

FINANCIAL STATEMENTS

The Cleveland Museum of Art  
Years Ended June 30, 2016 and 2015  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

The Cleveland Museum of Art

Financial Statements

Years Ended June 30, 2016 and 2015

**Contents**

Report of Independent Auditors.....1

Financial Statements

Statements of Financial Position.....3

Statements of Activities .....5

Statements of Cash Flows.....7

Notes to Financial Statements.....8



Ernst & Young LLP  
Suite 1800  
950 Main Avenue  
Cleveland, OH 44113-7214

Tel: +1 216 861 5000  
Fax: +1 216 583 2013  
ey.com

## Report of Independent Auditors

The Board of Trustees  
The Cleveland Museum of Art

We have audited the accompanying financial statements of The Cleveland Museum of Art, which comprise the statements of financial position as of June 30, 2016 and 2015, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

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

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of 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. 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 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 statement.

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 The Cleveland Museum of Art at June 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst + Young LLP*

November 23, 2016

The Cleveland Museum of Art

Statements of Financial Position  
(In Thousands)

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,482	\$ 4,094
Investments for current use	1,015	769
Accounts receivable	297	426
Inventories	1,236	1,035
Other current assets	1,679	1,980
Total current assets	<u>8,709</u>	<u>8,304</u>
Investments:		
Endowment investments	408,626	444,100
Other investments	52,863	42,356
Buildings and equipment:		
Buildings and improvements	386,767	386,621
Equipment	24,513	22,664
Construction-in-progress	6,080	1,437
	<u>417,360</u>	<u>410,722</u>
Less accumulated depreciation	102,765	92,138
Total buildings and equipment – net	<u>314,595</u>	<u>318,584</u>
Other assets:		
Charitable perpetual trusts	289,752	315,215
Pledges receivable	23,133	24,582
Other	1,404	1,566
	<u>314,289</u>	<u>341,363</u>
Total assets	<u><u>\$ 1,099,082</u></u>	<u><u>\$ 1,154,707</u></u>

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,384	\$ 3,235
Deferred revenue	850	623
Other current liabilities	196	203
Total current liabilities	<u>5,430</u>	4,061
Long-term debt	162,931	163,473
Other liabilities:		
Accrued postretirement medical benefits	624	699
Accrued pension obligation	12,097	10,207
Other	12,972	12,276
	<u>25,693</u>	23,182
Total liabilities	<u>194,054</u>	190,716
Net assets:		
Unrestricted	95,297	105,497
Temporarily restricted	437,298	461,586
Permanently restricted	372,433	396,908
Total net assets	<u>905,028</u>	963,991
Total liabilities and net assets	<u><u>\$ 1,099,082</u></u>	<u><u>\$ 1,154,707</u></u>

*See accompanying notes.*

# The Cleveland Museum of Art

## Statement of Activities (In Thousands)

Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues and support</b>				
Endowment and trust income	\$ 12,745	\$ 9,032	\$ –	\$ 21,777
Contributions and membership	5,788	11,077	–	16,865
Gifts, grants, and other revenue for special exhibitions	2,646	–	–	2,646
Program revenues and other support	3,763	4,527	–	8,290
Stores, café, parking, and products	3,819	–	–	3,819
Net assets released from restrictions used for operations	28,472	(28,472)	–	–
Total revenues and support	57,233	(3,836)	–	53,397
<b>Expenses</b>				
Curatorial, conservation, and registrar	8,705	–	–	8,705
Special exhibitions	3,497	–	–	3,497
Education, library, and community programs	5,549	–	–	5,549
Marketing and communications	933	–	–	933
Development and membership services	5,605	–	–	5,605
General and administrative	6,805	–	–	6,805
Building, facilities, and security	13,648	–	–	13,648
Stores, café, parking, and products	1,852	–	–	1,852
Depreciation	10,627	–	–	10,627
Total expenses	57,221	–	–	57,221
Excess of revenues and support over expenses before other changes in net assets	12	(3,836)	–	(3,824)
<b>Other changes in net assets</b>				
Trust revenue designated for art purchases	–	5,396	–	5,396
Investment return designated for art purchase	–	3,700	–	3,700
Net assets released from restrictions used to fund acquisition of art objects	3,692	(3,692)	–	–
Expenditures for acquisition of art objects	(3,478)	–	–	(3,478)
Gifts and contributions	–	1,368	988	2,356
Investment loss after amounts designated	(6,717)	(27,224)	–	(33,941)
Change in fair value of derivative instruments	(1,312)	–	–	(1,312)
Change in fair value of charitable perpetual trusts	–	–	(25,463)	(25,463)
Changes in funded status of pension benefits	(2,106)	–	–	(2,106)
Changes in funded status of postretirement medical benefits	(291)	–	–	(291)
Decrease in net assets	(10,200)	(24,288)	(24,475)	(58,963)
Net assets at beginning of year	105,497	461,586	396,908	963,991
Net assets at end of year	\$ 95,297	\$ 437,298	\$ 372,433	\$ 905,028

See accompanying notes.

# The Cleveland Museum of Art

## Statement of Activities (In Thousands)

Year Ended June 30, 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues and support</b>				
Endowment and trust income	\$ 13,029	\$ 9,630	\$ –	\$ 22,659
Contributions and membership	4,734	27,550	–	32,284
Gifts, grants, and other revenue for special exhibitions	404	2	–	406
Program revenues and other support	4,292	996	–	5,288
Stores, café, parking, and products	2,754	–	–	2,754
Net assets released from restrictions used for operations	28,083	(28,083)	–	–
Total revenues and support	53,296	10,095	–	63,391
<b>Expenses</b>				
Curatorial, conservation, and registrar	7,938	–	–	7,938
Special exhibitions	1,534	–	–	1,534
Education, library, and community programs	4,892	–	–	4,892
Marketing and communications	1,985	–	–	1,985
Development and membership services	4,476	–	–	4,476
General and administrative	5,665	–	–	5,665
Building, facilities, and security	13,888	–	–	13,888
Stores, café, parking, and products	1,777	–	–	1,777
Depreciation	11,010	–	–	11,010
Total expenses	53,165	–	–	53,165
Excess of revenues and support over expenses before other changes in net assets	131	10,095	–	10,226
<b>Other changes in net assets</b>				
Trust revenue designated for art purchases	–	5,248	–	5,248
Investment return designated for art purchase	–	6,256	–	6,256
Net assets released from restrictions used to fund acquisition of art objects	5,652	(5,652)	–	–
Expenditures for acquisition of art objects	(6,302)	–	–	(6,302)
Gifts and contributions	17	687	1,196	1,900
Investment loss after amounts designated	(2,357)	(7,120)	–	(9,477)
Change in fair value of derivative instruments	401	–	–	401
Change in fair value of charitable perpetual trusts	–	–	(7,846)	(7,846)
Changes in funded status of pension benefits	(2,495)	–	–	(2,495)
Changes in funded status of postretirement medical benefits	(402)	–	–	(402)
(Decrease) increase in net assets	(5,355)	9,514	(6,650)	(2,491)
Net assets at beginning of year	110,852	452,072	403,558	966,482
Net assets at end of year	\$ 105,497	\$ 461,586	\$ 396,908	\$ 963,991

See accompanying notes.



