



THE WESTERN RESERVE HISTORICAL SOCIETY

FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2012



SKODA MINOTTI

CPAs, BUSINESS & FINANCIAL ADVISORS

Delivering on the Promise.

THE WESTERN RESERVE HISTORICAL SOCIETY

YEAR ENDED JUNE 30, 2012

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INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF TRUSTEES
THE WESTERN RESERVE HISTORICAL SOCIETY

We have audited the accompanying statement of financial position of The Western Reserve Historical Society (a nonprofit organization) as of June 30, 2012, and the related statements of activities and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Society's management. Our responsibility is to express an opinion on these financial statements based on our audit. We have audited the financial statements of The Western Reserve Historical Society as of June 30, 2011, from which the 2011 comparative totals were derived, and expressed an unqualified opinion on those statements.

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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Western Reserve Historical Society as of June 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

SKODA MINOTTI

December 5, 2012

THE WESTERN RESERVE HISTORICAL SOCIETY

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2012

(WITH COMPARATIVE TOTALS AS OF JUNE 30, 2011)

	2012	2011
ASSETS		
Cash and cash equivalents	\$ 1,332,708	\$ 1,700,374
Capital accounts receivable	583,146	-
Other receivables	26,169	133,802
Prepaid expenses	14,162	50,115
Inventory	106,154	105,053
Pledges receivable, net of discount	1,275,922	686,363
Property and equipment, net of accumulated depreciation	11,660,633	9,353,387
Investments	13,694,170	14,481,636
Beneficial interests in trusts	6,560,258	7,122,451
Total assets	<u>\$ 35,253,322</u>	<u>\$ 33,633,181</u>
LIABILITIES		
Accounts payable	\$ 152,279	\$ 156,530
Accrued expenses	7,906	72,778
Capital accounts payable	756,424	125,984
Deferred revenue	58,297	67,095
Line of credit	339,617	217,903
Annuity obligations	53,428	60,864
Total liabilities	<u>1,367,951</u>	<u>701,154</u>
NET ASSETS		
Unrestricted	11,983,702	9,970,816
Temporarily restricted	7,374,522	7,884,739
Permanently restricted	14,527,147	15,076,472
Total net assets	<u>33,885,371</u>	<u>32,932,027</u>
Total liabilities and net assets	<u>\$ 35,253,322</u>	<u>\$ 33,633,181</u>

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

THE WESTERN RESERVE HISTORICAL SOCIETY
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2012
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2011)

	2012			Total	2011 Total
	Unrestricted	Temporarily Restricted	Permanently Restricted		
OPERATING REVENUES AND SUPPORT					
Gifts, grants and project support	\$ 1,418,696	\$ 1,558,397	\$ -	\$ 2,977,093	\$ 2,421,107
Capital grants	2,547,489	-	-	2,547,489	426,041
Admissions and memberships	516,793	-	-	516,793	643,043
Endowment support for current operations	622,840	-	-	622,840	648,558
Earned income	487,573	-	-	487,573	497,792
Net assets released from restrictions	1,378,866	(1,378,866)	-	-	-
Total operating revenues	<u>6,972,257</u>	<u>179,531</u>	<u>-</u>	<u>7,151,788</u>	<u>4,636,541</u>
OPERATING EXPENSES					
Program services					
Library, archives and museums	2,506,681	-	-	2,506,681	2,168,896
Hale Farm & Village	1,035,954	-	-	1,035,954	1,028,569
Other historic properties	100,224	-	-	100,224	91,654
Total program services	<u>3,642,859</u>	<u>-</u>	<u>-</u>	<u>3,642,859</u>	<u>3,289,119</u>
Supporting services					
Management and general	612,105	-	-	612,105	650,531
Fundraising	425,804	-	-	425,804	390,456
Total supporting services	<u>1,037,909</u>	<u>-</u>	<u>-</u>	<u>1,037,909</u>	<u>1,040,987</u>
Total operating expenses	<u>4,680,768</u>	<u>-</u>	<u>-</u>	<u>4,680,768</u>	<u>4,330,106</u>
CHANGES IN NET ASSETS FROM OPERATIONS	<u>2,291,489</u>	<u>179,531</u>	<u>-</u>	<u>2,471,020</u>	<u>306,435</u>
NON-OPERATING CHANGES					
Net investment gain (loss)	(130,740)	(34,156)	-	(164,896)	2,728,829
Less: endowment support for current operations	(35,171)	(587,669)	-	(622,840)	(648,558)
Proceeds from sales of gifts in-kind	34,559	-	-	34,559	521,768
Uncollectible pledges receivable	-	(55,055)	-	(55,055)	(17,251)
Change in beneficial interest in assets held by others	-	-	-	-	(16,600)
Changes in beneficial interests in trusts	-	(12,868)	(549,325)	(562,193)	801,809
Loss on retirement of property and equipment	(146,258)	-	-	(146,258)	(298,655)
Restructuring expenses	(993)	-	-	(993)	(11,263)
TOTAL NON-OPERATING CHANGES	<u>(278,603)</u>	<u>(689,748)</u>	<u>(549,325)</u>	<u>(1,517,676)</u>	<u>3,060,079</u>
CHANGES IN NET ASSETS	<u>2,012,886</u>	<u>(510,217)</u>	<u>(549,325)</u>	<u>953,344</u>	<u>3,366,514</u>
NET ASSETS - BEGINNING	<u>9,970,816</u>	<u>7,884,739</u>	<u>15,076,472</u>	<u>32,932,027</u>	<u>29,565,513</u>
NET ASSETS - ENDING	<u>\$ 11,983,702</u>	<u>\$ 7,374,522</u>	<u>\$ 14,527,147</u>	<u>\$ 33,885,371</u>	<u>\$ 32,932,027</u>

