

**Honolulu Academy of Arts  
dba Honolulu Museum of Art**

Financial Statements  
June 30, 2016 and 2015  
Together with Independent Auditor's Report



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A Hawaii Limited Liability Partnership

## **Independent Auditor's Report**

To the Board of Trustees of  
Honolulu Academy of Arts, dba Honolulu Museum of Art:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Honolulu Academy of Arts, dba Honolulu Museum of Art (the Museum), which comprise the statements of financial position as of June 30, 2016 and 2015, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

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

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

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Honolulu Academy of Arts, dba Honolulu Museum of Art, as of June 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

**Other Matters**

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of functional expenses for the year ended June 30, 2016 is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 as of and for the year ended June 30, 2016 is fairly stated in all material respects in relation to the financial statements as a whole.

Handwritten signature in black ink, appearing to read "KMH LLP".

KMH LLP

Honolulu, Hawaii  
February 17, 2017

**Honolulu Academy of Arts  
dba Honolulu Museum of Art**

Statements of Financial Position  
June 30, 2016 and 2015

**Assets**

	<u>2016</u>	<u>2015</u>
Cash and Cash Equivalents	\$ 3,640,525	\$ 5,258,440
Inventories	259,002	307,105
Contributions Receivable	948,113	1,454,303
Prepaid Expenses and Other	239,356	228,750
Contributed Rent	41,551	143,269
Investment in Real Estate	-	240,000
Land, Buildings, and Equipment, net	34,699,286	32,479,095
Long-term Investments	60,994,118	63,861,151
Beneficial Interest in Perpetual Trusts	15,661,602	17,081,350
	<u>\$ 116,483,553</u>	<u>\$ 121,053,463</u>
Total assets		

**Liabilities and Net Assets**

Liabilities:		
Accounts payable, accrued expenses, and other	1,341,336	987,287
Liabilities under split-interest agreements	2,257,965	2,379,747
Loans payable	3,000,000	-
Deferred revenue	421,256	470,965
Pension and other post-retirement obligations	4,658,121	5,054,636
	<u>11,678,678</u>	<u>8,892,635</u>
Total liabilities		

Commitments and Contingencies

Net Assets:		
Unrestricted:		
Undesignated	22,471,627	27,858,638
Board designated	552,451	132,551
Temporarily restricted	8,961,739	9,687,696
Permanently restricted	72,819,058	74,481,943
	<u>104,804,875</u>	<u>112,160,828</u>
Total net assets		
Total liabilities and net assets	<u>\$ 116,483,553</u>	<u>\$ 121,053,463</u>

See accompanying notes to financial statements.

**Honolulu Academy of Arts  
dba Honolulu Museum of Art**

Statement of Activities  
Year Ended June 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues, Gains, and Other Support:				
Gifts and bequests	\$ 2,732,511	\$ 1,492,060	\$ 63,569	\$ 4,288,140
Net realized and unrealized (loss) gain on investments	(1,143,201)	268,805	(306,706)	(1,181,102)
Gain on sale of investment in real estate, net	44,000		-	44,000
Loss on sale of land, buildings, and equipment	(251,390)			(251,390)
Change in value of split-interest agreements	(99,053)	4,704	-	(94,349)
Change in value of beneficial interest in perpetual trusts	-	-	(1,419,748)	(1,419,748)
Dividends and interest, net of investment fees and expenses of \$530,891	124,343	902,798	-	1,027,141
Museum shops and cafes	1,597,266		-	1,597,266
Income from Trusts:				
R. Allerton Acquisition Fund and R. Allerton Trust	705,724	45,008	-	750,732
Others	267,149	27,787	-	294,936
Membership dues	941,579	-	-	941,579
Tuition and fees	1,312,090		-	1,312,090
Admissions	350,549		-	350,549
Governmental grants	-	39,257	-	39,257
Special events and other, net	1,242,829	176,000	-	1,418,829
Net assets released from restrictions	3,682,376	(3,682,376)	-	-
Total revenues, net gains, and other support	<u>11,506,772</u>	<u>(725,957)</u>	<u>(1,662,885)</u>	<u>9,117,930</u>
Expenses:				
Program services:				
Education	4,457,193	-	-	4,457,193
Special exhibitions	2,799,260	-	-	2,799,260
Curatorial and conservation	2,083,733	-	-	2,083,733
Museum shop and cafes	2,105,663	-	-	2,105,663
Art acquisitions	190,785	-	-	190,785
Total program services	<u>11,636,634</u>	<u>-</u>	<u>-</u>	<u>11,636,634</u>
Supporting services:				
Management and general	3,096,213			3,096,213
Fundraising and development	1,741,036	-	-	1,741,036
Total supporting services	<u>4,837,249</u>	<u>-</u>	<u>-</u>	<u>4,837,249</u>
Total expenses	<u>16,473,883</u>	<u>-</u>	<u>-</u>	<u>16,473,883</u>
Change in net assets	(4,967,111)	(725,957)	(1,662,885)	(7,355,953)
Collections	-	-	-	-
Net Assets at Beginning of Year	<u>27,991,189</u>	<u>9,687,696</u>	<u>74,481,943</u>	<u>112,160,828</u>
Net Assets at End of Year	<u>\$ 23,024,078</u>	<u>\$ 8,961,739</u>	<u>\$ 72,819,058</u>	<u>\$ 104,804,875</u>

See accompanying notes to financial statements.

