

# AMERICAN FOLK ART MUSEUM



## **Financial Statements (Together with Independent Auditors' Report)**

**Years Ended June 30, 2018 and 2017**

**M A R K S P A N E T H**

ACCOUNTANTS & ADVISORS

**AMERICAN FOLK ART MUSEUM**

**FINANCIAL STATEMENTS**  
**(Together with Independent Auditors' Report)**

**YEARS ENDED JUNE 30, 2018 AND 2017**

**CONTENTS**

	<b><u>Page</u></b>
Independent Auditors' Report .....	1
Statements of Financial Position.....	2
Statements of Activities .....	3
Statements of Cash Flows .....	4
Notes to Financial Statements .....	5-14

## INDEPENDENT AUDITORS' REPORT

The Board of Trustees of  
the American Folk Art Museum

We have audited the accompanying financial statements of the American Folk Art Museum (the "Museum") which comprise the statements of financial position as of June 30, 2018 and 2017, and the related statements of activities and cash flows for the years 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.

### Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 the American Folk Art Museum as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Marks Paneth LLP*

New York, NY  
April 16, 2019

**AMERICAN FOLK ART MUSEUM  
STATEMENTS OF FINANCIAL POSITION  
AS OF JUNE 30, 2018 AND 2017**

	<u>2018</u>	<u>Restated 2017</u>
<b>ASSETS</b>		
Cash and cash equivalents (Note 2E)	\$ 97,471	\$ 129,960
Accounts and government grants receivable (Note 2G)	103,188	86,101
Pledges receivable, net (Notes 2G and 4)	1,331,695	2,452,568
Investments (Notes 2F and 5)	6,774,109	6,337,332
Prepaid expenses and other assets (Note 2K)	356,682	244,255
Property and equipment, net (Notes 2D and 3)	875,442	935,978
Bequest held in perpetual trust - permanently restricted (Notes 5 and 10)	970,041	946,082
Collections (Note 2C)	-	-
	<u>          </u>	<u>          </u>
<b>TOTAL ASSETS</b>	<u>\$ 10,508,628</u>	<u>\$ 11,132,276</u>
 <b>LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 103,857	\$ 182,377
Accrued salaries and vacation	62,725	64,864
Deferred rent (Note 2M)	105,229	102,609
	<u>          </u>	<u>          </u>
<b>TOTAL LIABILITIES</b>	<u>271,811</u>	<u>349,850</u>
 <b>COMMITMENTS AND CONTINGENCIES</b> (Note 8)		
 <b>NET ASSETS</b> (Note 2B)		
Unrestricted:		
Investment in property and equipment	875,442	935,978
Net (deficit) assets available for operations (Note 11)	(63,505)	164,050
Total unrestricted	<u>811,937</u>	<u>1,100,028</u>
Temporarily restricted (Note 10)	4,404,187	4,740,664
Permanently restricted (Note 10)	<u>5,020,693</u>	<u>4,941,734</u>
	<u>          </u>	<u>          </u>
<b>TOTAL NET ASSETS</b>	<u>10,236,817</u>	<u>10,782,426</u>
 <b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 10,508,628</u>	<u>\$ 11,132,276</u>

