

Rhode Island School of Design

Consolidated Financial Statements and
Supplementary Information

June 30, 2019 and 2018

Rhode Island School of Design
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June 30, 2019 and 2018

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Independent Auditors' Report

To the Board of Trustees of
Rhode Island School of Design

We have audited the accompanying consolidated financial statements of Rhode Island School of Design and its subsidiaries, which comprise the consolidated statements of financial position as of June 30, 2019, and the related consolidated statements of activities, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Rhode Island School of Design and its subsidiaries as of June 30, 2019, 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.

Other Matter

The consolidated financial statements of Rhode Island School of Design as of and for the year ended June 30, 2018, were audited by another auditor whose report, dated October 9, 2018, expressed an unmodified opinion on those consolidated financial statements.

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2019 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Rhode Island School of Design's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Rhode Island School of Design's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

New York, NY
October 25, 2019

Rhode Island School of Design
Consolidated Statements of Financial Position
June 30, 2019 and 2018
(Dollars in thousands)

| | <u>2019</u> | <u>2018</u> |
|--|-------------------|-------------------|
| Assets | | |
| Cash and cash equivalents | \$ 42,878 | \$ 49,478 |
| Accounts receivable, net (Note 6) | 2,734 | 2,387 |
| Student loans receivable, net (Note 7) | 2,196 | 2,725 |
| Pledges receivable, net (Note 8) | 4,961 | 6,017 |
| Funds held in trust by others (Note 2) | 46,256 | 1,825 |
| Inventories | 1,637 | 1,558 |
| Prepaid expenses | 1,304 | 1,010 |
| Other investments (Note 2) | 725 | 798 |
| Long-term investments (Note 2) | 344,460 | 344,551 |
| Property, plant and equipment, net (Note 9) | <u>250,191</u> | <u>217,377</u> |
| Total assets | <u>\$ 697,342</u> | <u>\$ 627,726</u> |
| Liabilities | | |
| Accounts payable and accrued liabilities (Note 10) | \$ 16,764 | \$ 9,373 |
| Deferred income (Note 11) | 7,101 | 8,096 |
| Obligations under long-term agreements (Note 12) | 10,008 | 10,007 |
| U.S. Government loan funds (Note 7) | 1,988 | 1,917 |
| Liability for interest rate swap (Notes 2, 13) | 4,182 | 2,058 |
| Bonds payable, net (Note 13) | <u>204,242</u> | <u>148,767</u> |
| Total liabilities | <u>244,285</u> | <u>180,218</u> |
| Net Assets | | |
| Net assets without donor restrictions (Notes 14, 15) | 309,720 | 310,021 |
| Net assets with donor restrictions (Notes 14, 15) | <u>143,337</u> | <u>137,487</u> |
| Total net assets | <u>453,057</u> | <u>447,508</u> |
| Total liabilities and net assets | <u>\$ 697,342</u> | <u>\$ 627,726</u> |

The accompanying notes are an integral part of the consolidated financial statements.

Rhode Island School of Design
Consolidated Statements of Activities
Year Ended June 30, 2019
(With Summarized Financial Information for the Year Ended June 30, 2018)
(Dollars in thousands)

| | Without Donor Restrictions | With Donor Restrictions | 2019 Total | 2018 Total |
|--|---------------------------------------|------------------------------------|-----------------------|-----------------------|
| Operating revenues | | | | |
| Net tuition and fees | \$ 104,546 | \$ - | \$ 104,546 | \$ 102,202 |
| Gifts and pledges | 2,672 | 3,380 | 6,052 | 10,249 |
| Grants | 475 | 3,395 | 3,870 | 3,266 |
| Auxiliary enterprises | 27,092 | - | 27,092 | 26,616 |
| Museum services | 962 | - | 962 | 1,167 |
| Investment income | 13,741 | 3,997 | 17,738 | 14,407 |
| Other income | 5,356 | - | 5,356 | 2,985 |
| Net assets released from restrictions | 5,885 | (5,885) | - | - |
| Total revenues | <u>160,729</u> | <u>4,887</u> | <u>165,616</u> | <u>160,892</u> |
| Operating expenses | | | | |
| Salaries and wages | 75,193 | - | 75,193 | 72,145 |
| Benefits | 21,500 | - | 21,500 | 20,229 |
| Contracted services | 16,759 | - | 16,759 | 13,996 |
| Depreciation, amortization and interest | 17,913 | - | 17,913 | 15,865 |
| Utilities, plant and equipment | 14,220 | - | 14,220 | 13,261 |
| Supplies and general | 8,588 | - | 8,588 | 9,307 |
| Other operating expenses | 3,108 | - | 3,108 | 3,119 |
| Total expenses | <u>157,281</u> | <u>-</u> | <u>157,281</u> | <u>147,922</u> |
| Increase in net assets from operating activities | 3,448 | 4,887 | 8,335 | 12,970 |
| Nonoperating | | | | |
| Realized and unrealized (losses) gains on interest rate swaps, net | (2,935) | - | (2,935) | 1,426 |
| Realized and unrealized (losses) gains on investments, net | (1,623) | 10 | (1,613) | 14,827 |
| Gifts and pledges | - | 953 | 953 | 5,436 |
| Change in net assets from nonoperating activities | <u>(4,558)</u> | <u>963</u> | <u>(3,595)</u> | <u>21,689</u> |
| Change in net assets | (1,110) | 5,850 | 4,740 | 34,659 |
| Total net assets | | | | |
| Beginning of year | 310,021 | 137,487 | 447,508 | 412,849 |
| Adoption of ASU 2014-09 | 809 | - | 809 | - |
| Beginning of year, as restated | <u>310,830</u> | <u>137,487</u> | <u>448,317</u> | <u>412,849</u> |
| End of year | <u>\$ 309,720</u> | <u>\$ 143,337</u> | <u>\$ 453,057</u> | <u>\$ 447,508</u> |

The accompanying notes are an integral part of the consolidated financial statements.

Rhode Island School of Design
Consolidated Statements of Activities
Year Ended June 30, 2018
(Dollars in thousands)

| | Without Donor Restrictions | With Donor Restrictions | 2018 Total |
|---|---------------------------------------|------------------------------------|-----------------------|
| Operating revenues | | | |
| Net tuition and fees | \$ 102,202 | \$ - | \$ 102,202 |
| Gifts and pledges | 2,456 | 7,793 | 10,249 |
| Grants | 496 | 2,770 | 3,266 |
| Auxiliary enterprises | 26,616 | - | 26,616 |
| Museum services | 1,159 | 8 | 1,167 |
| Investment income | 10,849 | 3,558 | 14,407 |
| Other income | 2,982 | 3 | 2,985 |
| Net assets released from restrictions | 7,483 | (7,483) | - |
| Total revenues | <u>154,243</u> | <u>6,649</u> | <u>160,892</u> |
| Operating expenses | | | |
| Salaries and wages | 72,145 | - | 72,145 |
| Benefits | 20,229 | - | 20,229 |
| Contracted services | 13,996 | - | 13,996 |
| Depreciation, amortization and interest | 15,865 | - | 15,865 |
| Utilities, plant and equipment | 13,261 | - | 13,261 |
| Supplies and general | 9,307 | - | 9,307 |
| Other operating expenses | 3,119 | - | 3,119 |
| Total expenses | <u>147,922</u> | <u>-</u> | <u>147,922</u> |
| Increase in net assets from operating activities | 6,321 | 6,649 | 12,970 |
| Nonoperating | | | |
| Realized and unrealized gains on interest rate swaps, net | 1,426 | - | 1,426 |
| Realized and unrealized gains on investments, net | 8,494 | 6,333 | 14,827 |
| Gifts and pledges | - | 5,436 | 5,436 |
| Increase in net assets from nonoperating activities | <u>9,920</u> | <u>11,769</u> | <u>21,689</u> |
| Increase in net assets | 16,241 | 18,418 | 34,659 |
| Total net assets | | | |
| Beginning of year | 293,780 | 119,069 | 412,849 |
| End of year | <u>\$ 310,021</u> | <u>\$ 137,487</u> | <u>\$ 447,508</u> |

The accompanying notes are an integral part of the consolidated financial statements.

