



THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2017



**SKODA MINOTTI**

CPAs, BUSINESS & FINANCIAL ADVISORS

Delivering on the Promise.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

YEAR ENDED JUNE 30, 2017

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INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF TRUSTEES  
THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

**Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of The Western Reserve Historical Society and Subsidiary (a nonprofit organization), which comprise the consolidated statement of financial position as of June 30, 2017, and the related consolidated statements of activities and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

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

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

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Western Reserve Historical Society and Subsidiary as of June 30, 2017, and the changes in net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

SKODA MINOTTI & CO.



Cleveland, Ohio  
December 13, 2017

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

JUNE 30, 2017

ASSETS:

Cash and cash equivalents	\$ 1,365,384
Accounts receivable	87,119
Prepaid expenses	21,258
Inventory	112,552
Pledges receivable, net	2,147,180
Property and equipment, net of accumulated depreciation	13,687,801
Investments	16,455,482
Cash equivalents held for investment in long-lived assets	361,575
Beneficial interests in trusts	<u>6,477,676</u>
 Total assets	 <u><u>\$ 40,716,027</u></u>

LIABILITIES:

Accounts payable	\$ 131,178
Accrued expenses	32,090
Capital accounts payable	179,390
Deferred revenue	847,307
Line of credit	725,197
Gift annuity obligations	<u>47,895</u>
Total liabilities	<u>1,963,057</u>

NET ASSETS:

Unrestricted	14,132,416
Temporarily restricted	10,002,718
Permanently restricted	<u>14,617,836</u>
Total net assets	<u>38,752,970</u>
 Total liabilities and net assets	 <u><u>\$ 40,716,027</u></u>

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

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY  
CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS  
YEAR ENDED JUNE 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>OPERATING REVENUES AND SUPPORT</b>				
Gifts, grants and project support	\$ 2,297,837	\$ 953,290	\$ -	\$ 3,303,616
Capital grants	255,000	1,661,750	-	1,916,750
Admissions and memberships	862,677	-	-	862,677
Endowment support for current operations	747,447	31,296	-	778,743
Earned income	844,211	-	-	844,211
Net assets released from restrictions	1,977,371	(1,977,371)	-	-
<b>Total operating revenues</b>	<b>6,984,543</b>	<b>668,965</b>	<b>-</b>	<b>7,705,997</b>
<b>OPERATING EXPENSES</b>				
Program services				
Library, archives, and museums	3,599,619	-	-	3,591,619
Hale Farm & Village	1,483,780	-	-	1,483,780
Other historic properties	113,688	-	-	113,688
<b>Total program services</b>	<b>5,197,087</b>	<b>-</b>	<b>-</b>	<b>5,189,087</b>
Supporting services				
Management and general	865,383	-	-	855,383
Fundraising	406,748	-	-	406,748
<b>Total supporting services</b>	<b>1,272,131</b>	<b>-</b>	<b>-</b>	<b>1,262,131</b>
<b>Total operating expenses</b>	<b>6,469,218</b>	<b>-</b>	<b>-</b>	<b>6,451,218</b>
<b>CHANGE IN NET ASSETS FROM OPERATIONS</b>	<b>515,325</b>	<b>668,965</b>	<b>-</b>	<b>1,184,290</b>
<b>NON-OPERATING CHANGES</b>				
Net investment return	174,196	1,727,622	4,123	1,905,941
Less: endowment support for current operations	(71,415)	(707,328)	-	(778,743)
Contribution of subsidiary	385,503	-	-	385,503
Endowment reclassification	133,270	(20,783)	(112,487)	-
Proceeds from sales of gifts-in-kind	23,000	-	-	23,000
Change in beneficial interests in trusts	-	-	179,966	179,966
Change in fair value of split-interest agreements	6,574	-	-	6,574
<b>TOTAL NON-OPERATING CHANGES</b>	<b>651,128</b>	<b>999,511</b>	<b>71,602</b>	<b>1,722,241</b>
<b>CHANGE IN NET ASSETS</b>	<b>1,166,453</b>	<b>1,668,476</b>	<b>71,602</b>	<b>2,906,531</b>
<b>NET ASSETS - BEGINNING (See Note 13)</b>	<b>12,965,963</b>	<b>8,334,242</b>	<b>14,546,234</b>	<b>35,846,439</b>
<b>NET ASSETS - ENDING</b>	<b>\$ 14,132,416</b>	<b>\$ 10,002,718</b>	<b>\$ 14,617,836</b>	<b>\$ 38,752,970</b>