**AMERICAN FOLK ART MUSEUM  
STATEMENTS OF ACTIVITIES  
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017**

	For the Year Ended June 30, 2018				For the Year Ended June 30, 2017 (Restated)			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2018	Total 2017	Unrestricted	Temporarily Restricted	Permanently Restricted
<b>OPERATING REVENUE, SUPPORT AND OTHER:</b>								
Contributions and membership (Note 2I)	\$ 1,171,118	\$ 10,000	\$ -	\$ 1,181,118	\$ 1,614,944	\$ 1,107,444	\$ 507,500	\$ -
Support from foundations and corporations	288,962	350,000	-	638,962	435,660	249,000	186,660	-
Special events and benefits, net of direct expense of \$105,689 in 2018 and \$128,287 in 2017 (Note 2O)	595,643	-	-	595,643	555,409	555,409	-	-
Museum's 5% spending policy (Note 2F)	294,310	-	-	294,310	271,369	271,369	-	-
Government support	173,101	199,500	-	372,601	365,750	331,750	34,000	-
Auxiliary activities (Note 6)	1,047,650	-	-	1,047,650	978,698	978,698	-	-
Other income	97,210	-	-	97,210	117,822	117,822	-	-
Net assets released from restrictions (Note 10)	986,366	(986,366)	-	-	-	608,185	(608,185)	-
<b>TOTAL OPERATING REVENUE, SUPPORT AND OTHER</b>	<b>4,654,360</b>	<b>(426,866)</b>	<b>-</b>	<b>4,227,494</b>	<b>4,339,652</b>	<b>4,219,677</b>	<b>119,975</b>	<b>-</b>
<b>OPERATING EXPENSES (Note 2O):</b>								
Programs (Note 7)	2,815,995	-	-	2,815,995	2,750,880	2,750,880	-	-
Auxiliary activities (Note 6)	855,205	-	-	855,205	849,367	849,367	-	-
Management and general	533,612	-	-	533,612	548,414	548,414	-	-
Fundraising	674,092	-	-	674,092	727,463	727,463	-	-
<b>TOTAL OPERATING EXPENSES</b>	<b>4,878,904</b>	<b>-</b>	<b>-</b>	<b>4,878,904</b>	<b>4,876,124</b>	<b>4,876,124</b>	<b>-</b>	<b>-</b>
<b>CHANGE IN NET ASSETS FROM OPERATIONS</b>	<b>(224,544)</b>	<b>(426,866)</b>	<b>-</b>	<b>(651,410)</b>	<b>(536,472)</b>	<b>(656,447)</b>	<b>119,975</b>	<b>-</b>
<b>NON-OPERATING REVENUE, (EXPENSES) AND OTHER (Note 2P):</b>								
Permanently restricted contributions and other revenue	-	-	55,000	55,000	35,000	-	-	35,000
Purchases of artwork (Note 2C)	(8,750)	-	-	(8,750)	(2,770)	(2,770)	-	-
Net assets released from restrictions for purchases of artwork	-	-	-	-	2,500	2,500	-	-
Investment activity, net (Note 5)	184,446	293,889	23,959	502,294	767,910	226,275	498,533	43,102
Investment activity from Board appropriation of temporarily restricted earnings (Note 10)	203,500	(203,500)	-	-	-	157,300	(157,300)	-
Museum's 5% spending policy (Note 2F)	(294,310)	-	-	(294,310)	(271,369)	(271,369)	-	-
Depreciation and amortization	(148,433)	-	-	(148,433)	(142,897)	(142,897)	-	-
<b>TOTAL NON-OPERATING REVENUE, (EXPENSES) AND OTHER</b>	<b>(63,547)</b>	<b>90,389</b>	<b>78,959</b>	<b>105,801</b>	<b>388,374</b>	<b>(30,961)</b>	<b>341,233</b>	<b>78,102</b>
<b>CHANGE IN NET ASSETS</b>	<b>(288,091)</b>	<b>(336,477)</b>	<b>78,959</b>	<b>(545,609)</b>	<b>(148,098)</b>	<b>(687,408)</b>	<b>461,208</b>	<b>78,102</b>
<b>Net assets - beginning of year, before prior period adjustments</b>	<b>1,100,028</b>	<b>4,740,664</b>	<b>4,941,734</b>	<b>10,782,426</b>	<b>10,455,524</b>	<b>1,762,436</b>	<b>3,829,456</b>	<b>4,863,632</b>
<b>Prior period adjustments (Note 12)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>475,000</b>	<b>25,000</b>	<b>450,000</b>	<b>-</b>
<b>Net assets - beginning of year, as restated</b>	<b>1,100,028</b>	<b>4,740,664</b>	<b>4,941,734</b>	<b>10,782,426</b>	<b>10,930,524</b>	<b>1,787,436</b>	<b>4,279,456</b>	<b>4,863,632</b>
<b>NET ASSETS - END OF YEAR</b>	<b>\$ 811,937</b>	<b>\$ 4,404,187</b>	<b>\$ 5,020,693</b>	<b>\$ 10,236,817</b>	<b>\$ 10,782,426</b>	<b>\$ 1,100,028</b>	<b>\$ 4,740,664</b>	<b>\$ 4,941,734</b>

The accompanying notes are an integral part of these financial statements.

