

PENNSYLVANIA ACADEMY OF THE FINE ARTS

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

JUNE 30, 2017

PENNSYLVANIA ACADEMY OF THE FINE ARTS

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

We have audited the accompanying financial statements of Pennsylvania Academy of the Fine Arts (a nonprofit organization), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities and changes in net assets and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pennsylvania Academy of the Fine Arts as of June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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

Report on Summarized Comparative Information

We have previously audited Pennsylvania Academy of the Fine Arts' 2016 financial statements, and our report dated October 27, 2016, 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, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Tait, Weller & Baker LLP

**Philadelphia, Pennsylvania
October 26, 2017**

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENTS OF FINANCIAL POSITION

June 30, 2017 And 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,506,345	\$ 1,850,001
Accounts receivable, net	211,012	328,095
Prepaid expenses	370,239	447,448
Inventories	117,190	93,018
Pledges receivable (<i>Notes 3 and 11</i>)	<u>2,322,711</u>	<u>2,607,862</u>
Total Current Assets	<u>4,527,497</u>	<u>5,326,424</u>
LONG-TERM ASSETS		
Pledges receivable (<i>Notes 3 and 11</i>)	2,511,689	3,379,382
Other assets (<i>Note 11</i>)	122,036	138,623
Long term investments (<i>Notes 4 and 7</i>)	45,641,008	42,528,374
Property, buildings and equipment (<i>Note 5</i>)	50,810,291	49,754,832
Beneficial interest in perpetual trusts (<i>Notes 4 and 6</i>)	<u>10,057,806</u>	<u>9,581,254</u>
Total Long-Term Assets	<u>109,142,830</u>	<u>105,382,465</u>
Total Assets	<u>\$ 113,670,327</u>	<u>\$ 110,708,889</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Line of credit (<i>Note 7</i>)	\$ 6,230,000	\$ 5,180,000
Accounts payable	954,480	1,022,593
Accrued expenses	729,132	357,803
Deferred revenue	<u>1,082,096</u>	<u>2,200,706</u>
Total Current Liabilities	8,995,708	8,761,102
LONG-TERM LIABILITIES		
Bonds payable (<i>Note 8</i>)	20,796,727	20,788,909
Other liabilities (<i>Notes 4 and 8</i>)	<u>330,211</u>	<u>810,100</u>
Total Liabilities	<u>30,122,646</u>	<u>30,360,111</u>
NET ASSETS		
Unrestricted net assets	56,074,058	53,381,735
Temporarily restricted net assets (<i>Note 10</i>)	1,161,507	1,722,592
Permanently restricted net assets (<i>Note 10</i>)	<u>26,312,116</u>	<u>25,244,451</u>
Total Net Assets	<u>83,547,681</u>	<u>80,348,778</u>
Total Liabilities and Net Assets	<u>\$ 113,670,327</u>	<u>\$ 110,708,889</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