# The Cleveland Museum of Art

## Statements of Cash Flows (In Thousands)

	<b>Year Ended June 30</b>	
	<b>2016</b>	<b>2015</b>
<b>Operating activities</b>		
Reconciliation of decrease in net assets to net cash used in operating activities:		
Decrease in net assets	\$ (58,963)	\$ (2,491)
Adjustments to reconcile decrease in net assets to cash used in operating activities:		
Depreciation	10,627	11,010
Amortization of bond premiums	(542)	(524)
Change in fair value of derivative instruments	1,312	(401)
Net realized and unrealized gains on long-term investments	23,975	(6,309)
Contributions restricted for long-term purposes	(11,077)	(27,550)
Decrease in fair value of charitable perpetual trusts	25,463	7,846
Acquisition of art objects	3,478	5,652
Changes in funded status of pension and postretirement medical benefits	2,397	2,897
Changes used in operating assets and liabilities:		
Accounts receivable	129	(204)
Inventories and other current assets	100	466
Pledges receivable	1,449	(13,943)
Other assets	162	159
Accounts payable and accrued expenses	742	(418)
Deferred revenue	227	245
Other current liabilities	(589)	12
Other liabilities	(616)	1,175
Net cash used in operating activities	(1,726)	(22,378)
<b>Financing activities</b>		
Contributions restricted for long-term purposes	11,077	27,550
Net cash provided by financing activities	11,077	27,550
<b>Investing activities</b>		
Purchases of buildings and equipment	(6,231)	(1,501)
Acquisition of art objects	(3,478)	(5,652)
Proceeds from the deaccession of art	-	-
Proceeds from sales and maturities of investments	54,636	30,896
Purchases of investments	(53,890)	(29,534)
Net cash used in investing activities	(8,963)	(5,791)
Net increase (decrease) in cash and cash equivalents	388	(619)
Cash and cash equivalents at beginning of year	4,094	4,713
Cash and cash equivalents at end of year	\$ 4,482	\$ 4,094

*See accompanying notes.*

# The Cleveland Museum of Art

## Notes to Financial Statements *(In Thousands, Unless Noted)*

June 30, 2016

### **1. Organization**

The Cleveland Museum of Art (the Museum) maintains in the City of Cleveland a museum of art of the widest scope for the benefit of the public.

### **2. Significant Accounting Policies**

#### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or for a specific purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Museum. Temporarily restricted gifts, grants, and bequests are recorded as additions to temporarily restricted net assets in the period received. When restricted net assets are expended for their stipulated purpose or time restriction expires, temporarily restricted net assets become unrestricted net assets and are reported in the statements of activities as net assets released from restrictions. For temporarily restricted net assets restricted for major capital projects, the Museum has adopted a policy of implying a time restriction on the use of such assets that expires over the assets' useful lives. The Museum records a reclassification to unrestricted net assets as net assets released from restrictions for annual depreciation for building and improvements constructed with restricted funds. Reclassifications of \$14,440 and \$14,944 in fiscal 2016 and 2015, respectively, are reflected in the statements of activities in net assets released from restrictions used for operations.

Permanently restricted net assets consist of amounts held in perpetuity as designated by the donors. Earnings on investments are included in temporarily restricted revenues and other changes in net assets until appropriated for expenditure by the Museum in accordance with the donors' specifications. The Museum is the income beneficiary of several charitable perpetual trusts. Because the trusts are not controlled by the Museum and the trust assets are held in perpetuity, the assets are classified as permanently restricted net assets. The Museum records its interest in charitable perpetual trusts at its pro rata share of the fair value of the underlying assets.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **2. Significant Accounting Policies (continued)**

Income distributed to the Museum by the trusts of \$14,322 and \$14,219 in fiscal 2016 and 2015, respectively, is included in endowment and trust income and trust revenue designated for art purchases on the statements of activities.

During fiscal 2010, the Museum received approval from the Court of Common Pleas, Probate Division to appropriate a percentage of the income restricted for art purchases generated from four charitable perpetual trusts for the purpose of funding the project costs and debt service costs associated with the expansion project recently completed by the Museum. The total appropriated is not to exceed \$75,000. During fiscal 2016 and 2015, the Museum appropriated approximately \$6,152 and \$5,889, respectively, for said purpose from the temporarily restricted income from the four charitable perpetual trusts.

#### **Art Collection**

The Museum's collections are made up of art objects and artifacts of historical significance that are held for educational, research, scientific, and curatorial purposes. Each of the items is cataloged, preserved, and cared for, and activities verifying their existence and assessing their condition are performed continuously.

Purchases for the collection are recorded as expenditures for the acquisition of art objects in the statements of activities in the year in which the objects are acquired. Proceeds from the deaccession of art objects are recorded as temporarily restricted net assets and are restricted to the acquisition of other art objects. In keeping with standard museum practice, the collections, which were acquired via purchases and contributions, are not recognized as assets on the statements of financial position. Art purchases included in accounts payable and accrued expenses and thus not presented in the statements of cash flows are \$295 and \$650 for the years ended June 30, 2016 and 2015, respectively.

#### **Cash Equivalents**

Cash equivalents are highly liquid investments with a maturity of three months or less when purchased. Cash equivalents are measured at fair value in the statements of financial position and exclude amounts limited to use by donor or board designation.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **2. Significant Accounting Policies (continued)**

#### **Inventories**

Inventories consist of merchandise available for sale and are stated at the lower of average cost or market.

#### **Investments and Investment Income**

Endowment investments include both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Other investments are primarily funds designated by the Board of Trustees for specific purposes.

Realized investment gains or losses are determined by comparison of the carrying value to net proceeds received on the settlement date. Unrealized gains or losses are determined by the difference between carrying value and fair value as of year-end. Investment income, including dividends and interest, and realized and unrealized gains (losses), is added to (deducted from) the appropriate net assets class (Note 8).