**Honolulu Academy of Arts  
dba Honolulu Museum of Art**

Statement of Activities  
Year Ended June 30, 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues, Gains, and Other Support:				
Gifts and bequests	\$ 2,007,863	\$ 2,050,264	\$ 295,189	\$ 4,353,316
Net realized and unrealized loss on investments	(315,241)	(419,425)	(434,710)	(1,169,376)
Loss on sale of investment in real estate, net	-	(5,682)	-	(5,682)
Change in value of split-interest agreements	(450,814)	9,024	-	(441,790)
Change in in value of beneficial interest in perpetual trusts	-	-	(893,605)	(893,605)
Dividends and interest, net of investment fees and expenses of \$376,532	284,966	2,203,624	-	2,488,590
Museum shops and cafes	1,639,008	71,810	-	1,710,818
Income from Trusts:				
R. Allerton Acquisition Fund and R. Allerton Trust	679,202	54,447	-	733,649
Others	262,181	27,071	-	289,252
Membership dues	958,036	-	-	958,036
Tuition and fees	1,257,726	88,143	-	1,345,869
Admissions	449,683	60	-	449,743
Governmental grants	-	17,527	-	17,527
Special events and other, net	1,382,209	200,717	-	1,582,926
Net assets released from restrictions	8,864,946	(8,864,946)	-	-
Total revenue, net gains, and other support	<u>17,019,765</u>	<u>(4,567,366)</u>	<u>(1,033,126)</u>	<u>11,419,273</u>
Expenses:				
Program services:				
Education	4,081,405	-	-	4,081,405
Special exhibitions	2,568,322	-	-	2,568,322
Curatorial and conservation	1,900,268	-	-	1,900,268
Museum Shop and Cafes	2,013,977	-	-	2,013,977
Art acquisitions	332,249	-	-	332,249
Total program services	<u>10,896,221</u>	<u>-</u>	<u>-</u>	<u>10,896,221</u>
Supporting services:				
Management and general	2,373,228	-	-	2,373,228
Fundraising and development	1,284,449	-	-	1,284,449
Total supporting services	<u>3,657,677</u>	<u>-</u>	<u>-</u>	<u>3,657,677</u>
Total expenses	<u>14,553,898</u>	<u>-</u>	<u>-</u>	<u>14,553,898</u>
Change in net assets	2,465,867	(4,567,366)	(1,033,126)	(3,134,625)
Collections	-	-	-	-
Net Assets at Beginning of Year	<u>25,525,322</u>	<u>14,255,062</u>	<u>75,515,069</u>	<u>115,295,453</u>
Net Assets at End of Year	<u>\$ 27,991,189</u>	<u>\$ 9,687,696</u>	<u>\$ 74,481,943</u>	<u>\$ 112,160,828</u>

See accompanying notes to financial statements.

**Honolulu Academy of Arts  
dba Honolulu Museum of Art**

Statements of Cash Flows  
Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities:		
Change in net assets	\$ (7,355,953)	\$ (3,134,625)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,123,107	1,127,742
Net realized and unrealized loss on investments	1,181,102	1,169,376
(Decrease) increase in pension and other retirement obligations	(396,515)	257,384
Loss on disposal of land, buildings, and equipment	256,404	-
Gain on sale of investment in real estate	(44,000)	(250,000)
Change in value of split-interest agreements	1,419,748	1,335,395
Contributions restricted for long-term investment	(700,081)	(593,208)
Changes in operating assets and liabilities:		
Decrease (increase) in inventories	48,103	(32,696)
Decrease in contributions receivable	506,190	1,954,834
Increase in prepaid expenses and other	(10,606)	(15,740)
Increase (decrease) in accounts payable and accrued expenses	116,759	(39,949)
Decrease in liabilities under split-interest agreements	(121,782)	(274,293)
(Decrease) increase in deferred revenue	(49,709)	310,838
(Decrease) increase in other liabilities	(2,832)	4,778
Net cash (used in) provided by operating activities	<u>(4,030,065)</u>	<u>1,819,836</u>
Cash Flows from Investing Activities:		
Proceeds from sale of investments	41,753,644	21,826,324
Proceeds from sale of investment in real estate	284,000	4,800,000
Purchase of investments	(40,067,713)	(20,921,355)
Purchases of land, buildings and equipment	(3,257,862)	(381,704)
Net cash (used in) provided by investing activities	<u>(1,287,931)</u>	<u>5,323,265</u>

(continued)

See accompanying notes to financial statements.

**Honolulu Academy of Arts  
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Statements of Cash Flows  
Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from Financing Activities:		
Proceeds from issuance of loans payable	3,000,000	-
Payments on loans payable	-	(3,989,263)
Proceeds from contributions restricted for:		
Investment in endowment	693,990	364,928
Investment in land, buildings, and equipment	<u>6,091</u>	<u>228,280</u>
Net cash provided by (used in) financing activities	<u>3,700,081</u>	<u>(3,396,055)</u>
Net (decrease) increase in cash and cash equivalents	(1,617,915)	3,747,046
Cash and Cash Equivalents, beginning of year	<u>5,258,440</u>	<u>1,511,394</u>
Cash and Cash Equivalents, end of year	<u>\$ 3,640,525</u>	<u>\$ 5,258,440</u>
Supplemental Disclosure of Cash Flow Information --		
Interest Paid	<u>\$ 32,044</u>	<u>\$ 50,887</u>
Supplemental Disclosure of Noncash Activities:		
Receipt of investment in real estate held in contribution receivable	<u>\$ -</u>	<u>\$ 240,000</u>
Purchases of land, buildings and equipment included in liabilities	<u>\$ 240,122</u>	<u>\$ -</u>

See accompanying notes to financial statements.



# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies

### a. General

The Honolulu Academy of Arts dba Honolulu Museum of Art (the Museum) was founded in 1927 to provide educational and cultural enrichment in the arts. It is a private, nonprofit institution accredited by the American Association of Museums. The Museum's operations are conducted in the state of Hawaii.

On July 1, 2011, subject to the restrictions and conditions of the gift agreement signed by The Contemporary Museum (TCM) and the Museum, TCM gifted artwork, real property, pledge receivables, cash, and investments, to the extent transferable, to the Museum. The Museum recorded approximately \$25,491,000 as gifts and bequests related to the gift agreement based on restrictions stipulated by the donor.

### b. Financial Statement Presentation

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

*Unrestricted Net Assets* – Net assets not subject to donor-imposed stipulations.

*Temporarily Restricted Net Assets* – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Museum and/or the passage of time.

*Permanently Restricted Net Assets* – Net assets subject to donor-imposed stipulations that must be maintained permanently by the Museum. The donors of these assets permit the Museum to use all of the income earned on related investments for general or specific purposes.