Rhode Island School of Design
Consolidated Statements of Cash Flows
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

| | <u>2019</u> | <u>2018</u> |
|--|------------------|------------------|
| Cash flows from operating activities | | |
| Change in net assets | \$ 4,740 | \$ 34,659 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities | | |
| Gains on investments | (11,922) | (25,301) |
| Unrealized losses (gains) on interest rate swaps, net | 2,123 | (2,620) |
| Change in funds held in trust by others | 884 | 17,428 |
| Depreciation and amortization | 10,644 | 10,904 |
| Contributions restricted for long-term purposes | (2,874) | (5,650) |
| Change in asset retirement obligation | 266 | 252 |
| Change in U.S. Government loan funds | 71 | (430) |
| Amortization of long-term agreements | 159 | 182 |
| Changes in operating assets and liabilities that provide (use) cash | | |
| Accounts receivable | (347) | 923 |
| Pledges receivable | 617 | (3,457) |
| Inventories | (79) | (70) |
| Prepaid expenses | (294) | (149) |
| Accounts payable and accrued liabilities | (922) | 1,421 |
| Deferred income | (185) | (126) |
| Net cash provided by operating activities | <u>2,881</u> | <u>27,966</u> |
| Cash flows from investing activities | | |
| Purchases of buildings and equipment | (35,458) | (21,243) |
| Bond Project Fund held in trust | (45,315) | - |
| Student loans issued | - | (364) |
| Student loans repaid | 529 | 666 |
| Purchases of investments | (60,417) | (368,293) |
| Sales of investments | 72,503 | 373,574 |
| Net cash used in investing activities | <u>(68,158)</u> | <u>(15,660)</u> |
| Cash flows from financing activities | | |
| Payments on long-term debt | (4,305) | (4,125) |
| Payments on obligations under long-term agreements | (425) | (399) |
| Proceeds from issuance of long-term debt | 60,095 | - |
| Contributions restricted for long-term purposes | 3,312 | 6,126 |
| Net cash provided by financing activities | <u>58,677</u> | <u>1,602</u> |
| Net (decrease) increase in cash and cash equivalents | <u>(6,600)</u> | <u>13,908</u> |
| Cash and cash equivalents | | |
| Beginning of year | 49,478 | 35,570 |
| End of year | <u>\$ 42,878</u> | <u>\$ 49,478</u> |
| Supplemental cash flow disclosures | | |
| Costs accrued for capital expenditures | \$ 8,576 | \$ 261 |
| Cash paid for interest | 6,905 | 5,210 |

The accompanying notes are an integral part of the consolidated financial statements.

Rhode Island School of Design

Notes to the Consolidated Financial Statements

Year Ended June 30, 2019 and 2018

(Dollars in thousands)

1. Nature of Operations and Significant Accounting Policies

Nature of Operations

The Rhode Island School of Design (the "School") is a private, not-for-profit art and design college founded in 1877 and located in Providence, Rhode Island. The mission of the School, through its college and museum, is to educate its students and the public in the creation and appreciation of works of art and design, to discover and transmit knowledge and to make lasting contributions to a global society through critical thinking, scholarship and innovation.

The consolidated financial statements of the School have been prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP") and with the reporting principles of not-for-profit accounting. The School includes RISD Holdings, Inc. ("RH") and Washington Place Holdings, LP ("Washington Place"), wholly owned subsidiaries. RH was founded in 1999, and was organized for the exclusive purposes of acquiring, holding title to, and collecting income from, real property. Washington Place was formed in 2017, for the purpose of endowment investment management.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the School and its wholly owned subsidiaries, RH and Washington Place. All significant inter-entity balances and transactions have been eliminated.

Financial statements of private, not-for-profit organizations measure aggregate net assets and net asset activity based on the absence or existence of donor-imposed restrictions. Net assets are reported as without donor restrictions and with donor restrictions and serve as the foundation of the accompanying consolidated financial statements. Brief definitions of the two net asset classes are presented below:

Net Assets Without Donor Restrictions - Net assets derived from tuition and other institutional resources that are not subject to explicit donor-imposed restrictions. Net assets without donor restrictions also include board designated funds functioning as endowment.

Net Assets with Donor Restrictions - Net assets that are subject to explicit donor-imposed restrictions on the expenditure of contributions or income and gains on contributed assets, net assets from endowments not yet appropriated for spending by the School. In addition, net assets with donor restrictions include restricted contributions from donors classified as funds functioning as endowment. The School records as net assets with donor restrictions the original amount of gifts which donors have given to be maintained in perpetuity. Restrictions include support of specific departments of the School, professorships, research, faculty support, scholarships and fellowships, library and museum, building construction and other purposes. When time and purpose restrictions expire, net assets with donor restrictions are reclassified to net assets without donor restrictions.

Measure of Operations

Revenues earned and expenses incurred in conducting the programs and services of the School, including gifts and investment income, are presented in the consolidated financial statements as operating activities. Net revenues and other resources from operating activities are not restricted by donors or other external sources and are, therefore, classified as net assets without donor restrictions. At the discretion of the School, all or a portion of the net assets resulting from any operating income may be designated for budgetary purposes, for capital acquisitions, for student loan funds, for principal payments on debt, or for future use by the Board of Trustees.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Nonoperating revenue and expenses include net realized and unrealized gains and losses on the interest rate swaps, contributions to be invested by the School to generate a return that will support future operations, and investment return or loss beyond what the School has appropriated for current operational support in accordance with the School's investment return spending guidelines.

Revenue Recognition

Tuition revenue is recognized in the fiscal year in which the academic programs are delivered. Such revenue is presented at transaction prices, which are determined based on standard published rates for the services provided, less any financial aid awarded by the School to qualifying students. The amount of revenue per student may vary based on the specific programs or classes in which the student is enrolled. Sales and services of auxiliary enterprises revenue, which consists of room and board related services, is recognized when the related service is provided or performed. Generally, the School's performance obligations are satisfied equally over the academic term. The School applies the practical expedient as allowed for within the accounting standards and, therefore, does not disclose information about remaining performance obligations that have original expected durations of one year or less.

Amounts are due for tuition, fees, room, and board at the beginning of each semester. In accordance with the School's refund policies, students may receive a full or partial refund up to five weeks after the start of the semester. Student accounts receivable includes amounts to which the School is unconditionally entitled. In connection with the adoption of the revenue recognition standard in fiscal 2019, the School considers such amounts as unconditional based on the payment due date.

Gifts and pledges are recognized as revenue when received. Gifts specified for the acquisition or construction of long-lived assets are released to net assets without donor restrictions from net assets with donor restrictions when the assets are placed in service.

Unconditional promises to give that are expected to be collected within one year are recorded at their net realizable value. Amounts expected to be collected in future years are recorded as receivables at the present value of their expected cash flows, less an allowance for uncollectibles. The related revenue is assigned to net assets with donor restrictions until collected and any other restrictions are met, if so restricted by the donor.

Private grants are generally deemed to be exchange (reciprocal) transactions and fall under the scope of the new revenue recognition standard. The performance obligation for each grant or contract is deemed to be the research itself and revenue is recognized as the eligible grant activities are conducted. Transaction prices are based on budgets in the award agreement. Private grants are generally one year or less in duration.

Government grants and contracts are deemed to be non-exchange (nonreciprocal) transactions and fall under the contribution accounting guidance. Under this guidance, revenue related to conditional grants and contracts is recorded when the conditions are met. Most grants and contracts are on a cost reimbursement basis and require the School to incur eligible expenses prior to the release of funds.

Rhode Island School of Design

Notes to the Consolidated Financial Statements

Year Ended June 30, 2019 and 2018

(Dollars in thousands)

Investments

The fair values of publicly traded investments are determined based upon quoted market prices. The School's alternative investment funds are carried at estimated fair value determined by management, based upon valuations provided by management of the privately held investment funds as of June 30, 2019 and 2018. Alternative investments include limited partnerships, limited liability corporations, real estate, and offshore investment funds. Because investments in alternative investment funds are not marketable, the estimated value is subject to uncertainty and therefore, may differ significantly from the value that would have been used had a market for such investments existed and such differences could be material. U.S. government and agency obligations are valued by quoted market prices. Corporate bonds are valued using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads.

During the fiscal year ended June 30, 2018, the School began the transition from using multiple fund managers to using a single multi-strategy limited partnership fund (the "Fund"). The Fund's investment strategy focuses on varied traditional and nontraditional investment opportunities to provide a diversified single portfolio for investors. The Fund invests in the following asset classes: Equity (public and private), Hedge Funds, Real Assets (public and private), Fixed Income and Cash.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with maturities of three-months or less at the time of purchase. Cash equivalents are stated at cost, which approximates fair value. Cash restricted for the Perkins loans totaled \$1,324 and \$693 at June 30, 2019 and 2018, respectively.

Inventories

Inventories are stated at the lower of cost or net realizable value. The School uses the first-in, first-out method of accounting for inventory.

Split-Interest Agreements

The School is party to various split-interest agreements with regards to irrevocable trusts and other agreements. These agreements include: perpetual trusts, charitable remainder trusts, charitable gift annuities, and pooled life income funds. The assets of gift annuities and pooled income funds are included at fair value in Other investments on the Consolidated Statements of Financial Position. The obligations associated with these arrangements are recorded at present value of the aggregate liability to beneficiaries based upon life expectancy. Assets held by an outside trustee are classified as Funds held in trust by others or as Pledges receivable. These assets represent the School's share of the fair value of the trust assets as of the date of the Consolidated Statements of Financial Position net of a liability for the present value of estimated future payments to the donors or other beneficiaries, where applicable. Distributions of income from the trusts to the School are recorded as released from restriction when donor stipulations are met. Split-interest agreements and annuity obligations are based on certain assumptions regarding life expectancy, discount rate and rate of return. Circumstances affecting these assumptions can change the estimate of the liabilities in future periods.