Year Ended June 30, 2017 With Summarized Information For 2016

	2017			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2017	2016
Program Revenues, Support Revenue and Investment Income					
Program Revenue					
Tuition and fees, net of scholarships	\$ 6,735,682	\$ -	\$ -	\$ 6,735,682	\$ 6,684,360
Continuing and public education	800,978	-	-	800,978	827,386
Government grants	233,368	-	-	233,368	180,266
Museum admissions, collection rental and fees	701,048	-	-	701,048	356,405
Museum shop and art supply store, net	180,156	-	-	180,156	160,018
Facility rental and catering	727,518	-	-	727,518	485,717
Women's Board	309,000	-	-	309,000	307,455
Other income	28,108	-	-	28,108	64,791
Total program revenue	9,715,858	-	-	9,715,858	9,066,398
Support Revenue					
Fundraising and support revenues	3,886,739	3,015,608	591,113	7,493,460	6,987,454
Bequests	33,888	-	-	33,888	55,403
Total support revenue	3,920,627	3,015,608	591,113	7,527,348	7,042,857
Investment Income					
Endowment income designated for operations (<i>Note 4</i>)	608,993	152,248	-	761,241	797,124
Income from outside trusts	400,975	-	-	400,975	488,902
Total investment income	1,009,968	152,248	-	1,162,216	1,286,026
Net assets released from restrictions (<i>Note 10</i>)	3,728,941	(3,728,941)	-	-	-
Total operating program, support and investment income	18,375,394	(561,085)	591,113	18,405,422	17,395,281
Program and Support Expenses					
Program Expenses					
School	7,988,305	-	-	7,988,305	7,462,843
Continuing and public education	1,285,049	-	-	1,285,049	1,350,976
Women's Board	79,050	-	-	79,050	77,603
Museum and exhibition	3,273,103	-	-	3,273,103	3,308,181
Total program expenses	12,625,507	-	-	12,625,507	12,199,603
Support Function Expenses					
Management and general	1,979,220	-	-	1,979,220	1,639,938
Facility rental and catering	249,664	-	-	249,664	236,568
Development and fundraising	1,855,676	-	-	1,855,676	1,543,501
	4,084,560	-	-	4,084,560	3,420,007
Total program and support expenses	16,710,067	-	-	16,710,067	15,619,610
Change in net assets before depreciation, gains (losses) and other income (expenses)	1,665,327	(561,085)	591,113	1,695,355	1,775,671
Depreciation and amortization	1,924,804	-	-	1,924,804	1,708,269
Change in net assets before gains (losses) and other income (expenses)	(259,477)	(561,085)	591,113	(229,449)	67,402

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, 2017 With Summarized Information For 2016

	2017			Total	
	Unrestricted	Temporarily Restricted	Permanently Restricted	2017	2016
Gains (Losses) and Other Income (Expenses)					
Investment return in excess (deficit) of amount designated for current operations (Notes 4 and 10)	810,095	-	-	810,095	(821,982)
Other investment income (Note 4)	3,277,678	-	-	3,277,678	103,188
Change in beneficial interest in perpetual trusts (Notes 4 and 10)	-	-	476,552	476,552	(516,363)
Change in market value of interest rate swap (Note 8)	479,889	-	-	479,889	(430,933)
Proceeds from art sales	-	-	-	-	250,000
Collection items purchased but not capitalized	(1,615,862)	-	-	(1,615,862)	(1,896,861)
Total non-operating revenue, expenses and gain (losses)	<u>2,951,800</u>	<u>-</u>	<u>476,552</u>	<u>3,428,352</u>	<u>(3,312,951)</u>
Change in net assets	2,692,323	(561,085)	1,067,665	3,198,903	(3,245,549)
Net Assets					
Beginning of year	<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>
End of year	<u>\$ 56,074,058</u>	<u>\$ 1,161,507</u>	<u>\$ 26,312,116</u>	<u>\$ 83,547,681</u>	<u>\$ 80,348,778</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2017 And 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 3,198,903	\$ (3,245,549)
Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities		
Depreciation expense	1,916,986	1,700,451
Net unrealized appreciation on long-term investments	(4,048,462)	(130,546)
Net realized (gains) losses on long-term investments	(278,735)	632,159
Net unrealized (appreciation) depreciation on outside perpetual trusts	(476,552)	516,363
Accrued interest earned on note receivable	(3,413)	(4,388)
Forgiveness of note receivable	20,000	20,000
Change in market value of swap	(479,889)	430,933
Amortization of deferred bond cost	7,818	7,818
(Increase) decrease in assets		
Accounts receivable	117,083	(97,237)
Inventories	(24,172)	2,334
Pledges receivable	1,152,843	(1,147,014)
Prepaid expenses and other assets	77,209	96,677
Increase (decrease) in liabilities		
Accounts payable	(68,113)	(445,979)
Accrued expenses	371,329	92,825
Deferred revenue	<u>(1,118,609)</u>	<u>939,996</u>
Net cash provided by (used for) operating activities	<u>364,226</u>	<u>(631,157)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(2,972,445)	(5,410,852)
Purchases of long-term investments	(3,001,943)	(7,859,741)
Proceeds from sale of long-term investments	<u>4,216,506</u>	<u>4,980,780</u>
Net cash used for investing activities	<u>(1,757,882)</u>	<u>(8,289,813)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from line of credit	<u>1,050,000</u>	<u>4,600,000</u>
Net cash provided by financing activities	<u>1,050,000</u>	<u>4,600,000</u>
Net decrease in cash and cash equivalents	(343,656)	(4,320,970)
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>1,850,001</u>	<u>6,170,971</u>
End of year	<u>\$ 1,506,345</u>	<u>\$ 1,850,001</u>
SUPPLEMENTAL INFORMATION		
Cash paid for interest	<u>\$ 575,068</u>	<u>\$ 470,357</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS

June 30, 2017 And 2016

(1) NATURE OF ORGANIZATION

The Pennsylvania Academy of the Fine Arts (“*PAFA*”) is the first and oldest American art school and museum in the United States. PAFA’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 PAFA are described below.

BASIS OF PRESENTATION

CASH EQUIVALENTS

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

CONCENTRATION OF CREDIT RISK

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

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

USE OF ESTIMATES

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

INVESTMENTS

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

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

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

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

WORKS OF ART

PAFA maintains a collection of rare American art that is held for public exhibition. The collection is kept under curatorial care and is subject to PAFA's policy that requires the proceeds from the sales of accessioned collection items to be used only to acquire other items for collection. PAFA does not recognize the contributions of donated collection items, as its collections are not capitalized. During the year ended June 30, 2017 and 2016, PAFA had donated accessions with approximate appraised values totaling \$610,500 and \$357,300, respectively. Collection items purchased but not capitalized totaled \$1,615,862 and \$1,896,861 during the years ended June 30, 2017 and 2016, respectively. In addition, PAFA received \$250,000 for the sale of art works during the year ended June 30, 2016.

INCOME TAXES

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

PAFA has reviewed its tax positions and has concluded that no liability for unrecognized tax benefits should be recorded related to uncertain tax positions taken on federal and state tax returns for the open tax years (2013 – 2015) or is expected to be taken in the current 2016 tax year.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

NET ASSETS

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

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

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

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

CONTRIBUTIONS

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

PAFA reports contributions of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as *"net assets released from restrictions."*

ALLOCATION OF FUNCTIONAL EXPENSES

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

PRIOR YEAR INFORMATION

The financial statements include certain prior-year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with PAFA's financial statements for the year ended June 30, 2016, from which the summarized information was derived.

RECLASSIFICATION

Certain account balances in the 2016 financial statements have been reclassified to conform to the 2017 financial statement presentation.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

(3) PLEDGES RECEIVABLE

Pledges receivable consist of the following at June 30:

	<u>2017</u>	<u>2016</u>
Capital Campaign pledges receivable	\$ 3,358,371	\$ 3,967,432
Major Gifts pledges receivable	1,126,029	2,019,812
Endowment pledge receivable	<u>350,000</u>	<u>-</u>
Total pledges receivable	4,834,400	5,987,244
Less: current portion	<u>(2,322,711)</u>	<u>(2,607,862)</u>
Pledges receivable – long-term	<u>\$ 2,511,689</u>	<u>\$ 3,379,382</u>

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

	<u>2017</u>	<u>2016</u>
Pledges receivable Capital Campaign:		
Past due and due within a year	\$ 1,670,871	\$ 1,605,741
Due between one and five years	<u>1,814,845</u>	<u>2,526,000</u>
Pledges receivable, gross	3,485,716	4,131,741
Less allowance for uncollectibles and discount	<u>(127,345)</u>	<u>(164,309)</u>
Pledges receivable Capital Campaign, net	<u>\$ 3,358,371</u>	<u>\$ 3,967,432</u>
Pledges receivable Major Gifts:		
Due within a year	\$ 678,438	\$ 1,167,090
Due between one and three years	<u>540,000</u>	<u>925,000</u>
Pledges receivable, gross	1,218,438	2,092,090
Less allowance for uncollectibles and discount	<u>(92,409)</u>	<u>(72,278)</u>
Pledges receivable Major Gifts, net	<u>\$ 1,126,029</u>	<u>\$ 2,019,812</u>
Pledges receivable Endowment:		
Due within a year	\$ 150,000	\$ -
Due between one and two years	<u>200,000</u>	<u>-</u>
Pledges receivable, gross	350,000	-
Less allowance for uncollectibles and discount	<u>-</u>	<u>-</u>
Pledges receivable Endowment, net	<u>\$ 350,000</u>	<u>\$ -</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

