

**THE HEARD MUSEUM AND AFFILIATE
CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED SEPTEMBER 30, 2018 AND 2017**

CliftonLarsonAllen LLP



WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING



**THE HEARD MUSEUM AND AFFILIATE
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YEARS ENDED SEPTEMBER 30, 2018 AND 2017**

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
The Heard Museum and Affiliate
Phoenix, Arizona

We have audited the accompanying consolidated financial statements of The Heard Museum and Affiliate, which comprise the consolidated statements of financial position as of September 30, 2018 and 2017, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Board of Trustees
The Heard Museum and Affiliate

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Heard Museum and Affiliate as of September 30, 2018 and 2017, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Phoenix, Arizona
January 24, 2019

**THE HEARD MUSEUM AND AFFILIATE
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2018 AND 2017**

ASSETS	2018	2017
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 269,461	\$ 461,830
Receivables	8,788	15,075
Pledges Receivable	490,568	96,000
Merchandise Inventories, Net	1,274,074	1,252,997
Prepaid Expenses	221,076	135,164
Total Current Assets	2,263,967	1,961,066
PLEDGES RECEIVABLE, Net	260,651	175,915
INVESTMENTS	10,775,508	11,084,583
RESTRICTED ASSETS		
Cash	1,552,754	1,455,283
PROPERTY AND EQUIPMENT, Net	15,703,935	17,171,766
OTHER ASSETS, Net	2,441	3,544
Total Assets	\$ 30,559,256	\$ 31,852,157
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts Payable and Accrued Expenses	\$ 482,828	\$ 527,609
Deferred Income	533,516	504,112
Lines of Credit	469,000	800,536
Deposits	62,606	70,455
Total Current Liabilities	1,547,950	1,902,712
GIFT ANNUITY PAYABLE	20,904	22,678
Total Liabilities	1,568,854	1,925,390
NET ASSETS		
Unrestricted Net Assets:		
Undesignated	15,831,939	17,133,596
Board Designated for Endowment	1,638,407	2,191,828
Board Designated Reserves	1,404,873	1,404,536
Total Unrestricted Net Assets	18,875,219	20,729,960
Restricted Net Assets:		
Temporarily	2,743,354	1,831,478
Permanently	7,371,829	7,365,329
Total Restricted Net Assets	10,115,183	9,196,807
Total Net Assets	28,990,402	29,926,767
Total Liabilities and Net Assets	\$ 30,559,256	\$ 31,852,157

See accompanying Notes to Consolidated Financial Statements.

**THE HEARD MUSEUM AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
YEAR ENDED SEPTEMBER 30, 2018**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES AND SUPPORT				
Revenues:				
Museum Shop and Bookstore Sales	\$ 3,023,218	\$ -	\$ -	\$ 3,023,218
Membership Dues	851,700	-	-	851,700
Admissions	893,208	-	-	893,208
Private Use Fees	499,067	-	-	499,067
Café Revenue	662,040	-	-	662,040
Educational Programs	1,930	-	-	1,930
Other Revenues	25,580	-	-	25,580
Total Revenues	5,956,743	-	-	5,956,743
Public Support:				
Individuals	346,665	263,167	6,000	615,832
Foundations	17,000	1,690,000	500	1,707,500
Government	80,595	213,569	-	294,164
Corporate Sponsorship	72,236	65,400	-	137,636
Contributed Goods and Services	157,938	-	-	157,938
Guild Event Revenue	504,650	1,000	-	505,650
Total Public Support	1,179,084	2,233,136	6,500	3,418,720
Special Events:				
Revenues from Special Events	655,617	-	-	655,617
Less: Costs of Direct Donor Benefits	(97,821)	-	-	(97,821)
Gross Profit from Special Events	557,796	-	-	557,796
Total Revenues and Support	7,693,623	2,233,136	6,500	9,933,259
Net Assets Released from Restriction	1,959,244	(1,959,244)	-	-
OPERATING EXPENSES				
Cost of Goods Sold	1,658,966	-	-	1,658,966
Education Costs	1,186,256	-	-	1,186,256
Shop Operations	595,672	-	-	595,672
Curatorial Costs	815,407	-	-	815,407
Exhibit Costs	674,264	-	-	674,264
Café Operations	662,873	-	-	662,873
Members Programs	358,985	-	-	358,985
Admissions	177,168	-	-	177,168
Facilities	1,255,068	-	-	1,255,068
Depreciation and Amortization	1,778,728	-	-	1,778,728
Administration	1,434,509	-	-	1,434,509
Development	449,800	-	-	449,800
Marketing	264,664	-	-	264,664
Private Use	314,575	-	-	314,575
Total Operating Expenses	11,626,935	-	-	11,626,935
CHANGE IN OPERATING NET ASSETS	(1,974,068)	273,892	6,500	(1,693,676)
NONOPERATING ACTIVITIES				
Investment Income	119,327	644,510	-	763,837
Change in Value of Gift Annuity	-	(6,526)	-	(6,526)
	119,327	637,984	-	757,311
CHANGES IN NET ASSETS	(1,854,741)	911,876	6,500	(936,365)
Net Assets - Beginning of Year	20,729,960	1,831,478	7,365,329	29,926,767
NET ASSETS - END OF YEAR	<u>\$ 18,875,219</u>	<u>\$ 2,743,354</u>	<u>\$ 7,371,829</u>	<u>\$ 28,990,402</u>

