines of credit on June 1, 2015, the interest rate was the J.P. Morgan Chase Guaranty Prime Rate minus 1.25%. At June 30, 2016 and 2015, the outstanding balance on the line of credit was \$5,180,000 and \$580,000, respectively. Interest expense on the lines of credit was \$71,002 and \$65,798 for the years ended June 30, 2016 and 2015, respectively.

### (8) LONG-TERM DEBT

On June 25, 2015, the Academy 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, 2016 And 2015**

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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, 2016 was 1.18%). Interest is paid monthly on the outstanding principal subject to its variable rate which was 0.9960% for the period from issuance, June 25, 2015, to June 30, 2015. Bonds payable of \$20,788,909 as of June 30, 2016 reflects bonds payable of \$21,000,000 net of unamortized deferred financing expenses of \$211,091. 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, the Academy entered into an interest rate swap agreement with the Bryn Mawr Trust Company. The swap agreement requires the Academy 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 \$810,100 and \$379,167 in favor of the bank as of June 30, 2016 and 2015, respectively, and is included in other liabilities in the statement of financial position.

The Academy 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 and 2010 issues, was \$428,207 and \$527,520 for the years ended June 30, 2016 and 2015, respectively.

The remaining balance of deferred financing expense of \$446,984 associated with issuance of the 2010 Bonds was expensed as a loss on refinancing for the year ended June 30, 2015.

Redemption payments required under the Bond Agreements are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2017	\$ -
2018	-
2019	541,000
2020	606,000
2021	621,000
Thereafter	<u>19,232,000</u>
Bond Payable at June 30, 2016	21,000,000
Deferred Financing Expenses	<u>(211,091)</u>
Bond Payable at June 30, 2016, Net	<u>\$ 20,788,909</u>
Bond Payable at June 30, 2015, Gross	\$ 21,000,000
Deferred Financing Fees	<u>(218,909)</u>
Bond Payable at June 30, 2015, Net	<u>\$ 20,781,091</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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### (9) 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, 2016 and 2015, the Academy contributed approximately \$186,000 and \$179,000, 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.

### (10) NET ASSETS

Temporarily restricted net assets at June 30, 2016 and 2015 are available for the following purposes:

	<u>2016</u>	<u>2015</u>
Building fund, net of discount	\$ 25,000	\$ 25,000
Campus Master Plan – Capital Campaign	347,972	1,288,052
Major gifts-time restriction	261,000	11,500
Scholarships	<u>1,088,620</u>	<u>1,250,000</u>
	<u>\$ 1,722,592</u>	<u>\$ 2,574,552</u>

Permanently restricted net assets at June 30, 2016 and 2015 are available for the following purposes:

	<u>2016</u>	<u>2015</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	5,412,954	5,416,176
School – other	1,309,978	1,309,978
Beneficial interest in perpetual trusts	<u>9,581,254</u>	<u>10,097,617</u>
	<u>\$ 25,244,451</u>	<u>\$ 25,764,036</u>

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

Purpose and time restrictions accomplished:

	<u>2016</u>
Acquisition of art	\$ 170,436
Campus Master Plan – Capital Campaign	4,029,053
Major gifts-time restriction	500
Scholarships	<u>161,380</u>
	<u>\$ 4,361,369</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

Endowment net asset composition by type of fund as of June 30, 2016 and 2015:

	<b>2016</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
Donor restricted endowment funds	<u>\$ (1,023,290)</u>	<u>\$ -</u>	<u>\$ 25,244,451</u>	<u>\$ 24,221,161</u>

	<b>2015</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
Donor restricted endowment funds	<u>\$ (221,308)</u>	<u>\$ -</u>	<u>\$ 25,764,036</u>	<u>\$ 25,542,728</u>

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, 2016 and 2015, the Academy had not designated any unrestricted net assets to function as an endowment. However, cumulative losses on the permanently restricted endowment of \$1,023,290 and \$221,308 as of June 30, 2016 and 2015, respectively, were charged to unrestricted net assets.

Changes in endowment net assets for the years ended June 30, 2016 and 2015:

	<b>2016</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
Endowment net assets, beginning of year	\$ (221,308)	\$ -	\$ 25,764,036	\$ 25,542,728
Investment income, net	301,535	-	-	301,535
Realized and unrealized gains	(496,829)	170,436	-	(326,393)
Contributions	-	-	16,778	16,778
Transfer of net assets	20,000	-	(20,000)	-
Endowment income designated for current operations	(626,688)	(170,436)	-	(797,124)
Change in beneficial interest in perpetual trust	<u>-</u>	<u>-</u>	<u>(516,363)</u>	<u>(516,363)</u>
	<u>\$ (1,023,290)</u>	<u>\$ -</u>	<u>\$ 25,244,451</u>	<u>\$ 24,221,161</u>

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

	2015			<u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Endowment net assets, beginning of year	\$ -	\$ 568,464	\$ 25,429,370	\$ 25,997,834
Investment income, net	358,544	-	-	358,544
Realized and unrealized gains	47,148	(394,464)	-	(347,316)
Contributions	-	-	70,877	70,877
Endowment income designated for current operations	(627,000)	(174,000)	-	(801,000)
Contribution of beneficial interest In beneficial interest	-	-	647,476	647,476
Change in beneficial interest in perpetual trust	-	-	(383,687)	(383,687)
	<u>\$ (221,308)</u>	<u>\$ -</u>	<u>\$ 25,764,036</u>	<u>\$ 25,542,728</u>

### (11) 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 \$14,646,000 and \$15,830,000 as of June 30, 2016 and 2015, respectively. The Academy was charged investment fees by the investment company. The fee was approximately for \$63,000 and \$69,000 for the years ended June 30, 2016 and 2015, respectively. In addition, this Trust Company provides a line of credit for the Academy; interest expense during the years ended June 30, 2016 and 2015 for this line of credit was approximately \$71,000 and \$66,000, 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, 2016 and 2015, the balance on the loan, including accrued interest, is \$138,623 and \$154,235, respectively, and is included in other assets in the statement of financial position. Accrued interest income was \$4,388 and \$5,363 for the years ended June 30, 2016 and 2015, 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 approximately \$3,081,000 and \$2,745,000 as of June 30, 2016 and 2015, respectively, in pledges for capital campaign and other purposes from several board members and their foundations.
- ♦ A Board member of the Academy is President of the financial institution which provided the Academy the 2015 Bond debt.

# PENNSYLVANIA ACADEMY OF THE FINE ARTS

## NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2016 And 2015

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### (12) COMMITMENTS AND CONTINGENCIES

#### *OPERATING LEASES*

The Academy leases certain office equipment and student housing apartments under lease agreements which expire at various dates through fiscal year 2021.

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

2017	\$ 547,411
2018	538,920
2019	539,152
2020	59,736
2021	<u>54,758</u>
Total	<u>\$1,739,977</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.

### (13) SUBSEQUENT EVENTS

Subsequent events after the statement of financial position date through the date that the financial statements were available for issuance, October 27, 2016 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.