

Asian Art Museum of San Francisco

Combined Financial Statements
and Independent Auditor's Report

As of and for the Year Ended June 30, 2017



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INDEPENDENT AUDITOR'S REPORT

Board of Trustees of
Asian Art Museum of San Francisco
San Francisco, California

Report on the Financial Statements

We have audited the accompanying combined financial statements of Asian Art Museum of San Francisco (the "Museum"), which comprise the combined statement of financial position as of June 30, 2017, and the related combined statements of activities and changes in net assets, and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Asian Art Museum of San Francisco as of June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited Asian Art Museum of San Francisco's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated November 21, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Armanino LLP
Armanino^{LLP}
San Ramon, California

November 20, 2017

ASIAN ART MUSEUM OF SAN FRANCISCO
 Combined Statement of Financial Position
 June 30, 2017
 (With Comparative Totals for 2016)
 (in Thousands)

| | <u>2017</u> | <u>2016</u> |
|---------------------------------------|-------------------|-------------------|
| <u>ASSETS</u> | | |
| Assets | | |
| Cash and cash equivalents | \$ 14,633 | \$ 7,924 |
| Short-term investment, restricted | 6,444 | 6,467 |
| Accounts and other receivables | 668 | 710 |
| Contributions receivable, net | 18,577 | 23,492 |
| Inventory, prepaids, and other assets | 537 | 587 |
| Investments | 104,578 | 103,815 |
| Investments held in trusts | 1,044 | 1,007 |
| Property and equipment, net | <u>88,970</u> | <u>90,361</u> |
| Total assets | <u>\$ 235,451</u> | <u>\$ 234,363</u> |
| <u>LIABILITIES AND NET ASSETS</u> | | |
| Liabilities | | |
| Accounts payable and accrued expenses | \$ 1,809 | \$ 2,140 |
| Interest payable | 676 | 693 |
| Deferred revenue and deposits | 982 | 943 |
| Loan payable, net | <u>87,834</u> | <u>89,805</u> |
| Total liabilities | <u>91,301</u> | <u>93,581</u> |
| Net assets | | |
| Unrestricted | 62,480 | 63,018 |
| Temporarily restricted | 49,557 | 41,222 |
| Permanently restricted | <u>32,113</u> | <u>36,542</u> |
| Total net assets | <u>144,150</u> | <u>140,782</u> |
| Total liabilities and net assets | <u>\$ 235,451</u> | <u>\$ 234,363</u> |

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

ASIAN ART MUSEUM OF SAN FRANCISCO
 Combined Statement of Activities and Changes in Net Assets
 For the Year Ended June 30, 2017
 (With Comparative Totals for 2016)
 (in Thousands)

| | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total 2017</u> | <u>Total 2016</u> |
|---|---------------------|-----------------------------------|-----------------------------------|-----------------------|-----------------------|
| Support, revenue, gains (losses) | | | | | |
| Contributions and grants | \$ 5,476 | \$ 6,755 | \$ 636 | \$ 12,867 | \$ 22,285 |
| City appropriation | 10,040 | - | - | 10,040 | 9,019 |
| Admissions | 1,546 | - | - | 1,546 | 1,402 |
| Membership | 1,769 | - | - | 1,769 | 1,577 |
| Investment income (loss), net | 6,553 | 3,825 | - | 10,378 | (614) |
| Change in fair value of split interest agreements | 51 | - | - | 51 | (29) |
| Tours and special events | 2,315 | - | - | 2,315 | 1,925 |
| Museum shop gross profit (gross revenues of \$1,176 less cost of sales of \$595) | 581 | - | - | 581 | 610 |
| Facilities rental gross profit | 667 | - | - | 667 | 572 |
| Other | 193 | - | - | 193 | 265 |
| Reclassification of net assets | - | 5,065 | (5,065) | - | - |
| Net assets released from restrictions | <u>7,249</u> | <u>(7,249)</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Total support, revenue, gains (losses) | <u>36,440</u> | <u>8,396</u> | <u>(4,429)</u> | <u>40,407</u> | <u>37,012</u> |
| Expenses | | | | | |
| Program | | | | | |
| Exhibitions | 7,897 | - | - | 7,897 | 5,061 |
| Curatorial, conservation, and research | 7,580 | - | - | 7,580 | 6,755 |
| Education and public programs | 1,972 | - | - | 1,972 | 2,266 |
| Art acquisitions | 1,378 | - | - | 1,378 | 556 |
| Communications | 2,240 | - | - | 2,240 | 4,020 |
| Supporting services | | | | | |
| Administration | 3,453 | - | - | 3,453 | 6,134 |
| Facilities | 3,118 | - | - | 3,118 | 1,598 |
| Development | 3,336 | - | - | 3,336 | 3,783 |
| Membership | 660 | - | - | 660 | 950 |
| Enterprise activities - Museum shop and facility | 1,177 | - | - | 1,177 | 1,313 |
| Interest and loan costs | 4,167 | - | - | 4,167 | 4,275 |
| Write-off uncollectible contribution | <u>-</u> | <u>61</u> | <u>-</u> | <u>61</u> | <u>171</u> |
| Total expenses | <u>36,978</u> | <u>61</u> | <u>-</u> | <u>37,039</u> | <u>36,882</u> |
| Change in net assets | (538) | 8,335 | (4,429) | 3,368 | 130 |
| Net assets - beginning of year | <u>63,018</u> | <u>41,222</u> | <u>36,542</u> | <u>140,782</u> | <u>140,652</u> |
| Net assets - end of year | <u>\$ 62,480</u> | <u>\$ 49,557</u> | <u>\$ 32,113</u> | <u>\$ 144,150</u> | <u>\$ 140,782</u> |