**AMERICAN FOLK ART MUSEUM  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017**

	<u>2018</u>	<u>Restated 2017</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$ (545,609)	\$ 326,902
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	148,433	142,897
Change in value of bequest	(23,959)	(43,102)
Realized loss (gain) on investment	553	(30)
Unrealized gains on investment	(304,152)	(611,478)
Permanently restricted contributions	<u>(55,000)</u>	<u>(35,000)</u>
Subtotal	(779,734)	(219,811)
Changes in operating assets and liabilities:		
(Increase) decrease in assets:		
Accounts and government grants receivable	(17,087)	77,211
Prepaid expenses and other assets	(112,427)	131,638
Pledges receivable	1,120,873	337,671
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(78,520)	(14,399)
Deferred rent	2,620	7,405
Deferred revenue	-	(1,285)
Accrued salaries and vacation	<u>(2,139)</u>	<u>5,827</u>
<b>Net Cash Provided by Operating Activities</b>	<u>133,586</u>	<u>324,257</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Property and equipment acquisitions	(87,897)	(12,500)
Purchase of investments	(349,862)	(1,554,486)
Proceeds from the sale of investments	<u>216,684</u>	<u>1,060,296</u>
<b>Net Cash Used in Investing Activities</b>	<u>(221,075)</u>	<u>(506,690)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Permanently restricted contributions	<u>55,000</u>	<u>35,000</u>
<b>Net Cash Provided by Financing Activities</b>	<u>55,000</u>	<u>35,000</u>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	(32,489)	(147,433)
Cash and cash equivalents - beginning of year	<u>129,960</u>	<u>277,393</u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<u>\$ 97,471</u>	<u>\$ 129,960</u>

The accompanying notes are an integral part of these financial statements.

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES**

The American Folk Art Museum (the "Museum") was founded in 1961 and is organized under the New York State Education Department. The Museum has been granted exemption as an educational institution from federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code.

The Museum is devoted principally to preserving and interpreting the rich and diverse folk art heritage of the United States through the development of a permanent collection and the presentation of exhibitions, educational programs, special events and publications of the highest quality. Recognizing that American folk art can be best understood in a global context, the Museum also presents programs related to folk art and related traditions from elsewhere in the world.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. *Basis of Presentation***

The Museum's financial statements have been prepared on the accrual basis of accounting. The Museum adheres to accounting principles generally accepted in the United States of America ("U.S. GAAP").

**B. *Net Assets Presentation***

The Museum's net assets and revenues, gains, and losses are classified based on the existence or absence of donor imposed restrictions. Accordingly, the net assets of the Museum and changes therein are classified and reported as follows:

- Unrestricted – represents resources available for support of the Museum's operations over which the Board of Trustees (the "Board") has discretionary control.
- Temporarily restricted net assets – Net assets subject to donor imposed stipulations that will be met either by actions of the Museum or the passage of time, and also the unappropriated endowment earnings.
- Permanently restricted – represents assets that must remain intact in perpetuity.

Revenues are reported as increases in unrestricted net assets unless their use is limited by donor imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as net assets released from restrictions.

**C. *Accounting for Collections***

The Museum is dedicated to preserving the rich folk art heritage of America through the presentation of exhibitions, educational programs, and publications of the highest quality. Works of folk art from the Museum's permanent collection are displayed in the Museum facility. Temporary exhibitions, featuring objects from the permanent collection, as well as from important museum and private collections across the country, are organized for presentation at the Museum. The collections are maintained for public exhibition, education and research in furtherance of public service, rather than for financial gain. Each of the items is catalogued, preserved, and cared for, and activities verifying their existence and assessing their condition are performed periodically.

