



RSM US LLP

310 Broadway Ave S
Suite 300
Rochester, MN 55904

T +1 507 288 6476
F +1 507 288 5448

www.rsmus.com

April 27, 2018

Mr. Brian Austin
Rochester Art Center
40 Civic Center Drive SE
Rochester, MN 55904

Dear Mr. Austin:

In accordance with your request, we are attaching the accompanying PDF file, which contains an electronic final version of the financial statements of Rochester Art Center as of December 31, 2017. We understand that your request for the electronic copy has been made as a matter of convenience. You understand that electronic transmissions are not entirely secure and that it is possible for confidential financial information to be intercepted by others.

These financial statements and our report(s) on them are not to be modified in any manner. This final version supersedes all prior drafts. Any preliminary draft version of the financial statements previously provided to you in an electronic format should be deleted from your computer, and all printed copies of any superseded preliminary draft versions should likewise be destroyed.

Professional standards and our firm policies require that we perform certain additional procedures whenever our reports are included, or we are named as accountants, auditors or "experts," in a document used in a public or private offering of equity or debt securities. Accordingly, as provided for and agreed to in the terms of our arrangement letter, Rochester Art Center will not include our reports, or otherwise make reference to us, in any public or private securities offering without first obtaining our consent. Any request to consent is also a matter for which separate arrangements will be necessary. After obtaining our consent, Rochester Art Center also agrees to provide us with printer's proofs or masters of such offering documents for our review and approval before printing, and with a copy of the final reproduced material for our approval before it is distributed. In the event our auditor/client relationship has been terminated when Rochester Art Center seeks such consent, we will be under no obligation to grant such consent or approval.

Thank you for the opportunity to serve you.

Sincerely,

Randolph L. Johnson, Partner
+1 507 226 0431

wpd
Attachment

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Rochester Art Center

Financial Report
December 31, 2017

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RSM US LLP

Independent Auditor's Report

To the Board of Directors
Rochester Art Center

Report on the Financial Statements

We have audited the accompanying financial statements of Rochester Art Center (the Organization), which comprise the statements of financial position as of December 31, 2017 and 2016; the related statements of activities and changes in net assets, functional expenses 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.

Auditor's 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 of 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 Rochester Art Center as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Rochester Art Center will continue as a going concern. As discussed in the Note 6 to the financial statements, the Organization has suffered recurring losses from operations, has an unrestricted net assets deficiency, and has stated that substantial doubt existed about the Organization's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in the Note 6. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

RSM US LLP

Rochester, Minnesota
April 27, 2018

Rochester Art Center

Statements of Financial Position
December 31, 2017 and 2016

	2017	2016
Assets		
Current assets:		
Cash	\$ 37,298	\$ 50,747
Receivables:		
Trade	6,178	-
Pledges (Note 2)	18,944	63,258
Inventory	657	657
Prepaid expenses	1,142	-
Total current assets	64,219	114,662
Property and equipment:		
Leasehold interest in facility (Note 5)	5,840,532	6,009,011
Furniture and equipment, net	14,553	17,550
Net property and equipment	5,855,085	6,026,561
Other assets:		
Works of art	84,742	84,742
Total assets	\$ 6,004,046	\$ 6,225,965
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 75,382	\$ 148,920
Accrued expenses	2,565	12,380
Deferred revenue	56,309	60,150
Total current liabilities	134,256	221,450
Net assets (Notes 3 and 5):		
Unrestricted:		
Undesignated (deficit)	(107,369)	(203,938)
Invested in:		
Equipment	14,553	17,550
Works of art	84,742	84,742
Total unrestricted (deficit)	(8,074)	(101,646)
Temporarily restricted	5,869,744	6,098,041
Permanently restricted	8,120	8,120
Total net assets	5,869,790	6,004,515
	\$ 6,004,046	\$ 6,225,965

See notes to financial statements.