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

ASIAN ART MUSEUM OF SAN FRANCISCO
 Combined Statement of Cash Flows
 For the Year Ended June 30, 2017
 (With Comparative Totals for 2016)
 (in Thousands)

| | 2017 | 2016 |
|--|-----------|----------|
| Cash flows from operating activities | | |
| Change in net assets | \$ 3,368 | \$ 130 |
| Adjustments to reconcile change in net assets to net cash used in operating activities | | |
| Depreciation and amortization | 3,635 | 3,646 |
| Endowment contributions | (3,449) | (2,985) |
| Non-cash interest expense | 14 | 14 |
| Net realized and unrealized (gains) losses on investments | (8,667) | 1,862 |
| Contributions restricted for long-term use | (3,565) | (4,137) |
| Change in investments held in trust | (36) | 723 |
| Changes in operating assets and liabilities | | |
| Accounts and other receivables | 42 | 336 |
| Contributions receivable, net | 4,915 | (7,020) |
| Inventory, prepaids and other assets | 51 | (118) |
| Accounts payable and accrued expenses | (332) | (278) |
| Interest payable | (17) | (14) |
| Deferred revenue and deposits | 40 | 16 |
| Net cash used in operating activities | (4,001) | (7,825) |
| Cash flows from investing activities | | |
| Restricted short-term cash investment | 23 | 4 |
| Property and equipment additions | (2,244) | (1,510) |
| Purchase of investments | (11,780) | (39,686) |
| Proceeds from sale/maturity of investments | 19,319 | 41,339 |
| Net cash provided by investing activities | 5,318 | 147 |
| Cash flows from financing activities | | |
| Endowment contributions | 3,449 | 2,985 |
| Principal payments on loan payable | (1,985) | (1,875) |
| Contributions restricted for long-term use | 3,565 | 4,137 |
| Net cash provided by financing activities | 5,029 | 5,247 |
| Net increase (decrease) in cash and cash equivalents | 6,346 | (2,431) |
| Cash and cash equivalents - beginning of the year | 7,924 | 10,355 |
| Cash and cash equivalents - end of the year | \$ 14,270 | \$ 7,924 |
| Supplemental cash flow information - Interest paid | \$ 4,154 | \$ 4,338 |

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

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

1. Organization

Founded in 1959, the Asian Art Museum of San Francisco (the "Museum") opened in 1966 to house the Avery Brundage Collection and other Asian art collections of the city and county of San Francisco (the "City"). The Museum is governed by the Asian Art Commission (the "Commission"), established under the City charter, and supported by the Asian Art Museum Foundation of San Francisco (the "Foundation"). The Commission members are appointed by the mayor of the City. The Foundation's board of trustees (the "Trustees") is nominated by the Foundation's Committee on Trustees and elected by the Trustees. The Foundation supports the Museum by raising funds for exhibitions and public programs, including school programs, conservation, the library, special exhibitions, acquisitions, and other needs of the Museum, not funded by the City.

In September, 2017, the Museum unveiled details of a \$90 million capital campaign to invest in the Museum's future; one that will transform public engagement with the collection, exhibitions and cultural programs offered by the city-owned Museum. In 2018, construction will begin on a new 13,000-square-foot exhibition Pavilion and Art Terrace added to the east Hyde Street side of the Museum's Civic Center home as well as other changes to existing galleries and public spaces. In addition, the campaign will raise funds for exhibitions, programs and endowments.

As of June 30, 2017, 68% of the Museum's employees were Foundation employees and 32% were City employees. At June 30, 2017, approximately 43% of the Foundation employees and 100% of the City employees were covered by collective bargaining agreements. All Foundation employees except for supervisors, managers, or confidential employees are under the Service Employees International Union 1021 collective bargaining agreements.

2. Summary of Significant Accounting Policies

Basis of presentation

The combined financial statements of the Foundation have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP") applicable for not-for-profit organizations. Accordingly, net assets and revenues gains and losses are classified based on the existence or absence of donor-imposed restrictions.

The combined financial statements include the operating and other transactions of the department of the City that relate to the Asian Art Museum of San Francisco and the activities of the Foundation (collectively, the "Museum").

