

The Museum of Fine Arts, Houston

Financial Statements as of and for the Year Ended
June 30, 2014, and Independent Auditors' Report

THE MUSEUM OF FINE ARTS, HOUSTON

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1-2
FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2014:	
Statement of Financial Position	3
Statement of Activities	4
Statement of Functional Expenses	5
Statement of Cash Flows	6
Notes to Financial Statements	7-20

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
The Museum of Fine Arts, Houston
Houston, Texas

We have audited the accompanying financial statements of The Museum of Fine Arts, Houston (the "Museum"), which comprise the statement of financial position as of June 30, 2014, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from 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 auditors' 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 auditors consider internal control relevant to the Museum'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 Museum's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Museum as of June 30, 2014, and the changes in its net assets, functional expenses, and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte's Touche LLP

November 21, 2014

THE MUSEUM OF FINE ARTS, HOUSTON

STATEMENT OF FINANCIAL POSITION

AS OF JUNE 30, 2014

(Dollars in thousands)

ASSETS

TEMPORARILY RESTRICTED CASH AND CASH EQUIVALENTS	\$ 69,465
RECEIVABLES:	
Pledges	112,683
Grants	511
Accounts	1,344
Interest/dividends	<u>1,589</u>
Total receivables	116,127
INVENTORY	720
PREPAID EXPENSES	1,528
INVESTMENTS	1,207,696
PROPERTY — Net	124,069
OTHER ASSETS	<u>1,404</u>
TOTAL	<u>\$ 1,521,009</u>

LIABILITIES AND NET ASSETS

LIABILITIES:	
Accounts payable and accrued liabilities	\$ 20,320
Deferred revenue	<u>3,861</u>
Total liabilities	<u>24,181</u>
COMMITMENTS (Note 9)	
NET ASSETS:	
Unrestricted	301,687
Temporarily restricted	509,415
Permanently restricted	<u>685,726</u>
Total net assets	<u>1,496,828</u>
TOTAL	<u>\$ 1,521,009</u>

See notes to financial statements.

THE MUSEUM OF FINE ARTS, HOUSTON

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2014 (Dollars in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES:				
Contributions and grants	\$ 12,850	\$ 2,080	\$ -	\$ 14,930
Investment returns designated for current use	32,776	159	-	32,935
Membership revenue	2,630	-	-	2,630
Admission revenue	2,585	-	-	2,585
Tuition revenue	1,642	-	-	1,642
Auxiliary revenue	3,061	-	-	3,061
Other	1,730	-	-	1,730
Net assets released from restriction	4,885	(4,885)	-	-
Total operating support and revenue	62,159	(2,646)	-	59,513
OPERATING EXPENSES:				
Program services:				
Curatorial and collections	8,717	-	-	8,717
Exhibitions	6,227	-	-	6,227
Education and public programs	6,490	-	-	6,490
Glassell School	3,690	-	-	3,690
Bayou Bend	3,504	-	-	3,504
Rienzi	1,574	-	-	1,574
Membership activities	1,472	-	-	1,472
Buildings and Grounds & Security	11,875	-	-	11,875
Sub-total program services	43,549	-	-	43,549
Supporting services:				
Management and General	9,637	-	-	9,637
Auxiliary activities	3,388	-	-	3,388
Fundraising	4,288	-	-	4,288
Sub-total supporting services	17,313	-	-	17,313
Total operating expenses before depreciation and amortization	60,862	-	-	60,862
OPERATING SURPLUS (DEFICIT) BEFORE DEPRECIATION AND AMORTIZATION	1,297	(2,646)	-	(1,349)
DEPRECIATION AND AMORTIZATION	6,708	-	-	6,708
CHANGES IN NET ASSETS FROM OPERATIONS	(5,411)	(2,646)	-	(8,057)
CHANGES IN NON-OPERATING ACTIVITIES:				
Contributions designated for capital expenditures and long term investment	150	51,731	573	52,454
Contributions for the purchase of art	25,719	2,560	-	28,279
Investment returns designated for art acquisition	7,123	12,185	-	19,308
Acquisition of art objects net of proceeds from the sale of art	(31,539)	-	-	(31,539)
Investment return in excess of amounts designed for current use and art acquisition	42,302	99,391	-	141,693
Net assets released from restriction to fund non-operating activities	40,618	(40,618)	-	-
Endowment related expenses (net)	(2,206)	539	-	(1,667)
Other	(1,532)	(1,357)	-	(2,889)
CHANGE IN NET ASSETS	75,224	121,785	573	197,582
NET ASSETS—Beginning of year	226,463	387,630	685,153	1,299,246
NET ASSETS—End of year	\$301,687	\$509,415	\$685,726	\$1,496,828

See notes to financial statements.