Rochester Art Center

**Statement of Activities and Changes in Net Assets
Year Ended December 31, 2017**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public support:				
General contributions	\$ 65,756	\$ -	\$ -	\$ 65,756
Grants:				
City of Rochester (Note 5)	325,000	-	-	325,000
Others	145,954	29,212	-	175,166
Corporate sponsorships	5,861	-	-	5,861
Membership	13,621	-	-	13,621
Fundraisers	36,624	-	-	36,624
In-kind	36,095	-	-	36,095
Total public support	628,911	29,212	-	658,123
Revenues:				
Admissions	18,023	-	-	18,023
Rentals	140,692	-	-	140,692
Gallery shop	3,794	-	-	3,794
Exhibitions	21,597	-	-	21,597
Education	25,942	-	-	25,942
Special programs	678	-	-	678
Other	4	-	-	4
Total revenues	210,730	-	-	210,730
Net assets released from restrictions	257,509	(257,509)	-	-
Total support and revenues	1,097,150	(228,297)	-	868,853
Expenses:				
Program services	593,877	-	-	593,877
Supporting services:				
Fundraising	84,811	-	-	84,811
Management and general	324,890	-	-	324,890
Total expenses	1,003,578	-	-	1,003,578
Change in net assets	93,572	(228,297)	-	(134,725)
Net assets, beginning	(101,646)	6,098,041	8,120	6,004,515
Net assets, ending	\$ (8,074)	\$ 5,869,744	\$ 8,120	\$ 5,869,790

See notes to financial statements.

Rochester Art Center

Statement of Activities and Changes in Net Assets
Year Ended December 31, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Public support:				
General contributions	\$ 123,893	\$ -	\$ -	\$ 123,893
Grants:				
City of Rochester (Note 5)	443,457	-	-	443,457
Others	23,008	160,063	-	183,071
Corporate sponsorships	5,000	-	-	5,000
Membership	20,246	-	-	20,246
Fundraisers	71,131	-	-	71,131
In-kind	18,605	-	-	18,605
Total public support	705,340	160,063	-	865,403
Revenues:				
Admissions	5,099	-	-	5,099
Rentals	145,531	-	-	145,531
Gallery shop	1,133	-	-	1,133
Exhibitions	2,910	-	-	2,910
Education	28,896	-	-	28,896
Special programs	25	-	-	25
Other	10	-	-	10
Total revenues	183,604	-	-	183,604
Net assets released from restrictions	322,281	(322,281)	-	-
Total support and revenues	1,211,225	(162,218)	-	1,049,007
Expenses:				
Program services	695,220	-	-	695,220
Supporting services:				
Fundraising	117,718	-	-	117,718
Management and general	458,646	-	-	458,646
Total expenses	1,271,584	-	-	1,271,584
Change in net assets	(60,359)	(162,218)	-	(222,577)
Net assets, beginning	(41,287)	6,260,259	8,120	6,227,092
Net assets, ending	\$ (101,646)	\$ 6,098,041	\$ 8,120	\$ 6,004,515

See notes to financial statements.

Rochester Art Center

**Statement of Functional Expenses
Year Ended December 31, 2017**

	Program Services				Total
	Exhibitions	Education	Special Programs	Gallery Shop	
Salaries and wages	\$ 57,941	\$ 11,589	\$ 25,494	\$ 50,987	\$ 146,011
Payroll taxes	3,931	562	1,685	3,744	9,922
Employee benefits	2,614	755	1,097	412	4,878
Total salaries and related expenses	64,486	12,906	28,276	55,143	160,811
Equipment purchase and repair	4,496	-	-	-	4,496
Supplies	9,061	2,880	1,915	-	13,856
Postage and printing	20,850	10	-	-	20,860
Shipping and transportation	5,899	-	-	-	5,899
Advertising	245	624	25	-	894
Utilities	26,735	6,684	13,368	26,735	73,522
Telephone	3,915	979	1,957	3,915	10,766
Exhibition openings	59,643	-	-	-	59,643
Fundraising event catering	-	-	-	-	-
Dues and subscriptions	1,294	-	-	-	1,294
Miscellaneous	2,293	-	11	-	2,304
Contract labor	26,568	10,200	13,075	-	49,843
Travel	4,091	-	-	-	4,091
Professional services	-	-	-	-	-
Bank and credit card fees	545	268	-	99	912
Insurance	15,463	3,314	1,105	884	20,766
Total operating expenses	245,584	37,865	59,732	86,776	429,957
Amortization of leasehold interest	117,934	25,272	8,424	6,738	158,368
Depreciation	4,135	886	295	236	5,552
Total other operating expenses	122,069	26,158	8,719	6,974	163,920
Total expenses	\$ 367,653	\$ 64,023	\$ 68,451	\$ 93,750	\$ 593,877

See notes to financial statements.