Investment income generated by permanently restricted net assets for which use of the income is restricted by the donor is reported as temporarily restricted until the program restriction of the donor is met. Investment income on temporarily restricted net assets for which use of the income is restricted by the donor is reported as temporarily restricted until the program restriction of the donor is met. Net unrealized and realized investment gains and losses are reported as unrestricted, temporarily restricted, or permanently restricted based upon the absence or presence of a restriction on the underlying asset.

#### **Donated Services**

No amounts have been reflected in the financial statements for donated services. The Museum pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the Museum with various programs.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **2. Significant Accounting Policies (continued)**

#### **Special Exhibitions**

Other current assets and deferred revenue include expenditures and revenues in connection with the development of special exhibitions. Revenues and expenses are recognized pro rata over the life of the exhibition. Revenues include such items as corporate and individual sponsorships. The expenditures generally include such items as research, travel, insurance, transportation, and other costs related to the development and installation of the exhibition.

#### **Contributions**

Unconditional pledges to give cash, marketable securities, and other assets are discounted to present value at the date the pledge is made to the extent estimated to be collectible by the Museum. Unconditional pledges are classified as other assets on the statements of financial position. Conditional promises to give and indications of intentions to give are not recognized until the condition is satisfied. Pledges received with donor restrictions that limit use are reported as either temporarily or permanently restricted support, or other changes in net assets if designated for long-term investment. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

#### **Buildings and Equipment**

Buildings and equipment are carried at cost. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation is computed by the straight-line method using the estimated useful lives of the assets. Buildings and improvements are assigned a useful life of up to 40 years. Equipment is assigned a useful life ranging from three to five years. Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

The Museum recently completed a major construction, renovation, and expansion project. Included in construction-in-progress are \$4,000 and \$343 related to the construction of the maintenance facility at June 30, 2016 and 2015, respectively. Capital expenditures included in accounts payable and accrued expenses and thus not presented in the statements of cash flows are \$407 and \$0 for the years ended June 30, 2016 and 2015, respectively.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **2. Significant Accounting Policies (continued)**

On January 10, 2013, the Museum entered into an agreement with another party to jointly purchase property. A payment of \$500 was deposited with an escrow agent and was held by the agent until the closing date of the transaction, which was September 30, 2015. The Museum made the final payment of \$4,100 on the closing date. These amounts are included in investments in the statements of financial position at June 30, 2016 and 2015.

#### **Derivative Instruments**

The Museum recognizes its derivative instruments as either an asset or liability in the statements of financial position at fair value. The change in fair value of the derivative instruments is recognized in the statements of activities as other changes in net assets in the period of change.

#### **Recent Accounting Pronouncement**

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, requiring that debt issuance costs related to a recognized debt liability be presented as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2015-03 is effective for the Museum for reporting periods beginning after December 15, 2015 with early adoption permitted. The Museum has \$979 of debt issuance costs at June 30, 2016 that will be reclassified upon adoption of the new guidance.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (ASC 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU eliminates the requirement to categorize within the fair value hierarchy investments whose fair values are measured at net asset value (NAV) as a practical expedient. ASU 2015-07 is effective for the Museum for reporting periods beginning after December 15, 2015, with early adoption permitted. The Museum will adopt the provisions as required upon the effective date and apply the new guidance retrospectively to all periods presented.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU requires lessees to recognize assets and liabilities on the balance sheet for leases with lease terms greater than twelve months. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. This amends current guidance that requires only capital leases to be recognized on the lessee balance sheet. ASU 2016-02 is effective for the Museum for reporting periods

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

### 2. Significant Accounting Policies (continued)

beginning after December 15, 2018, with early adoption permitted. The Museum is currently evaluating the impact that ASU 2016-02 will have on its financial statements and will adopt the provisions upon the effective date.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. This standard intends to make certain improvement to the current reporting requirements for not-for-profit entities. This standard sets forth changes to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance and cash flows. ASU 2016-14 is effective for the Museum for reporting periods beginning after December 15, 2017. The Museum is currently evaluating the impact that ASU 2016-02 will have on its financial statements and will adopt the provisions upon the effective date.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and requires significantly expanded disclosures about revenue recognition. ASU 2014-09 is effective for the Museum for reporting periods beginning after December 15, 2017. The Museum is currently evaluating the impact on the financial statements and the options of adopting using either a full retrospective or a modified approach.

### 3. Pledges Receivable

Outstanding pledges receivable from various corporations, foundations, and individuals are expected to be realized as follows:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Pledges due:		
In less than one year	\$ 3,577	\$ 3,435
In one to five years	10,084	10,276
Greater than five years	13,600	15,064
	<u>27,261</u>	<u>28,775</u>
Present value discount on pledges (1.80%–5.38% discount rate)	(4,128)	(4,193)
	<u>\$ 23,133</u>	<u>\$ 24,582</u>

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**4. Temporarily Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Acquisition of art	\$ 156,070	\$ 167,771
Specific operating activities:		
Curatorial and conservation	5,002	6,277
Education, library, and community programs	7,826	8,906
Buildings, grounds, and protection services	200,477	197,554
General operating and other	67,923	81,078
Total temporarily restricted net assets	<u>\$ 437,298</u>	<u>\$ 461,586</u>

**5. Permanently Restricted Net Assets**

Permanently restricted net assets are amounts held in perpetuity, the income from which is expendable to support the following purposes:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Purchase of art	\$ 135,844	\$ 143,514
Specific operating activities	31,471	30,876
General operating activities	205,118	222,518
Total permanently restricted net assets	<u>\$ 372,433</u>	<u>\$ 396,908</u>



# The Cleveland Museum of Art

## Notes to Financial Statements (continued) (In Thousands, Unless Noted)

### 6. Net Assets Released From Restrictions

Net assets were released from restrictions by incurring expenses or making capital expenditures satisfying the restricted purposes as follows:

	<b>Year Ended June 30</b>	
	<b>2016</b>	<b>2015</b>
Acquisition of art	<b>\$ 3,692</b>	\$ 5,652
Specific operating activities:		
Curatorial and conservation	\$ 2,122	\$ 1,638
Education, library, and community programs	892	898
Buildings, grounds, and protection services	22,365	20,811
General operating and other	3,093	4,736
Net assets released from restrictions used for operations	<b>\$ 28,472</b>	\$ 28,083

### 7. Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value. ASC 820 establishes a three-level hierarchy for fair value measurement based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the same term of the financial instrument.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