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

THE WESTERN RESERVE HISTORICAL SOCIETY

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2011)

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 953,344	\$ 3,366,514
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Add back (deduct): Items not affecting cash		
Contributions restricted for long-term purposes	-	(2,000)
Depreciation	800,940	734,665
Net realized and unrealized losses (gains) on investments	532,012	(2,313,144)
Net loss on retirement of property and equipment	146,258	298,655
Change in beneficial interest in trusts	562,194	(801,809)
Uncollectible pledges receivable	55,055	17,251
Uncollectible other receivables	-	15,185
Pledge discount	(14,167)	(21,906)
Cash provided by (used in) changes in the following items:		
Increase in capital accounts receivable	(583,146)	-
(Increase) decrease in pledges receivable	(644,614)	807,395
Decrease in other receivables	107,633	6,175
Decrease in prepaid expenses	35,953	3,536
Increase in inventory	(1,101)	(8,824)
Decrease in other assets	-	16,600
Increase (decrease) in accounts payable	(4,251)	19,971
Increase (decrease) in accrued expenses	(64,872)	40,237
Increase in capital accounts payable	630,440	-
Increase (decrease) in deferred revenue	(8,798)	29,838
Decrease in annuity obligations	(7,436)	(23,020)
Net cash provided by operating activities	<u>2,495,444</u>	<u>2,185,319</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(3,258,009)	(885,576)
Purchases of investments	(1,704,929)	(2,870,723)
Proceeds from sale of investments	1,978,114	3,099,881
Net cash used in investing activities	<u>(2,984,824)</u>	<u>(656,418)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Collection of contributions restricted for long-term purposes	-	2,000
Net draws (payments) on line of credit	121,714	(952,578)
Net cash provided by (used in) financing activities	<u>121,714</u>	<u>(950,578)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(367,666)	578,323
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	<u>1,700,374</u>	<u>1,122,051</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 1,332,708</u>	<u>\$ 1,700,374</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
CASH PAID DURING THE YEAR FOR:		
INTEREST	\$ 6,599	\$ 24,111

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

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

The Western Reserve Historical Society is a nonprofit institution that preserves and uses its collections, historic sites and museums to inspire people to discover the American experience by exploring the tangible history of Northeast Ohio.

Collections and exhibitions focus on the Western Reserve, placing this Northeast Ohio region in its larger historical context. The Society's holdings and exhibits provide an educational resource for library and museum users, including school children, the general public and scholars. In order to communicate effectively with these audiences, exhibits, whenever appropriate, employ modern interactive technologies and techniques. The Society seeks to make its research materials, exhibits and programs accessible to a diverse and inclusive audience.