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

In conformity with accounting policies generally followed by art museums, the collections, which were acquired through purchases and contributions since the Museum's inception, are not recognized as assets. Purchases of collection items are recorded as decreases in unrestricted net assets in the year in which the items are acquired. Proceeds from de-accessions or insurance recoveries are reflected as increases in unrestricted net assets. Proceeds from the sale of collections are used to acquire other items for collections.

Purchases of collection items in the amount of \$8,750 and \$2,770 were made during the years ended June 30, 2018 and 2017, respectively, and are included in program expenses in the accompanying statements of activities.

**D. *Property and Equipment***

The Museum records property and equipment at cost less accumulated depreciation and amortization. These amounts do not purport to be at fair value. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of their useful life or the term of the applicable lease. Assets with a useful life greater than one year and a cost of \$5,000 or more are capitalized by the Museum.

**E. *Cash Equivalents***

The Museum considers all highly liquid instruments purchased with original maturities of 90 days or less to be cash equivalents. Certain cash equivalents held in the investment portfolio are classified as investments in the statements of financial position.

**F. *Investments and Investment Income***

Investments are stated at fair value. Fair value measurements are based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, a fair value hierarchy prioritizes observable and unobservable inputs used to measure fair value into three levels, as described in Note 5. The fair value of alternative investments is based upon values provided by the investment manager, which are reviewed for reasonableness by management. Investment transactions are accounted for on the date the investments are purchased or sold (trade date).

Realized gains and losses are determined as the difference between the sales proceeds of an investment and the cost. Unrealized gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Interest income and dividend income are recorded as earned. The Museum has a spending policy of up to 5% of the fair value of the investments over a trailing period of three years. The amount up to 5% is allotted to operations.

**G. *Allowance for Doubtful Accounts and Pledges Receivable***

The Museum's allowance for doubtful accounts for: pledges, accounts receivable and government grants receivable is based on management's estimates of the creditworthiness of its contributors, current economic conditions and historical information. The allowance for doubtful pledges amounted to \$10,000 as of June 30, 2018 and 2017. There was no allowance for accounts and government grants receivable as of June 30, 2018 and 2017. Pledges that are expected to be collected in future years are computed using risk-adjusted interest rates applicable to the years in which the pledges are received unless such discount is immaterial.

The Museum received conditional pledges that are not recognized as income since the conditions were not met. Such conditional pledges amounted to \$500,000 as of June 30, 2018 and 2017. As of June 30, 2018, the conditions have not been met.



**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**H. *Donated Goods and Services***

A number of unpaid volunteers have made significant contributions of their time in furtherance of the Museum's programs covering most phases of the Museum's activities, except maintenance and art handling. Volunteers provide administrative assistance in various areas of the Museum and support the visitor information desk. The Museum does not reflect the value of such services since they do not meet the criteria for recognition. In addition, the Museum's Lincoln Square gallery license provides for a nominal annual fee. The fair rental value of the space is not recorded as income and expense.

**I. *Membership Dues***

Membership dues for individual membership categories are recognized as revenue in the year in which they are earned.

**J. *Traveling Exhibitions***

Revenue fees for traveling exhibitions are recognized as income when the exhibition opens. Amounts received in advance are considered deferred revenue.

**K. *Inventory***

Inventory amounted to \$164,540 and \$129,979 as of June 30, 2018 and 2017, respectively. Such amounts are included in prepaid expenses and other assets in the accompanying financial statements. Inventory consists primarily of goods sold at the Museum's shop. Such inventories are carried at the lower of cost or market.

**L. *Bequests and Other***

The Museum recognizes bequests when the cash or donated assets are received. Donated noncash assets are recorded at fair value in the period received.

**M. *Deferred Rent***

The Museum records rent expense for operating leases with scheduled rent increases on a straight-line basis over the term of the lease with the difference between the expense and rental payments recorded as an increase or decrease to the deferred rent liability on the statements of financial position.

**N. *Reclassifications***

Certain line items in the June 30, 2017 financial statements have been reclassified to conform to the June 30, 2018 presentation. These changes had no impact on the change in net assets for the year ended June 30, 2017.