## The Cleveland Museum of Art

### Notes to Financial Statements (continued) (In Thousands, Unless Noted)

#### 7. Fair Value Measurements (continued)

The following table presents the financial instruments carried at fair value at June 30, 2016, by the ASC 820 valuation hierarchy defined above:

	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets</b>				
Investments for current use:				
Commercial paper	\$ —	\$ 1,015	\$ —	\$ 1,015
Endowment investments:				
Cash and cash equivalents	23,027	—	—	23,027
Equities:				
Common stocks, primarily U.S.	64,059	—	—	64,059
Collective equity funds	—	83,518	—	83,518
Equity mutual funds	95,401	—	—	95,401
American depository receipts	8,079	—	—	8,079
Real estate investment trust	571	—	—	571
Fixed income securities:				
Corporate bonds	—	12,695	—	12,695
Asset-backed securities	—	3,950	—	3,950
Mortgage-backed securities	—	18,283	—	18,283
Government bonds	—	7,411	—	7,411
Fixed income mutual fund	8,994	—	—	8,994
Alternative investments:				
Absolute return	—	—	34,763	34,763
Private equity	—	—	33,340	33,340
Hedged equity	—	—	14,535	14,535
Total endowment investments	200,131	125,857	82,638	408,626
Other investments:				
Cash and cash equivalents	1	—	—	1
Commercial paper	—	52,862	—	52,862
Total other investments	1	52,862	—	52,863
Charitable perpetual trusts	—	—	289,752	289,752
Total assets at fair value	<u>\$ 200,132</u>	<u>\$ 179,734</u>	<u>\$ 372,390</u>	<u>\$ 752,256</u>
<b>Liabilities</b>				
Interest rate swap	\$ —	\$ 9,175	\$ —	\$ 9,175
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 9,175</u>	<u>\$ —</u>	<u>\$ 9,175</u>

# The Cleveland Museum of Art

## Notes to Financial Statements (continued) (In Thousands, Unless Noted)

### 7. Fair Value Measurements (continued)

The following table presents the financial instruments carried at fair value at June 30, 2015, by the ASC 820 valuation hierarchy defined above:

	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets</b>				
Investments for current use:				
Commercial paper	\$ —	\$ 769	\$ —	\$ 769
Endowment investments:				
Cash and cash equivalents	15,082	—	—	15,082
Equities:				
Common stocks, primarily U.S.	67,390	—	—	67,390
Collective equity funds	—	101,321	—	101,321
Equity mutual funds	125,029	—	—	125,029
American depository receipts	7,487	—	—	7,487
Real estate investment trust	421	—	—	421
Fixed income securities:				
Corporate bonds	—	12,610	—	12,610
Asset-backed securities	—	3,253	—	3,253
Mortgage-backed securities	—	9,237	—	9,237
Government bonds	—	1,224	—	1,224
Fixed income mutual fund	8,928	—	—	8,928
Alternative investments:				
Absolute return	—	—	49,581	49,581
Private equity	—	—	42,537	42,537
Total endowment investments	224,337	127,645	92,118	444,100
Other investments:				
Cash and cash equivalents	7,269	—	—	7,269
Commercial paper	—	35,087	—	35,087
Total other investments	7,269	35,087	—	42,356
Charitable perpetual trusts	—	—	315,215	315,215
Total assets at fair value	\$ 231,606	\$ 163,501	\$ 407,333	\$ 802,440
<b>Liabilities</b>				
Interest rate swap	\$ —	\$ 7,863	\$ —	\$ 7,863
Total liabilities at fair value	\$ —	\$ 7,863	\$ —	\$ 7,863

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

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

The following is a description of the Museum's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources, including market participants, dealers, and brokers. Fair value for Level 2 investments in collective equity funds are valued at NAV.

Fixed income securities include debt obligations of the U.S. government and various agencies, U.S. corporations, and other fixed income instruments such as asset-backed and mortgage-backed securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined fixed income indexes such as the Barclays Capital U.S. Aggregate Index. Additionally, fixed income securities include fixed income mutual funds that may also invest opportunistically in mortgage-backed and asset-backed securities as well as non-U.S. and high-yield debt instruments.

Equities include investments of publicly traded common stocks of both U.S. and international corporations, the majority of which represent actively traded and liquid securities that are traded on many of the world's major exchanges and include large-, mid-, and small-capitalization securities. The composition of these securities represents an expected return and risk profile that is commensurate with broadly defined equity indexes such as the Russell 3000 Index. Included in Level 2 are equity investments that reside in commingled equity funds whose underlying assets may include publicly traded equity securities.

Level 3 assets consist of charitable perpetual trusts and alternative investments. The Museum is the sole income beneficiary of several charitable perpetual trusts and a partial income beneficiary of other charitable perpetual trusts. The charitable perpetual trusts are presented at the fair value of the Museum's portion of the underlying trust assets. Since the Museum has no right to the underlying investments, the charitable perpetual trusts have been classified as Level 3. Fair value of alternative investments (principally limited partnership interests in absolute return, private equity and hedged equity) represent the Museum's ownership interest in the NAV of the respective partnership. Investments held by the partnerships consist of marketable securities as well as securities that do not have readily determinable fair values. The fair values of the

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

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

securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on historical cost, appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner, taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. Because alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material. At June 30, 2016, the Museum is committed to invest an additional \$46,492 in alternative investments. However, it is uncertain as to the timing or level of additional contributions that will ultimately be made.

Alternative investments are diversified across various strategies and may consist of absolute return funds, long/short funds, and other opportunistic funds. The underlying investments in such funds may include publicly traded and privately held equity and debt instruments issued by U.S. and international corporations as well as various derivatives based on these securities. Private equity investments generally consist of limited partnerships formed to invest in equity and debt investments in operating companies that are not publicly traded. Investment strategies in this category may include buyouts, distressed debt, and venture capital.