See accompanying Notes to Consolidated Financial Statements.

**THE HEARD MUSEUM AND AFFILIATE
CONSOLIDATED STATEMENT OF ACTIVITIES
YEAR ENDED SEPTEMBER 30, 2017**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES AND SUPPORT				
Revenues:				
Museum Shop and Bookstore Sales	\$ 3,521,406	\$ -	\$ -	\$ 3,521,406
Memberships Dues	766,654	-	-	766,654
Admissions	2,368,801	-	-	2,368,801
Private Use Fees	505,660	-	-	505,660
Café Revenue	844,100	-	-	844,100
Educational Programs	3,279	-	-	3,279
Other Revenues	36,606	-	-	36,606
Total Revenues	8,046,506	-	-	8,046,506
Public Support:				
Individuals	4,033,535	410,425	2,410,000	6,853,960
Foundations	1,293	741,816	-	743,109
Government	83,218	21,828	-	105,046
Corporate Sponsorship	71,420	287,621	-	359,041
Contributed Goods and Services	214,005	-	-	214,005
Guild Event Revenue	478,171	-	-	478,171
Total Public Support	4,881,642	1,461,690	2,410,000	8,753,332
Special Events:				
Revenues from Special Events	526,640	-	-	526,640
Less: Costs of Direct Donor Benefits	(107,737)	-	-	(107,737)
Gross Profit from Special Events	418,903	-	-	418,903
Total Revenues and Support	13,347,051	1,461,690	2,410,000	17,218,741
Net Assets Released from Restriction	4,032,318	(3,782,318)	(250,000)	-
OPERATING EXPENSES				
Cost of Goods Sold	1,994,889	-	-	1,994,889
Education Costs	946,087	-	-	946,087
Shop Operations	630,496	-	-	630,496
Curatorial Costs	680,633	-	-	680,633
Exhibit Costs	1,030,709	-	-	1,030,709
Café Operations	735,871	-	-	735,871
Members Programs	284,969	-	-	284,969
Admissions	219,901	-	-	219,901
Facilities	1,291,062	-	-	1,291,062
Depreciation and Amortization	1,727,321	-	-	1,727,321
Administration	1,464,822	-	-	1,464,822
Development	410,100	-	-	410,100
Marketing	337,279	-	-	337,279
Private Use	269,327	-	-	269,327
Total Operating Expenses	12,023,466	-	-	12,023,466
CHANGE IN OPERATING NET ASSETS	5,355,903	(2,320,628)	2,160,000	5,195,275
NONOPERATING ACTIVITIES				
Investment Income	359,117	521,454	-	880,571
Change in Value of Gift Annuity	-	(5,223)	-	(5,223)
	359,117	516,231	-	875,348
CHANGES IN NET ASSETS	5,715,020	(1,804,397)	2,160,000	6,070,623
Net Assets - Beginning of Year	15,014,940	3,635,875	5,205,329	23,856,144
NET ASSETS - END OF YEAR	<u>\$ 20,729,960</u>	<u>\$ 1,831,478</u>	<u>\$ 7,365,329</u>	<u>\$ 29,926,767</u>

See accompanying Notes to Consolidated Financial Statements.