Reclassification

Certain amounts related to 2018 have been reclassified to conform to the 2019 reporting format.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Property, Plant and Equipment

Property, plant and equipment is stated at acquisition cost or the fair value as of the date of the gift, net of accumulated depreciation (Note 9). Depreciation is computed on a straight-line basis over the following estimated useful lives:

| | |
|----------------------------------|-------------|
| Buildings and major improvements | 15–45 years |
| Machinery and equipment | 5 years |
| Furniture and fixtures | 5 years |

Expenditures for maintenance, repairs, interest and depreciation are expensed as incurred. Upon sale or retirement, the cost of the property and the related accumulated depreciation are removed from the respective accounts, and any resulting gains or losses are reflected in the Consolidated Statements of Activities.

Collections

The School does not capitalize or assign a value to the museum collections. Collections that are acquired through purchases and contributions are not recognized as assets on the Consolidated Statements of Financial Position. Purchases of collection items are recorded as decreases in net assets without donor restrictions in the year in which the items are acquired or in net assets with donor restrictions if the assets used to purchase items is restricted by donors.

Contributed collection items are not reflected in the consolidated financial statements. Proceeds from deaccessions or insurance recoveries are reflected as increases in the appropriate net asset classes.

Auxiliary Services

Auxiliary services include the RISD Store, dining halls, residence halls, and other on-campus undertakings that provide services to students, faculty, and staff for fees directly related, but not necessarily equivalent, to the costs of the services.

Deferred Income

Deferred income represents tuition and fees received for programs and services to be conducted predominantly in the next fiscal year.

Tax Status

The School is qualified for exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code. RH is qualified for exemption from Federal income tax under Section 501(c)(25) of the Internal Revenue Code.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Fair Value Measurements

The School complies with accounting guidance for *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Such guidance applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements.

The *Fair Value Measurements* standard emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement is determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace, as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable or can be corroborated by observable market data by correlation or other means.

Level 3 Unobservable inputs for an asset or liability that are supported by little or no market activity.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The School is permitted under US GAAP to estimate the fair value of an investment at the measurement date using the reported net asset value ("NAV") without further adjustment unless the entity expects to sell the investment at a value other than NAV or if the NAV is not calculated in accordance with US GAAP. The School's investments in private equity, mutual funds, hedge funds, and other securities are fair valued based on the most current NAV.

The School, through its outsourced primary investment firm, performs additional procedures including due diligence reviews on its investments in investment companies and other procedures with respect to the capital account or NAV provided to ensure conformity with US GAAP. The School has assessed factors including, but not limited to, managers' compliance with the *Fair Value Measurements* standard, price transparency, valuation procedures in place, the ability to redeem at NAV at the measurement date, and existence of certain redemption restrictions at the measurement date.

The guidance also requires additional disclosures to enable users of the consolidated financial statements to understand the nature and risk of the School's investments. Furthermore, investments which can be redeemed at NAV by the School on the measurement date or in the near term (defined as 90 days or less) are classified as Level 2. Investments which cannot be redeemed on the measurement date or in the near term are classified as Level 3. However, as required by US GAAP, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

Rhode Island School of Design

Notes to the Consolidated Financial Statements

Year Ended June 30, 2019 and 2018

(Dollars in thousands)

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606). This new accounting guidance outlines a single comprehensive model for entities to use in accounting for revenue for contracts with customers. The standard's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The School adopted ASU 2014-09 effective July 1, 2018 using the modified retrospective transition method which provides for application of the new standard to uncompleted contracts at the date of adoption without revising prior periods. The School determined that its major revenue streams of tuition and fees and sales and services of auxiliary enterprises as well as certain grants and contracts and other revenues were under the scope of the standard. Other revenues related to contributions, governmental grants and contracts, and investment return were determined to be outside the scope of ASU 2014-09 as they are covered by other accounting guidance. Upon adoption, the School determined that certain revenues related to summer 2018 sessions should be recognized during the fiscal year ended June 30, 2018. These revenues related to instruction days on summer sessions provided in June 2018. In fiscal 2018 and prior, the School recognized all summer session revenues in the subsequent fiscal year. Since the School adopted the modified retrospective transition method, the 2018 consolidated financial statements were not revised. Instead, a cumulative effect adjustment of \$809 was made to beginning net assets for fiscal 2019. In addition to the cumulative effect adjustment, the School has expanded its disclosures regarding revenue.

In August 2016, FASB issued ASU 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities. The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. The School adopted ASU 2016-14 in fiscal 2019, and has applied the changes retrospectively to all periods presented, except for the disclosures around liquidity and availability of resources and the analysis of expenses by nature and function which have been presented for fiscal 2019 only as permitted by the guidance. The new standard changes the following aspects of the consolidated financial statements:

- Unrestricted net assets were renamed "Net Assets Without Donor Restrictions"
- Temporarily and permanently restricted net assets were combined into a single net asset class called "Net Assets with Donor Restrictions"
- Disclosures on liquidity and availability of resources and natural classification of expenses were added.

The effect on the School's net asset balances at June 30, 2018 as a result of implementing ASU 2014-09 and 2016-14 are as follows:

Rhode Island School of Design
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| | <u>Without Donor Restrictions</u> | <u>With Donor Restrictions</u> | <u>Total</u> |
|--|---------------------------------------|------------------------------------|-------------------|
| Net assets, beginning, as previously presented | | | |
| Unrestricted | \$ 310,021 | \$ - | \$ 310,021 |
| Temporarily Restricted | - | 78,945 | 78,945 |
| Permanently Restricted | - | 58,542 | 58,542 |
| Net assets, beginning, as restated for ASU 2016-14 | <u>310,021</u> | <u>137,487</u> | <u>447,508</u> |
| Adoption of ASU 2014-09 | 809 | - | 809 |
| Net assets, beginning, as restated | <u>\$ 310,830</u> | <u>\$ 137,487</u> | <u>\$ 448,317</u> |

12The effect on the School's 2019 financial statements as a result of the adoption is as follows:

| | <u>Balance before Adoption of ASU 2014-09</u> | <u>Effect of Adoption</u> | <u>Balance after Adoption of ASU 2014-09</u> |
|-----------------------|---|-------------------------------|--|
| Net tuition and fees | \$ 104,688 | \$ (142) | \$ 104,546 |
| Auxiliary enterprises | 27,164 | (72) | 27,092 |
| Total | <u>\$ 131,852</u> | <u>\$ (214)</u> | <u>\$ 131,638</u> |

In June 2018, FASB issued ASU 2018-08, Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made. The guidance is intended to clarify and improve accounting guidance for contributions received and contributions made. The amendments in this ASU assist entities in: (1) evaluating whether transactions should be accounted for as a contribution (nonreciprocal transaction) or as an exchange (reciprocal transaction) subject to other guidance, and (2) determining whether a contribution is conditional. The guidance is only applied to agreements that were not completed at the date of adoption (July 1, 2018) and those entered into after that date. The guidance cannot be applied retrospectively. The School determined there were no significant changes to its consolidated financial statements from applying the new guidance as compared to prior guidance.

New Accounting Pronouncements

In February 2016, FASB issued ASU 2016-02, Leases. ASU 2016-02 was issued to increase transparency and comparability among entities. Lessees will need to recognize nearly all lease transactions (other than leases that meet the definition of a short-term lease) on the consolidated statements of financial position as a lease liability and a right-of-use asset (as defined). Lessor accounting under the new guidance will be similar to the current model. ASU 2016-02 is effective for the School in fiscal 2020. The School expects to use the optional transition method and recognize and measure leases at the beginning of the year of adoption and recognize a cumulative-effect adjustment to opening net assets in the year of adoption. The School is assessing the impact this standard will have on its consolidated financial statements.

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In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The standard addresses the classification of certain transactions within the statement of cash flows, including cash payments for debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, and distributions received from equity method investments. The ASU is effective for the School in fiscal year 2020. The School is assessing the impact this standard will have on its consolidated financial statements.

In November 2016, FASB issued ASU 2016-18, Restricted Cash. ASU 2016-18 requires that the statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts showing on the statement of cash flows. The guidance in ASU 2016-18 applies to all entities that have restricted cash or restricted cash equivalents and are required to present a statement of cash flows under Topic 230. ASU 2016-18 is effective for the School in fiscal 2020. Early adoption is permitted. The School is assessing the impact this standard will have on its consolidated financial statements.