Supporting Services			
Fundraising	Management and General	Total	Grand Totals
\$ 48,678	\$ 129,793	\$ 178,471	\$ 324,482
1,310	7,488	8,798	18,720
1,048	3,718	4,766	9,644
51,036	140,999	192,035	352,846
1,330	13,548	14,878	19,374
1,768	6,374	8,142	21,998
95	3,811	3,906	24,766
-	-	-	5,899
1,697	9,182	10,879	11,773
6,684	53,470	60,154	133,676
979	7,830	8,809	19,575
-	-	-	59,643
2,394	-	2,394	2,394
3,817	192	4,009	5,303
163	827	990	3,294
10,459	6,370	16,829	66,672
-	-	-	4,091
-	70,966	70,966	70,966
457	3,464	3,921	4,833
442	882	1,324	22,090
81,321	317,915	399,236	829,193
3,370	6,739	10,109	168,477
120	236	356	5,908
3,490	6,975	10,465	174,385
\$ 84,811	\$ 324,890	\$ 409,701	\$ 1,003,578

Rochester Art Center

Statement of Functional Expenses
Year Ended December 31, 2016

	Program Services				Total
	Exhibitions	Education	Special Programs	Gallery Shop	
Salaries and wages	\$ 78,718	\$ 28,625	\$ 25,047	\$ 10,734	\$ 143,124
Payroll taxes	6,193	2,252	1,971	854	11,270
Employee benefits	8,895	3,234	2,830	1,064	16,023
Total salaries and related expenses	93,806	34,111	29,848	12,652	170,417
Equipment purchase and repair	40,815	70	63	-	40,948
Supplies	920	-	1,868	-	2,788
Postage and printing	33,643	-	-	-	33,643
Shipping and transportation	10,368	-	-	-	10,368
Advertising	41,262	-	2,340	-	43,602
Utilities	69,982	11,664	-	-	81,646
Telephone	12,821	2,137	-	-	14,958
Exhibition openings	38,305	-	-	-	38,305
Fundraising event catering	-	-	-	-	-
Dues and subscriptions	1,281	60	225	-	1,566
Miscellaneous	13,085	783	-	62	13,930
Contract labor	39,402	2,000	4,699	-	46,101
Travel	15,899	-	-	-	15,899
Professional services	-	-	-	-	-
Bank and credit card fees	229	-	-	-	229
Insurance	11,971	2,565	855	684	16,075
Total operating expenses	423,789	53,390	39,898	13,398	530,475
Amortization of leasehold interest	117,934	25,272	8,424	6,738	158,368
Depreciation	4,749	1,018	339	271	6,377
Total other operating expenses	122,683	26,290	8,763	7,009	164,745
Total expenses	\$ 546,472	\$ 79,680	\$ 48,661	\$ 20,407	\$ 695,220

See notes to financial statements.

Supporting Services			
Fundraising	Management and General	Total	Grand Totals
\$ 32,203	\$ 182,482	\$ 214,685	\$ 357,809
2,534	14,357	16,891	28,161
3,639	22,749	26,388	42,411
38,376	219,588	257,964	428,381
-	42,117	42,117	83,065
2,270	18,955	21,225	24,013
375	3,475	3,850	37,493
-	-	-	10,368
1,186	6,943	8,129	51,731
-	34,991	34,991	116,637
-	6,410	6,410	21,368
-	-	-	38,305
-	-	-	-
3,588	4,141	7,729	9,295
-	8,616	8,616	22,546
68,075	81,266	149,341	195,442
-	9,666	9,666	25,565
-	12,528	12,528	12,528
-	2,256	2,256	2,485
342	684	1,026	17,101
114,212	451,636	565,848	1,096,323
3,370	6,739	10,109	168,477
136	271	407	6,784
3,506	7,010	10,516	175,261
\$ 117,718	\$ 458,646	\$ 576,364	\$ 1,271,584