THE MUSEUM OF FINE ARTS, HOUSTON

**STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2014
(Dollars in thousands)**

Area	Program Services							Supporting Services					Total Expenses Before Depreciation	
	Curatorial and Collections	Exhibitions	Education and Public Programs	Glassell School	Bayou Bend	Rienzi	Membership Activities	Buildings & Grounds/ Security	Total	Management and General	Auxiliary Activities	Fund-Raising		Total
Salaries	\$ 5,334	\$ 2	\$ 3,241	\$ 2,188	\$ 1,576	\$ 500	\$ 613	\$ 5,485	\$ 18,939	\$ 4,383	\$ 915	\$ 2,071	\$ 7,369	\$ 26,308
Employee benefits	<u>1,287</u>	<u>-</u>	<u>714</u>	<u>549</u>	<u>421</u>	<u>115</u>	<u>173</u>	<u>1,483</u>	<u>4,742</u>	<u>1,217</u>	<u>197</u>	<u>374</u>	<u>1,788</u>	<u>6,530</u>
Total	6,621	2	3,955	2,737	1,997	615	786	6,968	23,681	5,600	1,112	2,445	9,157	32,838
Printing and publication	2	14	448	74	48	23	157	-	766	29	5	101	135	901
Occupancy	251	-	78	247	341	315	-	2,956	4,188	530	-	60	590	4,778
Professional fees	494	299	470	26	9	15	56	-	1,369	882	165	138	1,185	2,554
Repairs and maintenance	5	48	4	2	75	143	-	619	896	252	1	-	253	1,149
Cost of goods sold	-	-	-	-	74	-	-	-	74	-	1,536	-	1,536	1,610
Insurance	535	243	-	58	71	43	-	686	1,636	184	2	6	192	1,828
Postage and shipping	265	2,969	30	29	13	8	92	-	3,406	62	49	81	192	3,598
Supplies	194	139	139	157	108	48	1	226	1,012	131	48	215	394	1,406
Programs and previews	61	2,453	256	190	333	161	49	-	3,503	46	116	418	580	4,083
Travel	254	46	86	17	8	15	7	-	433	139	18	74	231	664
Communications	13	-	-	1	2	1	-	-	17	260	-	-	260	277
Contract services	10	7	45	80	200	48	-	33	423	841	194	203	1,238	1,661
Special security	-	-	-	29	158	109	-	374	670	-	-	29	29	699
Promotion	6	6	680	40	47	18	321	1	1,119	63	140	469	672	1,791
Photography	-	1	25	-	4	9	-	-	39	-	-	11	11	50
Dues and subscriptions	5	-	9	3	1	-	1	12	31	288	2	27	317	348
Interest	-	-	-	-	-	-	-	-	-	39	-	-	39	39
Miscellaneous	1	-	7	-	1	3	2	-	14	291	-	11	302	316
Library	<u>-</u>	<u>-</u>	<u>258</u>	<u>-</u>	<u>14</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>272</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>272</u>
TOTAL	<u>\$ 8,717</u>	<u>\$ 6,227</u>	<u>\$ 6,490</u>	<u>\$ 3,690</u>	<u>\$ 3,504</u>	<u>\$ 1,574</u>	<u>\$ 1,472</u>	<u>\$ 11,875</u>	<u>\$ 43,549</u>	<u>\$ 9,637</u>	<u>\$ 3,388</u>	<u>\$ 4,288</u>	<u>\$ 17,313</u>	<u>\$ 60,862</u>

See notes to financial statements.

THE MUSEUM OF FINE ARTS, HOUSTON

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2014 (Dollars in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Change in net assets	\$ 197,582
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Depreciation	6,708
Write off of salvage values	512
Gains on sale of investments	(38,049)
Net unrealized appreciation on investments	(133,732)
Distributions from investing activities	17,021
Contributions restricted by donors	(56,944)
Increase in receivables	(6,981)
Decrease in inventory	651
Increase in prepaid expenses	(1,295)
Increase in liabilities	8,384
	<u>8,384</u>
Net cash used in operating activities	<u>(6,143)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property	(19,317)
Return of capital on investments	38,406
Purchases of investments	(99,488)
Proceeds from sale of investments	69,955
Increase in temporarily restricted cash and cash equivalents	(40,404)
Decrease in other assets	47
	<u>47</u>
Net cash used in investing activities	<u>(50,801)</u>
CASH FLOWS FROM FINANCING ACTIVITY—Contributions restricted by donors	
	<u>56,944</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	-
CASH AND CASH EQUIVALENTS—Beginning of year	<u>-</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ -</u>

See notes to financial statements.

THE MUSEUM OF FINE ARTS, HOUSTON

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2014 (Dollars in thousands)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of The Museum of Fine Arts, Houston (the “Museum”) have been prepared on the accrual basis of accounting. The significant accounting policies followed by the Museum, which is a Texas not-for-profit organization, are described below.