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

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES:

Change in net assets		\$ 2,906,531
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	\$ (925,450)	
Depreciation	1,195,775	
Net realized and unrealized gains on investments	(1,580,714)	
Change in beneficial interest in trusts	(179,966)	
Change in pledge discount	4,678	
Contribution of subsidiary	(385,503)	
Cash provided by (used in) changes in the following items:		
Increase in accounts receivable	(6,900)	
Decrease in prepaid expenses	23,930	
Increase in inventory	(11,419)	
Increase in pledges receivable	(921,560)	
Increase in accounts payable	29,945	
Decrease in accrued expenses	(157)	
Decrease in deferred revenue	(108,766)	
Decrease in gift annuity obligations	(15,229)	(2,881,336)
Net cash provided by operating activities		<u>25,195</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchases of property and equipment	(1,215,018)	
Net purchase of short-term investments	(361,575)	
Purchases of long-term investments	(2,015,216)	
Proceeds from sale of long-term investments	2,401,956	
Net cash used in investing activities		<u>(1,189,853)</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Collection of contributions restricted for long-term purposes	925,450	
Net payments on line of credit	(15,000)	
Net cash provided by financing activities		<u>910,450</u>

NET DECREASE IN CASH AND CASH EQUIVALENTS (254,208)

CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR 1,619,592

CASH AND CASH EQUIVALENTS - END OF YEAR \$ 1,365,384

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

# THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Nature of Activities

The Western Reserve Historical Society (the 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.

The Society acquired controlling interest on August 25, 2016 as sole member of Holsey Gates Residence Preservation Foundation, a 501(c)(3) Type I supporting organization whose mission is to support the charitable and educational purposes of the Society. The financial activity of the Holsey Gates Residence Preservation Foundation is presented as a subsidiary in these consolidated financial statements.

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 Cleveland 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 Cleveland 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 three other historic properties.

The Society's revenues are from a combination of earned and contributed revenue. Earned revenue includes admission fees, memberships, proceeds from space rentals, group tour fees, store sales, school group and public program income, and fees for service revenue. Store sales are reported net of 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 consolidated financial statements have been prepared on the accrual basis of accounting. Net assets, 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 Directors for the continuity of the Society's general activities, its exhibits and programs, and to meet emergency demands.

## THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

##### Basis of Presentation (continued)

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. Net assets subject to donor-imposed restrictions for the construction of property, plant, and equipment are reclassified to unrestricted net assets when the funds are spent on construction. If donor-imposed restrictions are met in the same year as they are imposed, the net assets are reported as unrestricted.

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.

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 programs and supporting services.

##### Use of Estimates

The preparation of consolidated 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 consolidated 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

The Society considers all highly liquid investments available for current use with an original maturity of three months or less to be cash equivalents. Cash equivalents held within the Society's investment portfolio are reported within investments in the statement of financial position because of the Society's intention to use these funds for long-term purposes and not for operations.

##### Capital Accounts Payable

The capital accounts payable are related to the renovations and improvements at the Cleveland History Center and Hale Farm & Village. See Note 5 for the construction in progress activities of the Society.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED 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. There were no pledges written off during the fiscal year.

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 net realizable value 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 in the Statement of Activities.

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.

# THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 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 Directors considers 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

#### 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 interests 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 gifts, grants, and project support in the Statement of Activities. Subsequent changes in the fair value of the beneficial interests in trust assets are recognized as non-operating activity in the Statement of Activities.

#### 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). However, the Society engages in activities subject to Federal income taxes that are considered unrelated to its exempt purpose. There is a net operating loss carry forward of \$781,458 to offset future income tax liabilities. The tax benefit of the net operating loss carryforward is offset by a valuation allowance, and accordingly, the Society has not recorded a deferred tax benefit for the effect of the net operating loss carry forward. Net operating loss carry forwards begin to expire in 2021.

#### 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 Directors. Though the market value of investments is subject to fluctuations on a year-to-year basis, the Board of Directors believes that the investment policy is prudent for the long-term welfare of the Society.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributed Services

The Society receives a significant amount of donated services from approximately 512 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 the year ended June 30, 2017.

Auxiliary Organizations

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

African American Archives Auxiliary  
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  
Citizens of Hale Farm & Village  
WRHS Young Professionals

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, 2017, the amount of the auxiliary funds included in temporarily restricted net assets of the Society was \$202,452.

Advertising

Advertising costs are expensed when incurred. Total advertising expenses were \$141,578 for the year ended June 30, 2017.

Subsequent Events

The Society evaluated subsequent events through December 13, 2017, the date these consolidated financial statements were available to be issued. There were no material subsequent events that required recognition or additional disclosure in these consolidated financial statements.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2. PLEDGES RECEIVABLE

As of June 30, 2017, gross outstanding written promises to give to the Society from its donors totaled \$2,242,993, of which \$369,100 was unrestricted and \$1,873,893 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:

Gross receivable in less than one year	\$ 1,668,700
Gross receivable in one to five years	574,293
Less allowance for uncollectible pledges	(44,200)
Less present value discount	<u>(51,613)</u>
Pledges receivable, net	<u>\$ 2,147,180</u>

As of June 30, 2017, \$291,673 of the pledges receivable are due from members of the Board of Directors. Additionally, 54% of gross outstanding pledges are from three donors. Contributions from one donor represented 11% of operating revenues received during the fiscal year.

3. INVESTMENTS

The following schedule details the investment return and its classification in the statement of activities and changes in net assets for the year ended June 30, 2017:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Interest and dividend income	\$ 37,958	\$ 338,133	\$ -	\$ 376,091
Net realized and unrealized gains	141,095	1,421,371	4,123	1,566,589
Management fees	<u>(4,857)</u>	<u>(31,882)</u>	<u>-</u>	<u>(36,739)</u>
Net investment return	<u>\$ 174,196</u>	<u>\$ 1,727,622</u>	<u>\$ 4,123</u>	<u>\$ 1,905,941</u>

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.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4. FAIR VALUE MEASUREMENTS (continued)

- 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 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used by the Society are intended to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as June 30, 2017.

Long-term investments – The fair values of the underlying assets are used to determine the fair value, based on the reported net asset value.

Beneficial interests in trusts – The fair values of the underlying assets are used to determine the fair value, based on the Society's proportionate beneficial interest in the investment pool.

The following table presents the Society's assets and liabilities measured at fair value on a recurring basis at June 30, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets:				
Investments:				
Equity	\$ 9,521,899	\$ -	\$ 35,771	\$ 9,557,670
Fixed income	4,779,203	-	9,234	4,788,437
Alternatives	1,704,061	73,038	12,066	1,789,165
Cash equivalents	<u>320,210</u>	<u>-</u>	<u>-</u>	<u>320,210</u>
Total Investments	16,325,373	73,038	57,071	16,455,482
Beneficial interests in trusts	<u>-</u>	<u>-</u>	<u>6,477,676</u>	<u>6,477,676</u>
Total financial assets	<u>\$ 16,325,373</u>	<u>\$ 73,038</u>	<u>\$ 6,534,747</u>	<u>\$ 22,933,158</u>
Financial liabilities:				
Gift annuity obligations	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 47,895</u>	<u>\$ 47,895</u>

