

Audited Financial Statements



JAPANESE AMERICAN NATIONAL MUSEUM

June 30, 2017 and 2016

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Independent Auditor's Report

Board of Trustees
Japanese American National Museum
Los Angeles, California

We have audited the accompanying financial statements of Japanese American National Museum (National Museum), a nonprofit organization, which comprise the statements of financial position as of June 30, 2017 and 2016, and the related statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

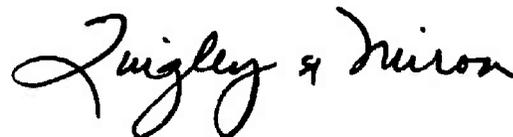
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Japanese American National Museum as of June 30, 2017 and 2016, and the changes in its net assets and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.



Japanese American National Museum
Statements of Financial Position
June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Assets		
Cash and cash equivalents	\$ 1,014,168	\$ 722,798
Restricted cash: gift annuities	51,408	53,386
Inventories, net	358,286	371,369
Pledges and grants receivable, net—Note 2	1,149,611	389,472
Investments—Note 3	12,546,253	12,433,551
Land held for investment	36,000	36,000
Beneficial interest in split-interest arrangements—Note 4	2,119,875	1,851,873
Building and land lease—Note 6	7,949,430	8,015,905
Historic Building—Note 6	5,100,007	5,318,252
Other assets	196,801	268,315
Property and equipment, net—Note 7	20,508,950	21,059,720
Capitalized bond issuance costs, net	113,557	141,945
Artifact collection—Note 1		
Total Assets	<u>\$ 51,144,346</u>	<u>\$ 50,662,586</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	\$ 606,223	\$ 636,005
Notes and bonds payable—Note 8	3,072,500	3,407,500
Tenant deposits	10,000	
Deferred revenue	7,698	
Gift annuities and planned giving liabilities	222,646	231,420
Total Liabilities	3,919,067	4,274,925
Net Assets		
Unrestricted		
Undesignated	17,590,462	17,833,342
Board designated—Note 9	2,309,954	2,815,779
Total Unrestricted Net Assets	19,900,416	20,649,121
Temporarily restricted—Note 10	18,358,462	16,807,358
Permanently restricted—Note 11	8,966,401	8,931,182
Total Net Assets	<u>47,225,279</u>	<u>46,387,661</u>
Total Liabilities and Net Assets	<u>\$ 51,144,346</u>	<u>\$ 50,662,586</u>

See notes to financial statements.

Japanese American National Museum
Statement of Activities
Year Ended June 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support				
Contributions and grant income	\$ 1,129,534	\$ 1,862,161	\$ 30,000	\$ 3,021,695
Contribution of use of Historic Building and land	878,591			878,591
Valuation of beneficial interest in split-interest arrangements		269,579	5,219	274,798
Membership fees	672,654			672,654
Special events, net—Note 12	972,513			972,513
Revenue				
Admissions	267,947			267,947
Museum store, net of cost of goods sold of \$207,456	213,915			213,915
Dividend and interest income	40,973	196,150		237,123
Realized and unrealized gain on investments	339,422	634,083		973,505
Rental income	463,053			463,053
Other revenue	322,019			322,019
Total Support and Revenue Before Reclassifications	5,300,621	2,961,973	35,219	8,297,813
Reclassifications				
Net assets released from restrictions	1,410,869	(1,410,869)		
Total Support and Revenue After Reclassifications	6,711,490	1,551,104	35,219	8,297,813
Expenses				
Program services	5,676,237			5,676,237
Management and general	1,081,532			1,081,532
Fundraising and development	702,426			702,426
Total Expenses	7,460,195			7,460,195
Change in Net Assets	(748,705)	1,551,104	35,219	837,618
Net Assets at Beginning of Year	20,649,121	16,807,358	8,931,182	46,387,661
Net Assets at End of Year	\$ 19,900,416	\$ 18,358,462	\$ 8,966,401	\$ 47,225,279

See notes to financial statements.

Japanese American National Museum
Statement of Activities
Year Ended June 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support				
Contributions and grant income	\$ 1,134,846	\$ 422,792	\$ 42,347	\$ 1,599,985
Contribution of use of Historic Building and land	895,888			895,888
Valuation of beneficial interest in split-interest arrangements		(274,918)	(46)	(274,964)
Membership fees	649,672			649,672
Special events, net—Note 12	956,796			956,796
Revenue				
Admissions	226,842			226,842
Museum store, net of cost of goods sold of \$298,696	142,975			142,975
Dividend and interest income	14,764	406,987		421,751
Realized and unrealized gain (loss) on investments	31,609	(230,978)		(199,369)
Rental income	381,592			381,592
Other revenue	206,641			206,641
Total Support and Revenue Before Reclassifications	4,641,625	323,883	42,301	5,007,809
Reclassifications				
Net assets released from restrictions	1,535,553	(1,535,553)		
Total Support and Revenue After Reclassifications	6,177,178	(1,211,670)	42,301	5,007,809
Expenses				
Program services	5,569,612			5,569,612
Management and general	1,244,948			1,244,948
Fundraising and development	660,821			660,821
Total Expenses	7,475,381			7,475,381
Change in Net Assets	(1,298,203)	(1,211,670)	42,301	(2,467,572)
Net Assets at Beginning of Year	21,947,324	18,019,028	8,888,881	48,855,233
Net Assets at End of Year	<u>\$ 20,649,121</u>	<u>\$ 16,807,358</u>	<u>\$ 8,931,182</u>	<u>\$ 46,387,661</u>

See notes to financial statements.