**THE HEARD MUSEUM AND AFFILIATE
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2018 AND 2017**

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	\$ (936,365)	\$ 6,070,623
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization	1,778,728	1,727,321
Contributions Restricted for Investment in Endowments	(6,500)	(2,410,000)
Unrealized and Realized Gain on Investments	(621,443)	(785,839)
Changes in Value of Gift Annuity Payable, Net of Payments	(1,774)	(3,908)
Increase (Decrease) in Cash Resulting from Changes In:		
Receivables	6,287	8,092
Pledges Receivable	(473,540)	167,687
Merchandise Inventories	(21,077)	357,464
Prepaid Expenses	(85,912)	83,499
Other Assets	-	-
Accounts Payable and Accrued Expenses	(44,781)	(601,630)
Deferred Income	29,404	62,069
Deposits	(7,849)	11,400
Net Cash Provided (Used) by Operating Activities	(390,586)	4,686,778
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales of Investments	3,650,405	8,166,823
Purchase of Investments	(2,719,887)	(13,154,481)
Purchases of Property and Equipment	(309,794)	(2,422,721)
Increase in Cash Restricted to Investment in Property and Equipment	(97,471)	717,849
Net Cash Provided (Used) by Investing Activities	523,253	(6,692,530)
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions Restricted for Investment in Endowments	6,500	2,410,000
Net Change in Lines of Credit	(331,536)	(297,173)
Repayments on Notes Payable	-	(28,674)
Net Cash Provided (Used) by Financing Activities	(325,036)	2,084,153
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(192,369)	78,401
Cash and Cash Equivalents - Beginning of Year	461,830	383,429
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 269,461	\$ 461,830
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Paid for Interest	\$ 27,285	\$ 47,822

See accompanying Notes to Consolidated Financial Statements.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Heard Museum is an institution incorporated in 1929 as an Arizona nonprofit corporation. The Heard Museum creates and presents exhibitions that are drawn from or inspired by American Indian art and culture, that are visually and intellectually stimulating, cost-effective and that attract the broadest possible audience both in Phoenix and abroad whilst setting new standards for excellence in scholarship, educational programming, community outreach, and visitor experience. The Heard Museum Guild and the Heard Museum Council are volunteer organizations that support and aid the work of the board of trustees and the staff of The Heard Museum and which are included in the records of The Heard Museum and are not separate legal entities.

Heard Family Trust (the Trust) is an irrevocable perpetual trust that was created by the Heard family for the benefit of The Heard Museum. The Trust is administered by JP Morgan Chase, an outside trustee. Effective October 2015, the administration of the Trust was moved to Texas. The Trust has elected to be classified as a private foundation and is subject to excise taxes.

The significant accounting policies are as follows:

Consolidated Financial Statements

The consolidated financial statements include the accounts of The Heard Museum, Guild, Council, and the Trust (collectively referred to as the Museum). All of the financial activities and balances of these organizations are included in these consolidated financial statements. All significant interorganization accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Museum's consolidated financial statements have been prepared in accordance with the American Institute of Certified Public Accountants (AICPA) Not-For-Profit Industry Guidance within the Financial Accounting Standards Board (FASB) Codification (Guidance). Under the Guidance, the Museum is required to provide financial statements which are prepared to focus on the Museum as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions in three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets as follows:

Unrestricted Net Assets – Unrestricted net assets are not subject to donor-imposed stipulations and are those currently available at the discretion of the board of trustees for use in the Museum's operations, in accordance with its bylaws.