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4. FAIR VALUE MEASUREMENTS (continued)

The following table includes a roll-forward of the amounts in the statement of financial position for the year ended June 30, 2017 (including the change in fair value) for beneficial interests in trusts classified within Level 3 of the fair value hierarchy:

Balance at July 1, 2016	\$ 6,297,710
Change in fair value	<u>179,966</u>
Balance at June 30, 2017	<u>\$ 6,477,676</u>

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. The Society valued the gift annuity obligation by estimating the future cash payout requirements based on actuarial assumptions on the annuitants' lives, and then discount the obligation using a discount rate of 3.0%.

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.

5. PROPERTY AND EQUIPMENT

At June 30, 2017, property and equipment consisted of the following:

Land	\$ 1,094,712
Building and land improvements	23,583,594
Equipment, furniture and fixtures	887,384
Construction in progress	<u>1,456,625</u>
	27,022,315
Less: accumulated depreciation	<u>(13,334,514)</u>
	<u>\$ 13,687,801</u>

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

5. PROPERTY AND EQUIPMENT (continued)

Construction in progress consists of a permanent core exhibit project and related site improvements at the Cleveland History Center site. The budget for the project is \$2,350,000 and was placed into service in November 2017.

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.

6. RESTRICTED NET ASSETS

Temporarily restricted net assets as of June 30, 2017 have donor-imposed restrictions for the following uses:

Library	\$	385,325
Education		76,098
Museums		340,122
Hale Farm and Village		3,912,828
Capital		1,026,187
Future years' operations		4,112,195
Other/auxiliary organizations		<u>202,452</u>
	\$	<u>10,055,207</u>

Permanently restricted net assets as of June 30, 2017 are composed of:

Perpetual endowment funds required to be retained permanently by either explicit donor stipulation or UPMIFA	\$	8,140,160
Beneficial interests in trusts		<u>6,425,187</u>
	\$	<u>14,565,347</u>

## THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 7. ENDOWMENT DISCLOSURES

The Society's endowment consists of 28 individual funds established for a variety of purposes, including both donor-restricted endowment funds and funds designated by the Board of Directors to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Directors 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.

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 \$26,117 as of June 30, 2017. 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 Directors. 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.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. ENDOWMENT DISCLOSURES (continued)

*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 Directors, 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 for the fiscal year ended June 30, 2017 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, 25% fixed income including cash equivalents, and 20% 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.

*Endowment Net Assets Composition by Type of Fund as of June 30, 2017*

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 7,049,276	\$ 8,140,160	\$ 15,189,436
Board-designated endowment funds	847,274	-	-	847,274
Donor-restricted funds below historic dollar value	<u>(26,117)</u>	<u>-</u>	<u>-</u>	<u>(26,117)</u>
Total funds	<u>\$ 821,157</u>	<u>\$ 7,049,276</u>	<u>\$ 8,140,160</u>	<u>\$ 16,010,593</u>

There are other investments held by the Society which are not included as part of the endowment. As of June 30, 2017, these other investments totaled \$444,889.

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. ENDOWMENT DISCLOSURES (continued)

*Changes in Endowment Net Assets for the Fiscal Year Ended June 30, 2017*

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Investment return:				
Investment income	\$ 30,117	\$ 298,540	\$ -	\$ 328,657
Realized and unrealized gains	<u>139,930</u>	<u>1,406,414</u>	<u>4,123</u>	<u>1,550,467</u>
Total investment return	170,047	1,704,954	4,123	1,879,124
Gifts	-	-	-	-
Other additions	132,268	-	-	132,268
Appropriation of endowment assets for expenditure	(71,415)	(707,328)	-	(778,743)
Reclassifications	<u>-</u>	<u>(20,783)</u>	<u>(112,487)</u>	<u>(133,270)</u>
Change in endowment	230,900	976,843	(108,364)	1,099,379
Endowment net assets, July 1, 2016	<u>590,257</u>	<u>6,072,433</u>	<u>8,248,524</u>	<u>14,911,214</u>
Endowment net assets, June 30, 2017	<u>\$ 821,157</u>	<u>\$ 7,049,276</u>	<u>\$ 8,140,160</u>	<u>\$ 16,010,593</u>