Japanese American National Museum
Statement of Functional Expenses
Year Ended June 30, 2017

	Program Services	Management and General	Fundraising and Development	Total
Expenses				
Salaries	\$ 1,370,237	\$ 423,993	\$ 386,115	\$ 2,180,345
Payroll taxes	100,702	25,146	26,721	152,569
Other employee benefits	138,675	42,079	36,181	216,935
Total Personnel Expenses	1,609,614	491,218	449,017	2,549,849
Facility and parking rental	1,173,580	69,782	33,495	1,276,857
Contracted services	712,766	122,506	53,339	888,611
Depreciation	787,594	35,352	20,304	843,250
Professional fees	372,820	153,941	51,517	578,278
Utilities	355,987	9,161	10,509	375,657
Supplies, materials, and equipment	149,441	13,128	26,742	189,311
Travel, meetings, and memberships	123,594	29,257	29,782	182,633
Insurance	49,571	62,855	1,356	113,782
Telephone	87,814	7,833	3,181	98,828
Interest	79,194	12,797	2,338	94,329
Postage and delivery	88,093	2,376	1,268	91,737
Bank and merchant fees	34,195	27,256	8,980	70,431
Taxes, licenses, permits, and fees	26,309	16,521	9,267	52,097
Advertising	25,665	16,403		42,068
Other expenses		11,146	1,331	12,477
Total Expenses	\$ 5,676,237	\$ 1,081,532	\$ 702,426	\$ 7,460,195

See notes to financial statements.

Japanese American National Museum
Statement of Functional Expenses
Year Ended June 30, 2016

Expenses	Program Services	Management and General	Fundraising and Development	Total
Salaries	\$ 1,505,353	\$ 482,904	\$ 409,824	\$ 2,398,081
Payroll taxes	109,413	36,520	29,021	174,954
Other employee benefits	199,879	59,453	37,172	296,504
Total Personnel Expenses	1,814,645	578,877	476,017	2,869,539
Facility and parking rental	1,175,184	66,092	33,959	1,275,235
Contracted services	525,712	148,922	29,256	703,890
Depreciation	749,206	33,629	19,315	802,150
Professional fees	237,407	155,058	35,723	428,188
Utilities	363,416	13,365	10,728	387,509
Supplies, materials, and equipment	234,334	23,819	14,862	273,015
Travel, meetings, and memberships	126,933	73,596	14,605	215,134
Insurance	57,028	48,064	1,435	106,527
Telephone	105,939	12,928	3,708	122,575
Interest	57,086	20,634	1,472	79,192
Postage and delivery	43,499	4,032	2,871	50,402
Bank and merchant fees	26,952	35,887	7,003	69,842
Taxes, licenses, permits, and fees	28,873	4,736	3,735	37,344
Advertising	21,086	2,823	4,878	28,787
Other expenses	2,312	22,486	1,254	26,052
Total Expenses	\$ 5,569,612	\$ 1,244,948	\$ 660,821	\$ 7,475,381

See notes to financial statements.

Japanese American National Museum
Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operations		
Change in net assets	\$ 837,618	\$ (2,467,572)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation expense	843,250	802,150
Amortization of forgivable debt	(15,000)	(15,000)
Net realized and unrealized (gain) loss on investment	(717,573)	199,369
Valuation of beneficial interest in split-interest arrangements	(268,002)	314,118
Permanently restricted contributions	(30,000)	(42,347)
Changes in operating assets and liabilities		
(Increase) decrease in restricted cash: gift annuities	1,978	(1,573)
Decrease in inventories, net	13,083	37,272
(Increase) decrease in pledges and grants receivable, net	(760,139)	214,753
Decrease in leased Historic Building and land lease	284,720	267,422
(Increase) decrease in other assets	71,514	(61,316)
Decrease in capitalized bond issuance costs, net	28,388	28,388
Decrease in accounts payable and accrued expenses	(29,782)	(104,771)
Increase in other liabilities	17,698	
Decrease in gift annuities and planned giving liabilities	(8,774)	(37,581)
Cash Provided by (Used in) Operating Activities	268,979	(866,688)
Cash Flows from Investing Activities		
Purchases of property and equipment	(292,480)	(257,387)
Purchases of investments in securities	(6,260,606)	(421,157)
Proceeds from sales of investments in securities	6,865,477	926,194
Cash Provided by Investing Activities	312,391	247,650
Cash Flows from Financing Activities		
Permanently restricted contributions	30,000	42,347
Payment of bond principal	(320,000)	(555,000)
Cash Used in Financing Activities	(290,000)	(512,653)
Net Increase (Decrease) in Cash	291,370	(1,131,691)
Cash at Beginning of Year	722,798	1,854,489
Cash at End of Year	\$ 1,014,168	\$ 722,798
Supplementary Disclosures		
Income taxes paid	\$	\$
Interest paid	\$ 94,329	\$ 79,192