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Net assets

The Museum's combined financial statements are presented on the basis of accounting for not-for-profit organizations, with separate accounting for unrestricted, temporarily restricted, and permanently restricted net assets in accordance with accounting principles generally accepted in the United States of America (US GAAP) as follows:

- Unrestricted Net Assets - Unrestricted net assets represent unrestricted resources available to support the Museum's operations and temporarily restricted resources that become available for use by the Museum in accordance with the intentions of donors. Unrestricted net assets may be designated for specific purposes by the Trustees.
- Temporarily Restricted Net Assets - Temporarily restricted net assets represent contributions that are limited in use by the Museum in accordance with temporary donor-imposed stipulations. These stipulations may expire with time or may be satisfied and removed by the actions of the Museum according to the terms of the contribution. Upon satisfaction of such stipulations, the associated net assets are released from temporarily restricted net assets and recognized as unrestricted net assets. If a restriction is fulfilled in the same fiscal year in which the contribution is received, the Museum classifies the support as unrestricted. Temporarily restricted net assets also include accumulated appreciation of permanently restricted endowment funds that have not been appropriated by the Trustees in accordance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA).
- Permanently Restricted Net Assets - Permanently restricted net assets represent contributions to be held as investments in perpetuity as directed by the donor. The income from these investments is primarily available to support activities of the Museum as determined by the donor. Permanently restricted net assets consist of endowments, which are assets designated by the donor to be held in perpetuity. The endowment must be expended in accordance with the terms and conditions established by the donor.

Revenues are reported as increases in unrestricted net assets unless use of the related asset is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Investment income and gains or losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor restriction or by law. Expirations of temporary restrictions on net assets (i.e., the donor-restricted purposes have been fulfilled and/or the stipulated time period has elapsed) or a donor redirection of a restricted gift are reported as net assets released from restriction between the applicable classes of net assets.

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash and cash equivalents

Cash and cash equivalents consist of demand accounts and highly liquid investments purchased with an original maturity of three months or less.

Short-term investments, restricted

The short-term investments restricted for the loan reserve are required to be held in a reserve fund and are related to the loan payable. The short-term investments are invested in money market funds and federal obligations that have terms of less than one year and will be held to maturity.

Contributions receivable

Contributions receivable consists of unconditional promises to give. Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give 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 risk-adjusted interest rates applicable in the years in which the promises are received. The risk free rates used for the year ending June 30, 2017 range from 0.45% to 2.04%. Amortization of the discounts is included in contributions and grants revenue. Conditional promises to give are not recorded as revenue until the conditions are substantially met. There were no conditional promises to give as of June 30, 2017. The Museum closely monitors receivables. The Museum's uncollectable receivables have historically not been significant.

Inventory

Inventory is stated at the lower of average cost or market. Inventory consists of retail store merchandise available for sale on June 30, 2017.

Investments and fair value measurements

Investments are reflected in the combined statement of financial position at fair value with changes in realized and unrealized gains and losses resulting from changes in fair value reflected in the combined statement of activities as investment gain or loss. Publicly traded investments in active markets are reported at the market closing. Investment transactions are recorded on a trade-date basis (for publicly traded investments) or upon closing of the transaction (for private investments).

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Investments and fair value measurements (continued)

Investments measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

- Level I - Quoted prices are available in active markets for identical investments as of the reporting date. The type of investments, which would generally be included in Level I, includes listed equity securities.
- Level II - Pricing inputs are observable for the investments, either directly or indirectly, as of the reporting date, but are not identical as those used in Level I. These inputs may include quoted prices for identical instruments on an inactive market. Fair value is determined through the use of models or other valuation methodologies.
- Level III - Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant judgment or estimation by management. The types of investments, which would generally be included in this category include debt, asset-backed securities, forward contracts, long-term debt securities, multi-strategy holding company swaps and warrants, real estate, and equity securities issued by private entities.

The Museum uses the Net Asset Value ("NAV") to determine the fair value of all underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for any given investment is based on the lowest level of input that is significant to the fair value measurement. The Museum's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment. See Note 4 for investments presented within the fair value hierarchy.

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Investments held in trusts

Charitable remainder trusts are stated at estimated fair value, less the present value of estimated future payments to the income beneficiaries based on the composition of investment portfolios, life expectancies from certain mortality tables, and the discount rate applicable in the years the trusts were established.

Investments held in trusts include the fair value of a trust held in perpetuity by an external trustee and other charitable remainder trusts. The fair value of the Museum's perpetual interest in the trust is estimated at the current fair value of trust assets based upon quoted market prices and management's valuation. Changes in the fair value of the Museum's interest in the perpetual trust are recorded as an increase or decrease in temporarily restricted net assets.

Property and equipment

Property and equipment are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, ranging from 3 to 40 years. Contributed property and equipment are recorded at fair value at the date of donation.