*Description of Amounts Classified as Permanently Restricted Net Assets and Temporarily Restricted Net Assets as of June 30, 2017 (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>\$ 8,140,160</u>
Temporarily restricted net assets:	
Term endowment funds	\$ 3,765,831
The portion of permanently restricted net assets subject to a time restriction under UPMIFA:	
Without purpose restrictions	1,759,267
With purpose restrictions	<u>1,524,178</u>
Total endowment funds classified as temporarily restricted net assets	<u>\$ 7,049,276</u>

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED 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 \$2,500,000. Interest is charged based on the outstanding balance at 150 basis points over the Daily LIBOR Rate. The interest rate was 2.63% at June 30, 2017. The line of credit has an expiration date of June 30, 2018, and is secured by unrestricted endowment assets and a first mortgage on property owned by the Society.

Total interest expense during the year ended June 30, 2017 was \$19,958. Interest expense is included within supporting services and program services in the accompanying consolidated statement of activities.

9. OPERATING LEASES

The Society leases certain equipment under long-term leases. Rent expense under these leases was \$27,482 for the year ended June 30, 2017. Future minimum rental commitments are as follows:

YEAR ENDING <u>JUNE 30,</u>	
2018	\$ 19,307
2019	16,419
2020	<u>1,596</u>
	<u>\$ 37,322</u>

10. 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. Matching contributions during the year ended June 30, 2017 were \$48,580.

11. BENEFICIAL INTEREST IN ASSETS HELD BY OTHERS

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

THE WESTERN RESERVE HISTORICAL SOCIETY AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

11. BENEFICIAL INTEREST IN ASSETS HELD BY OTHERS (continued)

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. The market value of the Frederick C. and Kathleen S. Crawford Fund was \$16,521,831 as of June 30, 2017. The Cleveland Foundation's grant awards from the Frederick C. and Kathleen S. Crawford Fund were \$713,200 and \$708,001 for the calendar years ending December 31, 2018 and 2017, respectively. These awards are recorded as temporarily restricted gifts, grants and project support until the donor-imposed restrictions are 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 restrictions.

In addition to the Crawford Fund, the market value of the community funds established for the benefit of the Western Reserve Historical Society was \$1,253,075 as of June 30, 2017.

The late Ambassador Holsey Gates Handyside created several trusts that are intended to assist in funding the property and operations of the Holsey Gates Residence Preservation Foundation. These trusts will be administered by The Cleveland Foundation. As of the date these financial statements were available to be issued, details have not been provided as to the amount of funding or to the variance power that The Cleveland Foundation will hold over these trusts.

12. SUPPLEMENTAL CASH FLOW INFORMATION

CASH PAID DURING THE YEAR FOR:

INTEREST	\$19,958
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13. PRIOR PERIOD ADJUSTMENT

During the year ended June 30, 2017, the Society discovered an error in the accounting for a capital appropriations grant during fiscal year 2012. Amounts that should have been recorded as deferred revenue and recognized over the grant period were recorded as earned income in this earlier period. As a result, at June 30, 2016 deferred revenue was understated and net assets were overstated by the same amount. Management of the Society has concluded that these amounts are not material to the overall financial statements and have revised the previously reported amounts as follows:

	<u>As Previously Reported</u>	<u>Revised June 30, 2016</u>
Deferred revenue	\$ 163,073	\$ 956,073
Unrestricted net assets	\$ 13,758,963	\$ 12,965,963