See notes to financial statements.

Japanese American National Museum
Notes to Financial Statements
June 30, 2017 and 2016

Note 1—Organization and Summary of Significant Accounting Policies

Organization—The Japanese American National Museum (National Museum) is a California not-for-profit corporation, incorporated March 1, 1985 in the State of California. The mission of the National Museum is to promote understanding and appreciation of America's ethnic and cultural diversity by sharing the Japanese American experience. As the premier institution in its field, the National Museum houses the largest well-documented collection of Japanese American artifacts in the world. The National Museum sponsors ongoing exhibitions, lectures, workshops, educational programs, and related events at its Los Angeles headquarters. As a "museum without borders", the institution regularly presents exhibitions, public programs, and research projects in collaboration with Japanese American communities, other ethnic communities, and pre-eminent scholars, museums, and educational and cultural institutions around the globe. The National Museum is accredited by the American Association of Museums and is an affiliate of the Smithsonian Institution.

Artifact Collection—The National Museum's artifact collection is comprised of objects, photographs, home movies, books, manuscripts, works of art, and artifacts of historical significance that are held for educational and curatorial purposes. Each item is catalogued, preserved, and cared for, and activities verifying their existence and assessing their condition are performed continuously. The artifact collection, which was acquired primarily through contributions since the National Museum's inception, is not recognized as an asset on the statement of financial position. The National Museum's collection policies are consistent with the Code of Ethics for Museums adopted by the American Association of Museums.

Financial Statement Presentation—The financial statements of the National Museum have been prepared on the accrual basis of accounting, in conformity with Generally Accepted Accounting Principles in the United States of America (GAAP). The National Museum's net assets are classified based on the existence or absence of donor-imposed restrictions. As such, the net assets of the National Museum and changes therein are presented and reported as follows:

Unrestricted net assets—Net assets that are not subject to donor-imposed stipulations and that may be expendable for any purpose in carrying out the National Museum's mission.

Temporarily restricted net assets—Net assets subject to donor-imposed stipulations that may or will be met either by actions of the National Museum and/or the passage of time. As the restrictions are satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statement of activities as net assets released from restrictions.

Permanently restricted net assets—Net assets subject to donor-imposed stipulations that resources be maintained in perpetuity. Investment income generated from these funds is available for general support of the National Museum's programs and operations unless otherwise stipulated by the donor.

Income Taxes—The Internal Revenue Service (IRS) has classified the National Museum as exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, and the National Museum is exempt from California state income taxes from the Franchise Tax Board.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 1—Organization and Summary of Significant Accounting Policies—Continued

Accounting standards require an organization to evaluate its tax positions and provide for a liability for any positions that would not be considered 'more likely than not' to be upheld under a tax authority examination. Management has evaluated its tax positions and has concluded that a provision for a tax liability is not necessary at June 30, 2017 and 2016. Generally, the National Museum's information returns remain open for examination for a period of three (federal) or four (state of California) years from the date of filing.

Cash and Cash Equivalents—Cash and cash equivalents consist of cash on premises generated through the course of daily activities and cash on deposit with banks as well as money market funds or short-term investments held at financial institutions, with original maturities of three months or less from the date of purchase.

Restricted Cash: Gift Annuities—Restricted cash: gift annuities represents the National Museum's charitable gift annuity fund. The National Museum offers a charitable remainder annuities program for those who desire to donate. The National Museum's annuities are written under authority granted to it by the Insurance Commissioner of the State of California. Annuity assets are held by a custodian at fair value. All investments are in a money market fund. Payments are made from these assets to the annuity beneficiary in accordance with the contract.

Inventories—Inventories are stated at the lower of cost or market. Cost is determined under the first-in, first-out (FIFO) method. Inventories consist of sundry items such as books, gift items, cards and educational materials available through the National Museum's retail store. The National Museum's allowance for excess and obsolete inventory amounted to \$100,000 and \$100,000 at June 30, 2017 and 2016, respectively.