Temporarily Restricted Net Assets – Temporarily restricted net assets are those whose uses are subject to donor-imposed stipulations that will be met by the Museum and/or the passage of time.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

Permanently Restricted Net Assets – Permanently restricted net assets are those which represent permanent endowments where it is stipulated by donors that the principal remain in perpetuity and only the income is available as unrestricted or temporarily restricted, as per the endowment agreements.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted explicitly by donor stipulation or by law. Expirations of temporary restrictions on net assets, i.e., the donor stipulated purpose has been fulfilled and/or the stipulated time period has elapsed, are reported as reclassifications to unrestricted net assets.

Use of Estimates in the Preparation of Consolidated Financial Statements

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid financial instruments purchased with original maturities of three months or less.

Receivables

Receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and an increase to a valuation allowance based upon its assessment of the current status of individual balances. Account balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a reduction of accounts receivables. At September 30, 2018 and 2017, the allowance for doubtful accounts was \$-0-.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pledges Receivable

Unconditional promises to give (pledges receivable) that are to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are initially recorded at the fair value, calculated as the net present value of their estimated future cash flows as of the date of the promise to give.

Merchandise Inventories

Merchandise inventories consist of books, gift items, and art-related objects held for resale and are carried at the lower of cost as determined by the specific identification method or net realizable value for purchased goods. Contributed goods held for sale are recorded at fair value. Inventory consists of the following:

	<u>2018</u>	<u>2017</u>
Jewelry	\$ 576,357	\$ 556,154
Kachinas	91,243	98,704
Pottery and Baskets	160,458	129,588
Textiles	183,579	158,139
Publications	88,119	105,442
Other	264,161	283,541
Inventory Valuation Reserve	(89,843)	(78,571)
Total	<u>\$ 1,274,074</u>	<u>\$ 1,252,997</u>

Inventory items, with the exception of publications and some sundries, are purchased from American Indian artists. In addition, the Museum shop sells American Indian art items on consignment; such consignment items are not reflected in the inventory balance. At September 30, 2018 and 2017, the shop held \$1,213,775 and \$1,312,615 of consignments respectively.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments

Investments, consisting primarily of equity securities, corporate bonds, and mutual funds with readily determinable market values are measured at fair value as of year-end in the consolidated statements of financial position. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) are recognized in the consolidated statements of activities. Investments in equity securities with readily determinable fair values and all investments in debt securities are presented at fair value in the consolidated statements of financial position as determined by available market prices.

Investments are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in risk in the near term could materially affect account balances and the amounts reported in the accompanying consolidated financial statements.

Restricted Assets

Certain contributions of cash were restricted by the donors or designated by the board for investment in exhibits and various property improvements.

Property and Equipment

Purchased property and equipment is stated at cost. Maintenance and repairs are charged to operations when incurred. Betterments and renewals in excess of \$2,000 are capitalized. When property and equipment is sold or otherwise disposed of, the asset and related accumulated depreciation and amortization accounts are relieved, and any gain or loss is included in operations. Leasehold improvements are amortized over the shorter of the useful lives of the improvements or the lease terms. Depreciation and amortization of property and equipment are computed on a straight-line basis over the respective useful lives of the assets, which range from 3 to 40 years, as follows:

Buildings	35 to 40 Years
Building Improvements	2 to 20 Years
Furniture, Fixtures, and Equipment	3 to 10 Years
Long-Term Exhibits	5 to 15 Years
Software	3 to 5 Years

Donations of property and equipment are recorded as contributions at their estimated fair value at the date of donation.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of Long-Lived Assets

The Museum reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Management does not believe impairment indicators are present.

Revenue Recognition

Admissions revenue consists of ticket sales and is recognized when the tickets are sold. Museum shop and bookstore sales consist of retail sales which are recognized when goods are sold. Private use fees consist of rentals of the Museum facilities for private functions and are recognized as the events occur. Educational programs revenue consists of educational program income and publication sales and is recognized as the events occur or when publications are sold. Café revenue consists of food and beverage sales in the Museum cafes which are recognized at the time of sale.

Membership Dues

Membership dues, which are assessed annually, are recorded as deferred membership income at the renewal period and accreted as revenue ratably over the membership period.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a 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 consolidated statement of activities as net assets released from restrictions.