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

Unrestricted Resources—Net assets not restricted by donor-imposed stipulations that may be designated for specific purposes by action of the Museum’s board of trustees (the “Board of Trustees”).

Temporarily Restricted Resources—Net assets resulting from contributions and other inflows of assets whose use by the Museum is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Museum pursuant to these stipulations.

Permanently Restricted Resources—Net assets that are subject to donor-imposed stipulations that they be maintained permanently by the Museum. Generally, the donors of these assets permit the Museum to use all or part of the income earned on these assets.

Pledges Receivable—Pledges receivable are presented at the net present value of future cash flows discounted at the five-year Treasury bill rate.

Inventory—Inventory is valued at the lower of cost (moving weighted-average method) or market.

Investments and Income Allocation—The Museum records investments in accordance with the Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Topic 958-320, *Not-for-Profit Entities—Investments—Debt and Equity Securities*. This statement establishes standards for the recognition of fair value of investments in certain equity and debt securities with gains and losses included in the statement of activities. Purchases and sales of investments are recorded on the trade date.

The Museum records investments at fair value. The estimated fair value of its investments is based on quoted market prices, except for certain investments for which quoted market prices are not available. Investments may be valued using various techniques, which may include value based upon prices supplied by pricing services, external broker quotes, and internal pricing matrices. In addition, U.S. GAAP provides guidance for estimating the fair value of investments in certain entities that calculate net asset value per share (or its equivalent). As such, the Museum utilizes net asset value as a practical expedient of fair value and other available information to determine fair value for investments meeting the prescribed requirements.

The Museum classifies net assets, expenses, revenues, and gains/losses as either permanently restricted, temporarily restricted, or unrestricted.

The income from investments, net of realized investment gains on investment transactions, and appreciation/depreciation in market value of investments in the permanently restricted endowment accounts are allocated among temporarily restricted and unrestricted operating and accessions' accounts based on their respective weighted-average number of investment units.

The Museum spending rule attempts to achieve two objectives by using a long-term spending rate of 5.0% combined with a smoothing rule that adjusts spending gradually to changes in endowment value. The amount released under the spending rule is based on a weighted average of prior spending adjusted for inflation (80% weight) and an amount determined by applying the target rate to the current endowment market value as of December 31 (20% weight).

Property—Property is recorded at cost or the estimated fair value at the date of the gift. The Museum reports gifts of land, buildings, and equipment as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted support. Absent explicit donor stipulations about how long these long-lived assets must be maintained, the Museum reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service; if insignificant, gifts of long-lived assets are expensed when received.

Depreciation is computed using primarily the straight-line method over 30 years for buildings and capital improvements and five to 10 years for equipment, furniture, and fixtures.

Deferred Revenue—Deferred revenue represents advance rentals of Museum facilities and is being recognized using the straight-line method over the 30-year lease term.

Statement of Cash Flows—The statement of cash flows is presented using the indirect method. The Museum considers all highly liquid investments with original maturities of three months or less when purchased to be cash and cash equivalents. Short-term investments that are managed within the Museum's pool of investments are excluded from cash and cash equivalents as they represent investing activities.

Art Collection—With approximately 67,674 works, the Museum's permanent collection of world art spans 6,000 years and six continents. The Museum acquires its art collection through purchases or by gifts. The cost of all art objects purchased, together with the value of art objects obtained by gift (for which the Museum receives a reasonable estimate), is reported as a part of collection expense. In accordance with policies followed by many art museums, no value has been assigned in the statement of financial position to the Museum's art collection.

Purchases for the art collection were \$13,070 for the year ended June 30, 2014. The value of art objects obtained by gifts is reported as contributions and collection expense in the statement of activities and totaled \$18,469 for the year ended June 30, 2014. Deaccessions made during the year had a fair market value of \$5, and were executed in accordance with the Museum's policy and accepted national standards.

Gifts of cash or other property restricted by donors for the purchase of items for the art collection are recognized as temporarily restricted revenue until acquisitions are made in accordance with the terms of

the gifts. Net assets are transferred from temporarily restricted net assets to unrestricted net assets upon satisfaction of donor restrictions.

Revenue Recognition—The Museum records contributions received, including unconditional promises to give, as revenues in the period received at their fair value.

Donated Services—Donated services that create or enhance nonfinancial assets or require specialized skills are recognized as revenues and corresponding expenses. Donated services that do not meet the above conditions are not recognized. In the year ended June 30, 2014, the Museum received donated legal services valued at \$154.

Allocation of Functional Expenses—Expenses are allocated to various programs and supporting services based on the ultimate use of the product or services. Expenses related to maintenance, operation, and security of building facilities are allocated based on the estimated use of the facilities.

Federal Income Taxes—The Museum is exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code. Accordingly, there is no provision for federal income taxes included in the financial statements.