### c. Cash and Cash Equivalents

The Museum considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Included in investments are cash and cash equivalents designated by the Board to be held in investment accounts for routine purchases and sales of investments.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### d. Inventories

Merchandise inventories consist of gift shop and cafe items and are recorded at the lower of cost (specific identification) or market.

### e. Investments

Marketable securities are reported at fair value in the statements of financial position with unrealized gains and losses included in the statements of activities. Fair value is based on quoted market prices or other methods as further described in Note 12.

Gains and losses on investments are reported in the statements of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

### f. Investment in Real Estate

Investment in real estate is reported at the lower of carrying value or fair value and is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques, including quoted market values and third-party independent appraisals, as considered necessary.

### g. Land, Buildings, and Equipment

Land, buildings, and equipment are capitalized at cost, if purchased, or at fair market value at the date of the donation, if contributed. Assets contributed for which the fair value is not determinable at the date of donation are recorded as support if and when such values are determined.

The Museum reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Museum reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### g. Land, Buildings, and Equipment (continued)

Depreciation on buildings and equipment is calculated on the straight-line method over the estimated economic life of the assets.

In 2016, the Museum purchased real property consisting of land and an existing building, for \$2.8 million. The land and building were purchased with the intent to demolish the building and repave the lot to expand the current staff parking lot at 1035 Kinau Street. The Museum recognized a loss on disposal at June 30, 2016 of \$251,390 based on the appraised value of the existing building at acquisition, as the building was demolished in October 2016.

### h. Contributions

Contributions are recorded in the period received. Unconditional promises to give (contributions receivable) that are expected to be collected within one year are recorded at net realizable value. Contributions receivable that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using fair value rates in the years in which promises are received. Amortization of the discounts is included in gifts and bequests in the accompanying statements of activities. Conditional contributions are recorded at their estimated fair value in the period the conditions are met or in the period received if there is only a remote likelihood that those conditions will not be met.

The Museum provides an allowance for uncollectible contributions based upon historical experience with its donors as well as individual donor circumstances.

The Museum reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statements of activities as net assets released from restrictions.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### i. Split-Interest Agreements

The Museum's split-interest agreements with donors consist of irrevocable pooled income funds, charitable remainder trusts, and charitable gift annuities for which the Museum serves as trustee. Assets held under these split-interest agreements are included in investments. Contribution revenues are recognized upon the effective date of the split-interest agreements as gifts and bequests in the accompanying statements of activities.

Liabilities are recorded for the present value (utilizing discount rates ranging between 4% and 7.25%) of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are subsequently adjusted during the term of the split-interest agreements for changes in the fair value of the assets, accretion of the discount, and other changes in the estimates of future benefits.

For the years ended June 30, 2016 and 2015, gifts and bequests related to pooled income funds, charitable remainder trusts, and charitable gift annuities amounted to approximately nil and \$20,000, respectively, and are included in gifts and bequests in the accompanying statements of activities. For the years ended June 30, 2016 and 2015, decreases in the value of liabilities under split-interest agreements related to pooled income funds, charitable remainder trusts, and charitable gift annuities amounted to (\$121,782) and (\$274,293), and are included in change in value of split-interest agreements in the accompanying statements of activities.

### j. Beneficial Interest in Perpetual Trusts

The Museum receives contributions of interests in irrevocable perpetual trusts of which third-party entities serve as trustee. Initial recognition and subsequent adjustments to the Museum's beneficial interest in the trust assets' carrying values are recognized as gifts and bequests revenue and changes in value of beneficial interest in perpetual trusts, respectively, and are classified as permanently restricted, as the trusts are to be invested in perpetuity by the trustee. For the years ended June 30, 2016 and 2015, income generated from the Museum's interests in beneficial interest in perpetual trusts amounted to \$1,045,668 and \$1,022,902, respectively, and are recorded as income from trusts in the accompanying statement of activities. For the years ended June 30, 2016 and 2015, changes in the value of split-interest agreements associated with beneficial interests in perpetual trusts amounted to \$(1,419,748) and \$(893,605), respectively, and are recorded as change in value of beneficial interest in perpetual trusts in the accompanying statements of activities. There were no new beneficial interests in perpetual trusts received in 2016 and 2015.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### k. Art Collection

The Museum's art collection comprises works of art, which are held for exhibition, research, and educational purposes. Each of the items is cataloged, preserved, and cared for, and activities verifying their existence and assessing their condition are performed continuously. The collections are subject to a policy that requires proceeds from their sales to be used to acquire other items for the collection.

Works of art in the Museum's collection are not recognized as assets in the statements of financial position. Purchases of art are recorded as decreases in unrestricted net assets in the year in which the items are acquired.

### l. Pension and Other Postretirement Plans

The Museum had a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. The benefits were based on age, years of service, and the level of compensation during the five years before retirement. The Museum also sponsors a defined benefit postretirement plan for select employees.

Effective June 30, 2015, the Museum terminated the pension plan. All vested benefits were settled with participants in 2017 and the Plan's assets were liquidated.

The Museum records annual amounts relating to its pension and postretirement plans based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, and turnover rates. The Museum reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The Museum believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions. The effect of modifications to those assumptions is recorded in its changes in unrestricted net assets and amortization to net periodic cost over future periods. The Museum uses a measurement date of June 30.

The net periodic costs are recognized as employees render the services necessary to earn the pension and postretirement benefits.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### m. Deferred Revenue

Deferred revenue represents table and ticket sales collected for future events and exhibition fees received as deposits for traveling exhibitions organized by the Museum and displayed subsequent to year-end.

### n. Income Taxes

The Museum is exempt from income taxes under Section 501 (c)(3) of the Internal Revenue Code and the Hawaii Revised Statutes. The Museum is also exempt from Hawaii general excise tax on gross receipts directly related to its mission. However, the Museum is subject to income and Hawaii general excise taxes on any net income or gross receipts that are derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

The Museum recognizes the effect of income tax positions only if it is more-likely-than-not that the tax position will be sustained upon examination by taxing authorities, based on the technical merits of the position. The tax effects recognized in the financial statements from such a position are measured based on the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Any interest or penalties related to any unrecognized tax benefit/liability are classified as management and general expenses.

The Museum has evaluated its tax positions and determined that there were no uncertain tax positions at June 30, 2016 and 2015.