**AMERICAN FOLK ART MUSEUM**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2018 AND 2017**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**O. Expenses**

The Museum reflects depreciation and amortization expenses and certain non-recurring expenses separately in its statements of activities. Under U.S GAAP, such expenses must be allocated to the appropriate functional expenses. Accordingly, the Museum's functional expenses consists of the following for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Programs	\$ 2,973,178	\$ 2,896,547
Auxiliary activities	855,205	849,367
Management and general	533,612	548,414
Fundraising	<u>674,092</u>	<u>727,463</u>
	<u>\$ 5,036,087</u>	<u>\$ 5,021,791</u>

Certain costs in the above functional expenses have been allocated among the program and supporting services benefited. In addition, the direct costs of special events include expenses for the benefit of the donor. For example, meals and facilities rental are considered direct costs of special events. These costs amounted to approximately \$106,000 and \$128,000 for the years ended June 30, 2018 and 2017, respectively. Lastly, advertising costs, included in management and general expense, are expensed as incurred and amounted to \$0 for each of the years ended June 30, 2018 and 2017.

**P. Statements of Activities – Non-Operating**

The Museum reflects in non-operating activities:

- Depreciation and amortization
- Permanently restricted contributions
- Purchases of artworks and any corresponding release of net assets pertaining to such purchases
- Investment activity, net and a corresponding reduction to such amount representing its 5% (up to) spending policy to operations
- Infrequently occurring items

**Q. Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 3 – PROPERTY AND EQUIPMENT**

Property and equipment consists of the following as of June 30:

	<u>2018</u>	<u>2017</u>	<u>Estimated Useful Lives</u>
Leasehold improvements	\$ 1,228,354	\$ 1,158,342	5-18 years
Furniture and equipment	<u>661,101</u>	<u>643,216</u>	5-10 years
Total cost	1,889,455	1,801,558	
Less: accumulated depreciation and amortization	<u>(1,014,013)</u>	<u>(865,580)</u>	
Net book value	<u>\$ 875,442</u>	<u>\$ 935,978</u>	

Depreciation and amortization expense amounted to \$148,433 and \$142,897 for the years June 30, 2018 and 2017, respectively.

**NOTE 4 – PLEDGES RECEIVABLE**

Pledges are expected to be collected as follows as of June 30:

	<u>2018</u>	<u>Restated 2017</u>
In less than one year	\$ 884,267	\$ 1,049,235
Between one and five years	<u>457,428</u>	<u>1,413,333</u>
	1,341,695	2,462,568
Less: Allowance for doubtful pledges	<u>(10,000)</u>	<u>(10,000)</u>
	<u>\$ 1,331,695</u>	<u>\$ 2,452,568</u>

**NOTE 5 – INVESTMENTS AND FAIR VALUE MEASUREMENTS**

Investments consist of the following as of June 30:

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 88,981	\$ 352,907
Fixed income	987,013	1,036,700
Equity	4,864,677	4,138,514
Alternative investments		
Hedge funds – fund of funds	<u>833,438</u>	<u>809,211</u>
Total Investments	6,774,109	6,337,332
Beneficial Interest in Perpetual Trust	<u>970,041</u>	<u>946,082</u>
Total	<u>\$ 7,744,150</u>	<u>\$ 7,283,414</u>

The Museum's Board has established a finance and investment committee, chaired by the Treasurer. The committee's terms of reference for investment matters, and an investment policy, have been approved by the Board. Investments are subject to market volatility that could substantially change their value in the near term.

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 5 – INVESTMENTS AND FAIR VALUE MEASUREMENTS (Continued)**

Investment activity consists of the following for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Interest and dividends	\$ 211,992	\$ 137,025
Realized (loss) gain on investment sales	(553)	30
Unrealized gains on investments	304,152	611,478
Change in value of bequest	<u>23,959</u>	<u>43,102</u>
	539,550	791,635
Less: investment expenses	<u>(37,256)</u>	<u>(23,725)</u>
	<u>\$ 502,294</u>	<u>\$ 767,910</u>

The fair value hierarchy defines three levels as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Museum has the ability to access.