Contributions—The Museum records contributions receivable in accordance with FASB ASC Topic 958-605, *Not-for-Profit Entities—Revenue Recognition*, which requires that unconditional promises to give be recorded as revenue in the period in which the promise is made and requires the organization to distinguish between contributions received for each net asset category in accordance with donor-imposed restrictions. When an externally imposed restriction expires or unrestricted contributions are realized, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Contributions for which restrictions are met in the same period in which the unconditional promise to give is received are recorded as unrestricted revenue. Contributions receivable are recorded at the present value of expected future cash flows, based on both the time value of money and expectations about possible variations in the amounts and timing of the cash flows. The Museum considers rates on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the expected contributions receivable and historical experience with uncollectible contributions to determine the present value factor to apply.

Subsequent Events—We have evaluated subsequent events through November 21, 2014, which is the date the financial statements were available for issuance.

New Accounting Pronouncements—On December 16, 2011, the FASB issued ASU No. 2011-11, *Disclosure about Offsetting Assets and Liabilities*, which contains new disclosure requirements regarding the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. This update was applied for the fiscal year ended June 30, 2014, and had no impact on the previously reported balances since the Museum does not have financial instruments or derivative instruments with offsetting, netting, or similar arrangements.

In May 2012, the Financial Accounting Standards Board issued Accounting Standards Update 2012-05, *Statement of Cash Flows—Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*, which indicates that the proceeds from the near-immediate sale of donated assets are to be included in cash flows from operations. If the donor restricted the use of an asset for a long-term purpose, the proceeds should be presented as a financing activity. If the sale of the donated assets is not near immediate nor restricted for a long-term purpose, then the proceeds should be reflected as an investing activity. This update was applied for the fiscal year ended

June 30, 2014, and there was no impact to the current cash flows of the Museum based on the adoption of this standard.

2. ENDOWMENT FUNDS AND INTERPRETATION OF RELEVANT LAW

Effective September 1, 2007, the State of Texas adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which governs Texas charitable institutions with respect to the management, investment, and expenditure of donor-restricted endowment funds.

The Board of Trustees has interpreted Texas's adoption of UPMIFA as requiring the Museum to adopt investment and spending policies that preserve the fair value of the original gift as of the date of gift, absent explicit donor stipulations to the contrary. Although the Museum has a long-term fiduciary duty to the donor (and to others) for a fund of perpetual duration, the preservation of the endowment's purchasing power is only one of several factors that are considered in managing and investing these funds. Furthermore, in accordance with UPMIFA, a portion of the endowment's original gift may be appropriated for expenditure in support of the restricted purposes of the endowment if this is consistent with a spending policy that otherwise satisfies the requisite standard of prudence under UPMIFA.

As a result of this interpretation, the Museum classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) subsequent gifts to the endowment, and (3) accumulations made pursuant to the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

Net earnings (realized and unrealized) on the investment of endowment assets are classified as temporarily restricted until those amounts are appropriated for expenditure by the Museum in a manner consistent with the purpose or time restrictions if any, imposed by the donor. Any investment return classified as permanently restricted represents only those amounts required to be retained permanently as a result of explicit donor stipulations.

With regard to endowment losses or appropriations in excess of the fair value of the original gift, the portion of a donor-restricted endowment that is classified as permanently restricted is not reduced by losses on the investments of the fund, except to the extent required by the donor, including losses related to specific investments that the donor requires the Museum to hold in perpetuity. Similarly, the amount of permanently restricted net assets is not reduced by the Museum's appropriations from the fund. In the absence of donor stipulations or law to the contrary, losses or appropriations of a donor-restricted endowment reduce temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been satisfied before the loss or appropriation occurs. Any remaining loss or appropriation reduces unrestricted net assets.

In accordance with UPMIFA, the Board of Trustees has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to the programs and operations supported by its own endowment, while also seeking to maintain the long-term purchasing of the endowment assets. Therefore, the Board of Trustees considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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

- The investment policies of the Museum

Endowment net asset composition by type of fund as of June 30, 2014, is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment funds	<u>\$ 200,439</u>	<u>\$ 300,569</u>	<u>\$ 685,726</u>	<u>\$ 1,186,734</u>

Changes in endowment net assets for the fiscal year ended June 30, 2014, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets — beginning of year	\$ 135,377	\$ 226,494	\$ 685,153	\$ 1,047,024
Investment return:				
Investment income	10,682	11,219	-	21,901
Net realized gains	18,792	18,977	-	37,769
Net unrealized gains	<u>65,018</u>	<u>67,797</u>	<u>-</u>	<u>132,815</u>
Total investment return	<u>94,492</u>	<u>97,993</u>	<u>-</u>	<u>192,485</u>
Contributions	-	-	573	573
Other	472	540	-	1,012
Appropriated for expenditures	(3,522)	-	-	(3,522)
Transfers to other funds	(50,838)	-	-	(50,838)
Net assets released from restrictions	<u>24,458</u>	<u>(24,458)</u>	<u>-</u>	<u>-</u>
Endowment net assets — end of year	<u>\$ 200,439</u>	<u>\$ 300,569</u>	<u>\$ 685,726</u>	<u>\$ 1,186,734</u>