### o. Long-Lived Assets

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, the Museum first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### o. Long-Lived Assets (continued)

carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques, including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary.

### p. Fair Value Measurements

The Museum applies the provisions of Accounting Standards Codification (ASC) Topic 820 to nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Museum's alternative investments consist of hedge funds, opportunistic and other funds of funds, and have been measured at fair value using the net asset value per share (or its equivalent) as a practical expedient in accordance with ASC Topic 820-10.

The Museum has elected to early adopt the provisions of Accounting Standards Update (ASU) No. 2015-07, *Investments in Certain Entities That Calculate Net Asset Value per Share*, as of June 30, 2016. This ASU amends ASC Topic 820-10 to allow for the exclusion of the Museum's alternative investments from classification in the fair value hierarchy and the related disclosures of changes in fair value for level 3 investments. The disclosures in Note 12 as of June 30, 2015 have been restated to reflect the adoption of this guidance.

### q. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the valuation of contributions and other receivables, real estate, long-term investments, beneficial interest in perpetual trusts, liabilities under split-interest agreements, and assets and obligations related to retirement plans. Actual results could differ from those estimates.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### r. Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which sets forth a new revenue recognition model, codified in FASB ASC Topic 606-10. In August 2015, the FASB issued ASU No. 2015-14, which deferred the effective date of the amendments in ASU 2014-09 by one year to the year ending June 30, 2019. The amendments in ASU 2014-09 require entities to recognize revenue to depict the transfer of 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 Museum is currently assessing the impact of ASU 2014-09 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases. The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The new standard is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Museum is currently assessing the impact of ASU 2016-02 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. The ASU focuses on improving the current net asset classification requirements and replaces the existing three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) with two new classes of net assets – *net assets with donor restrictions* and *net assets without donor restrictions*. The ASU also requires specific quantitative and qualitative information to be presented in the financial statements and



# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 1. Summary of Operations and Significant Accounting Policies (continued)

### r. Recently Issued Accounting Standards

notes that is useful in assessing a not-for-profit's liquidity, availability of resources, financial performance and cash flows. The ASU is effective for annual fiscal periods beginning after December 15, 2017. The Museum is currently assessing the impact of ASU 2016-14 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

## 2. Contributions Receivable

Contributions receivable amounted to \$948,113 and \$1,454,303 at June 30, 2016 and 2015, respectively. The amounts expected to be received in less than one year and in one to five years are \$455,410 and \$492,703 at June 30, 2016, respectively. The amounts expected to be received in less than one year and in one to five years are \$496,325 and \$957,978 at June 30, 2015, respectively.

## 3. Contributed Rent

The Museum leases land and a building for its Art School from the state of Hawaii. The lease is for a term of 55 years, through November 30, 2041. For the 10-year period beginning December 1, 2006, the lease is payable in annual installments of \$480. The annual rent will then be renegotiated at the expiration of the fortieth (2026), and fiftieth (2036) year. The lease was renegotiated effective December 1, 2016 at the same annual installment amount of \$480.

Contributed rent represents the net present value of the difference between the fair rental value of the property and the stated amount of the lease payments, which does not exceed the fair value of the real property at the lease commencement date. The amount is considered a temporarily restricted asset and will be released to unrestricted over the lease term.

Contributed rent at June 30, 2016 and 2015 is \$41,551 and \$143,269, respectively, and the related amortization for the years ended June 30, 2016 and 2015 is \$101,718 and \$106,612, respectively. The contribution is discounted over a 10-year period using a risk-free rate as of December 1, 2006 (lease date) of 4.81%.

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Notes to Financial Statements  
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**4. Land, Buildings, and Equipment**

A summary of land, buildings, and equipment at June 30, 2016 and 2015 is as follows:

	Depreciable lives	Cost	
		2016	2015
Depreciable assets:			
Land improvements	20 years	\$ 359,919	\$ 333,669
Buildings	20–50 years	38,170,958	38,003,946
Equipment	5–10 years	5,552,232	5,213,341
		44,083,109	43,550,956
Less accumulated depreciation		(18,676,497)	(17,660,443)
		25,406,612	25,890,513
Land		9,052,552	6,530,276
Construction in progress		240,122	58,306
		<u>\$ 34,699,286</u>	<u>\$ 32,479,095</u>

Depreciation expense for the years ended June 30, 2016 and 2015 was \$1,021,389 and \$1,021,132, respectively.

**5. Art Collection**

The Museum's collections, acquired through purchase and contributions, are not recognized as assets on the statements of financial position. Purchases of collection items are recorded in the year in which the items were acquired. Contributed collection items are not reflected in the financial statements. The cost of art objects purchased was \$190,785 and \$332,249 for the years ended June 30, 2016 and 2015, respectively, and is reported in the statements of activities.

Gifts of cash or other property restricted by donors for the purchase of art and artifacts for the collection or proceeds from deaccessions are recognized as income in temporarily restricted net assets and are only available to purchase art and artifacts for the Museum's collection. Proceeds from sale of collection items during the years ended June 30, 2016 and 2015 was \$12,535 and \$119,096, respectively, and included in special events and other, net on the Statement of Activities. Unexpended gifts are included in the temporarily restricted net assets at June 30, 2016 and 2015.

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Notes to Financial Statements  
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**6. Loans Payable**

Loans payable at June 30, 2016 and 2015 consist of the following:

	<u>2016</u>	<u>2015</u>
Borrowings under a \$3,000,000 term loan with a bank, various interest rate options available at bank's base rate or LIBOR (0.92% at June 30, 2016), interest-only payments due monthly, principal due upon maturity in December 2018; secured by certain investments	\$ 3,000,000	\$ -
Total loans payable	<u>\$ 3,000,000</u>	<u>\$ -</u>

In May 2015, the principal balance of \$3,989,263 on prior loans payable was paid in full. Interest expense on loans payable totaled \$32,044 and \$50,195 for the years ended June 30, 2016 and 2015, respectively.

**7. Commitments and Contingencies**

**a. Leases**

The Museum leases land, building, and improvements from the state of Hawaii for its Art School under an operating lease agreement that expires in 2041. The Museum also leases storage space under various operating leases on a month-to-month basis.