In August 2018, FASB issued ASU 2018-13, Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. ASU 2018-13 modifies the disclosure requirements for fair value measurements and is effective for the School in fiscal 2021. Early adoption is permitted. The School is assessing the impact this standard will have on its consolidated financial statements.

In March 2019, FASB issued ASU 2019-03, Not-for-Profit-Entities (Topic 958) - Updating the Definition of Collections. ASU 2019-03 modifies the definition of the term 'collections' and require that a collection-holding entity disclose its policy for the use of proceeds from when collection items are deaccessioned. ASU 2019-03, expands the definition of 'collections' and now allows Not-for-Profit Entities that have collections to use funds from deaccessioned collection pieces to support the direct care of existing collections in addition to the current requirement that proceeds from sales of collection items be used to acquire other items for collection. ASU 2019-03 is effective for the School in fiscal 2021. Early adoption is permitted and ASU 2019-03 is to be applied on a prospective basis. The School is assessing the impact this standard will have on its consolidated financial statements.

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2. Fair Value of Financial Instruments

In accordance with accounting guidance for Fair Value Measurements, the tables below summarize the financial instruments carried at fair value on a recurring basis as of June 30, 2019 and 2018, aggregated by the level in the fair value hierarchy within which those measurements fall. However, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy and instead are included in the following tables as “investments valued using the NAV practical expedient”. The fair value amounts presented in the following tables are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Statements of Financial Position:

| | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Investments Valued Using the NAV Practical Expedient | Total Fair Value 2019 |
|--|--|--|--|---|-----------------------------|
| Assets | | | | | |
| Investments | | | | | |
| Cash and cash equivalents | \$ 978 | \$ - | \$ - | \$ - | \$ 978 |
| Multi-strategy limited partnership investment fund | - | - | - | 275,225 | 275,225 |
| Hedge funds | | | | | |
| Multi-strategy hedge fund of funds | - | - | - | 21,453 | 21,453 |
| Equity long hedge fund of funds | - | - | - | 19,584 | 19,584 |
| Fixed income | - | - | - | 8,103 | 8,103 |
| Private equity | - | - | - | 19,117 | 19,117 |
| Total investments | 978 | - | - | 343,482 | 344,460 |
| Bond Project Fund held in trust | | | | | |
| Cash and cash equivalents | 16,814 | - | - | - | 16,814 |
| Fixed income | - | 28,501 | - | - | 28,501 |
| Total Bond Project Fund held in trust | 16,814 | 28,501 | - | - | 45,315 |
| Beneficial interests held by third parties | | | | | |
| | - | - | 1,666 | - | 1,666 |
| Total assets at fair value | \$ 17,792 | \$ 28,501 | \$ 1,666 | \$ 343,482 | \$ 391,441 |
| Liabilities | | | | | |
| Interest rate swap | | | | | |
| | \$ - | \$ (4,182) | \$ - | \$ - | \$ (4,182) |
| Total liabilities at fair value | \$ - | \$ (4,182) | \$ - | \$ - | \$ (4,182) |

| | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Investments Valued Using the NAV Practical Expedient | Total Fair Value 2018 |
|--|--|--|--|---|-----------------------------|
| Assets | | | | | |
| Investments | | | | | |
| Cash and cash equivalents | \$ 1,762 | \$ - | \$ - | \$ - | \$ 1,762 |
| Multi-strategy limited partnership investment fund | - | - | - | 228,846 | 228,846 |
| Hedge funds | | | | | |
| Multi-strategy hedge fund of funds | - | - | - | 43,911 | 43,911 |
| Equity long hedge fund of funds | - | - | - | 34,838 | 34,838 |
| Fixed income | - | - | - | 16,161 | 16,161 |
| Private equity | - | - | - | 19,033 | 19,033 |
| Total investments | 1,762 | - | - | 342,789 | 344,551 |
| Beneficial interests held by third parties | | | | | |
| | - | - | 1,535 | - | 1,535 |
| Total assets at fair value | \$ 1,762 | \$ - | \$ 1,535 | \$ 342,789 | \$ 346,086 |
| Liabilities | | | | | |
| Interest rate swap | | | | | |
| | \$ - | \$ (2,058) | \$ - | \$ - | \$ (2,058) |
| Total liabilities at fair value | \$ - | \$ (2,058) | \$ - | \$ - | \$ (2,058) |

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The School's policy for allocation to Levels 1, 2, 3, and Investments Valued Using the Practical Expedient in the tables above are described in Note 1.

The value of alternative investments (principally limited partnership interests in hedge, private equity, and other similar funds) represents the ownership interest in the NAV of the respective partnership as reported by the general partner. The School has performed due diligence around its alternative investments to ensure that they are recorded at fair value, which is based on the NAV. However, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

Interest rate swaps are valued using both observable and unobservable inputs, such as quotations received from the counterparty, dealers or brokers, whenever available and considered reliable.

The following table is a rollforward of the Consolidated Statements of Financial Position amounts for financial instruments classified by the School within Level 3 of the fair value hierarchy defined above. Prior year transfers out represent the \$19,929 distribution from the Rayon Trust that was received in June 2018.

| | <u>Fair Value</u> <u>6/30/18</u> | <u>Realized</u> <u>Gains</u> <u>(Losses)</u> | <u>Unrealized</u> <u>Gains</u> <u>(Losses)</u> | <u>Purchases</u> | <u>Sales</u> | <u>Tranfers</u> <u>In (Out)</u> | <u>Fair Value</u> <u>6/30/19</u> |
|---|-------------------------------------|--|--|------------------|--------------|------------------------------------|-------------------------------------|
| Beneficial interests held by third parties | \$ 1,535 | \$ - | \$ 131 | \$ - | \$ - | \$ - | \$ 1,666 |

| | <u>Fair Value</u> <u>6/30/17</u> | <u>Realized</u> <u>Gains</u> <u>(Losses)</u> | <u>Unrealized</u> <u>Gains</u> <u>(Losses)</u> | <u>Purchases</u> | <u>Sales</u> | <u>Tranfers</u> <u>In (Out)</u> | <u>Fair Value</u> <u>6/30/18</u> |
|---|-------------------------------------|--|--|------------------|--------------|------------------------------------|-------------------------------------|
| Beneficial interests held by third parties | \$ 18,918 | \$ 2,470 | \$ 76 | \$ - | \$ - | \$ (19,929) | \$ 1,535 |

All net realized and unrealized gains in the tables above are reflected in the accompanying Consolidated Statements of Activities and relate to those financial instruments held by the School at June 30, 2019 and 2018.

There were no transfers between levels for the years ended June 30, 2019 and 2018.

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The following tables present liquidity information for the investments carried at fair value at June 30, 2019 and 2018, respectively.

| | Investments Asset Value as of June 30, 2019 | | | |
|--|--|-----------------------------|-----------------------------|----------------------|
| | Fair Value | Unfunded Commitments | Redemption Frequency | Notice Period |
| Investment type | | | | |
| Cash and cash equivalents | \$ 978 | \$ - | Liquid | N/A |
| Multi-strategy limited partnership investment fund | 275,225 | 649 | Semiannually | 120 Days |
| Hedge funds | | | | |
| Multi-Strategy Hedge Fund of Funds | 21,453 | - | Quarterly | 7 Days |
| Equity Long Hedge Fund of Funds | 19,584 | - | Quarterly | 7 Days |
| Fixed Income | 8,103 | - | Quarterly | 7 Days |
| Private equity | 19,117 | 4,835 | At Manager's Discretion | |
| Total | <u>\$ 344,460</u> | <u>\$ 5,484</u> | | |

| | Investments Asset Value as of June 30, 2018 | | | |
|--|--|-----------------------------|-----------------------------|----------------------|
| | Fair Value | Unfunded Commitments | Redemption Frequency | Notice Period |
| Investment type | | | | |
| Cash and cash equivalents | \$ 1,762 | \$ - | Liquid | N/A |
| Multi-strategy limited partnership investment fund | 228,846 | 703 | Semiannually | 120 Days |
| Hedge funds | | | | |
| Multi-Strategy Hedge Fund of Funds | 43,911 | - | Quarterly | 7 Days |
| Equity Long Hedge Fund of Funds | 34,838 | - | Quarterly | 7 Days |
| Fixed Income | 16,161 | - | Quarterly | 7 Days |
| Private equity | 19,033 | 8,988 | At Manager's Discretion | |
| Total | <u>\$ 344,551</u> | <u>\$ 9,691</u> | | |

3. Liquidity and Availability of Resources

The School's financial assets available, reduced by amounts not available for general use due to contractual or donor-imposed restrictions, within one year of the consolidated statement of financial position date for general expenditure as of June 30, 2019 are as follows:

| | <u>2019</u> |
|---------------------------|--------------------|
| Cash and cash equivalents | \$ 12,399 |
| Accounts receivable, net | 2,618 |
| | <u>\$ 15,017</u> |

The School's endowment funds consist of donor-restricted endowments and a quasi-endowment. Income from donor-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditure. The endowment has a spending rate of 5%, of which \$11,130 of appropriations from the quasi-endowment will be available within the next 12 months.