The Society's headquarters in Cleveland is known as the History Center and includes the research library, exhibit galleries, two historic homes, collections storage and administrative offices. The renowned Society costume collection, one of the largest of its kind in the country, and the exhibit galleries of the Crawford Auto Aviation Collection, are located in the History Center.

The Society also owns and operates Hale Farm & Village, a 90 acre living history museum in the Cuyahoga Valley south of Cleveland, and two other historic properties.

The Society's revenues are from a combination of earned and contributed revenue. Earned revenue include admission fees, proceeds from space rentals, group tour fees, store sales, school group and public program income, and fee for service revenue. Store sales are reported net of cost and any sales taxes. Contributed revenue includes gifts, grants and endowments and trusts from individuals and organizations located primarily in Northeast Ohio.

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting. Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Society and changes therein are classified and reported as follows:

Unrestricted Net Assets – Net assets that are not subject to donor-imposed restrictions.

Unrestricted net assets consist of current operating net assets and board-designated net assets. The current operating net assets are used for general operating expenses. The board-designated net assets discussed in Note 7 are reserved by the Board of Trustees for the continuity of the Society's general activities, its exhibits and programs, and to meet emergency demands.

Temporarily Restricted Net Assets – Net assets subject to donor-imposed restrictions that may or will be met, either by actions of the Society and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. If donor-imposed restrictions are met in the same year as they are imposed, the net assets are reported as unrestricted.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of Presentation (continued)

Permanently Restricted Net Assets – Net assets subject to donor-imposed stipulations that they be maintained by the Society in perpetuity. Generally, the donors of these assets permit the Society to use all or part of the income earned on any related investments for general or specific purposes.

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America (GAAP). Accordingly, such information should be read in conjunction with the Society's financial statements for the year ended June 30, 2011, from which the summarized information was derived.

Non-operating activities reflect transactions of a long-term investment or capital nature. These include contributions to be invested by the Society to generate a return that will support future operations, proceeds from the sale of collection items, and the majority of investment income (including interest and dividends and realized and unrealized investment gains or losses).

Functional Allocation of Expenses

The costs of providing various programs and related supporting services have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated to the appropriate program and supporting services.

Use of Estimates

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

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Society considers all highly liquid investments available for current use with a maturity of three months or less to be cash equivalents. The balance of temporarily restricted cash at June 30, 2012 was \$1,036,475.

Capital Accounts Receivable and Payable

The capital accounts receivable and payable are related to the capital campaign for renovations and new construction at the Society's Cleveland location. See Note 5 for the construction in progress activities of the Society.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributions and Pledges Receivable

Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support depending on the existence and/or nature of any donor restrictions. Unconditional pledges receivable are recognized as unrestricted, temporarily restricted or permanently restricted revenues, dependent on the existence, or lack thereof, of donor-imposed restrictions in the period the promise is received. Conditional pledges receivable are recognized when the conditions on which they depend are substantially met. The pledges are stated at their estimated realizable value. The Society evaluates its outstanding pledges receivable on a specific identification basis and writes certain pledges off when determined uncollectible.

Pledges that are to be received over a period of years are discounted to their present value assuming their respective payment terms and an appropriate discount rate. The discount is amortized into contribution revenue over the term of the respective pledge agreement.

Inventory

Inventory is stated at the lower of cost or market on a first-in first-out (FIFO) basis. The Society capitalizes gift shop inventory when purchased and expenses it when sold.

Investments

Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in net investment gain (loss) under non-operating changes.

Property and Equipment

Expenditures for improvements, equipment, furniture and fixtures are capitalized and stated at cost. The Society capitalizes these types of expenditures for costs that exceed \$1,000. Depreciation is computed using the straight-line method over the estimated useful life of the assets as follows:

Building and land improvements	10 - 30 years
Equipment, furniture and fixtures	4 - 5 years

Routine expenditures for repairs and maintenance are expensed as incurred.

Collections

The Society's collections of historically significant artifacts, art objects and other materials are held for education, research and public exhibition, and are not capitalized by the Society. The cost of collection items purchased is recorded as an expense in the year acquired.