Rochester Art Center

**Statements of Cash Flows
Years Ended December 31, 2017 and 2016**

	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ (134,725)	\$ (222,577)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	5,908	6,784
Amortization of leasehold interest	168,477	168,477
(Increase) decrease in assets:		
Accounts receivable	38,136	(9,649)
Prepaid expenses	(1,142)	4,164
Increase (decrease) in liabilities:		
Accounts payable	(73,538)	99,364
Accrued expenses	(9,815)	(2,631)
Deferred revenue	(3,841)	(16,155)
Net cash provided by (used in) operating activities	(10,540)	27,777
Cash flows from investing activities:		
Purchase of property and equipment, net	(2,908)	(10,155)
Net increase (decrease) in cash	(13,448)	17,622
Cash, beginning	50,747	33,125
Cash, ending	\$ 37,299	\$ 50,747

See notes to financial statements.

Rochester Art Center

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Nature of business: Rochester Art Center (the Organization) is a nonprofit corporation organized under Chapter 309 of the revised statutes of the State of Minnesota. The Organization's purpose is to provide to the citizens of Rochester and southeastern Minnesota the opportunity to know, practice and enjoy the arts. In addition, the Organization works to show the vital relationship of the arts to our daily lives and to join with schools, churches, libraries and community groups to make Rochester a cultural center worthy of its scientific achievements. The Organization's primary funding comes from the City of Rochester (the City) (see Note 5) and through business and individual donations, grants and facility rental fees.

Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) 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.

Cash: The Organization maintains cash in depository bank accounts.

Receivables: Receivables that are expected to be collected within one year are recorded at net realizable value. Amounts not expected to be collected within one year are reported at present value of projected future cash flows using a risk-free interest rate. Management determines bad debts by regularly evaluating individual balances and considering current financial and economic conditions. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

At December 31, 2017 and 2016, management did not identify any receivables they believe to be uncollectible. No allowance for uncollectible accounts has been recorded.

Revenue recognition: Memberships and program fees are recognized as revenue over the period to which the membership or fees relate. Revenue from grants is recognized according to the terms of the agreements. All contributions and promises to give are recognized at the time the Organization has the unconditional right to receive them and are reported at fair value as unrestricted unless specifically restricted by the donor. Conditional contributions are recognized when the condition has been substantially met. Amounts recognized that are restricted for future periods or specific purposes are reported as increases in temporarily restricted or permanently restricted net 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 and changes in net assets as net assets released from restrictions. If the restriction is met in the period the related revenue is recognized, the amounts are reported only within the unrestricted activity.

Many individuals have contributed a significant amount of time to activities of the Organization. The Organization does not recognize these contributed services as revenues unless the services received (1) create or enhance existing facilities or (2) require specialized skills and are provided by individuals possessing those skills. The Organization recognized approximately \$3,425 and \$4,325 in contributed services during the years ended December 31, 2017 and 2016, respectively.

Donated goods and equipment are reflected as contributions in the accompanying financial statements at their estimated fair value at the date of receipt. Facility improvements from the City of Rochester were approximately \$33,000 and \$6,000 for the years ended December 31, 2017 and 2016, (see Note 5) and are included in the total donated goods and equipment recognized by the Organization of approximately \$36,100 and \$14,280 during the years ended December 31, 2017 and 2016, respectively.

Rochester Art Center

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Functional expense allocation: The cost of providing various programs and other activities has been summarized on a functional basis in the statements of activities and changes in net assets. Accordingly, certain costs have been allocated among the corresponding functional classifications, such as major classes of program services and supporting activities that benefit from such costs.

Works of art: The Organization recognizes works of art as assets. Donations of works of art are recorded at fair value at the date of the gift based on independent appraisals or valuations. Purchases of works of art are recorded at cost. Long-lived assets, such as works of art, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No indicators of potential impairment were present as of December 31, 2017 and 2016; therefore, no impairment analysis was performed on these dates.

Inventory: Gallery shop inventory is valued at the lower of cost (first-in, first-out) or net realizable value.

Furniture and equipment: Furniture and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation. Depreciation is provided on the straight-line basis over the estimated useful life of the various assets (five to 10 years for the furniture and equipment). At December 31, 2017 and 2016, accumulated depreciation was \$609,644 and \$603,737, respectively. Depreciation expense for the years ended December 31, 2017 and 2016, was \$5,907 and \$6,784, respectively.