Title to the land, buildings and improvements of the Museum rests with the City. Under the terms of the City Charter, no one other than the City can hold title to the building and the building cannot be sold or converted for the benefit of the Museum. The improvements to the City building which houses the Museum's collections and in which the Museum operates were funded entirely by donations and bond proceeds (See Note 5).

Deferred loan costs

Deferred loan costs are amortized over the term of the related loan payable based on the effective interest rate method. Interest expense related to loan costs for the year ended June 30, 2017 was \$14.

Deferred revenue

Deferred revenue consists primarily of fees received for future exhibitions, advance tickets sales, and unearned membership dues.

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Collections

The Museum's permanent collections represent more than 40 Asian countries and span 6,000 years of Asian history. Objects are held for educational, research, and curatorial purposes. Under the Museum's Collections Management Policy, all objects are catalogued, preserved, and provided with ongoing care. Activities verifying their existence and assessing their condition are performed regularly. Title to the permanent collection of works of art rests with the City. If accepted into the permanent collection, donated art objects become the property of the City and are not recorded in the Museum's combined financial statements. Purchases of art are recorded as an expense in the Museum's combined statements of activities and changes in net assets. The Museum deaccessions objects deemed no longer relevant to the permanent collection in accordance with the Museum's Collections Management Policy. Proceeds from deaccessions are used to acquire other objects for the collection. There were no deaccessions during the year ended June 30, 2017.

Contributed services

The Museum recognizes contribution revenue for certain services received at the fair value if the services (a) create or enhance nonfinancial assets or (b) require specialized skills that would need to be purchased, if not donated. During the year ended June 30, 2017, contributed services recognized in the combined statement of activities and changes in net assets as contributions and grants were \$129, and the corresponding expense was included in legal, marketing, travel, and advertising services. In addition, the Trustees and a substantial number of volunteers have donated significant amounts of time to develop the Museum's program and objectives. The value of donated volunteer services has not been recognized in the accompanying combined financial statements because such volunteer services do not meet the above criteria.

Functional expense allocation

The costs of providing the various programs and other activities have been summarized on a functional basis in the combined statement of activities. Expenses applicable to more than one program or activity have been allocated among the programs, supporting services, and enterprise activities based on headcounts and square footage and on estimates made by the Museum's management.

Fair value of financial instruments

The fair value of cash and cash equivalents, accounts and other receivables, contributions receivable, accounts payable and accrued expenses at June 30, 2017 approximates the carrying amount because of the relatively short-term maturities of these financial instruments.

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Concentration of credit risk

Financial instruments that potentially subject the Museum to credit risk consist primarily of cash and cash equivalents, investments, and receivables. The Museum maintains cash and cash equivalents with commercial banks and other major financial institutions. Cash equivalents include demand accounts and highly liquid investments purchased with an original maturity of three months or less. At times, such amounts might exceed Federal Deposit Insurance Corporation limits. The Museum attempts to limit its credit risk associated with investments by utilizing outside investment managers to place the Museum's investments with highly rated corporate and financial institutions.

Use of estimates

The preparation of combined financial statements in conformity with US GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Tax-exempt status

The Foundation has been classified as a publicly supported tax-exempt organization that is exempt from federal taxes under Section 501(c)(3) of the Internal Revenue Code and from California franchise and/or income taxes under Revenue and Taxation Code Section 23701(d). The Foundation management believes that no liabilities are required to accrue for uncertain tax positions as of June 30, 2017.

Comparative information

The combined financial statements and related footnotes include certain prior-year comparative information summarized in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in accordance with US GAAP. Accordingly, such information should be read in conjunction with the Museum's combined financial statements for the year ended June 30, 2016, from which the summarized information is derived.

Reclassifications

Certain amounts in the 2016 financial statements have been reclassified to conform with 2017 presentation.

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

2. Summary of Significant Accounting Policies (continued)

Accounting changes

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurements (Topic 820); disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (NAV, or its Equivalent)*. The amendments in the update remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the NAV per share practical expedient. Sufficient information must be provided to allow a reconciliation of the fair value assets categorized with the fair value hierarchy to the amounts shown in the statement of financial position. The Museum has adjusted the fair value measurement disclosure presented herein under the provision of ASU 2015-07.

In April 2017, the FASB issued ASU 2015-03, *Interest - Imputation of interest (Subtopic 935-30) Simplifying the Presentation of Debt Issuance Costs*. The amendment in the update changes the requirements for the presentation of debt issuance costs, requiring the costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. Previously, the Museum reflected unamortized debt issuance costs as deferred charges in the statement of financial position and has retroactively reclassified 2016 amounts for consistency with the new debt deduction presentation. The reclassifications reduced total assets and debt at June 30, 2017 by \$316 with no effect on net assets.

Subsequent events

In preparing its combined financial statements for the year ended June 30, 2017, the Museum has evaluated, for potential recognition and disclosure, events and transactions that have occurred subsequent to the fiscal year ended June 30, 2017, through the issuance date of these annual combined financial statements were available to be issued on November 20, 2017. There were no events identified for disclosure as a result of this evaluation.