Total rent expense under operating leases for the years ended June 30, 2016 and 2015 was \$241,039 and \$220,268, respectively.

Future minimum lease commitments under non-cancelable operating leases as of June 30, 2016 are as follows:

Year ending June 30:		
2017	\$	480
2018		480
2019		480
2020		480
2021		480
Thereafter		9,800
	<u>\$</u>	<u>12,200</u>

**Honolulu Academy of Arts  
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Notes to Financial Statements  
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**7. Commitments and Contingencies (continued)**

**b. Contingencies**

There is legal action pending against the Museum in the normal course of business. Although the outcome of the action against the Museum cannot be predicted with certainty, after consultation with legal counsel, management believes that the resolution of these matters will not likely have a material adverse effect on the Museum's financial position, results of operations or cash flows.

**8. Temporarily Restricted Net Assets**

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

	2016	2015
Spalding House	\$ 167,592	\$ 167,592
Education	1,177,408	1,413,887
Named galleries and other purposes	5,910,651	6,171,029
Art acquisitions	812,896	963,482
Special exhibitions	596,678	532,118
Curatorial and conservation	296,514	439,588
	<u>\$ 8,961,739</u>	<u>\$ 9,687,696</u>

Net assets in the amount of \$3,682,376 and \$8,864,946 for the years ended June 30, 2016 and 2015, respectively, were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows:

	2016	2015
Special exhibitions	\$ 542,788	\$ 458,165
Investment in real estate	-	(248,154)
Education	628,711	640,697
Curatorial and conservation	537,140	628,786
Art acquisitions	412,549	1,249,257
Auxiliary and other	1,561,188	6,136,195
	<u>\$ 3,682,376</u>	<u>\$ 8,864,946</u>

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Notes to Financial Statements  
June 30, 2016 and 2015

**9. Permanently Restricted Net Assets**

At June 30, 2016 and 2015, permanently restricted net assets (e.g., endowment funds) consisted of the following:

	<u>2016</u>	<u>2015</u>
Museum operations	\$ 56,534,240	\$ 58,213,274
Art acquisitions	6,446,559	7,644,560
Curatorial and conservation	4,904,976	3,566,818
Education	3,557,008	3,502,708
Special exhibitions	<u>1,376,275</u>	<u>1,554,583</u>
	<u>\$ 72,819,058</u>	<u>\$ 74,481,943</u>

**10. Retirement Benefit Plans**

The Museum had a noncontributory defined benefit pension plan (pension plan) covering substantially all of its employees upon their retirement. The benefits were based on age, years of service, and the level of compensation during the five years before retirement. The Museum made annual contributions to the plan consistent with the funding requirements of the Employee Retirement Income Security Act. The pension plan was frozen on June 1, 2009, and no participants have accrued any benefits under the pension plan after the plan's freeze.

Effective June 30, 2015, the Museum terminated the pension plan. All vested benefits were settled with participants as of December 31, 2016 through lump-sum distributions or the purchase of annuity contracts. At June 30, 2016 and 2015, the accrued pension liability of approximately \$4.2 million and \$4.6 million, respectively, includes the additional contributions required for all vested benefits due and additional plan expenses associated with the termination.

The Museum also sponsors a noncontributory defined benefit supplemental retirement plan that provides retirement benefits to select full-time employees.

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Notes to Financial Statements  
June 30, 2016 and 2015

**10. Retirement Benefit Plans (continued)**

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at June 30, 2016 and 2015:

	2016		2015	
	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>
Benefit obligation	\$ (10,189,588)	\$ (475,838)	\$ (10,656,857)	\$ (487,674)
Fair value of plan assets	<u>6,007,305</u>	<u>-</u>	<u>6,089,895</u>	<u>-</u>
Funded status	<u>\$ (4,182,283)</u>	<u>\$ (475,838)</u>	<u>\$ (4,566,962)</u>	<u>\$ (487,674)</u>
Amounts recognized in the statements of financial position consist of:				
Liabilities	\$ 4,182,283	\$ 475,838	\$ 4,566,962	\$ 487,674

Amounts recognized in change in net assets consist of the following:

	2016		2015	
	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>
Net periodic benefit cost	\$ (166,451)	\$ (15,542)	\$ (154,584)	\$ (17,849)
Net gain (loss)	<u>(698,870)</u>	<u>(26,042)</u>	<u>(442,723)</u>	<u>164,353</u>
	<u>\$ (865,321)</u>	<u>\$ (41,584)</u>	<u>\$ (597,307)</u>	<u>\$ 146,504</u>

The Museum recognizes net periodic pension cost as part of its employee benefits expense included in program expenses the accompanying statements of activities.

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Notes to Financial Statements  
June 30, 2016 and 2015

**10. Retirement Benefit Plans (continued)**

Weighted average assumptions used to determine benefit obligations for 2016 and 2015 were as follows:

	2016		2015	
	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>
Discount rate	3.40%	2.52%	4.21%	3.37%
Expected long-term rate of return on plan assets	3.95%	-	3.95%	-
Rate of compensation increase	-	-	-	-

Weighted average assumptions used to determine net benefits cost for 2016 and 2015 were as follows:

	2016		2015	
	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>	<u>Pension benefits</u>	<u>Supplemental retirement plan benefits</u>
Discount rate	4.21%	3.37%	4.03%	2.70%
Expected long-term rate of return on plan assets	3.95%	N/A	4.20%	N/A
Rate of compensation increase	-	N/A	-	N/A

In 2016, the Museum changed the composition of the plan assets resulting in an overall expected long-term rate of return on plan assets of 3.95%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the return on individual asset categories. The return is based exclusively on historical performance of similar assets, without adjustments.