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In addition to the noted available financial assets, a significant portion of the School's annual expenditures will be funded by current year operating revenues. The School's cash flows have seasonal variations during the year, attributable to tuition billing and concentration of contributions received at calendar and fiscal year end. As part of the School's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. To help manage unanticipated liquidity needs, the School has a committed line of credit in the amount of \$10,000 (Note 19), which it could draw upon. In addition, the School has a board-designated endowment of \$250,926 (Notes 14, 15). Although the School does not intend to spend from its board-designated endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation process, amounts from the board-designated endowment could be made available if necessary. However, both the board-designated endowment and donor-restricted endowments contain investments with lock-up provisions that would reduce the total investments that could be made available.

4. Tuition and Fees

For the years ended June 30, 2019 and 2018, revenue from tuition and fees recognized by the School reflects aggregate reductions as follows:

| | <u>2019</u> | <u>2018</u> |
|--------------------------------|-------------------|-------------------|
| Tuition and fees | \$ 129,600 | \$ 124,532 |
| Less: | | |
| School sponsored financial aid | (22,326) | (20,604) |
| Donor sponsored financial aid | (2,728) | (1,726) |
| Net tuition and fees | <u>\$ 104,546</u> | <u>\$ 102,202</u> |

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5. Investment Income

Investment income for the year ended June 30, 2019 and 2018, was as follows:

| | 2019 | | | 2018 |
|------------------------------|------------------------------|---------------------------|------------------|------------------|
| | Without Donor Restriction | With Donor Restriction | Total | Total |
| Interest and dividend income | \$ 206 | \$ 3,997 | \$ 4,203 | \$ 3,933 |
| Realized gains | 34,814 | 8,928 | 43,742 | 39,897 |
| Net unrealized losses | <u>(22,902)</u> | <u>(8,918)</u> | <u>(31,820)</u> | <u>(14,596)</u> |
| Total investment return | <u>\$ 12,118</u> | <u>\$ 4,007</u> | <u>\$ 16,125</u> | <u>\$ 29,234</u> |

Reconciliation from Consolidated Statement of Activities

| | | |
|--|------------------|------------------|
| Investment income | \$ 17,738 | \$ 14,407 |
| Realized and unrealized losses on investments, net | <u>(1,613)</u> | <u>14,827</u> |
| Total investment return | <u>\$ 16,125</u> | <u>\$ 29,234</u> |

Investment management fees and other expenses (netted from interest and dividend income) totaled \$1,398 and \$868 for the year ended June 30, 2019 and 2018, respectively.

Certain net assets are pooled for investment income purposes. Units in the pool are assigned on the basis of fair value at the time net assets to be invested are received, and income is distributed monthly thereafter on a per-unit basis. The market value of long-term investments, as stated in the Consolidated Statements of Financial Position, represents the value of pooled endowment plus other nonpooled investments at June 30, 2019 and 2018.

6. Accounts Receivable

Accounts receivable consisted of the following at June 30, 2019 and 2018:

| | 2019 | 2018 |
|--|-----------------|-----------------|
| Student tuition and fees | \$ 1,730 | \$ 1,714 |
| Computer loan programs | 116 | 131 |
| Government grants | 883 | 580 |
| Other | <u>470</u> | <u>312</u> |
| | 3,199 | 2,737 |
| Less: Allowance for uncollectible accounts | <u>(465)</u> | <u>(350)</u> |
| Accounts receivable, net | <u>\$ 2,734</u> | <u>\$ 2,387</u> |

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7. Student Loans Receivable

Student Loans are made with funds advanced to the School by the Federal government under the Federal Perkins Loan Program.

The Federal Perkins loan program expired on September 30, 2017; after June 30, 2018, no new loans are permitted. Institutions are permitted to liquidate all Perkins loans or continue to service all or some of their outstanding Perkins loans. The School is continuing to service its Perkins loans while performing an ongoing assessment of the loan portfolio.

Student loans receivable consisted of the following at June 30, 2019 and 2018:

| | <u>2019</u> | <u>2018</u> |
|--|-----------------|-----------------|
| Student loan funds | \$ 2,603 | \$ 3,137 |
| Less: Allowance for uncollectible accounts | <u>(407)</u> | <u>(412)</u> |
| Student loans receivable, net | <u>\$ 2,196</u> | <u>\$ 2,725</u> |

U.S. Government Loan Funds

Under existing laws, Perkins loan funds of the United States Government are ultimately refundable to the extent funds are available from the program and are, therefore, shown as a liability on the Consolidated Statements of Financial Position, in the event that the Perkins Loan program ceases. This number represents the federal capital contribution and federal percentage of revenues and expenses for the current year's Perkins Loan program. At June 30, 2019 and 2018, the liability was \$1,988 and \$1,917, respectively.

Management regularly assesses the adequacy of the allowance for credit losses by performing evaluations on the student loan portfolio, current economic environment, and level of delinquent loans. The allowance is adjusted based on the results of these evaluations. Loans disbursed under the Federal Perkins Loan Program are able to be assigned to the Federal government in certain non-repayment situations. Management believes that this allowance at June 30, 2019 is adequate to absorb credit losses inherent in the portfolio as of that date. There were no changes in the allowance for credit losses for the year ended June 30, 2019.

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8. Pledges Receivable

Pledges receivable at June 30, 2019 and 2018, are expected to be realized in the following periods:

| | <u>2019</u> | <u>2018</u> |
|--|-----------------|-----------------|
| In one year or less | \$ 1,814 | \$ 1,733 |
| Between one year and five years, net of discount | 2,926 | 3,996 |
| Five years and over, net of discount | 696 | 862 |
| | <u>5,436</u> | <u>6,591</u> |
| Less: Allowance for uncollectible pledges | (475) | (574) |
| Pledges receivable, net | <u>\$ 4,961</u> | <u>\$ 6,017</u> |

Pledges receivable expected to be collected within one year are recorded at their net realizable value. Those expected to be collected in future years are recorded at the present value of estimated future cash flows. The present value of estimated future cash flows has been measured at the time of the pledge using rates indicative of the market and credit risk associated with the pledge. Discount rates used to calculate the present value of pledges receivable ranged from 0.72% to 2.91%, resulting in discounts of \$112 and \$203 for the years ended June 30, 2019 and 2018, respectively.

The School has pledges outstanding from Trustees of approximately \$3,044 in 2019 and \$4,005 in 2018.

9. Property, Plant and Equipment

| | <u>2019</u> | <u>2018</u> |
|------------------------------------|-------------------|-------------------|
| Land and buildings | | |
| Educational plant | \$ 191,393 | \$ 189,335 |
| Dormitories and refectory | 96,771 | 94,634 |
| Administrative and other | 39,028 | 35,308 |
| Residences | 1,723 | 1,693 |
| Building under capital lease | 7,275 | 7,275 |
| Construction in progress | 47,030 | 15,025 |
| Land | 9,017 | 9,017 |
| Land under capital lease | 2,537 | 2,537 |
| | <u>394,774</u> | <u>354,824</u> |
| Furniture, fixtures and equipment | 66,145 | 62,192 |
| | <u>460,919</u> | <u>417,016</u> |
| Less: Accumulated depreciation | (210,728) | (199,639) |
| Property, plant and equipment, net | <u>\$ 250,191</u> | <u>\$ 217,377</u> |

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Depreciation expense for the years ended June 30, 2019 and 2018 was \$11,089 and \$11,093, respectively.

Outstanding commitments on uncompleted construction contracts totaled \$221 at June 30, 2019.

10. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following at June 30, 2019 and 2018:

| | <u>2019</u> | <u>2018</u> |
|--|------------------|-----------------|
| Trade accounts payable | \$ 7,790 | \$ 4,540 |
| Accrued interest | 1,690 | 842 |
| Annuities payable | 297 | 360 |
| Accrued payroll | 424 | 410 |
| Accrued vacation | 532 | 538 |
| Payroll-related liabilities | 678 | 67 |
| Other | 5,353 | 2,616 |
| Accounts payable and accrued liabilities | <u>\$ 16,764</u> | <u>\$ 9,373</u> |

Included in trade accounts payable and other are construction related payables totaling \$8,576 and \$261 at June 30, 2019 and 2018, respectively.