3. Contributions Receivable

Contributions receivable as of June 30, 2017, are due as follows:

| | |
|---|-----------------|
| Less than one year | \$ 5,210 |
| One to five years | <u>13,568</u> |
| Total | 18,778 |
| Less: allowance for doubtful contributions receivable | (31) |
| Less: discount on multiyear contributions receivable | <u>(170)</u> |
| Total contributions receivable, net | <u>\$18,577</u> |

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

4. Investments

The Museum's investments and the levels in the fair value hierarchy into which the Museum's investments fall as of June 30, 2017, are as follows:

| | <u>Level I</u> | <u>Level II</u> | <u>Level III</u> | <u>Total</u> |
|---|-----------------|-----------------|------------------|------------------|
| Assets | | | | |
| Short-term investments, restricted | \$ - | \$ 6,444 | \$ - | \$ 6,444 |
| Investments | | | | |
| Cash equivalents | 4,821 | - | - | 4,821 |
| Large cap equity securities | 16,911 | - | - | 16,911 |
| Other equity securities | 17,970 | - | - | 17,970 |
| Mutual funds - bonds | 22,519 | - | - | 22,519 |
| Mutual funds - equity | 11,444 | - | - | 11,444 |
| Mutual funds - other | 1,254 | - | - | 1,254 |
| Commercial real estate | - | - | 7,355 | 7,355 |
| Total investments in the fair value hierarchy | <u>74,919</u> | <u>-</u> | <u>7,355</u> | <u>82,274</u> |
| Investments measured at net asset value* | <u>-</u> | <u>-</u> | <u>-</u> | <u>22,667</u> |
| Total investments measured at fair value | <u>\$74,919</u> | <u>\$ 6,444</u> | <u>\$ 7,355</u> | <u>\$111,385</u> |

* In accordance with Subtopic 820-10, 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. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

ASIAN ART MUSEUM OF SAN FRANCISCO
Notes to Combined Financial Statements
June 30, 2017
(in Thousands)

4. Investments (continued)

Investment strategy and redemption information

The changes in investments classified as Level III for the year ended June 30, 2017 are as follows:

Level III - Commercial Real Estate

| | |
|--------------------------------------|-----------------|
| Balance - beginning of year | \$ 7,313 |
| Change in value | <u>42</u> |
| Balance - end of year ^(g) | <u>\$ 7,355</u> |

The following table summarizes the investment strategy types and various features of the investment portfolio for investments that are recorded at net asset value as of June 30, 2017. The Museum has commitments under the associated investment agreements to make additional capital contributions as noted.

| | <u>Net Asset Value</u> | <u>Unfunded Commitments</u> | <u>Redemption Term</u> | <u>Redemption Restrictions</u> |
|---|----------------------------|---------------------------------|----------------------------|------------------------------------|
| Equity long and/or short hedge funds ^(a) | \$ 1,170 | \$ - | Quarterly | 50 - 70 days |
| Event-driven hedge funds ^(b) | 2,324 | - | Quarterly | 60 - 90 days |
| Opportunistic hedge funds ^(b) | 2,011 | - | Monthly - semiannually | 7 - 90 days |
| Diversified hedge funds ^(c) | 8,170 | - | Quarterly - annually | 45 - 595 days |
| Relative value hedge funds ^(d) | 2,956 | - | Quarterly - semiannually | 90 - 95 days |
| Real estate funds ^(e) | 1,857 | 224 | N/A | N/A |
| Private equity funds ^(f) | <u>4,179</u> | <u>1,681</u> | N/A | N/A |
| | <u>\$22,667</u> | <u>\$1,905</u> | | |

(a) This category includes investments in hedge funds that invest both long and short positions primarily in US common stocks. Management of the hedge funds has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position. The fair value of the assets of the investments in this category has been estimated using the NAV per share of investments.

(b) This category includes investments in hedge funds that invest in bank debt, corporate debt securities, equity, and derivative contracts. A majority of the investments are targeted at economic policy decisions. The fair value of the investments in this category has been estimated using the NAV per share of investments.

ASIAN ART MUSEUM OF SAN FRANCISCO
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4. Investments (continued)

Investment strategy and redemption information (continued)