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Notes to Financial Statements  
June 30, 2016 and 2015

**10. Retirement Benefit Plans (continued)**

The following table summarizes employer contributions and benefits paid during the years ended June 30, 2016 and 2015:

	2016		2015	
	Pension benefits	Supplemental retirement plan benefits	Pension benefits	Supplemental retirement plan benefits
Employer contributions	\$ 1,250,000	\$ 53,420	\$ 140,000	\$ 53,420
Benefits paid	(1,527,599)	(53,420)	(845,669)	(53,420)

**a. Plan Assets**

The asset allocations of the Museum's pension benefits as of the June 30 measurement date were as follows:

	2016	2015
Asset category:		
Debt securities	94.00%	98.00%
Other	6.00%	2.00%
Total	100.00%	100.00%

The Museum's investment goals are to maximize returns subject to specific risk management policies, which permit investments in mutual funds, debt and equity securities, and prohibits investments in derivative financial instruments, commodities, and foreign securities, other than those listed on a major U.S. security exchange. The Museum addresses diversification by the use of mutual fund investments whose underlying investments are in domestic and international fixed-income securities and domestic and international equity securities. These mutual funds are readily marketable and can be sold to fund benefit payment obligations as they become payable.



# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 10. Retirement Benefit Plans (continued)

### a. Plan Assets (continued)

The following tables present the Museum's pension plan assets measured at fair value as of June 30, 2016 and 2015:

<b>Fair value measurements at June 30, 2016</b>				
<b>Pension benefits – plan assets</b>				
	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>	
<b>Asset category:</b>	<b>Total</b>			
Cash and cash equivalents	\$ 355,832	\$ 355,832	\$ -	\$ -
U.S. Treasury obligations	1,775,187	-	1,775,187	-
U.S. government agencies	1,042,184	-	1,042,184	-
Municipal obligations	70,490	-	70,490	-
Fixed income mutual funds	963,174	963,174	-	-
Corporate bonds	1,800,438	-	1,800,438	-
<b>Total</b>	<b>\$ 6,007,305</b>	<b>\$ 1,319,006</b>	<b>\$ 4,688,299</b>	<b>\$ -</b>

<b>Fair value measurements at June 30, 2015</b>				
<b>Pension benefits – plan assets</b>				
	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>	
<b>Asset category:</b>	<b>Total</b>			
Cash and cash equivalents	\$ 130,920	\$ 130,920	\$ -	\$ -
U.S. Treasury obligations	1,594,106	-	1,594,106	-
U.S. government agencies	1,058,549	-	1,058,549	-
Municipal obligations	80,192	-	80,192	-
Fixed income mutual funds	1,439,436	1,439,436	-	-
Corporate bonds	1,786,692	-	1,786,692	-
<b>Total</b>	<b>\$ 6,089,895</b>	<b>\$ 1,570,356</b>	<b>\$ 4,519,539</b>	<b>\$ -</b>

**Honolulu Academy of Arts  
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Notes to Financial Statements  
June 30, 2016 and 2015

**10. Retirement Benefit Plans (continued)**

**b. Cash Flows**

The Museum expects to contribute \$53,420 to its supplemental retirement plan in fiscal year 2016. Future benefits expected to be paid for the supplemental retirement plan are as follows:

2017	\$	53,420
2018		50,000
2019		48,000
2020		45,000
2021		43,000
2022-2026		<u>172,000</u>
Total	\$	<u><u>411,420</u></u>

The expected benefits are based on the same assumptions used to measure the Museum's benefit obligation at June 30 and include estimated future employee service.

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Notes to Financial Statements  
June 30, 2016 and 2015

**11. Endowments**

The Museum's endowment funds consist of approximately 50 individual donor-restricted funds and board-designated funds established for a variety of purposes at June 30, 2016 and 2015:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
2016:				
Donor-restricted funds	\$ (8,836,922)	\$ 1,497,179	\$ 72,819,058	\$ 65,479,315
Board-designated funds	<u>552,451</u>	<u>-</u>	<u>-</u>	<u>552,451</u>
	<u>\$ (8,284,471)</u>	<u>\$ 1,497,179</u>	<u>\$ 72,819,058</u>	<u>\$ 66,031,766</u>
2015:				
Donor-restricted funds	\$ (7,405,886)	\$ 2,329,179	\$ 74,481,943	\$ 69,405,236
Board-designated funds	<u>132,551</u>	<u>-</u>	<u>-</u>	<u>132,551</u>
	<u>\$ (7,273,335)</u>	<u>\$ 2,329,179</u>	<u>\$ 74,481,943</u>	<u>\$ 69,537,787</u>

**Honolulu Academy of Arts  
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Notes to Financial Statements  
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**11. Endowments (continued)**

A summary of amounts classified as permanently restricted net assets and temporarily restricted net assets is as follows:

	<u>2016</u>	<u>2015</u>
Permanently restricted net assets:		
The portion of endowment funds that is required to be retained permanently either by explicit donor stipulation or by HUPMIFA	\$ 57,157,456	\$ 57,400,593
Beneficial interests in perpetual trusts	<u>15,661,602</u>	<u>17,081,350</u>
Total permanently restricted net assets	<u><u>\$ 72,819,058</u></u>	<u><u>\$ 74,481,943</u></u>
Temporarily restricted net assets:		
The portion of temporarily restricted net assets, excluding endowment funds, subject to purpose restrictions	\$ 7,464,560	\$ 7,358,517
The portion of the perpetual endowment funds subject to HUPMIFA with purpose restrictions	<u>1,497,179</u>	<u>2,329,179</u>
Total temporarily restricted net assets	<u><u>\$ 8,961,739</u></u>	<u><u>\$ 9,687,696</u></u>

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 11. Endowments (continued)