Concentration of Credit Risk—Cash and cash equivalents, investments in securities, and receivables are the primary form of concentration of credit risk to which the National Museum is subject. The National Museum places its cash and cash equivalents with high credit quality financial institutions where the funds are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per institution. Cash held in investment accounts at investment custodians are insured by the Securities Investors Protection Corporation (SIPC) up to \$250,000 and the investments in securities are insured up to \$500,000. At times, in the normal course of business, such cash balances are in excess of the FDIC/SIPC insurance limits, but management deems the risk of loss due to these concentrations to be minimal. Conservative investment guidelines established by the Board of Trustees (Board) govern the National Museum's investments in securities to achieve diversification of the portfolio.

During the year ended June 30, 2017, two donors contributed 33% and 17% of total contributions and grant income, respectively. During the year ended June 30, 2016, one donor contributed 17% of total contributions and grant income.

Allowance for Doubtful Accounts—An allowance for uncollectible amounts is determined using the age of the receivable, creditworthiness of parties and historical collection experience.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 1—Organization and Summary of Significant Accounting Policies—Continued

Fair Value of Financial Instruments—The fair value of the National Museum's financial instruments as of June 30, 2017 and 2016 represents management's best estimates of the amounts that would be received to sell those assets 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 are little, if any observable inputs, management's own judgments about the assumptions of market participants were used in pricing the asset. Those judgments are developed by management based on the best information available in the circumstances as further detailed in Note 5 to the financial statements.

Investments—Investments in securities are initially recorded at cost, if purchased, or fair market value, if received as a contribution. Subsequent to acquisition, investments in securities are reported at fair value. Investment income, gains and losses are reported as unrestricted income unless use of the earnings is restricted by the donor.

Land Held for Investment—Undeveloped land was donated in 1990 and was recorded at the estimated fair market value on the date of receipt. It is the intention of the National Museum to hold the land as a long-term investment. The property is carried at the lower of the value recorded at the date of receipt or net realizable value.

Beneficial Interest in Split-Interest Arrangements—The National Museum is the beneficiary under various charitable remainder trusts. The National Museum is the trustee of some of the irrevocable and revocable trusts; others are administered by third party trustees.

National Museum as Trustee—For irrevocable agreements, assets are included in the National Museum's beneficial interest in split-interest arrangements and stated at fair value. Contribution revenue is recognized at the date each trust is established after recording liabilities for the actuarially-determined present value of the estimated future payments to be made to the beneficiaries. The actuarial liability is based on the present value of the future payments discounted at the appropriate risk-free rate at the inception of each agreement and the applicable mortality tables.

Liabilities are adjusted during the terms of the trust for changes in the fair value of the assets, accretion of discounts, and other changes in the estimates of future benefits. Actuarial liabilities totaled \$222,646 and \$231,420 at June 30, 2017 and 2016, respectively, and are included in gift annuities and planned giving liabilities in the statement of financial position. The Annuity 2000 Mortality Table was used for both of the years ended June 30, 2017 and 2016.

Assets held by others—The National Museum is the beneficiary of charitable remainder trusts held and administered by others. The present value of the estimated future cash flows from these trusts approximates the value of the underlying assets and is included in beneficial interest in split-interest arrangements in the statement of financial position. Contribution revenues are recognized at the date the trusts are established.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 1—Organization and Summary of Significant Accounting Policies—Continued

Property and Equipment—Purchased property and equipment are recorded at cost, and donated assets are recorded at the estimated fair value on the date of receipt. The National Museum depreciates its property and equipment using the straight-line-method over the following estimated useful lives:

Furniture, fixtures and equipment	3-10 years
Building improvements	10-20 years
Buildings	55 years
Exhibition and media development costs	5-10 years

Repairs and maintenance costs are expensed as incurred. Gifts of long-lived assets with explicit restrictions as to how the assets are to be used and gifts of cash or other assets that must be used to acquire and maintain long-lived assets are reported as restricted support. Absent explicit donor stipulations, the National Museum reports expirations of donor restrictions when such long-lived assets are placed in service.

Capitalized Bond Issuance Costs—Bond discount and issuance costs are amortized as additional interest expense based on the terms of the bond using the straight-line method, which approximates the effective interest method.

Revenue Recognition—The National Museum's revenue recognition policies are as follows:

Contributions—Contributions are reported as support in the period received and as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expiration of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as net assets released from restrictions in the accompanying statement of activities. Contributions whose restrictions are met in the same year as the contribution is made are initially classified as temporarily restricted net assets. Amounts expected to be collected beyond one year are recorded at the present value of estimated future cash flows. Management determined an appropriate interest rate based on historical risk-free interest adjusted for determined risk. The amortization of the discount is included in support.

Grants and contracts—Revenues from grants and contracts are reported as increases in unrestricted net assets as allowable expenditures under such agreements are incurred. The amounts expended in excess of reimbursements are reported as grants receivable.

Membership fees—Membership fees are recognized as revenue when such income is received.

Admissions—Revenues from service revenue are recognized at the time services are provided.