- (c) This category includes investments in hedge funds that have an investment objective to seek consistent long-term growth of capital with reduced volatility. The funds invest in a diversified portfolio of global natural resource securities, commodities, and real assets as well as global, multistrategy, event-driven funds focused on producing strong risk-adjusted returns with low volatility relative to the stock market and relatively low correlation to both the equity and debt markets. These funds have the ability to make principally noncontrol investments in debt, equity, or other securities or indebtedness of (i) companies in financial distress or undergoing a turnaround; (ii) companies in bankruptcy, organization, or liquidation; (iii) companies that are undervalued because of discrete extraordinary events; or (iv) companies whose securities deem to be undervalued. The fair values of these hedge funds have been determined using the NAV per share of the investment funds.
- (d) This category includes investments in hedge funds that invest in fixed-income securities, equities, warrants, credit default swap agreements, currency forward contracts, and mortgage-backed securities.
- (e) The real estate partnerships were formed for the purpose of acquiring, investing in, developing, managing, operating, leasing, owning, financing, holding, and selling office buildings and mixed-use projects and investing in debt or equity instruments related to similar real estate projects. The partnerships may also invest in real estate as a long-term operating business set against a backdrop of powerful market cycles driven primarily by capital flows. The fair values of these real estate funds have been determined using the NAV per share of the investment funds. Investments representing 100% of the value of the investment in this category cannot be redeemed because the investments include restrictions.
- (f) The private equity category includes several funds that invest in a broad range of privately owned domestic and foreign companies. The nature of these funds is that distributions are received through the liquidation of the underlying assets of the funds. Investments may include common and preferred stocks and warrants, convertible notes, and partnership interests. Some funds are established for the purpose of seeking capital appreciation through early-to-late-stage venture capital investments in companies in the biotechnology industry, including those focused in the pharmaceuticals, medical devices, genomics, drug delivery, diagnostics, energy and natural resources, media, retail, telecommunications, financial services, and health care information technology sectors. The fair values of these private equity funds have been determined using the NAV per share of the investment funds.

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4. Investments (continued)

Investment strategy and redemption information (continued)

Also, these private equity funds are invested in a variety of sectors, including (i) banks, (ii) insurance and reinsurance companies, (iii) asset management and brokerage houses, (iv) consumer finance businesses, (v) mortgage companies, (vi) credit card companies, (vii) stock exchanges, and (viii) other businesses related to or supportive of these sectors. The geographic focus of these funds is expected to be primarily in the United States, Western Europe, and Asia. The investments in this category cannot be redeemed because the investments include restrictions at June 30, 2017.

- (g) The quantitative commercial information about significant unobservable inputs related to Level III alternative investments in real estate investments used as of June 30, 2017, is as follows:

| | <u>Fair Value</u> | <u>Valuation Techniques</u> | <u>Unobservable Inputs</u> | <u>Assumptions</u> |
|------------------------|-------------------|-----------------------------|----------------------------|--------------------|
| Commercial real estate | \$7,355 | Market Valuation | Rent growth rate | 3% |

5. Property and Equipment

Property and equipment as of June 30, 2017, comprise the following:

| | |
|-----------------------------------|------------------|
| Building improvements | \$130,500 |
| Art storage and display cases | 7,177 |
| Computer related equipment | 3,985 |
| Furniture and fixtures | 1,535 |
| Computer software | 685 |
| Construction in progress | <u>3,425</u> |
| Total | 147,307 |
| Less accumulated depreciation | <u>(58,337)</u> |
| Total property and equipment, net | <u>\$ 88,970</u> |

Depreciation expense for the year ended June 30, 2017, was \$3,635.

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6. Loan Payable

The rehabilitation of the Museum building (the "Project") was initially financed through a combination of public and private financing, including the proceeds of approximately \$40,000 in City General Obligation Bonds and \$107,445 of Revenue Bonds, Series 2000 (the "2000 IBank Bonds") issued by California Infrastructure and Economic Development Bank ("IBank"). Total costs related to the Project were approximately \$180,000.

As a result of a settlement agreement, the Museum restructured the 2000 IBank Bonds under the terms of a February 11, 2011, loan agreement to \$96,985. Specifically, on February 11, 2011, the California Enterprise Development Authority (the "Authority") obtained a loan from JPMorgan Chase Bank, National Association ("JPMorgan") in an aggregate principal amount of \$96,985, plus costs related thereto, for the purpose of the refinancing, and loaned the proceeds thereof to the Museum, all pursuant to that certain loan agreement dated as of February 11, 2011, between JPMorgan, the Authority, and the Museum (the "Loan Agreement" or "2011 Loan").

The principal amount of the loan under the Loan Agreement bears interest at the rate of 4.60% per annum. Under certain circumstances provided for in the Loan Agreement, the loan bears interest at the default rate of 6.60% per annum. The Loan Agreement provides for the accrual of interest on the aggregate principal balance of the loan from the February 11, 2011, closing date to the February 1, 2040, maturity date, or earlier prepayment, as provided therein. Such interest is payable by the Museum quarterly, on each quarterly installment date, commencing May 1, 2011, in arrears on or prior to such date (unless the loan is bearing interest at the default rate, whereupon interest becomes payable on demand).

The Loan Agreement also provides that the principal amount of the loan is to be paid in quarterly installments, on each quarterly installment date, commencing on May 1, 2012. The interest payments assume that all payments are made by the Museum on schedule.

The short-term investment, restricted of \$6,444 at June 30, 2017 includes \$6,156 of investments, which is equivalent to one year's debt service on the 2011 Loan, at June 30, 2017, and is required to be held in a reserve fund through the maturity date of the 2011 Loan. The short-term investment is invested in money market funds and federal obligations.