(4) INVESTMENTS

Investments consist of the following at June 30:

	2017			
	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Money Market Funds	\$ 791,799	\$ -	\$ -	\$ 791,799
Common Stocks	14,661,453	4,659,493	-	19,320,946
Mutual Funds	22,690,241	1,758,411	-	24,448,652
Pooled Investment Fund/Hedge Fund	<u>953,671</u>	<u>125,940</u>	<u>-</u>	<u>1,079,611</u>
	<u>\$ 39,097,164</u>	<u>\$ 6,543,844</u>	<u>\$ -</u>	<u>\$ 45,641,008</u>

	2016			
	<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	15,547,129	2,406,663	-	17,953,792
Corporate Bonds	75,981	1,219	-	77,200
Mutual Funds	21,988,606	14,588	-	22,003,194
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>

PAFA has a hedge fund investment, BBH Wealth Strategies, LLC REMS Group Series, of \$1,079,611 and \$1,060,599 as of June 30, 2017 and 2016, 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, 2017, PAFA has no outstanding commitment for further investment into this Series. Investors of the Series are eligible for redemptions at month-end with 30 days prior notification.

Investments as of June 30, 2017 and 2016, include unrestricted investments of \$30,004,792 and \$27,881,978, respectively, which are invested separately from those investments for the permanently restricted endowment. Other investment income of \$3,277,677 and \$103,188 for the years ended June 30, 2017 and 2016, respectively, represents the net investment income on these unrestricted investments.

The change in unrealized gain was \$4,048,462 and \$130,546 in 2017 and 2016, respectively.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

For the years ended June 30, 2017 and 2016, the Board approved a 5% and 5.25% 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, 2017 Total</u>	<u>June 30, 2016 Total</u>
Interest and dividends (net of fees of \$65,990 and \$62,922, respectively)	\$ 321,417	\$ -	\$ 321,417	\$ 301,535
Net realized and unrealized (losses) gains	<u>1,097,671</u>	<u>152,248</u>	<u>1,249,919</u>	<u>(326,393)</u>
Return on long-term investments	1,419,088	152,248	1,571,336	(24,858)
Investment return designated for current operations	<u>608,993</u>	<u>152,248</u>	<u>761,241</u>	<u>797,124</u>
Investment return in excess (deficit) of amounts designated for current operations	<u>\$ 810,095</u>	<u>\$ -</u>	<u>\$ 810,095</u>	<u>\$(821,982)</u>

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

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

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

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

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

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

The summary of inputs used to value PAFA’s assets and liabilities that are carried at fair value as of June 30, 2017 and 2016 are as follows:

	2017			Total
	Level 1	Level 2	Level 3	
Investments				
Money Market Funds	\$ 791,799	\$ -	\$ -	\$ 791,799
Common Stocks	19,320,946	-	-	19,320,946
Mutual Funds	<u>24,448,652</u>	<u>-</u>	<u>-</u>	<u>24,448,652</u>
	<u>\$ 44,561,397</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 44,561,397</u>
Alternative Investments reported at Net Asset Value				<u>1,079,611</u>
				<u>\$ 45,641,008</u>
Beneficial Interest in Perpetual Trust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,057,806</u>	<u>\$ 10,057,806</u>
Interest Rate Swap Obligation	<u>\$ -</u>	<u>\$ (330,211)</u>	<u>\$ -</u>	<u>\$ (330,211)</u>
	2016			
	Level 1	Level 2	Level 3	Total
Investments				
Money Market Funds	\$ 1,433,589	\$ -	\$ -	\$ 1,433,589
Common Stocks	17,953,792	-	-	17,953,792
Corporate Bonds	-	77,200	-	77,200
Mutual Funds	<u>22,003,194</u>	<u>-</u>	<u>-</u>	<u>22,003,194</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>

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, 2017 or 2016.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