Auxiliary enterprises—Revenues from supporting services, such as the National Museum gift shop, are recorded at the time of delivery of a product or service.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 1—Organization and Summary of Significant Accounting Policies—Continued

Investment gain (loss)—Investment transactions are recorded on the trade date. Investment income and realized and unrealized gains and losses, net of investment management fees, are reported as increases or decreases in the appropriate net asset category.

Rental Income—Rental income consists of facilities rental fees earned from unrelated third parties including retail vendors, film production companies, and individuals. Rental income is recognized upon the occurrence of the events for which the facilities were rented.

Benefits Provided to Donors at Special Events—The National Museum conducts special fundraising events in which a portion of the gross proceeds paid by the participants represents payment for the direct cost of the benefits received by participants at the event. The National Museum values benefits, primarily the meals and entertainment, at the actual cost.

Contributed Services—A substantial number of unpaid volunteers have made significant contributions of their time and services to further the National Museum's mission. During the years ended June 30, 2017 and 2016, these in-kind contributions amounted to over 24,000 and 28,000 volunteer hours valued at approximately \$480,000 and \$560,000, respectively. These amounts are not reflected in these financial statements as the recognition criteria under GAAP were not met.

Functional Expenses—The costs of providing the various program and supporting activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been directly charged to the program services and supporting services benefitted. Indirect costs are allocated between program services, management and general, and fundraising expenses, based on an analysis of personnel time utilized for the related activities.

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 certain estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications—Certain amounts in 2016 have been reclassified to conform with the 2017 financial statement presentation.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 2—Pledges and Grants Receivable, Net

Net pledges and grants receivable at June 30, 2017 and 2016 consist of:

	<u>2017</u>	<u>2016</u>
Due within 1 year	\$ 319,985	\$ 306,172
Due within 2 to 5 years	900,000	87,500
	Gross	393,672
	1,219,985	393,672
Less present value discount	(70,374)	(4,200)
	Net	389,472
	\$ 1,149,611	\$ 389,472

The present value of estimated future cash flows on unconditional promises to give was determined using a discount rate of 2% and 5% for the years ended June 30, 2017 and 2016, respectively.

Note 3—Investments

Investments consist of the following as of June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Fixed income funds	\$ 3,094,286	\$ 6,426,794
Domestic equity funds	8,473,513	5,131,518
International equity fund	978,454	875,239
	Totals	12,433,551
	\$ 12,546,253	\$ 12,433,551

Return on investments for the years ended June 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Realized gain (loss) on investments	\$ 399,073	\$ (20,435)
Unrealized gain (loss) on investments	574,432	(178,934)
	Realized and Unrealized Gain (Loss)	(199,369)
	973,505	(199,369)
Investment interest and dividends	236,854	421,157
	Return on Investments, Net	221,788
	\$ 1,210,359	\$ 221,788

Japanese American National Museum
Notes to Financial Statements—Continued

Note 4—Beneficial Interest in Split-Interest Arrangements

Beneficial interest in split-interest arrangements, by trustee, consists of the following:

	<u>National Museum</u>	<u>Others</u>	<u>Total</u>
Beneficial Interest in Split-Interest Arrangements at July 1, 2015	\$ 636,642	\$ 1,529,349	\$ 2,165,991
Amortization of discount, payments to income beneficiaries, and income	<u>(29,562)</u>	<u>(284,556)</u>	<u>(314,118)</u>
Beneficial Interest in Split-Interest Arrangements at June 30, 2016	607,080	1,244,793	1,851,873
Amortization of discount, payments to income beneficiaries, and income	<u>203,460</u>	<u>64,542</u>	<u>268,002</u>
Beneficial Interest in Split-Interest Arrangements at June 30, 2017	<u>\$ 810,540</u>	<u>\$ 1,309,335</u>	<u>\$ 2,119,875</u>

Payout rates ranged between 6% for those assets held by the National Museum, and 5% and 8% for assets held by others.

The National Museum used a discount rate under Internal Revenue Code section 7520(a) of 2.2% to value all trust assets as of June 30, 2017 and 2016. Included with charitable remainder trusts is real property. Real property market value was \$180,000 at June 30, 2017 and 2016. The remaining assets are invested in various institutional trust funds for which the underlying assets are generally traded in public or private markets and are reported at fair value. The charitable remainder trust amounts include vested and non-vested trusts, of which only the vested portions are recognized by the National Museum.

Note 5—Fair Value

Accounting standards have established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This 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 that the entity has the ability to access at the measurement date. The National Museum's Level 1 assets consist of common stock and domestic, international, and fixed income mutual funds.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 5—Fair Value—Continued

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the assets, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other observable inputs that can be corroborated by observable market data. The National Museum has no Level 2 assets or liabilities.

Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. The National Museum's Level 3 assets include beneficial interests in split-interest arrangements, and assets and liabilities related to its gift annuities.