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6. Loan Payable (continued)

Interest expense for the year ended June 30, 2017, was \$4,154. Future principal payments due under the loan payable at June 30, 2017 is as follows:

| <u>Years Ending June 30,</u> | |
|---------------------------------------|-----------------|
| 2018 | \$ 2,080 |
| 2019 | 2,180 |
| 2020 | 2,270 |
| 2021 | 2,390 |
| Thereafter | <u>79,230</u> |
| | 88,150 |
| Less: unamortized debt issuance costs | <u>(316)</u> |
| | <u>\$87,834</u> |

7. Related-Party Transactions

The City provided \$10,040 of direct operational funding for the year ended June 30, 2017. At June 30, 2017, \$162 included in accounts and other receivables are due from the City.

Other related-party transactions included gross contributions from Commission members and Trustees, which totaled approximately \$6,276 for the year ended June 30, 2017. At June 30, 2017 contributions receivable from Commission members and Trustees totaled \$16,532.

A member of the Museum's board of trustees is a general partner of a limited partnership investment valued at \$200 at June 30, 2017 and included in other funds - private equity. Another Trustee contributed legal services recognized as revenues in the accompanying combined financial statements in the amount of \$126.

8. Temporarily Restricted Net Assets

Temporarily restricted net assets as of June 30, 2017, are available for the following purposes or periods:

| | |
|---|-----------------|
| General | \$ 7,999 |
| Programs and salaries | 5,279 |
| Acquisition and conservation | 6,456 |
| Capital campaign | <u>29,823</u> |
| Total temporarily restricted net assets | <u>\$49,557</u> |

ASIAN ART MUSEUM OF SAN FRANCISCO
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8. Temporarily Restricted Net Assets (continued)

Temporarily restricted net assets were released from donor restrictions during the year ended June 30, 2017 by incurring expenses satisfying the purpose of the restriction or by the passage of time as follows:

| | |
|---|-----------------|
| General | \$ 1,758 |
| Programs and salaries | 478 |
| Acquisition and conservation | 1,944 |
| Capital campaign | <u>3,069</u> |
| Total releases from temporarily restricted net assets | <u>\$ 7,249</u> |

9. Permanently Restricted Net Assets

Permanently restricted net assets as of June 30, 2017 are endowments restricted to investments in perpetuity, the income of which is expendable to support:

| | |
|---|-----------------|
| General | \$16,972 |
| Programs and salaries | 7,909 |
| Acquisition and conservation | <u>7,232</u> |
| Total permanently restricted net assets | <u>\$32,113</u> |

There were donor reclassifications from permanently restricted to temporarily restricted in the amount of \$5,065 for the year ended June 30, 2017.

10. Retirement Plan

The Foundation participates in a defined contribution plan (the "Foundation Plan") covering all eligible Foundation employees. The Foundation Plan stipulates mandatory contributions to be made by both participants and the Foundation. The Foundation employees are fully vested in the Foundation's contributions after five years.

The City participates in a defined benefit plan (the "City Plan"). The City Plan covers all eligible City employees, including certain Museum employees, and stipulates mandatory contributions to be made by participants under the City charter and provisions of the current memoranda of understanding. More information on the City Plan can be found on the City website.

The Museum's retirement plan expense was \$324 for the Foundation and \$765 for the City for the year ended June 30, 2017.

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11. Commitments

The Museum leases storage space and certain equipment under noncancelable operating and capital leases, certain of which are renewable. Future minimum lease payments for all noncancelable operating and capital leases in excess of one year as of June 30, 2017, are as follows:

| <u>Years Ending June 30,</u> | <u>Operating</u> | <u>Capital</u> |
|------------------------------|------------------|----------------|
| 2018 | \$ 14 | \$ 25 |
| 2019 | <u>-</u> | <u>4</u> |
| Total minimum payments | <u>\$ 14</u> | <u>\$ 29</u> |

Rent expense for storage space and small equipment totaled \$205 for the year ended June 30, 2017.

The Museum has \$1,905 in unfunded commitments in alternative investments as of June 30, 2017.

12. Contingencies

The Museum is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Museum's combined statement of financial position or its combined statement of activities and changes in net assets.

13. Endowments

The Museum's endowment fund consists of individual donor-restricted endowment funds and funds designated by the Museum's Trustees to function as endowments. The net assets associated with endowment funds, including those funds designated by the Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

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13. Endowments (continued)

The State of California enacted UPMIFA in 2008. The Trustees have interpreted the adopted UPMIFA 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. 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 appropriated for expenditure by the Museum in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purposes of the Museum and the donor-restricted endowment fund
- General economic conditions
- The possible effects of inflation and deflation
- The expected total return from income and appreciation of investments
- Other resources of the Museum
- The investment policies of the Museum

Where the Trustees designate unrestricted funds to function as endowments, they are classified as unrestricted net assets.