Leasehold interest in facility: The leasehold interest in the Rochester Art Center facility is stated at cost less amortization. Amortization is provided on the straight-line basis over the remaining term of the lease (see Note 5).

Net assets: Unrestricted net assets are those funds presently available for use by or on behalf of the Organization, including amounts available for general and administrative expenses. Temporarily restricted net assets are contributions that have donor-imposed stipulations that can be fulfilled by certain actions of the Organization. These are primarily contributions that are restricted for special programs, events and leasehold interest in facility. Permanently restricted net assets are contributions that have donor-imposed restrictions, whereby the amount of the gift is to be held in perpetuity.

Income taxes: The Organization is generally exempt from federal income taxes as a public charity under section 501(c)(3) of the Internal Revenue Code. The Organization files federal exempt income tax returns. As of December 31, 2017, generally, the federal and Minnesota tax returns for the Organization are open for examination by taxing authorities for the years 2015 to 2017. There was no material unrelated business income for the years ended December 31, 2017 and 2016.

As of December 31, 2017, management evaluated the Organization's tax positions and concluded that the Organization had taken no uncertain tax provisions that require adjustment to the financial statements to comply with the provisions of the Income Taxes topic of the Financial Accounting Standards Board (FASB)'s *FASB Accounting Standards Codification*.

Pension plan: The Organization maintains a noncontributory pension plan for all qualified employees. Contributions to the plan are at the discretion of the Board of Directors. Pension expense was approximately \$-0- and \$2,100 for the years ended December 31, 2017 and 2016, respectively.

Rochester Art Center

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Recent accounting pronouncements: In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Contribution public support revenue has been scoped out of this ASU; therefore, only the other revenue sources of the Organization will be impacted by the ASU. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. The updated standard becomes effective for the Organization for the year beginning January 1, 2019. Management has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. While both lessees and lessors are affected by the new guidance, the effects on lessees are much more significant. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases. For short-term leases, lessees may elect an accounting policy by class of underlying asset under which right-of-use assets and lease liabilities are not recognized and lease payments are generally recognized as expense over the lease term on a straight-line basis. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under the legacy lease accounting guidance. For many entities, this could significantly affect the financial ratios they use for external reporting and other purposes, such as debt covenant compliance. The ASU is effective for the Organization for the year beginning January 1, 2020. Management is currently evaluating the effect that the standard will have on its financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, to improve the current net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. ASU 2016-14 will be effective for the Organization for fiscal years beginning after December 15, 2017.

In September 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)*, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 will be effective for the Organization for fiscal years beginning after December 15, 2018.

Subsequent events: In preparing these financial statements, the Organization has evaluated events and transactions for potential recognition or disclosure through April 27, 2018, the date the financial statements were available to be issued.

Note 2. Pledges Receivable

As of December 31, 2017 and 2016, pledges receivable are approximately \$18,900 and \$63,300, respectively, and are all expected to be collected in the next year. Accordingly, an allowance for uncollectible pledges receivable has not been established.

Rochester Art Center

Notes to Financial Statements

Note 3. Net Assets

Permanently restricted net assets, with the earnings available to support donor purposes, as of December 31, 2017 and 2016, consisted of the following:

	2017	2016
Endowment Fund: The fund was established in 2005 to support the long-term financial stability of Rochester Art Center.	\$ 1,100	\$ 1,100
John Riese Memorial Fund: The fund was established in 1994 to recognize high school students' excellence in art.	7,020	7,020
	<u>\$ 8,120</u>	<u>\$ 8,120</u>

Temporarily restricted net assets as of December 31, 2017 and 2016, consisted of the following:

	2017	2016
Purpose restricted:		
Public exhibitions and admissions	\$ -	\$ 23,000
Art education and scholarships	-	7,500
Time restricted:		
Operations	29,212	58,530
Time restricted based on the life of the lease agreement:		
Leasehold interest in facility	5,840,532	6,009,011
	<u>\$ 5,869,744</u>	<u>\$ 6,098,041</u>

Note 4. Funds Held by Others

Rickee Henoeh Art Fund: The Rickee Henoeh Art Fund is a donor-designated fund established in 1989 to provide funding for Rochester Art Center in support of its programs, special events or other special needs relating to arts and education. The principal and investment of the funds are under the control of the Rochester Area Foundation, which has the ability to grant out the income of the fund to the Organization, and are not reflected in the Organization's financial statements. The total funds held by the Rochester Area Foundation as of December 31, 2017 and 2016, were \$24,805 and \$22,730, respectively. The Organization did not receive any distributions from this fund in 2017 or 2016.