The fair value of the interest rate swaps was determined based on the present value of expected future cash flows using discount rates appropriate with risks involved and adjusted for a credit adjustment to reflect non-performance risk.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Museum believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The Cleveland Museum of Art

Notes to Financial Statements (continued)  
(In Thousands, Unless Noted)

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

The following table is a rollforward of financial instruments classified by the Museum within Level 3 of the valuation hierarchy defined above:

	Absolute Return	Private Equity	Hedged Equity	Charitable Perpetual Trusts & Other	Total
Fair value at July 1, 2014	\$ 61,013	\$ 48,491	\$ –	\$ 323,061	\$ 432,565
Net realized gains (losses)	(926)	2,089	–	–	1,163
Net unrealized gains (losses)	2,103	(3,978)	–	(7,846)	(9,721)
Purchases	–	7,925	–	–	7,925
Distributions	(71)	(11,990)	–	–	(12,061)
Settlements	(12,538)	–	–	–	(12,538)
Fair value at June 30, 2015	49,581	42,537	–	315,215	407,333
Net realized gains (losses)	(83)	6,292	–	–	6,209
Net unrealized losses	(4,338)	(12,125)	(820)	(25,463)	(42,746)
Purchases	–	12,245	15,355	–	27,600
Distributions	(2)	(15,609)	–	–	(15,611)
Settlements	(10,395)	–	–	–	(10,395)
Fair value at June 30, 2016	<u>\$ 34,763</u>	<u>\$ 33,340</u>	<u>\$ 14,535</u>	<u>\$ 289,752</u>	<u>\$ 372,390</u>

At June 30, 2016, the Museum's alternative investments are subject to various liquidity restrictions as follows:

Available for redemption:	
Quarterly	\$ 12,916
Semiannual	2,514
Subject to remaining lock-up provisions:	
One to three years	32,803
More than three years	34,405
Total alternatives	<u>\$ 82,638</u>

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

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

Investments that are available for redemption may be redeemed by the Museum generally with a 60-day to 120-day advance notice on a quarterly or semiannual basis subject to the terms of the investment agreement.

Investments subject to lock-up provisions cannot be redeemed by the Museum currently without incurring a penalty. After expiration of the lock-up provisions, the funds may be redeemed by the Museum on a monthly, quarterly, or annual redemption basis subject to the terms of the investment agreement.

ASC 825, *Financial Instruments*, provides an option to elect fair value as an alternative measurement for selected financial assets and liabilities not previously recorded at fair value. The Museum did not elect fair value accounting for any assets or liabilities that are not currently required to be measured at fair value.

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of their fair value due to the short-term nature of these financial instruments. The carrying value of pledges receivable approximates fair value as these donations are recorded at the net present value of the amount pledged. The carrying value of the Museum's variable rate long-term debt approximates fair value. The Museum's fixed rate long-term debt had a carrying value of \$70,430 and a fair value of \$81,788 at June 30, 2016, and a carrying value of \$70,430 and a fair value of \$79,953 at June 30, 2015. The fair value of the fixed rate long-term debt is estimated by discounted cash flow analyses using current borrowing rates for similar types of borrowing arrangements and adjusted for credit and would be classified as Level 2 inputs in the fair value hierarchy.

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**8. Investments and Charitable Perpetual Trusts**

The following summarizes returns from the Museum's investments and charitable perpetual trusts and the related classifications in the statements of activities:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>
<b>Year ended June 30, 2016</b>			
Dividends and interest	\$ 907	\$ 5,709	\$ —
Realized and unrealized gains, net of realized and unrealized losses	(3,621)	(20,354)	—
Change in fair value of charitable perpetual trusts	—	—	(25,463)
Investment return	(2,714)	(14,645)	(25,463)
Investment return designated for current operations (included in endowment and trust income)	(4,003)	(8,879)	—
Investment return designated for art purchase	—	(3,700)	—
Investment return after amounts designated	<u>\$ (6,717)</u>	<u>\$ (27,224)</u>	<u>\$ (25,463)</u>
<b>Year ended June 30, 2015</b>			
Dividends and interest	\$ 905	\$ 5,507	\$ —
Realized and unrealized gains, net of realized and unrealized losses	979	3,091	—
Change in fair value of charitable perpetual trusts	—	—	(7,846)
Investment return	1,884	8,598	(7,846)
Investment return designated for current operations (included in endowment and trust income)	(4,241)	(9,462)	—
Investment return designated for art purchase	—	(6,256)	—
Investment return after amounts designated	<u>\$ (2,357)</u>	<u>\$ (7,120)</u>	<u>\$ (7,846)</u>



## The Cleveland Museum of Art

### Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

#### **8. Investments and Charitable Perpetual Trusts (continued)**

Investment return is net of investment-related expenses of \$2,321 and \$2,249 for the years ended June 30, 2016 and 2015, respectively. The Museum's investments and charitable perpetual trusts are exposed to various risks, such as interest rate, market, and credit risks.

#### **9. Endowment**

On February 3, 2012, the Museum and the John Huntington Art and Polytechnic Trust (Trust), referred to collectively as the Members, entered into an operating agreement with CleveHunt LLC (the Company), an Ohio limited liability company. CleveHunt was formed for the objective and purpose of investing certain property of the Company. The investments of the Company are directed by an investment committee consisting of the members of the Museum's Investment Committee and the Trustees of the Trust.

Initial contributions to the Company consisted of substantially all of the Museum's endowment assets and all of the assets of the Trust. In exchange for these contributions, the Museum and Trust received a 73.77% and 26.23% ownership share in the Company, respectively. The contributed assets are unitized and profits and losses, including income, are allocated according to the proportion of the Members' percentage interest. Capital contributions and withdrawals adjust the Members' percentage interest. As the Museum has a controlling interest in the Company, the Museum has included all of the net assets and changes in net assets in its statements of financial position, statements of activities and statements of cash flows in either investments (including realized and unrealized gains and losses on investments) for the Museum's ownership share of the Company or charitable perpetual trusts and related changes for the Trust's ownership share in the Company. The Museum has not reported noncontrolling interest for the Trust's ownership share in the Company, as the Museum continues to be the sole beneficiary of the Trust.

At June 30, 2016, the total net assets of the Company were \$518,984. Based on the Museum's ownership percentage at June 30, 2016, of 76.78%, the Museum's share of the net assets amounted to \$398,464 and are included in endowment investments in the Museum's statement of financial position. The Trust's share of the Company's net assets of \$120,520 at June 30, 2016, are included in charitable perpetual trusts in the Museum's statement of financial position. At June 30, 2015, the total net assets of the Company were \$572,247. Based on the Museum's ownership percentage at June 30, 2015, of 76.80%, the Museum's share of the net assets amounted to \$439,458 and are included in endowment investments in the Museum's statement of financial position. The Trust's share of the Company's net assets of \$132,789 at June 30, 2015, are included in charitable perpetual trusts in the Museum's statement of financial position.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **9. Endowment (continued)**

The Museum endowment consists of approximately 340 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

#### **Interpretation of Relevant Law**

The Board of Trustees of the Museum has interpreted 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 Museum classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Museum in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate donor-restricted funds:

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

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **9. Endowment (continued)**

#### **Return Objectives and Risk Parameters**

The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Museum must hold in perpetuity or for a donor-specific period(s) 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 a real return, net of inflation and investment management costs, of at least 7% over the long term. Actual returns in any given year may vary from this amount.