Level 2 - Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the assets or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Financial assets measured at fair value on a recurring basis as of June 30, 2018 are presented in the following table:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total 2018</u>
Investments:				
Cash and money market funds	\$ 88,981	\$ -	\$ -	\$ 88,981
US fixed income funds	848,336	-	-	848,336
Non-US fixed income funds	138,677	-	-	138,677
Equity funds				
US Large Cap	2,604,392	-	-	2,604,392
Europe, Australia and Far East	1,736,273	-	-	1,736,273
Japanese Large Cap Equity	111,333	-	-	111,333
Global	412,679	-	-	412,679
Hedge fund – fund of funds	-	-	833,438	833,438
Beneficial interest in perpetual trust	<u>-</u>	<u>970,041</u>	<u>-</u>	<u>970,041</u>
Total Assets at Fair Value	<u>\$ 5,940,671</u>	<u>\$ 970,041</u>	<u>\$ 833,438</u>	<u>\$ 7,744,150</u>

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 5 – INVESTMENTS AND FAIR VALUE MEASUREMENTS (Continued)**

Financial assets measured at fair value on a recurring basis as of June 30, 2017 are presented in the following table:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total 2017</u>
Investments:				
Cash and money market funds	\$ 352,907	\$ -	\$ -	\$ 352,907
US fixed income funds	761,391	-	-	761,391
Non-US fixed income funds	275,309	-	-	275,309
Equity funds				
US Large Cap	1,996,743	-	-	1,996,743
US Mid Cap	124,702	-	-	124,702
Europe, Australia and Far East	1,459,519	-	-	1,459,519
Japanese Large Cap Equity	64,066	-	-	64,066
Global	493,484	-	-	493,484
Hedge fund – fund of funds	-	-	809,211	809,211
Beneficial interest in perpetual trust	<u>-</u>	<u>946,082</u>	<u>-</u>	<u>946,082</u>
Total Assets at Fair Value	<u>\$ 5,528,121</u>	<u>\$ 946,082</u>	<u>\$ 809,211</u>	<u>\$ 7,283,414</u>

Investments in money market funds, equity funds, government fixed income securities, non-US fixed income securities and commodity index funds are valued using the closing prices on the active market in which they are traded (Level 1). The investment in beneficial interest in perpetual trust is classified as Level 2 as the underlying investments of the trust are mutual funds that are actively traded.

As of June 30, 2018 and 2017, the Museum's investment in the hedge fund was recorded at fair value as reported by investment managers, in an amount equal to the net asset value ("NAV") of shares of units held by the Museum at year-end. The financial statements of this hedge fund are prepared in accordance with U.S. GAAP and are audited annually by independent auditors. As of June 30, 2018 and 2017, the Museum had no unfunded commitments to invest in this hedge fund. The hedge fund's investment strategies include diversified portfolio allocations across a broad range of equity and limited liability company investments, and may include long and short positions in publicly traded equity securities across various industries and geographies. Redemptions, at NAV, of shares in these investments range from quarterly to annually, generally with 30 to 90 days' redemption notice, and typically after the expiration of a defined lock-up period. The investment is classified as Level 3 by management due to the redemption features.

The Board of Trustees reviews and approves the Museum's fair value measurement policies and procedures annually. At least annually, the finance committee and the Board determine if the valuation techniques used in fair value measurements are still appropriate.

The table below presents information about fair value measurements that use significant unobservable inputs (level 3):

	<u>2018</u>	<u>2017</u>
Beginning balance	\$ 809,211	\$ 858,238
Sales	-	(102,827)
Gains (realized/unrealized)	<u>24,227</u>	<u>53,800</u>
Ending balance	<u>\$ 833,438</u>	<u>\$ 809,211</u>

The Museum recognizes transfers between levels in the fair value hierarchy at the end of the reporting period. There were no such transfers during the years ended June 30, 2018 and 2017.

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 6 – AUXILIARY ACTIVITIES**

Auxiliary activities consist primarily of goods sold at the Museum's shop located at Lincoln Square in New York City. The Museum has a number of licensing agreements with various companies (generally for up to three years), for which it receives royalties from the sale of reproductions of items in the Museum's collection made by the licensees.