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. Assets and liabilities measured at fair value on a recurring basis at June 30, 2017 consist of the following:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
June 30, 2017:				
Investments	\$ 12,546,253	\$	\$	\$ 12,546,253
Split-interest arrangements			2,119,875	2,119,875
Planned giving liabilities			(164,465)	(164,465)
Gift annuities—assets	51,408			51,408
Gift annuities—liabilities			(58,181)	(58,181)
Totals	<u>\$ 12,597,661</u>	<u>\$</u>	<u>\$ 1,897,229</u>	<u>\$ 14,494,890</u>

Assets and liabilities measured at fair value on a recurring basis at June 30, 2016 consist of the following:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Fair Value</u>
June 30, 2016:				
Investments	\$ 12,433,551	\$	\$	\$ 12,433,551
Split-interest arrangements			1,851,873	1,851,873
Planned giving liabilities			(171,054)	(171,054)
Gift annuities—assets	53,386			53,386
Gift annuities—liabilities			(60,366)	(60,366)
Totals	<u>\$ 12,486,937</u>	<u>\$</u>	<u>\$ 1,620,453</u>	<u>\$ 14,107,390</u>

A reconciliation of the National Museum's Level 3 assets and liabilities is as follows:

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 1,620,453	\$ 1,896,990
Change in value of split-interest arrangements	276,776	(276,537)
Ending Balance	<u>\$ 1,897,229</u>	<u>\$ 1,620,453</u>

Japanese American National Museum
Notes to Financial Statements—Continued

Note 6—Historic Building and Land Leases

In February 1987, the National Museum entered into a 50-year lease at \$1 per year with the City of Los Angeles for the use of land and a 33,000 square foot building (Historic Building). The National Museum restored the facility and opened it to the public in May 1992. In February 1997, the original lease was superseded by a new 55-year lease with the City of Los Angeles for the same property, as well as three adjacent parcels of land, the largest of which is the site of an 85,000 square foot expansion pavilion, which opened to the public in January 1999. In 2002, the lease was amended to provide an additional 5,000 square feet for use by the National Museum. The present value of the building and land lease is \$7,949,430 and \$8,015,905 as of June 30, 2017 and 2016, respectively, based on an annual estimated lease expense of \$594,060 and a discount rate of 6.6%.

The Historic Building was expanded and renovated to support the National Center for the Preservation of Democracy (National Center) with a \$20 million federal grant awarded in 2001. The construction was completed and the National Center was opened in October 2005. The federal government retains a reversionary interest in the building costs purchased under the grant. As such, the building costs paid with the funds received from the grant are not recorded on the National Museum's financial statements. However, the National Museum has been allowed to use the building rent-free. Accordingly, the National Museum initially recorded the present value of the building rent of \$6,881,032 as a historic building on the statement of financial position and as corresponding temporarily restricted contributions in the statement of activities for the year ended June 30, 2007, based upon an estimated annual rent expense of \$569,250 and a discount rate of 6.6%. A rent period of 25 years was used, approximating the estimated useful life of the building, as there is no definitive time restriction for the National Museum's use of the building under the grant. The present value of the Historic Building was \$5,100,007 and \$5,318,252 as of June 30, 2017 and 2016, respectively.

Note 7—Property and Equipment, Net

The major classes of property and equipment, net at June 30, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Museum building	\$ 30,118,137	\$ 30,118,137
Furniture, fixtures, and equipment	3,211,636	2,919,156
Exhibition and media development costs	1,812,221	1,812,221
Historic Building improvements	1,487,643	1,487,643
Museum building improvements	254,348	254,348
	<u>36,883,985</u>	<u>36,591,505</u>
Less accumulated depreciation	(16,375,035)	(15,531,785)
Net	<u>\$ 20,508,950</u>	<u>\$ 21,059,720</u>

Total depreciation expense recorded for the years ended June 30, 2017 and 2016 was \$843,250 and \$802,150, respectively.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 8—Notes and Bonds Payable

Notes and bonds payable as of June 30, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
California Statewide Communities Development Authority Variable Rate Demand Revenue Bonds, Series 2000A, maturing August 1, 2030. Secured by the full faith and credit of the National Museum, a lien on gross revenues, and a pledge of real property and endowment assets. The National Museum was in compliance with required financial covenants.	\$ 3,050,000	\$ 3,370,000
Noninterest-bearing note payable to the Community Redevelopment Agency of the City of Los Angeles (CRA) with \$15,000 of principal balance forgiven each year.	22,500	37,500
Totals	<u>\$ 3,072,500</u>	<u>\$ 3,407,500</u>

On June 15, 2000, the California Statewide Communities Development Authority (Issuer) sold \$10,000,000 of Variable Rate Demand Revenue Bonds (Japanese American National Museum), Series 2000A (Bonds). The proceeds were loaned by the Issuer to the National Museum pursuant to a loan agreement and were used to (a) repay and retire an existing five-year term loan provided by a group of banks and (b) to pay a portion of costs of issuance of the bonds. The bonds have a variable interest rate which is reset weekly. The effective rate was 1.48% for the years ended June 30, 2017 and 2016, respectively.