For the years ended June 30, 2016 and 2015, the changes in donor-restricted endowment net assets are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2014	\$ (6,399,662)	\$ 2,849,691	\$ 75,515,069	\$ 71,965,098
Investment return:				
Dividends and interest, net of management fees and expenses	-	2,150,860	-	2,150,860
Net realized and unrealized losses	<u>(1,006,224)</u>	<u>460,763</u>	<u>(434,710)</u>	<u>(980,171)</u>
Total net investment return	(1,006,224)	2,611,623	(434,710)	1,170,689
Change in value of split-interest agreements	-	-	(893,605)	(893,605)
Gifts and bequests	-	-	295,189	295,189
Appropriation of endowment assets for expenditures	<u>-</u>	<u>(3,132,135)</u>	<u>-</u>	<u>(3,132,135)</u>
Endowment net assets, June 30, 2015	<u>(7,405,886)</u>	<u>2,329,179</u>	<u>74,481,943</u>	<u>69,405,236</u>
Investment return:				
Dividends and interest, net of management fees and expenses	-	797,693	-	797,693
Net realized and unrealized losses	<u>(1,431,037)</u>	<u>918,399</u>	<u>(306,706)</u>	<u>(819,344)</u>
Total net investment return	(1,431,037)	1,716,092	(306,706)	(21,651)
Change in value of split-interest agreements	-	-	(1,419,748)	(1,419,748)
Gifts and bequests	552,452	-	63,569	616,021
Appropriation of endowment assets for expenditures	<u>-</u>	<u>(2,548,092)</u>	<u>-</u>	<u>(2,548,092)</u>
Endowment net assets, June 30, 2016	<u>\$ (8,284,471)</u>	<u>\$ 1,497,179</u>	<u>\$ 72,819,058</u>	<u>\$ 66,031,766</u>

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 11. Endowments (continued)

### a. Interpretations of Relevant Law

The Board of the Museum (Board) has interpreted Hawaii's Uniform Prudent Management of Institutional Funds Act (HUPMIFA), which was enacted by the state of Hawaii on July 1, 2009, as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Museum classifies as permanently restricted net assets (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. Unless otherwise stated in the gift instrument, the remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are expended by the Museum in a manner consistent with the standard of prudence prescribed by HUPMIFA. In accordance with HUPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Museum 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 the appreciation of investments
- (6) Other resources of the Museum
- (7) The investment policies of the Museum

### b. Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or HUPMIFA requires the Museum to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were \$8,284,471 and \$7,405,886 as of June 30, 2016 and 2015, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred due to the investment of permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 11. Endowments (continued)

### c. Return Objectives and Risks Parameters

The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Museum must hold in perpetuity or for donor-specified periods. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed certain published indexes while assuming a moderate level of investment risk.

### d. Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Museum relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Museum targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

### e. Spending Policy

The Museum's spending policy is to distribute 5% annually from the total endowment fund as calculated by a trailing 12-quarter moving average of the total fund as determined on June 30 of the fiscal year under consideration. Over the long term, the Museum expects the current spending policy to allow its endowment to be a balance between preserving the real (after inflation) purchasing power of the endowment principal with the need to fund program-related expenses.

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Notes to Financial Statements  
June 30, 2016 and 2015

## 12. Fair Value Measurements

### a. Fair Value Hierarchy

ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Museum has the ability to access at the measurement date.
- Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety at the measurement date.

### b. Fair Value of Financial Instruments

The fair value of financial instruments represents management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects management's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by management based on the best information available in the circumstances.

The carrying amounts of cash, accounts payable and accrued expenses, deferred revenue, and other liabilities approximate fair value because of the short maturity of these instruments.

Contributed rent was valued using a risk-free rate as of the date of lease to calculate present value. Management believes this approximates fair value.



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**12. Fair Value Measurements (continued)**

**b. Fair Value of Financial Instruments (continued)**

The fair value of investments in marketable securities is based primarily on quoted market prices. The fair value of other investments that do not have readily determinable fair values is generally based on quoted market prices of the underlying investments and information provided by the respective external investment managers at the most recent valuation date and adjusted for cash flows from the valuation date to fiscal year-end, if applicable. As described in note 1p, the Museum utilized the net asset value (NAV) per share for certain investments in alternative structures as a practical expedient for the estimation of the fair value of these investments.

The fair value of beneficial interest in perpetual trusts is based on quoted market prices of the underlying investments held by the trustee.

The carrying amount of liability under split-interest agreements approximates fair value as discount rates used are generally commensurate with current published risk-free rates.

The carrying amount of debt at June 30, 2016 approximates fair value as the interest rate is commensurate with interest rates currently offered by local lending institutions for loans with similar terms to companies with comparable credit risk.

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 12. Fair Value Measurements (continued)

### b. Fair Value of Financial Instruments (continued)

The following tables present assets that are measured at fair value on a recurring basis at June 30, 2016 and 2015:

	June 30, 2016	Fair Value Measurements at Reporting Date Using:	
		Level 1	Level 2
Long-term investments:			
Cash	\$ 537,177	\$ 537,177	\$ -
Money market fund	1,855,273	-	1,855,273
U.S. treasury obligations	3,364,755	-	3,364,755
U.S. government agency bonds	339,728	-	339,728
Municipal obligations	224,376	-	224,376
Corporate stocks	4,512,155	4,512,155	-
Corporate bonds	1,635,168	-	1,635,168
ETF and closed end funds	1,338,048	-	1,338,048
Mutual funds:			
Fixed income	3,477,602	3,477,602	-
Domestic equities	11,210,164	11,210,164	-
Opportunistic and other	10,581,569	10,581,569	-
	<u>39,076,015</u>	<u>30,318,667</u>	<u>8,757,348</u>
Alternative investments measured at net asset value:			
Mutual funds:			
Foreign equities	1,897,311		
Master limited partnership	1,047,286		
Total mutual funds	<u>2,944,597</u>		
Hedge funds:			
Real estate assets	3,407,927		
Domestic equities	4,856,122		
Foreign equities	2,715,143		
Emerging markets equities	1,329,134		
Other	79,846		
Total hedge funds	<u>12,388,172</u>		
Fund of funds:			
Marketable alternative assets	5,754,291		
Opportunistic and other	831,043		
Total hedge funds	<u>6,585,334</u>		
Total alternative investments	<u>21,918,103</u>		
Total long-term investments	60,994,118		
Beneficial interests in perpetual trusts	15,661,602	-	15,661,602
Total	<u>\$ 76,655,720</u>	<u>\$ 30,318,667</u>	<u>\$ 24,418,950</u>