Revenue and expenses for auxiliary activities consist of the following for the years ended June 30:

	2018		2017	
	Revenues	Expenses	Revenues	Expenses
Book and gift shops	\$ 1,024,816	\$ 855,205	\$ 954,045	\$ 822,985
Reproduction rights	22,834	-	24,653	-
	<u>\$ 1,047,650</u>	<u>\$ 855,205</u>	<u>\$ 978,698</u>	<u>\$ 822,985</u>

**NOTE 7 – PROGRAM EXPENSES**

Program expenses result primarily from costs associated with the Museum's gallery, exhibitions and education, as well as the Museum's library, including a proportionate share of insurance, rent, utilities and maintenance costs and the purchase of art works.

**NOTE 8 – COMMITMENTS AND CONTINGENCIES**

- A. The Museum has a license agreement to occupy space in a public area at Lincoln Square and to provide access to works of art and items related thereto. The licensing agreement requires a nominal annual fee and expires in 2075. If the Museum vacates the area earlier than the end of the license term, the Museum may be obligated to pay approximately \$400,000 to the landlord. If the Museum were to negotiate the assignment of the license, the Museum would be exempt from such obligation.

Rent expense (including real estate tax escalation charges and the effects of straight-lining) amounted to \$250,446 and \$255,352, for the years ended June 30, 2018 and 2017, respectively.

The minimum annual lease payments for the Museum's other Long Island City location are as follows for the years ending subsequent to June 30, 2018:

2019	\$ 169,205
2020	174,281
2021	180,010
2022	186,395
2023	190,442
Thereafter	<u>275,818</u>
	<u>\$ 1,176,151</u>

Such amounts do not include real estate escalation charges and straight-lining.

- B. The Museum believes it has no uncertain tax positions as of June 30, 2018 and 2017 as defined in Accounting Standards Codification ("ASC") Topic 740, *Income Taxes*, which provides standards for establishing and classifying tax expense for uncertain tax positions.

**NOTE 9 – PENSION PLANS**

The Museum maintains two pension plans under Internal Revenue Code Section 403(b) for all eligible employees. Under the tax deferred annuity plan, there is no employer match of employee contributions by the Museum. Under the defined contribution retirement plan, the Museum matches employee contributions to this plan up to a maximum of the greater of 3% of gross compensation of the employee or their contribution. For the years ended June 30, 2018 and 2017, the Museum contributed to this plan \$44,389 and \$52,224, respectively. Employees become eligible upon completing three months of service to the Museum.

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 10 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes as of June 30:

	<u>2018</u>	<u>Restated 2017</u>
Program restricted	\$ 3,323,292	\$ 3,366,158
Unappropriated endowment earnings (see below)	480,895	390,506
Time restricted for future periods	<u>600,000</u>	<u>984,000</u>
	<u>\$ 4,404,187</u>	<u>\$ 4,740,664</u>

Temporarily restricted net assets of \$986,366 and \$608,185 for the years ended June 30, 2018 and 2017, respectively, were released from donor restrictions by incurring costs (or through the passage of time), thereby satisfying the restrictions specified by the donors.

Permanently restricted net assets consist of the following as of June 30:

	<u>2018</u>	<u>2017</u>
Museum's 50% beneficial interest in a trust	\$ 970,041	\$ 946,082
All other funds	<u>4,050,652</u>	<u>3,995,652</u>
	<u>\$ 5,020,693</u>	<u>\$ 4,941,734</u>

The Museum receives unrestricted annual income (dividends and interest) from the investment assets pertaining to its 50% beneficial interest in a trust. These funds are held in perpetuity by a third party trustee. Realized and unrealized gains or losses remain in the fund assets as permanently restricted. The assets of the trust consist primarily of fixed income securities and money market funds, and the Museum's ownership interest is stated at fair value. All other funds' earnings are unrestricted by the donor during the year ended June 30, 2018.

The change in the permanently restricted beneficial interest in the perpetual trust for the years ended June 30, 2018 and 2017 relates to the change in the value of such trust. All other permanently restricted net assets are included in investments on the statements of financial position as of June 30, 2018 and 2017, respectively.