The aggregate future maturities of notes payable and bonds payable are as follows:

For the Year Ending June 30,

2018	\$ 330,000
2019	345,000
2020	360,000
2021	380,000
2022	395,000
Thereafter	<u>1,262,500</u>
Total	<u>\$ 3,072,500</u>

Note 9—Board-Designated Net Assets

Board-designated net assets are voluntary board-approved segregations of unrestricted net assets for specific purposes, projects or investments in infrastructure.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 10—Temporarily Restricted Net Assets

The National Museum's temporarily restricted net assets as of June 30, 2017 and 2016 consist of the following:

	<u>2017</u>	<u>2016</u>
Building and land lease	\$ 7,949,430	\$ 8,015,905
Historic Building	5,100,007	5,318,252
Exhibitions, education, public programs and research	899,459	526,573
Charitable remainder trusts and gift annuities	1,702,993	1,433,464
Grants and contributions pledged for future periods	2,706,573	1,513,164
Totals	<u>\$ 18,358,462</u>	<u>\$ 16,807,358</u>

Note 11—Permanently Restricted Net Assets

The National Museum's endowment consists of its beneficial interest in split-interest agreements held by others, and one investment fund and four unified pools of investments managed by the National Museum established to support its operations and programs. The endowment comprises donor-restricted endowment funds only and, as of June 30, 2017 and 2016, there were no funds designated by the Board to function as endowments. As required by GAAP, net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

In January 1, 2009, the State of California adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA requires 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. The Board is aware that there is an implicit understanding that the market value of the donor-restricted endowment may, from time to time, fall below the fair value of the original gift as of the gift date due to market conditions or continued prudent expenditures by the Board of certain amounts of the endowment. If such a temporary deficit condition occurred, the Board would take all prudent steps, given ongoing market conditions, to restore the fair value of the fund to an amount at or above the amount of the original gift.

The National 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 National Museum in a manner consistent with the standard of prudence prescribed by UPMIFA.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 11—Permanently Restricted Net Assets—Continued

In accordance with UPMIFA, the National 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 National 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 National Museum
- 7) The investment policies of the National Museum

Return Objectives and Risk Parameters—It is the purpose of the National Museum's endowment fund to secure the future of the National Museum and to support its programs and operations as designated by the Board.

The primary long-term financial objective is to preserve and enhance the real (i.e., inflation-adjusted) purchasing power of the endowment through a prudent long-term investment strategy. This objective should be achieved over rolling three-, five-, and ten-year periods on a total return basis. An additional objective is to provide a relatively predictable, stable, and (in real terms) constant stream of current income for the National Museum's annual operating needs.

The primary investment objective of the endowment is to earn an average annual minimum nominal return of 8% per year and a real total return of at least 5% per year, net of management fees, over the long-term (rolling three-, five- and ten-year periods). The National Museum considers itself a risk-averse investor. That is, among various investment alternatives with comparable expected returns, the preference is for those having the lowest risk.

Strategies Employed for Achieving Objectives—The National Museum manages its endowment on a total rate of return basis consisting of dividends, interest, and any net increase / decrease in market value of securities for the fiscal year, not favoring returns from one source over another.

The National Museum has determined that marketable debt and equity securities traded in the United States are appropriate investments consistent with its return objectives and risk parameters. Cash invested in money market accounts is also an acceptable investment within these guidelines. The investment portfolio is to be sufficiently balanced so that no single security or class of securities will have a disproportionate impact on the risk of the total portfolio.

Spending Policy and How the Investment Objectives Relate to Spending Policy—The National Museum has a policy governing the amount of endowment earnings that can be released annually for spending, consistent with the restrictions, if any, placed on the endowment by donors. The spending policy authorizes an annual distribution equal to 5% of the average market value of the portfolios as of the preceding 20 calendar quarters, subject to the requirement that the portfolios increase by an inflation factor annually.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 11—Permanently Restricted Net Assets—Continued

In establishing this policy, the National Museum considered the long-term expected return on its endowment. Accordingly, over the long term, the National Museum expects the current spending policy to allow its endowment to grow at an amount that will at least keep pace with expected inflation.