The Board of Trustees consider staff recommendations regarding collection items to be deaccessioned and sold, which may occur because the items are duplicates or no longer meet the mission or purposes of the Society. Net sales proceeds are used to address specific needs of the Society, including debt retirement as deemed warranted. Such activity is reflected in the statement of activities as proceeds from sales of gifts-in-kind, under non-operating changes.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Beneficial Interests in Trusts

The Society is the beneficiary of certain trusts administered by others. The trusts' assets are invested in debt and equity securities, and the Society records its interest in these trusts at the fair value of the trust assets, unless facts and circumstances indicate that the fair value of the beneficial interests differs from the fair value of the underlying trust assets. Unless otherwise specified by the donor, trust distributions are recognized as unrestricted revenue in the statement of activities, and the expense is recorded in the change in beneficial interests in trusts under non-operating changes. Subsequent changes in the fair value of the beneficial interest in trust assets are recognized as non-operating activity in the statement of activities. As of June 30, 2012, the temporary and permanently restricted balances of beneficial interests in trusts were \$165,206 and \$6,395,052, respectively.

Deferred Revenue

Deferred revenue consists of rental fees and monies received on grants for services yet to be performed.

Income Taxes

The Society is tax-exempt, under Section 501(c)(3) of the Internal Revenue Code (IRC) of 1986. However, the Society engages in activities subject to Federal income taxes that are considered unrelated to its exempt purpose. Management has determined that the income tax effect of these activities is not material to the financial statements and accordingly, has not recorded any provision for income taxes.

The Society was required to adopt certain provisions of GAAP regarding tax uncertainties on July 1, 2009. However, the adoption of these provisions had no effect on net assets or the results of operations. Based on IRC rules regarding the statute of limitations of examining historical income tax returns, the Society's Forms 990, *Return of Organization Exempt from Income Tax*, are no longer subject to examination by tax authorities for years ending before June 30, 2009. The Society currently has no uncertain tax positions that it has taken and believes that it can defend the Society's tax returns to any jurisdiction.

Concentrations of Credit Risk

The Society has significant investments in equity and debt securities and is therefore subject to concentrations of credit risk. Investments are managed by investment advisors who are supervised by the Board of Trustees. Though the market value of investments is subject to fluctuations on a year-to-year basis, the Board of Trustees believes that the investment policy is prudent for the long-term welfare of the Society.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributed Services

The Society receives a significant amount of donated services from approximately 450 unpaid volunteers who assist in program, fund-raising and special projects. The Society would recognize significant contributions of services received when those services (a) create or enhance nonfinancial assets, or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by the donation. In accordance with GAAP, the Society has not recognized revenue from contributed services for fiscal year 2012.

Auxiliary Organizations

Included in the assets of the Society are the accounts of the following auxiliary organizations:

African American Archives Auxiliary
American Furniture Collectors
Aviation Hall of Fame
Friends of the Chisholm Halle Costume Wing
Friends of the Crawford Auto-Aviation Museum
Friends of the Library
Genealogical Committee
Museum Advisory Council

Donations to these organizations are made for the benefit of the Society. The organizations remit to the Society funds they have received to invest on their behalf. The Society tracks the funds and earnings for each organization and will disburse the funds as requested by the organization to further the purposes of the Society.

As of June 30, 2012, the amount of the auxiliary funds included in temporarily restricted net assets of the Society was \$202,685.

Advertising

Advertising costs are expensed when incurred. Total advertising expenses were \$59,975 for the year ended June 30, 2012.

Subsequent Events

The Society has evaluated events and transactions that occurred between June 30, 2012 and December 14, 2012, which is the date the financial statements were available to be issued, for possible recognition or disclosure in the financial statements. Except as described in Note 8, there were no material subsequent events that required recognition or additional disclosure in these financial statements.

Reclassifications

Certain reclassifications have been made to the 2011 comparative financial statement totals to conform to the 2012 financial statement presentation. Such reclassifications had no effect on the change in net assets as previously reported.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

2. PLEDGES RECEIVABLE

As of June 30, 2012, gross outstanding written promises to give to the Society from its donors totaled \$1,312,128, of which \$303,744 was unrestricted and \$1,008,384 was temporarily restricted. Outstanding pledges were discounted to their present value assuming their respective terms, using a discount rate of 5%. The discounted pledges are scheduled to be collected as follows:

Receivable in less than one year	\$	906,017
Receivable in one to five years		98,111
Restricted to investment in property		308,000
Less present value discount		<u>(36,206)</u>
	\$	<u>1,275,922</u>

As of June 30, 2012, \$362,595 of the pledges receivable are due from members of the Board of Trustees. Additionally, 85% of gross outstanding pledges are from four donors.