Endowment spending policy

The Museum's spending policy for its endowment defines the timing and amount of funds available to be transferred to operations. The objective of the spending policy is to provide a predictable and consistent source of support of the Museum's operations calculated in a manner that permits efficient and timely preparation of operating budgets.

The Museum's spending policy for the endowment (the "Endowment Spending Policy") permits withdrawals from the endowment, which are budgeted on an annual basis in an amount equal to a percentage ranging from 4% to 7.5% of the previous three-year average of the endowment's total balance. For fiscal years 2012 through 2017, the Museum has withdrawn 4% annually. Amounts withdrawn from the endowment under the Endowment Spending Policy are for the Museum's programs and operating expenses, allocated in accordance with the restrictions pertaining to those funds. The timing and amounts of withdrawals are determined by the Museum's management in consultation with the budget and finance committee and the executive committee. Investment-related expenses are charged separately against the endowment.

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13. Endowments (continued)

Endowment funds with deficiencies

From time to time, the fair value of assets associated with individual donor endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When individual donor endowments decline, temporarily restricted net assets are reduced up to the fair value of the original gift. Further reductions in the fair value of the individual donor endowment are classified as a reduction of unrestricted net assets. There were no deficits of this nature reported in unrestricted net assets as of June 30, 2017.

Return objectives and risk parameters

The Museum 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. Endowment assets include those assets of donor-restricted funds that the Museum must hold in perpetuity, as well as Trustees-designated funds. Under this policy, endowment assets are invested in a manner that is intended to yield a long-term rate of return of approximately 8% annually, while assuming a moderate level of investment risk. Actual returns in any given year may vary from this amount.

Strategies employed for achieving investment objectives

To achieve 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 gains) and current yield (interest and dividends). The Museum targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

Relationship of spending policy to investment objectives

The Museum's Investment Committee (the "Committee") determines the method to be used to appropriate endowment funds for expenditure. The appropriation amount is determined as of the end of the year, one year prior to when it becomes available for expenditure, and is equal to a percentage ranging from 4% to 7.5% of the previous three-year average of the endowment's total balance. For fiscal years 2012 through 2017, the Museum has withdrawn 4% annually. In establishing this method, the Committee considered the expected long-term rate of return on the investment of the Museum's endowment funds. Accordingly, over the long term, the Museum expects the current spending policy to allow its endowment to grow at an average of 4.3% annually, consistent with its intention to maintain the purchasing power of the endowment assets, as well as to provide additional real growth through new gifts. Depending upon market conditions and the needs and available resources of the Museum, appropriations for expenditure from individual endowments may be temporarily suspended to facilitate preservation of the endowment.

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13. Endowments (continued)

Relationship of spending policy to investment objectives (continued)

| Endowment Net Asset Composition <u>By Fund as of June 30, 2017</u> | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total</u> |
|---|---------------------|-----------------------------------|-----------------------------------|-----------------|
| Donor-restricted endowment fund | \$ - | \$14,954 | \$32,113 | \$47,067 |
| Trustees-designated endowment fund | <u>6,456</u> | <u>-</u> | <u>-</u> | <u>6,456</u> |
| Total fund | <u>\$ 6,456</u> | <u>\$14,954</u> | <u>\$32,113</u> | <u>\$53,523</u> |
| Endowment net assets - beginning of year | \$ 6,139 | \$11,993 | \$36,542 | \$54,674 |
| Contributions | - | - | 636 | 636 |
| Donor reclassification | - | - | (5,065) | (5,065) |
| Investment income | 570 | 3,825 | - | 4,395 |
| Appropriation of endowment asset for expenditures | <u>(253)</u> | <u>(864)</u> | <u>-</u> | <u>(1,117)</u> |
| Endowment net assets - end of year | <u>\$ 6,456</u> | <u>\$14,954</u> | <u>\$32,113</u> | <u>\$53,523</u> |

Description of Amount Classified as Permanently Restricted Net Assets and Temporarily Restricted Net Assets (Endowment Only)

Permanently restricted net assets

| | |
|--|-----------------|
| The portion of perpetual endowment funds not participating in the investment pool that is required to be held in perpetuity either by explicit donor stipulation or UPMIFA | \$ 3,803 |
| The portion of perpetual endowment funds participating in the investment pool that is required to be held in perpetuity either by explicit donor stipulation or UPMIFA | <u>28,310</u> |
| Total permanently restricted net assets - end of year | <u>\$32,113</u> |

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13. Endowments (continued)

Relationship of spending policy to investment objectives (continued)

| | |
|--|-----------------|
| Temporarily restricted net assets | |
| The portion of perpetual endowment funds not participating in the investment pool subject to a time restriction under UPMIFA - with purpose restrictions | \$ 3,986 |
| The portion of perpetual endowment funds participating in the investment pool subject to a time restriction under UPMIFA - with purpose restrictions | <u>10,968</u> |
| Total endowment funds classified as temporarily restricted assets | <u>\$14,954</u> |