Summary of Endowment Fund Balances and Activity—Endowment net asset composition by donor-imposed stipulations for the years ended June 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Nikkei Legacy program	\$ 3,000,000	\$ 3,000,000
Artistic programs	2,816,884	2,811,665
General operating purposes	2,149,517	2,119,517
Humanities programs	1,000,000	1,000,000
Totals	<u>\$ 8,966,401</u>	<u>\$ 8,931,182</u>

Change in endowment net assets for the year ended June 30, 2017 and 2016 consists of:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment Net Assets at June 30, 2015	\$ 1,464,107	\$ 8,888,881	\$ 10,352,988
Investment income	406,987		406,987
Change in value of split-interest agreements		(46)	(46)
Realized and unrealized loss on investments, net	(230,978)		(230,978)
Total Investment Return	176,009	(46)	175,963
Contributions		42,347	42,347
Appropriation of expenditure	(518,623)		(518,623)
Endowment Net Assets at June 30, 2016	1,121,493	8,931,182	10,052,675
Investment income	196,150		196,150
Change in value of split-interest agreements		5,219	5,219
Realized and unrealized gain on investments, net	634,083		634,083
Total Investment Return	830,233	5,219	835,452
Contributions		30,000	30,000
Appropriation of expenditure	(502,787)		(502,787)
Endowment Net Assets at June 30, 2017	<u>\$ 1,448,939</u>	<u>\$ 8,966,401</u>	<u>\$ 10,415,340</u>

Japanese American National Museum
Notes to Financial Statements—Continued

Note 12—Special Events

Special events during the years ended June 30, 2017 and 2016 represent activities related to the annual gala event and are summarized as follows:

	<u>2017</u>	<u>2016</u>
Revenue	\$ 1,319,619	\$ 1,281,101
Less direct expenses	<u>(347,106)</u>	<u>(324,305)</u>
Net	<u>\$ 972,513</u>	<u>\$ 956,796</u>

Total fundraising expenses for the years ended June 30, 2017 and 2016 consist of the following:

	<u>2017</u>	<u>2016</u>
Fundraising expenses per statement of functional expenses	\$ 702,426	\$ 660,821
Special event expenses	<u>347,106</u>	<u>324,305</u>
Totals	<u>\$ 1,049,532</u>	<u>\$ 985,126</u>

Note 13—Employee Benefit Plan

The National Museum has a defined contribution retirement plan covering substantially all of its employees. The Board annually determines the amount to be contributed to the plan. Participants are fully vested after five years of service. The National Museum made contributions of \$11,229 and \$14,565 to the plan during the years ended June 30, 2017 and 2016, respectively.

Note 14—Recent Accounting Pronouncements

Fair Value Measurement—In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2015-07 (ASU 2015-07), Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent). ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using net asset value per share as a practical expedient. For nonpublic business entities, ASU 2015-07 is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The National Museum is currently evaluating the impact that the adoption of ASU 2017-07 will have on its financial statements.

Japanese American National Museum
Notes to Financial Statements—Continued

Note 14—Recent Accounting Pronouncements—Continued

Leases—In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires organizations that lease assets (lessees) to recognize the assets and related liabilities for the rights and obligations created by the leases on the statement of financial position for leases with terms exceeding 12 months. ASU No. 2016-02 defines a lease as a contract or part of a contract that conveys the right to control the use of identified assets for a period of time in exchange for consideration. The lessee in a lease will be required to initially measure the right-of-use asset and the lease liability at the present value of the remaining lease payments, as well as capitalize initial direct costs as part of the right-of-use asset. ASU No. 2016-02 is effective for the National Museum in 2020; early adoption is permitted. The National Museum is currently evaluating the impact that the adoption of ASU 2016-02 will have on its financial statements.

Net Assets Presentation—In August 2016, the FASB issued ASU No. 2016-14, Presentation of Financial Statements of Not-for-Profit Entities, which is intended to improve how a not-for-profit entity classifies its net assets, as well as the information it presents in its financial statements about its liquidity and availability of resources, expenses and investment returns, and cash flows. The guidance replaces the three classes of net assets currently presented on the statement of financial position with two new classes of net assets, which are based on the existence or absence of donor-imposed restrictions. ASU No. 2016-14 includes specific disclosure requirements intended to improve a financial statement user's ability to assess an entity's available financial resources, along with its management of liquidity and liquidity risk. The guidance requires all not-for-profit entities to present expenses by both their natural and functional classification in a single location in the financial statements. ASU No. 2016-14 is effective for the National Museum for the year ending June 30, 2018. Early adoption is permitted. The National Museum is currently evaluating the impact that the adoption of ASU 2016-14 will have on its financial statements.

Inventory—In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory. ASU 2015-11 simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. ASU 2015-11 applies only to inventories for which cost is determined by methods other than last-in first-out and the retail inventory method. ASU 2015-11 is effective on a prospective basis for public companies for annual reporting periods beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the ASU 2015-11 is effective on a prospective basis for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 31, 2017. Early adoption of ASU 2015-11 is permitted. The National Museum is currently evaluating ASU 2015-11 to determine if this guidance will have a material impact on our financial position, results of operations or cash flows.

Note 15—Subsequent Events

Management evaluated all activities of Japanese American National Museum through October 28, 2017, which is the date the financial statements were available to be issued, and concluded that no other material subsequent events have occurred that would require adjustment to the financial statements or disclosure in the notes to the financial statements.