3. INVESTMENTS

Investments are stated at fair value and, if available, quoted market prices are used to value such investments. The financial statements include alternative investments valued at \$314,416 (21% of net assets), whose fair values have been estimated by the Museum's management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Unrealized appreciation or depreciation is recognized within the statement of activities currently. Accumulated unrealized appreciation of investments consists of unrealized gains and losses of \$459,120 as of June 30, 2014.

The Museum has made capital commitments of \$455,037 for purchases of limited partnership interests, of which the total net amount funded was \$328,135 as of June 30, 2014. Subsequent to June 30, 2014, the Museum funded an additional \$8,271.

Subsequent to June 30, 2014, the Museum made no additional commitments to investment managers in other asset classes.

A summary of investments as of June 30, 2014, is as follows:

	Cost	Fair Value	Unrealized Appreciation
At cost and fair value:			
Equity and equity mutual funds	\$ 356,360	\$ 740,287	\$ 383,926
U.S. treasuries, bonds, and bond mutual funds	69,172	73,970	4,799
Alternative investments	247,097	314,416	67,319
Real estate and REITS	10,163	13,239	3,076
Money market mutual funds	<u>65,784</u>	<u>65,784</u>	<u>-</u>
Total investments	<u>\$ 748,576</u>	<u>\$ 1,207,696</u>	<u>\$ 459,120</u>

Investment income earned by the Museum and its allocation among net asset classifications as of June 30, 2014, are as follows:

Investment income	\$ 22,152
Net realized gains on investments reported at fair value	38,052
Net unrealized gains on investments reported at fair value	<u>133,732</u>
Total investment income	<u>\$ 193,936</u>
Net asset classification of investment income:	
Unrestricted	\$ 82,201
Temporarily restricted	111,735
Permanently restricted	<u>-</u>
Total investment income	<u>\$ 193,936</u>

Fair Value Measurement—The Museum utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1—Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Museum has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment. As of June 30, 2014, the Museum valued, using Level 1 inputs, \$871,467 of investments, which included equity securities traded on active exchanges.

Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly. As of June 30, 2014, using Level 2 inputs, the Museum valued \$33,951 of investments, which included certain commingled equity funds, commingled debt funds and most government agency securities, investment-grade corporate bonds, certain mortgage products, less-liquid equities, and state and municipal obligations.

Level 3—Valuations based on inputs that are unobservable and not corroborated by market data. As of June 30, 2014, using Level 3 inputs, the Museum valued \$302,278 of investments, which included certain fixed-income funds, private equity and real estate investments, less-liquid corporate debt securities (including distressed debt instruments), collateralized debt obligations, and less-liquid mortgage securities (backed by either commercial or residential real estate). When observable prices are not available for these securities, the Museum uses one or more valuation techniques for which sufficient and reliable data is available. The degree of judgment exercised in determining fair value is greatest for securities categorized in Level 3, due to the inherent uncertainty of these valuations. Level 3 estimated values may differ significantly from the values that would have been used, had a ready market for the investment existed, and the differences could be material.

The inputs used by the Museum in estimating the value of Level 3 investments include the original transaction price, recent transactions in the same or similar instruments, completed or pending third-party transactions in the investment or comparable issuers, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows. Level 3 investments may also be adjusted to reflect illiquidity and/or nontransferability, with the amount of such discount estimated by the Museum in the absence of market information. The fair value measurement of Level 3 investments does not include transaction costs that may have been capitalized as part of the security's cost basis.

The financial instruments included in the statement of financial position by caption and by level within the valuation hierarchy as of June 30, 2014, were as follows:

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Equity and equity mutual funds	\$ 740,287	\$ -	\$ -	\$ 740,287
U.S. treasuries, bonds, and bond mutual funds	52,157	21,813	-	73,970
Alternative investments	-	12,138	302,278	314,416
Real estate and REITS	13,239	-	-	13,239
Money market mutual funds	<u>65,784</u>	<u>-</u>	<u>-</u>	<u>65,784</u>
Total	<u>\$ 871,467</u>	<u>\$ 33,951</u>	<u>\$ 302,278</u>	<u>\$ 1,207,696</u>

The following table includes a rollforward for the year ended June 30, 2014, of amounts for financial instruments classified within Level 3. The classification of a financial instrument within Level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement. Net operating income/expenses, net realized gains, and net unrealized gains are included within realized and unrealized investment income (loss)—net within the statement of activities.