Rochester Art Center Fund: The Rochester Art Center Fund is an agency endowment fund established by the Organization in 1998 to provide long-term sustainable endowment growth for the Organization. The principal and investment of the funds are under the control of the Rochester Area Foundation, which has the ability to grant out the income of the fund to the Organization, or other similar board-approved organizations, and are not reflected in the Organization's financial statements. The total funds held by the Rochester Area Foundation as of December 31, 2017 and 2016, were \$14,184 and \$12,565, respectively. The Organization did not receive any distributions from this fund in 2017 or 2016.

Rochester Art Center

Notes to Financial Statements

Note 5. Leasehold Interest in Facility and Concentration

The Organization completed a capital campaign to fund the construction of the Rochester Art Center facility, which was completed in 2004 and constructed on land owned by the City of Rochester. The Organization exchanged the facility with the City for a 50-year lease. The lease terms are a \$1 annual fee through December 2052. This agreement results in a contribution reported in the accompanying statements of financial position as a leasehold interest in facility. The Organization recognized a release from restriction and amortization of leasehold interest of \$168,477 in each year ended December 31, 2017 and 2016. The Organization is responsible for routine maintenance, and the City is responsible for major capital improvements.

The Organization receives a significant amount of support from the City in the form of other unrestricted contributions for operating activities and grants for minor facility improvements. For the years ended December 31, 2017 and 2016, the Organization recognized approximately \$325,000 and \$443,000, respectively, in grant revenues and approximately \$33,000 and \$6,000, respectively, in facility repairs. This support from the City represents approximately 41 percent and 43 percent of total revenues for the years ended December 31, 2017 and 2016, respectively.

Note 6. Going Concern and Management's Plans

The accompanying financial statements for the year ended December 31, 2017, have been prepared assuming the Organization will continue as a going concern. Management has assessed its ability to continue as a going concern and has determined that due to the liquidity position and losses from operations, substantial doubt about its ability to continue as a going concern one year after the financial statements are available to be issued, on April 27, 2018, exists. The following are management's observations, comments and plans to mitigate the going-concern matter.

There were improvements in operating performance during 2017, which management believes demonstrate the Organization's ability to function as a going concern. Specifically, the Organization reduced its net loss to \$134,725 compared to a \$222,577 loss in 2016. This was achieved through expense reductions, which began at the end of 2016 and continued throughout 2017.

In 2017, the Organization implemented a multistage restructuring plan led by a new interim executive director. The plan includes reducing the existing net asset deficiency and creating a reserve fund for future operational reliability by:

- Decreasing expenses for staffing, operations and programming that are not vital to support the revenue producing activities of the Organization. The 2018 and 2019 budgets project operating revenues will exceed operating expenses before depreciation and amortization. This was also budgeted in the 2017 budgets and these results were realized in 2017.
- The Organization continues to implement project-based budgeting with internal measurements and controls for all projects.
- The Organization does not anticipate any significant reductions in current funding sources as identified at April 27, 2018. A loss of any significant funding sources or levels, specifically the City of Rochester, Minnesota, could further increase the risk of continued existence to the Organization.

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Notes to Financial Statements

Note 6. Going Concern and Management's Plans (Continued)

Based on these efforts, management projects that there will be improvements to the liquidity position for 2018 and 2019. The Organization's cash position decreased as of December 31, 2017, as a result of making payments on prior-year liabilities. As the Organization continues to reduce expenses and make payments on current liabilities, working capital, while negative at December 31, 2017, should continue to improve. Through April 27, 2018, the Organization is on budget to achieve revenues exceeding expenses before depreciation and amortization for the year ending December 31, 2018.

These financial statements do not include adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Organization be unable to continue as a going concern.