3. INVESTMENTS

Investments under the control of the Society are stated at fair value and consist of the following at June 30, 2012:

	<u>Cost</u>	<u>Fair Value</u>	<u>Unrealized Gain</u>
Money market funds	\$ 17,470	\$ 17,470	\$ -
Mutual funds	9,412,904	9,599,669	186,765
Bond funds	<u>3,887,211</u>	<u>4,077,031</u>	<u>189,820</u>
	<u>\$ 13,317,585</u>	<u>\$ 13,694,170</u>	<u>\$ 376,585</u>

Investment management fees are included in the net investment gain (loss) in the statement of activities. The total of these fees were \$39,367 for the year ended June 30, 2012.

The following schedule summarizes the investment return and its classification in the statement of activities and changes in net assets for the year ended June 30, 2012.

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Interest and dividend income	\$ 17,748	\$ 349,369	\$ -	\$ 367,117
Net realized and unrealized losses	(38,220)	(493,792)	-	(532,012)
Fund balance transfers	<u>(110,268)</u>	<u>110,268</u>	<u>-</u>	<u>-</u>
Net investment gain (loss)	<u>\$ (130,740)</u>	<u>\$ (34,155)</u>	<u>\$ -</u>	<u>\$ (164,895)</u>

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

4. FAIR VALUE MEASUREMENTS

GAAP requires disclosure of a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into the following three broad categories:

- Level 1 - Quoted unadjusted prices for identical instruments in active markets to which the Society has access at the date of measurement.
- Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. Level 2 inputs are those in markets for which there are few transactions, the prices are not current, little public information exists, or in instances where prices vary substantially over time or among brokered market makers.
- Level 3 - Model derived valuations in which one or more significant inputs of significant value drivers are unobservable. Unobservable inputs are those inputs that reflect the Society's own assumptions that market participants would use to price the assets or liabilities based on the best available information.

The following table presents the Society's assets measured at fair value on a recurring basis at June 30, 2012:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Long-term investments	\$ 13,020,458	\$ 673,712	\$ -	\$ 13,694,170
Beneficial interests in trusts	-	-	6,560,258	6,560,258
Total	<u>\$ 13,020,458</u>	<u>\$ 673,712</u>	<u>\$ 6,560,258</u>	<u>\$ 20,254,428</u>

The following table includes a roll-forward of the amounts in the statement of financial position for the year ended June 30, 2012 (including the change in fair value) for beneficial interests in trusts classified within Level 3 of the fair value hierarchy:

Balance at July 1, 2011	\$ 7,122,451
Interest and dividends	229,639
Net disbursements, purchases, transfers and sales	(454,685)
Net unrealized losses	<u>(337,147)</u>
Balance at June 30, 2012	<u>\$ 6,560,258</u>

Changes in the beneficial interests in trusts are included in the non-operating changes of the statement of activities and changes in net assets.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

4. FAIR VALUE MEASUREMENTS (continued)

In determining the fair values of the assets classified within the Level 2 hierarchy, the Society applied a market-based valuation approach and used net asset value per share as the significant observable input to determine the assets' fair value. The fair value of the investments approximated the net asset value per share reported by the investee. The significant investment strategy of the investee is to provide capital appreciation consistent with the return characteristics of alternative investment portfolios of larger endowments and also to provide capital appreciation with less volatility than that of the equity markets. The investments may be redeemed at quarterly intervals upon written notice at the most recently closed net asset value per share reported by the investee.

Assets classified within the Level 3 fair value hierarchy were also valued using a market-based approach, however, because the nature of the interests being valued have no observable market values, the Society relied upon comparable net asset values of the underlying securities for estimating the fair values of the beneficial interests in trusts.

5. PROPERTY AND EQUIPMENT

At June 30, 2012, property and equipment consisted of the following:

Land	\$ 1,123,973
Building and land improvements	15,506,608
Equipment, furniture and fixtures	815,209
Construction in progress	<u>2,946,535</u>
	20,392,325
Less accumulated depreciation	<u>(8,731,692)</u>
	<u>\$ 11,660,633</u>

During the year ended June 30, 2012, the Society invested over \$2,000,000 in construction in progress for the major renovations of the History Center and a collaborative project with the Cleveland Carousel Society to construct a glass pavilion intended to house the iconic Euclid Beach Park Grand Carousel.