#### **Strategies Employed for Achieving Objectives**

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

#### **Spending Policy and How the Investment Objectives Relate to Spending Policy**

The Museum uses the spending rule concept in making distributions from its investments. In doing so, the Museum takes into account the distributions from the charitable perpetual trusts. The amount of investment income used by the Museum for its operations and purchases of art is calculated using a spending rate of between 4.5% to 5.5% of the market value of the investments for the prior 20-quarter average ended March 31, 2015 and 2014, for the fiscal years ended June 30, 2016 and 2015, as adjusted (subject to certain limitations) for inflation and additional contributions. For fiscal 2016 and 2015, the calculations resulted in an annual spending rate of approximately 5.0%. Investment returns in excess of (less than) amounts designated for current operations are classified as other changes in net assets in the statements of activities. Accordingly, over the long-term, the Museum expects the current spending policy to allow its endowment to grow at an average of 1.5% to 2.5% annually. This is consistent with the Museum's objective to maintain the purchasing power of the endowment assets held in perpetuity.

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**9. Endowment (continued)**

**Endowment Net Asset Composition by Type of Fund at June 30**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>2016</b>				
Donor restricted	\$ —	\$ 225,606	\$ 82,459	\$ 308,065
Charitable perpetual trusts	—	—	289,752	289,752
Board-designated	<b>100,561</b>	—	—	<b>100,561</b>
Total endowment	<b>\$ 100,561</b>	<b>\$ 225,606</b>	<b>\$ 372,211</b>	<b>\$ 698,378</b>
<b>2015</b>				
Donor restricted	\$ —	\$ 254,980	\$ 81,243	\$ 336,223
Charitable perpetual trusts	—	—	315,215	315,215
Board-designated	107,877	—	—	107,877
Total endowment	<b>\$ 107,877</b>	<b>\$ 254,980</b>	<b>\$ 396,458</b>	<b>\$ 759,315</b>

Changes in endowment net assets for the fiscal year ended June 30, 2016, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	<b>\$ 107,877</b>	<b>\$ 254,980</b>	<b>\$ 396,458</b>	<b>\$ 759,315</b>
Investment return:				
Investment income	<b>907</b>	<b>5,062</b>	—	<b>5,969</b>
Net appreciation (realized and unrealized)	<b>(3,620)</b>	<b>(20,206)</b>	<b>(25,463)</b>	<b>(49,289)</b>
Total investment income	<b>(2,713)</b>	<b>(15,144)</b>	<b>(25,463)</b>	<b>(43,320)</b>
Contributions	<b>41</b>	<b>110</b>	<b>1,216</b>	<b>1,367</b>
Appropriation of endowment assets for expenditure	<b>(4,644)</b>	<b>(14,340)</b>	—	<b>(18,984)</b>
Endowment net assets, end of year	<b>\$ 100,561</b>	<b>\$ 225,606</b>	<b>\$ 372,211</b>	<b>\$ 698,378</b>

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**9. Endowment (continued)**

Changes in endowment net assets for the fiscal year ended June 30, 2015, consisted of the following:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets, beginning of year	\$ 109,857	\$ 260,312	\$ 402,725	\$ 772,894
Investment return:				
Investment income	905	5,047	–	5,952
Net appreciation (realized and unrealized)	979	5,334	(7,846)	(1,533)
Total investment income	1,884	10,381	(7,846)	4,419
Contributions	308	231	1,579	2,118
Appropriation of endowment assets for expenditure	(4,172)	(15,944)	–	(20,116)
Endowment net assets, end of year	<u>\$ 107,877</u>	<u>\$ 254,980</u>	<u>\$ 396,458</u>	<u>\$ 759,315</u>

**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 Museum to retain as a fund of perpetual duration. These deficiencies result 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 Museum. There were twenty-six endowment funds considered deficient as of June 30, 2016, with deficiencies totaling approximately \$0.8 million.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **10. Benefit Plans**

The Museum converted from a contributory defined benefit pension plan for eligible employees to a noncontributory defined benefit pension plan (the Pension Plan) on January 1, 2002. Eligible participants in the contributory defined benefit pension plan on December 31, 2001, were given the option of continuing to contribute to this plan until July 1, 2009. For those employees not making this election, their accumulated benefit was converted to the noncontributory defined benefit pension plan. For either contributing or noncontributing participants, benefits under the Pension Plan are based on years of service and the final five-year average compensation. It is the policy of the Museum to fund with an insurance company at least the minimum amounts required by the Employee Retirement Income Security Act of 1974. Pension Plan assets are invested in group annuity contracts.

Effective July 1, 2009, the Museum modified the Pension Plan, eliminating the contributory portion of the plan, and the benefit calculation is based on career years of service. Effective December 31, 2010, the Museum modified the Pension Plan to allow participants meeting certain eligibility requirements to elect to accrue additional benefits in the current defined benefit plan. Those participants not meeting the eligibility requirements cease to accrue additional benefits under the plan. For those participants not meeting eligibility requirements or who elected not to accrue additional benefits in the defined benefit plan, the Museum provides an enhanced contribution to the participant's 401(k) account for employees meeting defined eligibility requirements.

The Museum provides health care benefits upon retirement to certain employees meeting eligibility requirements as of December 31, 2001, and contractually required additions. No other employees are eligible to receive these postretirement health care benefits. The Museum's policy is to fund the annual costs of these benefits from unrestricted net assets of the Museum.

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**10. Benefit Plans (continued)**

Included in unrestricted net assets at June 30, 2016 and 2015, are the following amounts that have not yet been recognized in net periodic benefit cost:

	<b>Pension Plan</b>		<b>Other Postretirement</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Actuarial loss (gain)	\$ 14,362	\$ 12,315	\$ (1,397)	\$ (1,510)
Net prior service credit	(394)	(453)	(228)	(406)
Total unrecognized amounts included in unrestricted net assets	\$ 13,968	\$ 11,862	\$ (1,625)	\$ (1,916)

The actuarial loss (gain) and prior service credit for the Pension Plan that will be amortized from unrestricted net assets into periodic benefit cost over the next fiscal year are \$1,042 and \$(58), respectively. There are no actuarial gains and prior service (credits) for the postretirement medical plan that will be amortized from unrestricted net assets into periodic benefit cost over the next fiscal year.