	Level 3 Investments
Balance—beginning of fiscal year	\$ 277,012
Purchases	41,151
Distributions	(70,128)
Net operating expenses	(5,163)
Net realized gains	22,175
Net unrealized gains	<u>37,231</u>
Balance—June 30, 2014	<u>\$ 302,278</u>

4. INVESTMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

A description of the alternative investments included in securities measured at fair value with significant unobservable inputs is as follows:

	Category	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Multi-Strategy Hedge Funds	(a)	\$ 25,059	\$ -	Quarterly–Annually	30–100 days
Private Equity Funds	(b)	160,215	43,065	N/A	N/A
Venture Capital Funds	(c)	16,983	1,715	N/A	N/A
Energy/Natural Resources Funds	(d)	85,149	65,266	N/A	N/A
Distressed Debt Funds	(e)	6,889	-	N/A	N/A
Real Estate Funds	(f)	<u>20,121</u>	<u>16,856</u>	N/A	N/A
Total		<u>\$314,416</u>	<u>\$126,902</u>		

- (a) This category includes hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The hedge funds' composite portfolio for this category includes investments in U.S. common stocks, credit instruments, and arbitrage investments. The lockup period has expired for these investments. The fair values of the investments in this category have been estimated using the net asset value per share of the investments.
- (b) This category invests in private equity transactions such as growth equity financing, leveraged buyouts, acquisitions and/or industry consolidations, recapitalizations, and restructurings. The fund seeks to earn returns substantially above those on publicly traded stocks over a long-term (seven- to 10-year) horizon. Due to the nature of investments in this category, distributions are received through the liquidation of the underlying assets for the fund and would be liquidated over five to 10 years. It is probable that all of the investments in this category will be sold at an amount different from the net asset value of the Museum's ownership interest in partners' capital.
- (c) These venture capital funds invest in early-stage, high-growth private companies, principally in the information technology and life sciences/health care fields. Due to the nature of investments in this category, distributions are received through the liquidation of the underlying assets of the fund and would be liquidated over five to 10 years. It is probable that all of the investments in this category will be sold at an amount different from the net asset value of the Museum's ownership interest in partners' capital.

- (d) This category invests in exploration and production companies, midstream companies, royalty interests, and other natural resource-focused companies. Due to the nature of investments in this category, distributions are received through the liquidation of the underlying assets of the fund. It is probable that all of the investments in this category will be sold at an amount different from the net asset value of the Museum's ownership interest in partners' capital.
- (e) This category invests in financially distressed companies or companies in Chapter 11, concentrating on senior and secured debt instruments and U.S. private subordinated debt securities with significant equity components. Due to the nature of investments in this category, distributions are received through the liquidation of the underlying assets of the fund. It is probable that all of the investments in this category will be sold at an amount different from the net asset value of the Museum's ownership interest in partners' capital.
- (f) This category invests in private equity and debt of real estate investments in the office, industrial, multifamily, hotel, and retail segments. Due to the nature of investments in this category, distributions are received through the liquidation of the underlying assets of the fund. It is probable that all of the investments in this category will be sold at an amount different from the net asset value of the Museum's ownership interest in partners' capital.

The allocation of investments held by the Museum to the various endowments, operations, accessions, and plant accounts as of June 30, 2014, is as follows:

	Cost	Market Value
Operations Endowment Investment Accounts:		
Museum:		
Brown Foundation Maintenance Endowment	\$ 32,722	\$ 131,416
The General and Mrs. Maurice Hirsch Library Endowment	8,792	22,055
The Caroline Wiess Law Operating Endowment	320,088	377,452
Alice Pratt Brown, "Brown Wing" Endowment	6,533	32,568
Jesse H. and Mary Gibbs Jones Exhibition Endowment	2,693	9,288
Permanent Endowment	3,066	19,981
Robert A. Welch - Works of Art Restoration Endowment	1,508	5,742
Gus and Lyndall Wortham Curatorial Chair Endowment	1,125	3,879
Cullinan Wing Endowment	526	2,946
William Randolph Hearst Educational Outreach Endowment	526	1,116
Harry C. Wiess Memorial Endowment	181	1,031
Frank and Eleanor Freed Lecture Series Endowment	134	276
Shell Companies Exhibition Endowment	101	347
Alice Pratt Brown Garden Endowment	47	124
The Fondren Foundation Education Endowment	516	661
National Endowment for the Humanities - Education Endowment	606	895
The Caroline Wiess Law Education Endowment	1,477	2,452
B.M.C. Software, Inc. Education Endowment	509	632
The Wortham Foundation Audrey Jones Beck Building Endowment	4,103	5,211
Garden Endowment	20	70
Houston Antiques Dealers Association Endowment	116	162
Fayez Shalaby Sarofim and Meredith J. Long Endowment Fund for Exhibitions	1,006	1,255
Ralph S. O'Connor Statue Maintenance Endowment	32	39
The Virginia and Ira Jackson Lecture on Prints and Drawings Endowment	187	221
National Endowment for the Arts - Planning and Stabilization	311	335
Favrot Education Endowment Fund	101	109
The Wallace Foundation Education Endowment	553	608
W. T. and Louise J. Moran Education Director Endowment	3,389	4,379
The Carol Crow Photography Conservator Chair Endowment	1,512	2,092
Latin American and Latino Art Curator Endowment	1,509	1,902
The Margaret Cooke Skidmore Endowed Exhibition Fund	247	329
Frank and Eleanor Carroll Lecture Fund	4	4
Audrey Jones Beck European Art Curator Endowment	2,021	1,992
Audrey Jones Beck Capital Campaign Endowment	3,032	2,988
Beth B. Schneider Endowed Summer Internship Fund	22	22
Alfred C. Glassell, Jr. Endowment Fund for The Museum of Fine Arts, Houston	11,250	16,305
Neal Myers and Ken Black Children's Art Fund	194	343
The John C. Wynne Memorial Lecture Series for Arts Education	31	36
John Blodgett Davis Endowment Fund	537	589
The Cyvia and Melvyn Wolff Endowment for Exhibitions	216	235
	<hr/>	<hr/>
Total Museum	411,543	652,087

(Continued)

	Cost	Market Value
Bayou Bend Collection and Gardens:		
Bayou Bend Trust Endowment	\$ 3,457	\$ 14,470
Bayou Bend Endowments	3,225	10,365
David B. Warren Symposium Endowment	268	349
The Carol and Les Ballard Endowed Lecture Series	258	302
Underwood Bayou Bend Annual Gift Endowment	68	183
The Judy and Charles Tate Education Endowment	104	123
Bayou Bend 50th Anniversary Endowment	112	114
The Twinkle Fund in support of operations for Bayou Bend Collection and Gardens	21	23
The Sparkle Fund in support of education programs for the docents at Bayou Bend Collection and Gardens	<u>5</u>	<u>6</u>
Total Bayou Bend Collection and Gardens	<u>7,518</u>	<u>25,935</u>
Glassell School of Art:		
Alfred C. Glassell, Jr. Endowment Fund	10,051	14,602
Glassell School Endowments	1,881	6,063
Glassell Scholarship Endowments	2,330	3,768
Glassell School Special Endowment	<u>1</u>	<u>2</u>
Total Glassell School of Art	<u>14,263</u>	<u>24,435</u>
Rienzi:		
The Carroll Sterling and Harris Masterson III Endowment	5,495	12,766
The Caroline Wiess Law Endowment	5,406	10,791
Rienzi Garden Endowment Fund	<u>374</u>	<u>374</u>
Total Rienzi	<u>11,275</u>	<u>23,931</u>
Total Operations Endowment Investment Accounts	<u>444,599</u>	<u>726,388</u>
Accessions Endowment Investment Accounts:		
Brown Foundation Accessions Endowment	12,350	52,386
Alice Pratt Brown Museum Endowment	9,440	48,434
Agnes Cullen Arnold Endowment	4,338	26,980
Caroline Wiess Law Accessions Endowment	205,104	244,404
Director's Accessions Endowment	2,132	15,311
Alvin S. Romansky Print Accessions Endowment	1,043	2,781
S. I. Morris Photography Endowment	268	887
Long American Art Endowment	230	1,222
The Marjorie G. and Evan C. Horning Print Fund	105	392
Audrey Jones Beck Accessions Endowment	8,923	11,823
Photography Endowment	16	22
Mundy Photography Department Endowment	131	146
W. H. Keenan Family Endowment Fund	399	486
Bayou Bend Docent Organization Endowment Fund	101	120
Marian and Speros Martel Early Americana Accessions Endowment Fund Honoring William S. Kilroy	152	170
Jack R. McGregor Endowment Fund For Glass	273	321

(Continued)