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

	Beneficial Interest In Perpetual Trust	
	<u>2017</u>	<u>2016</u>
Balance, July 1	\$ 9,581,254	\$ 10,097,617
Unrealized gains / (losses)	<u>476,552</u>	<u>(516,363)</u>
Balance, June 30	<u>\$ 10,057,806</u>	<u>\$ 9,581,254</u>

(5) PROPERTY, BUILDINGS AND EQUIPMENT

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

	<u>2017</u>	<u>2016</u>
Land, buildings and improvements	\$ 68,410,257	\$ 64,429,418
Furniture, fixtures and equipment	<u>4,871,687</u>	<u>4,517,481</u>
	73,281,944	68,946,899
Less accumulated depreciation	<u>(23,346,215)</u>	<u>(21,429,229)</u>
	49,935,729	47,517,670
Construction in progress	<u>874,562</u>	<u>2,237,162</u>
	<u>\$ 50,810,291</u>	<u>\$ 49,754,832</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, 2017, PAFA was unable to determine the extent of any remediation AROs that would be required in the future.

Depreciation expense was \$1,916,986 and \$1,700,451 for years ended June 30, 2017 and 2016, respectively.

(6) BENEFICIAL INTEREST IN PERPETUAL TRUSTS

The beneficial interest in perpetual trusts of \$10,057,806 and \$9,581,254 at June 30, 2017 and 2016, respectively, includes PAFA’s respective share of the fair value of the total funds held in trust by others for which PAFA is the recipient of all or a percentage of the income.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

(7) LINE OF CREDIT

PAFA has two revolving lines of credit for \$10,000,000. The lines of credit, \$7,500,000 for capital projects and \$2,500,000 for working capital, are collateralized by certain marketable securities held by a financial institution and expire July 31, 2019. Interest on the line of credit is payable on a monthly basis at a variable percentage based upon the J.P. Morgan Chase Guaranty Prime Rate minus 1.40% (2.85% and 2.10% as of June 30, 2017 and 2016, respectively). At June 30, 2017 and 2016, the outstanding balance on the line of credit was \$6,230,000 and \$5,180,000, respectively. Interest expense on the lines of credit was \$128,508 and \$71,002 for the years ended June 30, 2017 and 2016, respectively.

(8) LONG-TERM DEBT

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

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, 2017 and 2016 was 1.58% and 1.18%, respectively). Interest is paid monthly on the outstanding principal. Bonds payable of \$20,796,727 and \$20,788,909 as of June 30, 2017 and 2016 reflects bonds payable of \$21,000,000 net of unamortized deferred financing expenses of \$203,273 and \$211,091, respectively. Deferred financing expenses are being amortized on a straight-line basis over the life of the Bonds.

In connection with the issuance of the 2015 Bonds, PAFA entered into an interest rate swap agreement with the Bryn Mawr Trust Company. The swap agreement requires PAFA to pay a fixed interest rate of 2.62% on a notional balance of \$12,600,000 while receiving a variable interest rate equal to the rate paid for the Bond. The purpose of the swap agreement is to hedge against increases in the variable interest rates on the 2015 Bonds. The market value of the swap was \$330,211 and \$810,100 in favor of the bank as of June 30, 2017 and 2016, respectively, and is included in other liabilities in the statement of financial position.

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

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

Total interest expense on the tax exempt bonds, 2015 issue, was \$449,346 and \$428,207 for the years ended June 30, 2017 and 2016, respectively.

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

Redemption payments required under the Bond Agreements are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2018	\$ -
2019	541,000
2020	606,000
2021	621,000
2022	640,000
Thereafter	<u>18,592,000</u>
Bond Payable at June 30, 2017	21,000,000
Deferred Financing Expenses	<u>(203,273)</u>
Bond Payable at June 30, 2017, Net	<u>\$ 20,796,727</u>
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>

(9) RETIREMENT PLANS

PAFA has a defined contribution plan covering employees over the age of 21 who work 1,000 hours or more in a calendar year. Under this plan, employees can contribute to the plan immediately, not to exceed the limits imposed by IRC 402(g). Effective after ninety days of employment, PAFA matches up to 4% for each employee contribution. During the years ended June 30, 2017 and 2016, PAFA contributed approximately \$191,000 and \$186,000, respectively, to the plan.