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**10. Benefit Plans (continued)**

The following table sets forth the actuarial present value of benefit obligations and aggregate funded status of the Pension Plan:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Change in benefit obligation:		
Benefit obligation at beginning of fiscal year	\$ 36,444	\$ 34,863
Service cost	468	500
Interest cost	1,477	1,362
Actuarial losses	4,453	1,220
Benefits paid	(1,612)	(1,501)
Benefit obligation at end of fiscal year	<u>41,230</u>	36,444
Change in plan assets:		
Fair value of plan assets at beginning of fiscal year	26,237	27,367
Actual return on plan assets	2,919	(278)
Employer contributions	1,589	649
Benefits paid	(1,612)	(1,501)
Fair value of plan assets at end of fiscal year	<u>29,133</u>	26,237
Underfunded status of the plan and accrued pension obligation	<u>\$ (12,097)</u>	<u>\$ (10,207)</u>
Accumulated benefit obligation	<u>\$ 40,984</u>	<u>\$ 36,229</u>



The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**10. Benefit Plans (continued)**

Weighted-average assumptions for the Pension Plan are as follows:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Discount rate – liability	<b>3.25%</b>	4.15%
Discount rate – cost	<b>4.15</b>	4.00
Expected rate of return on plan assets	<b>5.25</b>	5.25
Compensation growth rate – liability	<b>3.00</b>	3.00
Compensation growth rate – cost	<b>3.00</b>	3.00

The assumptions used in the actuarial valuations were established by the Museum in conjunction with its actuary. The expected long-term rate of return on plan assets was established using the Museum’s target asset allocation for equity and fixed income securities and the historical average rates of return for equity and fixed income securities adjusted by an assessment of possible future influences that could cause the returns to trail long-term patterns. The weighted-average rates of increase in compensation were established based upon the Museum’s long-term internal compensation plans.

	<b>Year Ended June 30</b>	
	<b>2016</b>	<b>2015</b>
Components of net periodic benefit cost recognized in the statements of activities:		
Service cost	\$ <b>468</b>	\$ 500
Interest cost	<b>1,477</b>	1,362
Expected return on plan assets	<b>(1,366)</b>	(1,549)
Amortization of prior service cost	<b>(58)</b>	(58)
Recognized net actuarial loss	<b>851</b>	610
	<b>\$ 1,372</b>	\$ 865

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**10. Benefit Plans (continued)**

The Pension Plan invests in an unallocated immediate participation guarantee group annuity contract with John Hancock Life Insurance Company (the Insurer), which is considered a Level 3 investment in the fair value hierarchy. The investment balances and related investment results are based on information provided by the Insurer, which considers significant inputs for the unallocated insurance contract, including specific terms and contractual provisions outlined in the contract, such as the effective interest rate. The Insurer credits the Pension Plan's deposits that are intended to provide future benefits to present employees to an account that is invested with other assets of the Insurer. The account is credited with its share of the Insurer's actual investment income. The investment in the group annuity contract is designed to grow at a rate consistent with the underlying obligation. The actual asset allocations by asset category are consistent with its targets and are as follows:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Debt securities	<b>99%</b>	95%
Equity securities	<b>1</b>	1
Other	–	4
Total	<b>100%</b>	100%

The Museum expects to make a contribution of \$1,275 to the Pension Plan in fiscal year 2017. The Museum reserves the right to contribute more or less than this amount but not less than any minimum contribution requirement under the Pension Protection Act (PPA). Benefit payments over the next five fiscal years are estimated as follows:

Years ending:	
2017	\$ 1,857
2018	1,914
2019	1,984
2020	2,069
2021	2,141
Five years thereafter	11,312

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**10. Benefit Plans (continued)**

In addition, the Museum sponsors a 401(k) savings plan. The Museum matches employee contributions at a rate of 50% of the first 4% of total compensation. The Museum's contributions to the 401(k) plan were \$250 and \$288 for the years ended June 30, 2016 and 2015, respectively.

The following information is provided for the Museum's postretirement medical benefits plan:

	<b>June 30</b>	
	<b>2016</b>	<b>2015</b>
Change in benefit obligation:		
Benefit obligation at beginning of fiscal year	\$ 755	\$ 772
Interest cost	26	26
Actuarial gain	(47)	16
Benefits paid	(107)	(120)
Participant contributions	50	61
Benefit obligation at end of fiscal year	<u>677</u>	<u>755</u>
Change in plan assets:		
Fair value of plan assets at beginning of fiscal year	-	-
Participant contributions	50	61
Employer contributions	57	59
Benefits paid	(107)	(120)
Fair value of plan assets at end of fiscal year	<u>-</u>	<u>-</u>
Underfunded status of the plan and accrued postretirement medical benefits	<u>\$ (677)</u>	<u>\$ (755)</u>

Approximately \$(53) and \$(56) of the accrued postretirement medical benefit liability is included in accounts payable and accrued expenses on the statements of financial position as of June 30, 2016 and 2015, respectively.

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**10. Benefit Plans (continued)**

The discount rate used in determining the accumulated postretirement benefit obligation at June 30, 2016 and 2015, was 2.7% and 3.6%, respectively. The discount rate used in determining the net periodic benefit cost was 3.6% and 3.45% at June 30, 2016 and 2015, respectively. The health care cost trend rate used is 8.5% for fiscal year 2016, declining to 5.50% by 2022. A one-percentage-point increase or decrease in the health care cost trend would have increased or decreased the fiscal 2016 and 2015 interest costs in total by \$3 and \$2, respectively, and would have increased or decreased the accumulated postretirement benefit obligation by \$64 and \$73, respectively.

	<b>Year Ended June 30</b>	
	<b>2016</b>	<b>2015</b>
Components of net periodic benefit credit recognized in the statements of activities:		
Interest cost	\$ 26	\$ 25
Amortization of prior service credit	(177)	(196)
Recognized net actuarial gain	(160)	(190)
	<u>\$ (311)</u>	<u>\$ (361)</u>

The benefits expected to be paid in each year for the fiscal years 2017–2021 are \$53, \$54, \$55, \$55, and \$54, respectively. The anticipated benefits to be paid in the five years from 2022 to 2026 are \$240.

**11. Financing Arrangements and Long-Term Obligations**

**Operating Leases**

The Museum has an operating lease for warehouse space that can be terminated at its discretion. Total rental expense for the years ended June 30, 2016 and 2015, was \$93 and \$103, respectively.