	Cost	Market Value
Decorative Arts Accessions Endowment Fund	\$ 53	\$ 79
Elizabeth S. and Marjorie G. Horning Asian Art Accessions Endowment Fund	106	147
The Ann Gordon Trammell American Art Endowment Fund	179	214
Lora Jean Kilroy Accessions Endowment	507	575
The Pamela and David Ott American Art Endowment	131	149
Marjorie & Evan Horning Endowment For Decorative Arts	35	47
Alice C. Simkins Drawing Endowment Fund	181	221
The Gloria Garic Anderson Endowment Fund For Accessions For Bayou Bend	109	132
Myron Bonham Deily Endowment Fund For Latin American Art	255	271
Houston Junior Woman's Club Charitable Fund -- An Endowment Fund for Bayou Bend Accessions	92	101
The Toni and Ralph Wallingford Accessions Endowment for Bayou Bend	52	52
The Carol Jean and Michael Moehlman Bayou Bend Accessions Endowment Fund	53	65
Linda and Ronny Finger Endowment Fund	15	21
The Ira and Virginia Jackson Endowment Fund	120	133
Rienzi Collections Endowment Fund	190	205
Alfred C. Glassell, Jr. Endowment Fund for Accessions	33,749	48,916
Michael K. Brown Metals Endowment Fund	121	143
The Alice C. Simkins Endowment for Southern Art for Bayou Bend	54	58
Lynn and Marcel Mason Photography Endowment Fund	29	32
The Cyvia and Melvyn Wolff Endowment for American Art	<u>868</u>	<u>937</u>
Total accessions endowment investment accounts	281,904	458,383
Total investments within operations accounts	9,699	9,699
Total investments within accessions accounts	10,555	10,555
Total investments within plant account	<u>1,819</u>	<u>2,671</u>
Total investments	<u>\$748,576</u>	<u>\$1,207,696</u>

(Concluded)

5. PLEDGES RECEIVABLE

As of June 30, 2014, the Museum had unconditional pledges receivable of \$115,764. Pledges receivable—net represents the present value of future cash flows, discounted at the average five-year Treasury bill rate (1.68% as of June 30, 2014), and are as follows:

Due within one year	\$ 26,729
Due within two to five years	85,502
Due after five years	<u>3,533</u>
Total	115,764
Less present value discount	<u>(3,081)</u>
Pledges receivable—net	<u>\$ 112,683</u>

6. PROPERTY

Property as of June 30, 2014, is as follows:

Land	\$ 28,362
Buildings and capital improvements	166,391
Equipment, furniture, and fixtures	<u>14,238</u>
Total	208,991
Less accumulated depreciation	<u>(84,922)</u>
Total	<u>\$ 124,069</u>

7. PENSION PLAN

The Museum has a money-purchase defined contribution pension plan (the "Plan") covering substantially all of its regular full and part-time employees. The Plan provides for employee contributions of up to 100% of compensation, up to the maximum dollar limit, which is set by the Internal Revenue Service, and employer contributions of 5% of the employee's compensation. Museum contributions are fully vested immediately upon the employee's participation. The Museum's policy is to currently fund accrued pension cost. The total pension expense for the year ended June 30, 2014, was \$855 which is included as part of employee benefits expense.

8. RELATED-PARTY TRANSACTIONS

The Museum bylaws incorporate a conflict of interest policy. The purpose of this article is to protect the Museum's interest when it is contemplating a transaction or arrangement that might benefit the private interest of a member of its Board of Trustees, officer, director, or associate director of the Museum or a voting member of a committee with board-delegated powers. A person who has a financial interest may have a conflict of interest only if the Board of Trustees or appropriate committee decides that a conflict of interest exists. All members of the board, professional staff, and committee consultants complete a conflict of interest document when joining the institution and/or annually and/or when changes occur.

9. CAPITAL AND OPERATING LEASE COMMITMENTS

The Museum financed the purchase of certain equipment through capital lease obligations with a principal amount of \$2,903. The imputed interest is approximately 4.5% per annum. The equipment was placed in service during the year ended June 30, 2014, and has an estimated useful life of 3 to 5 years.

The capital leases will be repaid as follows:

Years Ending June 30	
2015	\$ 793
2016	793
2017	789
2018	437
2019	<u>314</u>
Capital lease obligation including interest	3,126
Less: interest	<u>(223)</u>
Total capital lease obligation	<u><u>\$ 2,903</u></u>

The Museum has various noncancelable operating lease commitments as of June 30, 2014, payable as follows:

Years Ending June 30	
2015	\$ 273
2016	129
2017	113

Rental expense under these leases for the year ended June 30, 2014, was \$274.

10. NET ASSETS

Temporarily and permanently restricted net assets as of June 30, 2014, were restricted for the following uses:

	Temporarily Restricted	Permanently Restricted
Operations and operations endowment	\$ 126,272	\$ 417,288
Accessions and accessions endowment	207,926	268,438
Plant	<u>175,217</u>	<u>-</u>
Total	<u><u>\$ 509,415</u></u>	<u><u>\$ 685,726</u></u>

Included in operations and accession endowments are various contributions and other inflows of assets that are maintained in donor accounts, which are restricted by donor-imposed stipulations to be used, or income from such assets to be used, for various operations and accession activities of the Museum, including activities of Bayou Bend Collection and Gardens, Glassell School of Art, and Rienzi. Included in plant accounts are various pledges received that are temporarily restricted to be used by the Museum for various plant activities.

* * * * *