The Museum adheres to the New York Prudent Management of Institutional Funds Act ("NYPMIFA"). NYPMIFA contains a rebuttable presumption of imprudence if an organization appropriates more than 7% of a donor-restricted permanent endowment fund's fair value (averaged over a period not less than the preceding five years) in any year. In addition, in accordance with U.S. GAAP, any unappropriated earnings on endowment funds that would otherwise be considered unrestricted by the donor are reflected as temporarily restricted until appropriated by the Board of Trustees. The policy for valuing the Museum's investments is described in Note 2F.

The Board of Trustees of the Museum has interpreted New York State law as allowing the Museum to appropriate for expenditure or accumulate so much of an endowment fund as the Museum determines is prudent for the uses, benefits, purposes and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. Unless permanently or otherwise temporarily restricted in the gift instrument, the earnings (realized and unrealized gains/losses, dividends and interest) in the endowment fund shall be temporarily restricted assets until appropriated for expenditure by the Board of Trustees. See Note 2B for how the Museum maintains its net assets.

The Museum's endowment investment policy is to invest primarily in equities, fixed income and alternative investments based on an asset allocation, approved by the Board of Trustees, to satisfy overall endowment financial and investment objectives such as to preserve the principal, protect against inflation, receive stable returns and achieve long-term growth. The Museum relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends).

**AMERICAN FOLK ART MUSEUM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018 AND 2017**

**NOTE 10 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (Continued)**

Changes in endowment net assets including permanently restricted net assets for the year ended June 30, 2018 are as follows:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2018 Total</u>
Endowment net assets, beginning of year	\$ 390,506	\$ 3,995,652	\$ 4,386,158
Contributions	-	55,000	55,000
Investment activity	293,889	-	293,889
Board appropriation for expenditures	<u>(203,500)</u>	<u>-</u>	<u>(203,500)</u>
Endowment net assets, end of year	<u>\$ 480,895</u>	<u>\$ 4,050,652</u>	<u>\$ 4,531,547</u>

Changes in endowment net assets including permanently restricted net assets for the year ended June 30, 2017 are as follows:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2017 Total</u>
Endowment net assets, beginning of year	\$ 49,273	\$ 3,960,652	\$ 4,009,925
Contributions	-	35,000	35,000
Investment activity	498,533	-	498,533
Board appropriation for expenditures	<u>(157,300)</u>	<u>-</u>	<u>(157,300)</u>
Endowment net assets, end of year	<u>\$ 390,506</u>	<u>\$ 3,995,652</u>	<u>\$ 4,386,158</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor required the Museum to retain as a fund of perpetual duration due to appropriation for expenditure or unfavorable market fluctuations. In accordance with the Museum's policy, deficiencies of this nature are reported in either restricted or unrestricted net assets. As of June 30, 2018 and 2017, there were no such deficiencies.

**NOTE 11 – NET ASSETS AVAILABLE FOR OPERATIONS**

Unrestricted net assets available for operations decreased by approximately \$228,000 from June 30, 2017 to June 30, 2018. Management is committed to creating and maintaining a break-even budget going forward, in order to stabilize the use of such net assets. Additionally, management is working to improve the net assets available for operations in the next few years, by increasing revenues and decreasing expenses.

**NOTE 12 – PRIOR PERIOD ADJUSTMENTS**

- A. In the June 30, 2017 financial statements, there was a two-year grant not properly reflected. As a result, temporarily restricted net assets increased by \$350,000 from the balance that was previously reported. This decreased temporarily restricted revenue by the same amount for the year ended June 30, 2018.
- B. In the June 30, 2017 financial statements, there was a multi-year grant not properly reflected. As a result, unrestricted net assets increased by \$25,000 and temporarily restricted net assets increased by \$100,000 from the balance that was previously reported. This decreased current year unrestricted and temporarily restricted revenue by the same amount for the year ended June 30, 2018.

**NOTE 13 – SUBSEQUENT EVENTS**

Management has evaluated, for potential recognition and disclosure, events subsequent to the date of the statements of financial position through April 16, 2019, the date the financial statements were available to be issued.