# Honolulu Academy of Arts dba Honolulu Museum of Art

Notes to Financial Statements  
June 30, 2016 and 2015

## 12. Fair Value Measurements (continued)

### b. Fair Value of Financial Instruments (continued)

	June 30, 2015	Fair Value Measurements at Reporting Date Using:	
		Level 1	Level 2
Long-term investments:			
Cash	\$ 502,020	\$ 502,020	\$ -
Money market fund	2,658,805	-	2,658,805
U.S. Treasury obligations	2,372,265	-	2,372,265
U.S. government agency bonds	306,021	-	306,021
Municipal obligations	252,944	-	252,944
Corporate stocks	5,483,241	5,483,241	-
Preferred stocks	181,886	181,886	-
Corporate bonds	1,699,633	-	1,699,633
ETF and closed end funds	941,991	-	941,991
Mutual funds:			
Foreign equities	6,822,210	6,822,210	-
Fixed income	1,549,380	1,549,380	-
Domestic equities	10,946,962	10,946,962	-
Opportunistic and other	4,993,500	4,993,500	-
	<u>38,710,858</u>	<u>30,479,199</u>	<u>8,231,659</u>
Alternative investments measured at net asset value:			
Hedge funds:			
Real estate assets	5,141,098		
Domestic equities	4,708,716		
Foreign equities	3,032,974		
Emerging markets equities	1,464,332		
Other	195,402		
Total hedge funds	<u>14,542,522</u>		
Fund of funds:			
Marketable alternative assets	8,860,520		
Opportunistic and other	783,925		
Total fund of funds	<u>9,644,445</u>		
Mutual funds - foreign equities	<u>963,326</u>		
Total alternative investments	<u>25,150,293</u>		
Total long-term investments	<u>63,861,151</u>		
Beneficial interest in perpetual trusts	17,081,350	-	17,081,350
Total	<u>\$ 80,942,501</u>	<u>\$ 30,479,199</u>	<u>\$ 25,313,009</u>

# **Honolulu Academy of Arts dba Honolulu Museum of Art**

Notes to Financial Statements  
June 30, 2016 and 2015

## **12. Fair Value Measurements (continued)**

### **b. Fair Value of Financial Instruments (continued)**

There were no liabilities measured at fair value on a recurring basis for the years ended June 30, 2016 and 2015.

The following lists the significant restrictions on the Museum's ability to sell its alternative investments, including the redemption frequency and notice period, as of June 30, 2016 and 2015:

- Investments in hedge funds and fund of funds, except for the investment in the marketable alternative assets hedge fund and opportunistic fund of funds, are subject to redemption policies ranging from monthly to quarterly with redemption notice periods ranging from 1 to 65 days.
- Investment in the marketable alternative assets hedge fund is subject to a redemption period of 90 days. Investments in the opportunistic fund of funds are not redeemable until 2021.

There were no unfunded commitments related to any alternative investments.

## **13. Subsequent Events**

The Museum has evaluated subsequent events from the balance sheet date through February 17, 2017, the date at which the financial statements were available to be issued, and determined there were no other items to disclose.

**Honolulu Academy of Arts  
dba Honolulu Museum of Art**

Schedule of Functional Expenses  
Year Ended June 30, 2016

	Program Services						Supporting Services			Total Expenses
	Education	Special Exhibitions	Curatorial and Conservation	Museum Shops and Cafes	Art Acquisitions	Subtotal	Management and General	Fund-Raising and Development	Subtotal	
Salaries and Wages	\$ 2,017,842	\$ 938,218	\$ 1,122,992	\$ 842,405	\$ -	\$ 4,921,457	\$ 1,364,507	\$ 765,552	\$ 2,130,059	\$ 7,051,516
Employee Benefits	381,160	224,788	246,045	193,082	-	1,045,075	328,025	162,982	491,007	1,536,082
Utilities	232,964	275,737	58,929	87,153	-	654,783	195,490	3,621	199,111	853,894
Professional and Other Services	403,750	110,678	38,272	45,385	-	598,085	324,093	442,645	766,738	1,364,823
Depreciation and Amortization	305,301	418,981	155,062	88,455	-	967,799	33,980	19,610	53,590	1,021,389
Purchases for Resale	14,490	-	-	559,875	-	574,365	-	-	-	574,365
Repairs and Maintenance	151,785	161,068	49,945	68,925	-	431,723	153,404	36,440	189,844	621,567
Rental	191,426	18,742	4,676	2,137	-	216,981	23,553	505	24,058	241,039
Supplies	164,601	69,243	89,074	45,522	-	368,440	72,728	34,409	107,137	475,577
Publicity and Printing	43,757	158,534	4,115	674	-	207,080	112,496	107,905	220,401	427,481
Insurance	31,409	63,450	72,879	14,394	-	182,132	6,391	2,588	8,979	191,111
Art Acquisitions	-	-	-	-	190,785	190,785	-	-	-	190,785
Hospitality	103,508	57,496	16,890	1,468	-	179,362	26,834	25,360	52,194	231,556
Other	13,365	3,165	1,562	37,569	-	55,661	16,698	(2,174)	14,524	70,185
Postage and Freight	36,777	141,584	37,068	3,702	-	219,131	6,443	15,001	21,444	240,575
Interest	4,464	12,136	2,046	3,609	-	22,255	43,348	15,757	59,105	81,360
Education and Theatre	65,327	874	5,287	532	-	72,020	18,246	2,199	20,445	92,465
Retirement Plans	241,279	45,511	123,884	98,566	-	509,240	329,362	100,880	430,242	939,482
Security	18,667	24,003	4,501	6,983	-	54,154	18,529	85	18,614	72,768
Exhibitions	-	59,500	-	-	-	59,500	-	-	-	59,500
Travel	33,423	7,994	19,999	5,164	-	66,580	21,972	7,193	29,165	95,745
Conservation	-	7,450	30,116	-	-	37,566	-	-	-	37,566
Books	1,898	108	391	63	-	2,460	114	478	592	3,052
	<u>\$ 4,457,193</u>	<u>\$ 2,799,260</u>	<u>\$ 2,083,733</u>	<u>\$ 2,105,663</u>	<u>\$ 190,785</u>	<u>\$ 11,636,634</u>	<u>\$ 3,096,213</u>	<u>\$ 1,741,036</u>	<u>\$ 4,837,249</u>	<u>\$ 16,473,883</u>

See accompanying independent auditor's report.