The Society has not capitalized the original cost of the land and museum buildings. Under GAAP, only improvements made to these assets since 1990 have been capitalized. The depreciation expense on property and equipment is allocated between program and supporting services based on the relative usage of the property and equipment.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

6. RESTRICTED NET ASSETS

Temporarily restricted net assets as of June 30, 2012 have donor-imposed restrictions for the following uses:

Library	\$	242,214
Education		104,120
Museums		297,850
Hale Farm and Village		3,308,921
Capital project		408,000
Future years' operations		2,810,732
Other		<u>202,685</u>
	\$	<u>7,374,522</u>

Permanently restricted net assets as of June 30, 2012 are composed of:

Perpetual endowment funds required to be retained permanently by either explicit donor stipulation or UPMIFA	\$	8,132,095
Beneficial interests in trusts		<u>6,395,052</u>
	\$	<u>14,527,147</u>

7. ENDOWMENT DISCLOSURES

The Society's endowment consists of 27 individual funds established for a variety of purposes, including both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Society has interpreted the State of Ohio's enacted version of the Uniform Prudent Management of Institutional Funds Act (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 Society classifies as permanently restricted net assets (a) the original value of the 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 instruments 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 Society in a manner consistent with the standard of prudence prescribed by UPMIFA.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

7. ENDOWMENT DISCLOSURES (continued)

In accordance with UPMIFA, the Society 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 purpose of the Society and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and appreciation of investments
- (6) Other resources of the Society and investment policies of the Society

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Society to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were \$183,033 as of June 30, 2012. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions, and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

Return Objectives and Risk Parameters

The Society has adopted investment and spending policies for endowment assets that attempt to provide funds for various operating and maintenance expenses while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Society must hold in perpetuity or for a donor-specified period as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce an annual return that equals or exceeds 5%, net of inflation and fees, measured over rolling periods of at least 10 years in length.

The Society has a spending policy which establishes the annual cash outflow from the endowment at 5%, calculated on the basis of market values that are determined at least quarterly and averaged over a period of three years immediately preceding the year in which the appropriation for expenditure was made. The annual spending rate at June 30, 2012 was 5%, excluding investment management fees.

Strategies Employed for Achieving Objectives

In order to maintain long-term purchasing power, the asset allocation policy emphasizes equity-based investments. The Society's long-term broad asset allocation target is 55% equities, 30% fixed income including cash equivalents, and 15% alternative investment strategies. In addition to directing new cash inflows or cash outflows in accordance with asset allocation policy, the Investment Committee reviews the asset allocations quarterly, and makes any necessary adjustments to the allocations based on the policy.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

7. ENDOWMENT DISCLOSURES (continued)

Fund Balance Transfers

The fund balance transfers represent appreciation of investments on donor-imposed restricted funds with deficiencies. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets by fund balance transfer.

Endowment Net Assets Composition by Type of Fund as of June 30, 2012

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 5,022,224	\$ 8,132,095	\$ 13,154,319
Board-designated endowment funds	544,445	-	-	544,445
Donor-restricted funds below historic dollar value	<u>(183,033)</u>	<u>-</u>	<u>-</u>	<u>(183,033)</u>
Total funds	<u>\$ 361,412</u>	<u>\$ 5,022,224</u>	<u>\$ 8,132,095</u>	<u>\$ 13,515,731</u>

There are other investments held by the Society which are not included as part of the endowment. As of June 30, 2012, these other investments totaled \$178,439.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

7. ENDOWMENT DISCLOSURES (continued)

Changes in Endowment Net Assets for the fiscal year ended June 30, 2012

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Investment return:				
Investment income	\$ 17,748	\$ 370,009	\$ -	\$ 387,757
Net appreciation (realized and unrealized)	(24,760)	(509,437)	-	(534,197)
Fund balance transfers	<u>(110,268)</u>	<u>110,268</u>	<u>-</u>	<u>-</u>
Total investment return	(117,280)	(29,160)	-	(146,440)
Appropriation of endowment assets for expenditure	<u>(35,171)</u>	<u>(587,669)</u>	<u>-</u>	<u>(622,840)</u>
Change in endowment	(152,451)	(616,829)	-	(769,280)
Endowment net assets, July 1, 2011	<u>513,863</u>	<u>5,639,053</u>	<u>8,132,095</u>	<u>14,285,011</u>
Endowment net assets, June 30, 2012	<u>\$ 361,412</u>	<u>\$ 5,022,224</u>	<u>\$ 8,132,095</u>	<u>\$ 13,515,731</u>