11. Deferred Income

Deferred income primarily represents payments received for tuition, room and board prior to the start of the fall academic term, as well as unearned revenue for the summer 2019 term. The following table is a rollforward of the activities within deferred income for the year ended June 30, 2019:

| | <u>Balance at 6/30/18</u> | <u>Revenue recognized included in 6/30/18 Balance</u> | <u>Payments received in advance of performance</u> | <u>Balance at 6/30/19</u> |
|-------------------------------|-------------------------------|---|--|-------------------------------|
| Degree programs | \$ 2,613 | \$ (2,613) | \$ 2,241 | \$ 2,241 |
| Continuing education programs | 5,161 | (5,161) | 4,670 | 4,670 |
| Other | 322 | (322) | 190 | 190 |
| Total Deferred Income | <u>\$ 8,096</u> | <u>\$ (8,096)</u> | <u>\$ 7,101</u> | <u>\$ 7,101</u> |

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12. Obligations Under Long-Term Agreements

During fiscal year 2004, the School entered into a long-term agreement with a third party in order to purchase the Center for Integrative Technology building. The amount outstanding on the capital lease was \$4,704 and \$4,969 at June 30, 2019 and 2018, respectively. The net book value of the capital lease was \$7,239 and \$7,401 at June 30, 2019 and 2018, respectively. Based on a variety of assumptions, the current estimation is that the lease term will end on or about 2031.

Minimum annual lease payments due for the building over the next five years and thereafter are as follows:

| | | |
|------------------------------|----|---------|
| 2020 | \$ | 439 |
| 2021 | | 439 |
| 2022 | | 439 |
| 2023 | | 439 |
| 2024 | | 483 |
| 2025-2031 | | 3,529 |
| Total minimum lease payments | | 5,768 |
| Interest expense | | (1,064) |
| Total obligation | \$ | 4,704 |

The School presents an asset retirement obligation on its Consolidated Statements of Financial Position that represents the probability and projected cost to remedy certain environmental hazards in relation to its buildings and boiler systems. The asset retirement obligation was \$5,304 and \$5,038 at June 30, 2019 and 2018, respectively.

13. Bonds Payable and Other Debt

| <u>Name</u> | <u>Original Issue</u> | <u>Rate</u> | <u>Maturity</u> | <u>2019</u> | <u>2018</u> |
|--|-----------------------|---------------|-----------------|-------------|-------------|
| Rhode Island Health and Education Building Corporation | | | | | |
| Series 2008A | \$61,930 | 1.25% - 2.60% | 2035 | \$ 43,620 | \$ 45,400 |
| Series 2008B | \$31,850 | 1.25% - 2.60% | 2037 | 31,850 | 31,850 |
| Series 2012 | \$28,340 | 2.50% - 4.00% | 2031 | 23,510 | 24,245 |
| Series 2012B | \$51,815 | 2.50% - 5.00% | 2036 | 42,150 | 43,940 |
| Series 2018 | \$54,950 | 4.00% - 5.25% | 2049 | 54,950 | - |
| Bonds payable, net | | | | 196,080 | 145,435 |
| Add: Unamortized Premium on Bonds | | | | 9,453 | 4,254 |
| Less: Bond Issuance Costs | | | | (1,291) | (922) |
| Bonds payable, net | | | | \$ 204,242 | \$ 148,767 |

All bond premiums and issuance costs are being accreted straight line over the lives of the Bonds which approximates the effective interest basis. Amortization expense for the years ended June 30, 2019 and 2018, was \$316 and \$187, respectively.

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Rhode Island Health and Education Building Corporation (RIHEBC)

On September 13, 2018, the School sold \$54,950 par value, 30 year, 5% coupon tax exempt bonds, resulting in \$60,095 proceeds for use by RISD, net of issuance costs. The School is utilizing the bond proceeds to construct a new residential facility and address deferred maintenance in several buildings. The proceeds from the bonds were deposited into a Project Fund, which is held by the Bond Trustee. The Project Fund investments are classified as funds held in trust by others on the Consolidated Statements of Financial Position. Any unused funds at the earlier of the completion of the defined projects, or the third anniversary of the bond issuance date will be transferred into a Bond Fund, which must be used to repay bond redemptions or bond principal and interest payments as defined. The bonds maturing before August 15, 2029 are not subject to redemption prior to maturity (unless redeemed pursuant to the extraordinary redemption provisions). The bonds maturing on or after August 15, 2029 may be redeemed prior to maturity, at the option of the Institution beginning on or after August 15, 2028, in whole or in part at any time at their principal amounts, without premium, plus accrued interest to the redemption date.

Series 2008A and Series 2008B Bonds can be optionally redeemed on any interest payment date (the first business day of each month) at par plus accrued interest. RIHEBC Bonds (Series 2008A and Series 2008B) are due in principal amounts and mandatory redemption requirements ranging from \$1,800 in 2008 to \$13,945 in 2036. In the event that the School receives notice of any optional redemption on its Series 2008A and 2008B variable-rate bonds, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the School will be obligated to purchase the bonds redeemed.

Series 2012, 2012B and 2018 Bonds are subject to optional, extraordinary optional, and mandatory redemption.

On June 28, 2018, the School secured a \$31,850 letter of credit to cover an amount up to the outstanding balance of the 2008B Bonds at the time of redemption. Any payout was to be repaid immediately or accrue interest. If payout was not made in 90 days, the payout would convert to a term loan, due in five semi-annual installments beginning six months after the conversion date. The expiration date of this letter of credit is November 2, 2021.

On June 28, 2018, the School secured a new \$48,740 letter of credit to cover an amount up to the outstanding balance of the 2008A Bonds at the time of redemption plus 45 days' interest at the maximum rate of 12%. The expiration date of this letter of credit is November 2, 2021.

The School is required to comply with debt covenants to support its letters of credit. The debt service ratio minimum requirement is 1.15 to 1 and the liquidity ratio minimum requirement is 0.50 to 1. The School was in compliance with its debt covenant requirements as of June 30, 2019.

The School has pledged as collateral all revenue received in each fiscal year up to an amount equal to the debt service on the bonds due during the fiscal year.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Mandatory annual principal payments due for the next five years and thereafter are as follows:

| | <u>RIHEBC</u> |
|---------------------------|-------------------|
| 2020 | \$ 4,505 |
| 2021 | 4,705 |
| 2022 | 4,915 |
| 2023 | 6,110 |
| 2024 | 6,385 |
| 2025–2049 | <u>169,460</u> |
| Annual principal payments | <u>\$ 196,080</u> |

Cash paid for interest on long-term debt for the year ended June 30, 2019 and 2018, was \$5,932 and \$3,744, respectively. Total interest expense for the year ended June 30, 2019 and 2018, was \$6,316 and \$4,261, respectively.

The School has entered into various interest rate swap agreements to manage the interest cost and variable rate risk associated with its outstanding debt. The interest rate swap agreements were not entered into for trading or speculative purposes. The risks associated with interest rate swaps are primarily market risk. Under the terms of these agreements, the School pays a fixed rate, determined at inception, to a third party who in turn pays the School a variable rate on these respective notional principal amounts. During the years ended June 30, 2019 and 2018, the School incurred net realized and unrealized losses and gains of \$2,935 and \$1,426, respectively.

The interest rate swap balances are classified as liabilities on the Consolidated Statements of Financial Position. Net payments or receipts under the swap agreements, along with the change in fair value of the swaps, are included in nonoperating revenues on the Consolidated Statements of Activities.

In June 2017, the School restructured its \$28,500 callable swap by extending the call date from August 2019 to August 2024. As a result, the interest rate the School pays on this Swap was reduced from 3.94% to 2.68%. In addition, the School entered into a \$17,995 at-market future swap commencing on February 2020 to hedge a portion of its outstanding variable rate debt. RISD owns an option to cancel the swap beginning August 15, 2027 and semi-annual thereafter.

The following schedule presents the notional principal amounts of the School's interest rate swaps at June 30, 2019 and 2018.

| Maturity | Original Notional | Fair Value 2019 | Fair Value 2018 |
|----------------------------------|------------------------------|----------------------------|----------------------------|
| February 1, 2020 | \$ 18,000 | \$ (132) | \$ (240) |
| August 15, 2025 | 24,300 | (1,185) | (1,103) |
| August 15, 2034 | 28,500 | (2,052) | (988) |
| August 15, 2036 | 17,995 | <u>(813)</u> | <u>273</u> |
| Liability for interest rate swap | | <u>\$ (4,182)</u> | <u>\$ (2,058)</u> |

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

14. Net Assets

Details of the School's Net Assets are provided below:

| | <u>2019</u> | <u>2018</u> |
|---|-------------------|-------------------|
| Without donor restrictions | | |
| Designated funds | \$ 10,820 | \$ 11,888 |
| Designated for endowment | 250,926 | 251,995 |
| Capital and other undesignated funds | <u>47,974</u> | <u>46,138</u> |
| Total net assets without donor restrictions | 309,720 | 310,021 |
| With donor restrictions | | |
| Restricted by time or purpose | 83,842 | 78,945 |
| Restricted in perpetuity | <u>59,495</u> | <u>58,542</u> |
| Total net assets with donor restrictions | 143,337 | 137,487 |
| Total net assets | <u>\$ 453,057</u> | <u>\$ 447,508</u> |