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

(10) NET ASSETS

Temporarily restricted net assets at June 30, 2017 and 2016 are available for the following purposes:

	<u>2017</u>	<u>2016</u>
Building fund	\$ 25,000	\$ 25,000
Campus Master Plan – Capital Campaign, net of discount	127,835	347,972
Major gifts-time restriction	211,000	261,000
Scholarships	<u>797,672</u>	<u>1,088,620</u>
	<u>\$1,161,507</u>	<u>\$1,722,592</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

Permanently restricted net assets at June 30, 2017 and 2016 are available for the following purposes:

	<u>2017</u>	<u>2016</u>
Operations	\$ 5,064,406	\$ 4,664,406
Art acquisitions and conservation	3,349,691	3,349,691
Museum operations	926,168	926,168
School scholarships and prizes	5,604,065	5,412,954
School – other	1,309,979	1,309,978
Beneficial interest in perpetual trusts	<u>10,057,807</u>	<u>9,581,254</u>
	<u>\$ 26,312,116</u>	<u>\$ 25,244,451</u>

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

Purpose and time restrictions accomplished:

	<u>2017</u>
Acquisition of art	\$ 152,248
Campus Master Plan – Capital Campaign	3,193,650
Major gifts-time restriction	92,095
Scholarships	<u>290,948</u>
	<u>\$ 3,728,941</u>

Endowment net asset composition by type of fund as of June 30, 2017 and 2016:

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

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

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

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

As of June 30, 2017 and 2016, PAFA had not designated any unrestricted net assets to function as an endowment. However, cumulative losses on the permanently restricted endowment of \$213,195 and \$1,023,290 as of June 30, 2017 and 2016, respectively, were charged to unrestricted net assets.

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

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

	2016			Total
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
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	-	-	(516,363)	(516,363)
	<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, 2017 And 2016

(11) RELATED PARTY TRANSACTIONS

PAFA had the following related party transactions:

- ♦ PAFA uses the services of a Trust Company where three Board members are paid Directors. Assets under management with this investment company totaled approximately \$15,636,000 and \$14,646,000 as of June 30, 2017 and 2016, respectively. PAFA was charged investment fees by the investment company. The fee was approximately for \$66,000 and \$63,000 for the years ended June 30, 2017 and 2016, respectively. In addition, this Trust Company provides a line of credit for PAFA; interest expense during the years ended June 30, 2017 and 2016 for this line of credit was approximately \$128,500 and \$71,000, respectively.
- ♦ PAFA has an employment agreement with its President whereby PAFA paid \$200,000 during fiscal year 2009 to assist in acquiring a residence. As of June 30, 2017 and 2016, the balance on the note receivable for purchase of this residence, including accrued interest, is \$122,036 and \$138,623, respectively, and is included in other assets in the statement of financial position. PAFA has an equity interest in the property. During 2017, PAFA used unrestricted net assets to reimburse the endowment for the outstanding balance on the note receivable. In prior years, the note receivable was treated as an asset of the endowment. Accrued interest income was \$3,413 and \$4,388 for the years ended June 30, 2017 and 2016, respectively.
- ♦ PAFA receives the income from a beneficial trust held by a third party, of which one of the Trustees of that beneficial trust is a Board member of PAFA.
- ♦ PAFA has approximately \$2,691,000 and \$3,081,000 as of June 30, 2017 and 2016, respectively, in pledges for capital campaign and other purposes from several board members and their foundations.
- ♦ A Board member of PAFA is President of the financial institution which provided PAFA the 2015 Bond debt.

(12) COMMITMENTS AND CONTINGENCIES

OPERATING LEASES

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

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

2018	\$ 538,920
2019	539,152
2020	59,736
2021	<u>54,758</u>
Total	<u>\$1,192,566</u>

PENNSYLVANIA ACADEMY OF THE FINE ARTS

NOTES TO FINANCIAL STATEMENTS – (Continued)

June 30, 2017 And 2016

LITIGATION

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

GRANTS

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

(13) SUBSEQUENT EVENTS

Subsequent events after the statement of financial position date through the date that the financial statements were available for issuance, October 26, 2017 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.