The Cleveland Museum of Art

Notes to Financial Statements (continued)

(In Thousands, Unless Noted)

**11. Financing Arrangements and Long-Term Obligations (continued)**

**Cultural Facility Revenue Bonds**

Cultural Facility Revenue Bonds consist of the following:

	Interest Rates	Final Fiscal Year Maturity	Amount Outstanding at June 30	
			2016	2015
Series 2005	Variable rate	2037–2041	\$ 90,000	\$ 90,000
Series 2010	3% to 5%	2019–2023	70,430	70,430
			<b>160,430</b>	160,430
Unamortized premium			2,501	3,043
Current portion			–	–
			<b>\$ 162,931</b>	<b>\$ 163,473</b>

**Series 2005**

In October 2005, pursuant to certain agreements between the Museum and the Cleveland-Cuyahoga Port Authority, the Cleveland-Cuyahoga Port Authority issued \$90,000 in variable rate, tax-exempt Cultural Facility Revenue Bonds (The Cleveland Museum of Art Project), Series 2005, payable October 1, 2040 (the 2005 Bonds). The proceeds of the 2005 Bonds were used to finance the Museum’s construction, renovation, and expansion project. The 2005 Bonds were issued in four series: (i) the Series A Bonds in the principal amount of \$30,000, (ii) the Series B Bonds in the principal amount of \$20,000, (iii) the Series C Bonds in the principal amount of \$20,000, and (iv) the Series D Bonds in the principal amount of \$20,000. The 2005 Bonds have adjustable methods of interest rate determination and interest payment dates, and were in weekly variable rate mode based on a tax-free LIBOR on June 30, 2016, bearing interest at .42% (range from .01% to .42% during the year ended June 30, 2016), and on June 30, 2015, bearing interest at 0.07% and 0.09% (range from 0.02% to 0.13% during the year ended June 30, 2015). The interest rate is determined by an external agent.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **11. Financing Arrangements and Long-Term Obligations (continued)**

The 2005 Bonds are secured by a standby bond purchase agreement, with an expiration date of December 31, 2017. Under the terms of this agreement, in the event of a failed remarketing, the bank will provide liquidity to make payment to the bond holders. Fees incurred related to the remarketing of the bonds were \$444 and \$445 during the years ended June 30, 2016 and 2015, respectively, and are included in general and administrative expense in the statements of activities.

#### **Series 2010**

On July 1, 2010, pursuant to certain agreements between the Museum and the Cleveland-Cuyahoga Port Authority, the Cleveland-Cuyahoga Port Authority issued \$70,430 in fixed rate, tax-exempt Cultural Facility Revenue Bonds, Series 2010 (The Cleveland Museum of Art Project). The proceeds of the 2010 Bonds are being used to finance the Museum's ongoing construction project. The 2010 Bonds were issued at a premium with varying maturity dates ranging from October 2018 to 2022 and with coupon rates ranging from 3.00% to 5.00%.

While these Cultural Facility Revenue Bonds are not a direct indebtedness of the Museum, the loan agreement with the Cleveland-Cuyahoga Port Authority obligates the Museum to make payments equal to the principal of and premium, if any, and interest on the respective Bonds, whether at maturity, upon acceleration or upon redemption. Bond service charges due on the Bonds will be required to be made by the Museum as loan payments under the agreement. Interest-only payments are required to be made until October 1, 2036, for the Series 2005 Bonds and October 1, 2018, for the Series 2010 Bonds.

The Museum is subject to certain restrictive covenants, including provisions relating to maintaining certain debt ratios and other matters. The Museum was in compliance with these covenants at June 30, 2016.

#### **Unamortized Financing Costs**

Unamortized financing costs are amortized over the period the obligation is outstanding using the effective interest method. Included in general and administrative expense on the statements of activities was \$126 of amortization of deferred financing costs during each of the years ended June 30, 2016 and 2015. Unamortized financing costs of \$979 and \$1,105 are included in other long-term assets on the statements of financial position at June 30, 2016 and 2015, respectively.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **11. Financing Arrangements and Long-Term Obligations (continued)**

#### **Interest Rate Swap**

In connection with the 2005 Bonds, the Museum entered into a floating-to-fixed rate swap to manage the risk of increased debt service costs resulting from rising variable interest rates. The swap consists of a \$90,000, eight-year floating-to-fixed rate swap whereby the Museum paid a fixed rate of 3.341% and received 70% of one-month LIBOR. The notional amount of the swap declined each year until its maturity on January 1, 2014.

In December 2009, the Museum entered into a floating-to-fixed rate swap to hedge the unhedged principal amount of the 2005 Bonds, due to the declining notional amount of the previous swap. The effective date of the swap was January 3, 2011, with an initial notional amount of \$63,500, increasing to \$90,000 on January 2, 2014, when the original swap matured. The swap matures on January 1, 2021, and consists of a floating-to-fixed rate swap whereby the Museum pays a fixed rate of 2.8623% and receives 70% of one-month LIBOR. This derivative instrument is not designated as a hedging instrument. At June 30, 2016 and 2015, the fair value of the swap agreement as of the close of business that day, was \$(9,175) and \$(7,863), respectively, owed to the counterparty and has been recorded in other liabilities on the statements of financial position. The change in fair value of the swap agreement is recorded in other changes in net assets on the statements of activities. Net interest cost incurred under the swap agreement was \$2,372 and \$2,471 for fiscal 2016 and 2015, respectively, and is included in general and administrative expense on the statements of activities.

#### **Interest**

Interest expense on the 2005 Bonds was approximately \$120 and \$43 in fiscal years 2016 and 2015, respectively, and is included in general and administrative expense on the statements of activities. Interest expense on the 2010 Bonds was approximately \$3,155 in fiscal 2016 and 2015, and is included in general and administrative expense on the statements of activities. Interest paid on the 2005 and 2010 Bonds was \$3,275 and \$3,198 in fiscal years 2016 and 2015, respectively.

# The Cleveland Museum of Art

## Notes to Financial Statements (continued)

*(In Thousands, Unless Noted)*

### **11. Financing Arrangements and Long-Term Obligations (continued)**

#### **Line of Credit**

The Museum has a line of credit with a financial institution totaling \$10,000. The line is intended to meet the short-term financing needs of the Museum. There were no amounts borrowed on the line of credit during fiscal 2016 or 2015 and no amounts outstanding as of June 30, 2016 or 2015.

#### **12. Income Taxes**

The Museum is a nonprofit organization and is exempt from federal income taxes on related income under Section 501(c)(3) of the Internal Revenue Code. There were no amounts recorded for uncertain tax positions as of June 30, 2016 and 2015.

#### **13. Subsequent Events**

The Museum has evaluated subsequent events through November 23, 2016, the date the accompanying financial statements were issued.



**About EY**

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [ey.com](http://ey.com).

© 2016 Ernst & Young LLP.  
All Rights Reserved.

**[ey.com](http://ey.com)**