15. Endowment Funds

The School's endowment consists of approximately 275 individual donor-restricted endowment funds and 36 board-designated endowment funds for a variety of purposes plus the following where the assets have been designated for endowment: pledges receivable, split interest agreements, and other net assets. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. The net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The School's Board of Trustees has interpreted the UPMIFA as requiring the preservation of the original gift as of the gift date(s) of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the School classifies as net assets with donor restrictions, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund is also classified as net assets with donor restrictions until those amounts are appropriated for expenditure by the School in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the School considers the following factors in making a determination to appropriate or accumulate endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the School and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and appreciation of investments
- (6) Other resources of the School
- (7) The investment policies of the School

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Endowment net asset composition by type of fund as of June 30, 2019 and 2018, were as follows:

| | 2019 | | |
|---|---------------------------------------|------------------------------------|-------------------|
| | Without Donor Restrictions | With Donor Restrictions | Total |
| Board-designated | | | |
| For scholarships | \$ 12,320 | \$ - | \$ 12,320 |
| For academic and institutional purposes | 236,130 | - | 236,130 |
| For museum support | 2,476 | - | 2,476 |
| Total board designated | <u>250,926</u> | <u>-</u> | <u>250,926</u> |
| Donor-restricted | | | |
| For scholarships | - | 41,020 | 41,020 |
| For academic and institutional purposes | - | 25,504 | 25,504 |
| For museum support | - | 33,681 | 33,681 |
| Total donor restricted | <u>-</u> | <u>100,205</u> | <u>100,205</u> |
| Total endowment funds | <u>\$ 250,926</u> | <u>\$ 100,205</u> | <u>\$ 351,131</u> |
| 2018 | | | |
| | Without Donor Restrictions | With Donor Restrictions | Total |
| Board-designated | | | |
| For scholarships | \$ 12,400 | \$ - | \$ 12,400 |
| For academic and institutional purposes | 237,103 | - | 237,103 |
| For museum support | 2,492 | - | 2,492 |
| Total board designated | <u>251,995</u> | <u>-</u> | <u>251,995</u> |
| Donor-restricted | | | |
| For scholarships | - | 40,581 | 40,581 |
| For academic and institutional purposes | - | 25,281 | 25,281 |
| For museum support | - | 33,592 | 33,592 |
| Total donor restricted | <u>-</u> | <u>99,454</u> | <u>99,454</u> |
| Total endowment funds | <u>\$ 251,995</u> | <u>\$ 99,454</u> | <u>\$ 351,449</u> |

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Changes in endowment net assets for the year ended June 30, 2019 and 2018, were as follows:

| | <u>Without Donor Restrictions</u> | <u>With Donor Restrictions</u> | <u>Total</u> |
|--|---------------------------------------|------------------------------------|-------------------|
| Endowment net assets at June 30, 2018 | \$ 251,995 | \$ 99,454 | \$ 351,449 |
| Investment return | | | |
| Investment income, net of fees | (475) | (186) | (661) |
| Net appreciation (realized and unrealized) | 10,708 | 4,162 | 14,870 |
| Total investment return | 10,233 | 3,976 | 14,209 |
| Gifts | 1 | 953 | 954 |
| Endowment return allocated for spending | (12,303) | (4,178) | (16,481) |
| Designated for endowment | 1,000 | - | 1,000 |
| Endowment net assets at June 30, 2019 | <u>\$ 250,926</u> | <u>\$ 100,205</u> | <u>\$ 351,131</u> |
| | | | |
| | <u>Without Donor Restrictions</u> | <u>With Donor Restrictions</u> | <u>Total</u> |
| Endowment net assets at June 30, 2017 | \$ 242,867 | \$ 87,356 | \$ 330,223 |
| Investment return | | | |
| Investment income, net of fees | (15) | (5) | (20) |
| Net appreciation (realized and unrealized) | 20,228 | 7,406 | 27,634 |
| Total investment return | 20,213 | 7,401 | 27,614 |
| Gifts | 40 | 5,436 | 5,476 |
| Endowment return allocated for spending | (11,125) | (3,349) | (14,474) |
| Transfer of net assets | - | 2,610 | 2,610 |
| Endowment net assets at June 30, 2018 | <u>\$ 251,995</u> | <u>\$ 99,454</u> | <u>\$ 351,449</u> |

The following provides additional information about the School's policies regarding the management of its endowment assets.

Endowment Funds with Deficits

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts ("underwater"). When donor endowment deficits exist, they are classified as a reduction of donor-restricted net assets. There were no endowment funds underwater as of June 30, 2019 and 2018, respectively.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

Return Objectives and Risk Parameters

The School has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle of approximately five years, is to maximize the return against various market indexes across the investment portfolio as determined by the Investment Committee while minimizing risk. The goal of each investment manager over the investment horizon is to exceed the appropriate market index. The overall portfolio is intended to embody no greater risk than the risk of a blend of the indexes assigned to the managers.

Strategies Employed for Achieving Investment Objectives

To achieve its long-term rate of return objectives, the School relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends).

Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives

The Board of Trustees of the School determines the method to be used to appropriate endowment funds for expenditure. In 2019 and 2018, the spending policy was to spend 5.00% and 4.75% of a rolling twelve-quarter average and twenty-quarter average, respectively.

16. Museum

Museum revenues for the year ended June 30, 2019 and 2018, are described below:

| | <u>2019</u> | <u>2018</u> |
|-----------------------|-----------------|-----------------|
| Service revenue | \$ 962 | \$ 1,167 |
| Investment income | 1,682 | 1,331 |
| Gifts and grants | <u>2,792</u> | <u>614</u> |
| Total museum revenues | <u>\$ 5,436</u> | <u>\$ 3,112</u> |

Collections

The majority of the School's collections resides in the Museum and consists of artifacts of historical significance, art objects and books that are held for educational, research, and curatorial purposes. Each of the items are cataloged, preserved, and cared for and activities verifying their existence and assessing their condition are performed periodically. The collections are subject to a policy that requires proceeds from their sales to be used to acquire other items for collections. The School expended \$932 and \$396 for acquisitions during the year ended June 30, 2019 and 2018, respectively. The School sold collections in the amount of \$0 and \$6 during the year ended June 30, 2019 and 2018, respectively. The sales proceeds were subsequently reinvested in the collection.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

17. Functional Expenses

The consolidated financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the School. Expenses reported by functional categories include allocations of costs for operation and maintenance of plant, interest on indebtedness and depreciation and amortization expense. The School applies various methods to allocate costs among the program and support functions, the most significant of which is by the amount of building space utilized.

Operating expenses by functional and natural classification for the year ended June 30, 2019, were as follows:

| | Instruction and Academic Support | Administrative and Institutional Support | Auxiliary Services | Museum | 2019 Total | 2018 Total |
|--|---|---|-------------------------------|------------------|-----------------------|-----------------------|
| Salaries and wages | \$ 41,706 | \$ 23,649 | \$ 4,463 | \$ 5,375 | \$ 75,193 | \$ 72,145 |
| Benefits | 12,207 | 5,924 | 1,447 | 1,922 | 21,500 | 20,229 |
| Contracted services | 2,686 | 10,062 | 1,352 | 2,659 | 16,759 | 13,996 |
| Depreciation, amortization and interest | 4,968 | 2,441 | 7,284 | 3,220 | 17,913 | 15,865 |
| Utilities, plant and equipment | 1,951 | 6,952 | 4,392 | 925 | 14,220 | 13,261 |
| Supplies and general | 1,851 | 888 | 5,473 | 376 | 8,588 | 9,307 |
| Other operating expenses | 1,859 | 949 | 102 | 198 | 3,108 | 3,119 |
| Total operating expenses | <u>\$ 67,228</u> | <u>\$ 50,865</u> | <u>\$ 24,513</u> | <u>\$ 14,675</u> | <u>\$ 157,281</u> | <u>\$ 147,922</u> |

Operating expenses by functional categories for the year ended June 30, 2018 were: instruction (\$51,215), research (\$351), academic support (\$7,564), student services (\$8,765), institutional support (\$26,433), operation and maintenance (\$29,915), auxiliary services (\$14,679), and museum (\$9,000). 2019 and 2018 functional expenses are not comparable as a result of a change in reporting methodology, as such it is not practicable to present 2018 functional expenses using the 2019 categories.

18. Retirement and Pension Plans

The School participates in the Teachers Insurance and Annuity Association (TIAA) for eligible faculty, administrative and staff employees. The School made contributions to the TIAA retirement plan which totaled approximately \$4,744 and \$4,442 for the year ended June 30, 2019 and 2018, respectively.