Description of Amounts Classified as Permanently Restricted Net Assets and Temporarily Restricted Net Assets as of June 30, 2012 (Endowment only)

Permanently restricted net assets:	
The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or UPMIFA	<u>\$ 8,132,095</u>
Temporarily restricted net assets:	
Term endowment funds	\$ 3,213,512
The portion of permanently restricted net assets subject to a time restriction under UPMIFA:	
Without purpose restrictions	423,102
With purpose restrictions	<u>1,385,610</u>
Total endowment funds classified as temporarily restricted net assets	<u>\$ 5,022,224</u>

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

8. LINE OF CREDIT

The Society maintains a revolving line of credit with a commercial bank. The line of credit has a maximum allowed borrowing of \$3,100,000. Interest is charged based on the outstanding balance at 1.50% over the Daily LIBOR Rate. The interest rate was 1.75% at June 30, 2012. The line of credit has an expiration date of August 31, 2013, and is secured by unrestricted endowment assets and a first mortgage on property owned by the Society.

Subsequent to year end, the Society amended its line of credit agreement with the bank. The amended agreement changes the maximum borrowing amount from \$3,100,000 to \$2,500,000 and the expiration date was extended to August 31, 2014.

Total interest expense during the year ended June 30, 2012 was \$2,883 and total interest expense capitalized to construction in progress was \$4,277. The Society met and maintained certain financial covenants as stipulated under the existing line of credit agreement.

9. OPERATING LEASES

The Society leases certain equipment under long-term leases. Rent expense under these leases was \$27,110 for the year ended June 30, 2012. Future minimum rental commitments are as follows:

YEAR ENDED JUNE 30,	
2013	\$ 23,854
2014	23,639
2015	23,639
2016	23,240
2017	15,790
Thereafter,	<u>2,760</u>
	<u>\$ 112,922</u>

10. RELATED PARTY TRANSACTIONS

Certain members of the Society's Board of Trustees work for banks, legal and consulting firms with which the Society conducts business. Fees paid to these related parties for the year ended June 30, 2012 were \$30,982.

11. EMPLOYEE BENEFIT PLAN

The Society maintains a defined contribution salary deferred (403(b)) plan (the Plan) covering eligible employees. Under the Plan, the Society may match 100% of employee salary deferrals up to 3%, and matches 50% of employee salary deferrals over 3% up to a maximum of 5%. The match is discretionary on an annual basis based on budgetary considerations by management. For the year ending June 30, 2012, the Society elected to not match employee salary deferrals under the Plan.

THE WESTERN RESERVE HISTORICAL SOCIETY

NOTES TO THE FINANCIAL STATEMENTS

12. BENEFICIAL INTEREST IN ASSETS HELD BY OTHERS

The Society is the beneficial recipient of funds held at the Cleveland Foundation and the Akron Community Foundation. In accordance with GAAP, the Society cannot record their beneficial interest in the principal amounts because the funds are held at these community foundations and are subject to the respective foundations' variance powers.

These foundations have the discretion to direct funds from these beneficial interests to the Society. In May 2011, the Frederick C. and Kathleen S. Crawford Fund was established at the Cleveland Foundation with an initial bequest of \$12,000,000. In September 2011, an additional \$1,000,000 was added to the Frederick C. and Kathleen S. Crawford Fund. The Cleveland Foundation's grant awards from the Frederick C. and Kathleen S. Crawford Fund were \$571,487 and \$319,000 for calendar years 2012 and 2011, respectively. These awards were recorded as temporarily restricted gifts, grants and project support until the donor-imposed restrictions were met, by actions of the Society and the passage of time, and subsequently reclassified into unrestricted net assets in the statement of activities as net assets released from restriction.

As of June 30, 2012, the market value of these community funds established for the benefit of the Western Reserve Historical Society was \$12,890,933.