Rhode Island School of Design
Notes to the Consolidated Financial Statements
Year Ended June 30, 2019 and 2018
(Dollars in thousands)

19. Commitments and Contingencies

On November 2, 2015, the School secured a line of credit with TD Bank, N.A. of \$10,000. On May 7, 2019, the line of credit was amended to extend the maturity date to June 15, 2020. The School had no outstanding borrowings against the line of credit as of June 30, 2019 and 2018.

In conducting its activities from time to time the School is the subject of various claims and also has claims against others from time to time. In management's opinion, the ultimate resolution of such claims would not have a material adverse or favorable effect on the financial position of the School.

20. Subsequent Events

Management has evaluated subsequent events for the period after June 30, 2019, through October 25, 2019, the date the consolidated financial statements were issued.

**Rhode Island School of Design
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2019**

| Federal Grantor/ Program or Cluster Title | Federal CFDA Number | Pass-Through Entity | Pass-Through Entity Identification Number | Total Federal Expenditures |
|--|---------------------------|-----------------------------|--|----------------------------------|
| Student Financial Assistance Cluster | | | | |
| U.S. Department of Education | | | | |
| Federal Supplemental Educational Opportunity Grant Program | 84.007 | | | \$ 191,856 |
| Federal Work Study Program | 84.033 | | | 287,403 |
| Federal Perkins Loan Program | 84.038 | | | 3,355,228 |
| Federal Pell Grant Program | 84.063 | | | 1,747,153 |
| Federal Direct Student Loans | 84.268 | | | <u>15,131,212</u> |
| Total U.S. Department of Education and Student Financial Assistance Cluster | | | | <u>20,712,852</u> |
| Research and Development Cluster | | | | |
| National Aeronautics and Space Administration | | | | |
| Aerospace Education Services Program | 43.008 | Brown University | 00000780 | <u>8,549</u> |
| National Endowment for the Arts | | | | |
| NEA, Engagement | 45.024 | | | <u>45,000</u> |
| National Science Foundation | | | | |
| Office of Computer and Information Science and Engineering | 47.070 | | | 115,194 |
| Office of Education and Human Resources | 47.076 | | | 115,632 |
| Office of International Science and Engineering | 47.079 | University of New Hampshire | 16-017 | 36,083 |
| Office of Experimental Program to Stimulate Competitive Research | 47.081 | University of Rhode Island | 0005916/101817 | <u>107,324</u> |
| Total National Science Foundation | | | | <u>374,233</u> |
| Total Research and Development Cluster | | | | <u>427,782</u> |
| Total Expenditures of Federal Awards | | | | <u>\$ 21,140,634</u> |

Rhode Island School of Design

Notes to the Schedule of Expenditures of Federal Awards

Year Ended June 30, 2019

1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes federal award activity of Rhode Island School of Design (the "School") under programs of the federal government for the year ended June 30, 2019. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Because the Schedule presents only a selected portion of the operations of the School, it is not intended to and does not present the financial position, changes in net assets or cash flows of the School.

2. Relationship to Basic Financial Statements

Expenditures reported in the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain expenditures are not allowable or limited as to reimbursement.

3. Federal Student Loan Programs

The federal student loan program listed below is administered directly by the School, and balances and transactions relating to this program is included in the student loans receivable balance of the School's consolidated financial statements. Loans outstanding at the beginning of the year and loans made during the year are included in the federal expenditures presented in the Schedule. The balance of loans outstanding at June 30, 2019 consists of:

| | Outstanding Balance at June 30, 2019 |
|------------------------------|---|
| Federal Perkins Loan Program | \$ 2,961,646 |

4. Indirect Cost Rate

The School applies its predetermined approved facilities and administrative rate when charging indirect costs to federal awards rather than the 10% de minimus indirect cost rate allowed under the Uniform Guidance.

**Independent Auditors' Report on Internal Control
Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards***

To the Board of Directors of
Rhode Island School of Design

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Rhode Island School of Design (the "School"), which comprise the consolidated statement of financial position as of June 30, 2019, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 25, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the School's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control. Accordingly, we do not express an opinion on the effectiveness of the School's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be significant deficiencies or material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

New York, NY
October 25, 2019

**Independent Auditors' Report on Compliance
for the Major Federal Program and
Report on Internal Control Over Compliance
Required by the Uniform Guidance**

To the Board of Directors of
Rhode Island School of Design

Report on Compliance for the Major Federal Program

We have audited Rhode Island School of Design's (the "School") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the School's major federal program for the year ended June 30, 2019. The School's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the School's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the School's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the School's compliance.

Opinion on the Major Federal Program

In our opinion, the School complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2019.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2019-001. Our opinion on the major federal program is not modified with respect to this matter.

The School's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs and corrective action plan. The School's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the School is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the School's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We did identify a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as item 2019-001 that we consider to be a significant deficiency.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

New York, NY
November 22, 2019

**Rhode Island School of Design
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2019**

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unmodified

Internal control over financial reporting:

| | | | | |
|---|-------|-----|---------------|---------------|
| Material weakness(es) identified? | _____ | yes | _____ X _____ | no |
| Significant deficiency(ies) identified? | _____ | yes | _____ X _____ | None reported |

Noncompliance material to financial statements noted? _____ yes _____ X _____ no

Federal Awards

Internal control over the major federal program:

| | | | | |
|---|---------------|-----|---------------|---------------|
| Material weakness(es) identified? | _____ | yes | _____ X _____ | no |
| Significant deficiency(ies) identified? | _____ X _____ | yes | _____ _____ | None reported |

Type of auditors' report issued on compliance for the major federal program: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 516(a)? _____ X _____ yes _____ no

Identification of major federal program:

| <u>CFDA Number</u> | <u>Name of Federal Program or Cluster</u> |
|--------------------|---|
| 84.007 | Student Financial Assistance Cluster: |
| 84.033 | Federal Supplemental Educational Opportunity Grants |
| 84.038 | Federal Work Study Program |
| 84.063 | Federal Perkins Loan Program |
| 84.268 | Federal Pell Grant Program |
| | Federal Direct Student Loans |

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as low-risk auditee? _____ X _____ yes _____ no

Rhode Island School of Design

Schedule of Findings and Questioned Costs

Year Ended June 30, 2019

Section II - Financial Statement Findings

No findings noted.

Section III - Federal Award Findings and Questioned Costs

Finding 2019-001 - Gramm-Leach Bliley Act

Federal Program - Student Financial Assistance Cluster
Federal Agency - U.S. Department of Education
Pass-Through Entity - Not Applicable
CFDA Number - 84.007, 84.033, 84.038, 84.064, 84.268
Federal Award Year - June 30, 2019

Criteria: In accordance with Title IV regulations (CFR 314.1 (b)), an Institution is required to designate an individual to coordinate the information security program, perform a risk assessment that addresses (1) employee training and management; (2) information systems, including network and software design, as well as information processing, storage, transmission and disposal; and (3) detecting, preventing and responding to attacks, intrusions, or other systems failures, and document safeguards for identified risks.

Condition: The Institution has not designated an individual responsible for coordinating an information security program, nor has the Institution performed a risk assessment to address employee training and management related to information security as required by the Gramm-Leach Bliley Act ("GLBA").

Cause: The Institution does not have a designated coordinator nor has procedures and processes in place specific to GLBA.

Effect: Failure to comply with the requirements of GLBA standards puts the Institution at risk of compromising consumer nonpublic personal information.

Questioned costs: None.

Recommendation: The institution should designate an individual responsible for coordinating the information security program. Additionally, the Institution should perform and document an annual risk assessment to determine the institution's specific risks relevant to protecting consumer nonpublic personal information. At a minimum, the Institution should have at least one risk statement aligned or referenced to each of the three required areas noted in the GLBA law at 16 CFR 314.4 (b). Finally, the Institution should identify and document at least one safeguard (i.e., control) for each of the risks identified and documented in the risk assessment. Each control should be aligned or referenced to the risk(s) to which the safeguard applies.

Rhode Island School of Design

Schedule of Findings and Questioned Costs

Year Ended June 30, 2019

Views of Responsible Officials and Planned Corrective Actions: RISD management agrees with the finding related to Title IV regulations (CFR 314.1 (b)) and the following actions will be taken. We will coordinate a team of relevant individuals at RISD to modify and document RISD's Information Security Program to include specifications of the Gramm-Leach Bliley Act (GLBA). The modified Information Security Program will include at least one risk statement aligned to each of the three required areas noted in the GLBA law at 16 CFR 314.4 (b) and a plan for an annual risk assessment of consumer nonpublic personal information. It will also include the identification and documentation of safeguards for each of the risks identified in the risk assessment and delegate an individual responsible for coordinating the Information Security program. RISD will complete the plan by June 2020. In the interim, the Director of Network Services will continue to act as the information security officer and be the individual responsible for coordinating the information security program. We will be completing the statement of work for an external risk assessment that will begin in the fall of 2019. We continue to contract with CI Security for managed detection and response services.

Section IV - Summary Schedule of Prior Year Findings

No findings noted in the prior year.