Special Events Revenue

The Museum conducts special events in which a portion of the gross proceeds paid by the participant represents payments for the benefits received by the participant at the event. The fair value of meals and entertainment provided at special events is generally measured at the actual cost to the Museum. The direct costs of the special events which ultimately benefit the donor rather than the Museum are recorded as special events costs, specifically direct donor benefits. All proceeds received in excess of the direct costs are recorded as gross profit from special events in the accompanying consolidated statements of activities.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Collections

The collections of the Museum include several categories of Native American art, primarily kachina dolls, baskets, jewelry, textiles, ceramics, and fine art, as well as collections from other indigenous peoples of Latin America, Africa and Oceania, and are expensed in the period purchased. In conformity with the practice followed by many museums, art objects contributed to the Museum are not included in the accompanying consolidated financial statements. Furthermore, in conformity with industry practice, the Museum has not recorded the value of its collections on the consolidated statements of financial position. The fair value of certain collections is determined based on third-party evidence of comparable art sold through auction houses. The fair value of collections contributed to the Museum during the years ended September 30, 2018 and 2017 were \$417,376 and \$446,780, respectively.

Donated Services

Donated professional services are recorded as contributions in the accompanying consolidated financial statements at their estimated fair value if the services (a) enhance the Museum's nonfinancial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased if not provided by donation. No amounts have been reflected in the consolidated financial statements for certain donated volunteer services because they did not qualify for recording under the generally accepted accounting principle guidelines; however, a substantial number of volunteers have donated significant amounts of their time to the Museum's program services and fundraising campaigns, primarily through the Heard Museum Guild and the Heard Museum Council.

Advertising

The Museum uses advertising to promote its programs to the various groups it serves. The advertising costs are charged to operations as incurred. Advertising expense charged to operations for the years ended September 30, 2018 and 2017 were \$209,194 and \$296,652, respectively.

Income Taxes

The Heard Museum qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (IRC) and the Trust qualifies as a charitable trust under Section 4947(a)(i) of the IRC and accordingly, there is no provision for income taxes. In addition, The Heard Museum qualifies for the charitable contribution deduction under Section 170 of the IRC and has been classified as an organization that is not deemed to be a private foundation. Income determined to be unrelated business taxable income (UBTI) would be taxable.

The Museum evaluates its uncertain tax positions, if any, on a continual basis through review of its policies and procedures, review of its regular tax filings, and discussions with outside experts. Management believes that the Heard Museum and the Trust have no uncertain tax positions as of September 30, 2018 and 2017.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassification

Certain items in the prior year consolidated financial statements have been reclassified to conform to the current year's presentation. These reclassifications had no effect on total assets or changes in net assets as previously reported.

Subsequent Events

Management has evaluated subsequent events through January 24, 2019, the date the consolidated financial statements were available to be issued. There were no material subsequent events that required recognition or additional disclosure in these financial statements.

NOTE 2 PLEDGES RECEIVABLE

Pledges receivable consist of unconditional promises to give as follows:

	2018	2017
Unconditional Promises to Give Due in Less Than One Year	\$ 490,568	\$ 96,000
Unconditional Promises to Give Due in Two to Five Years	293,500	203,000
	784,068	299,000
Less: Discount to Present Value	(32,849)	(27,085)
	751,219	271,915
Current Portion	(490,568)	(96,000)
Noncurrent Portion	\$ 260,651	\$ 175,915

The estimated cash flows for pledges were discounted over the collection period using a management-determined discount rates ranging from 5.98% to 6.18%. As of September 30, 2018 and 2017, the allowance for uncollectible pledges was \$-0-.

NOTE 3 INVESTMENTS

Investments consist of the following:

	2018	2017
Equity Securities	\$ 4,696,706	\$ 4,174,903
Mutual Funds	5,063,500	5,098,507
Cash and Cash Equivalents Held for Reinvestment	344,779	646,706
Corporate Bonds	347,658	1,074,866
Investment Held by Arizona Community Foundation	89,354	89,601
Alternative Assets - Hedge Funds	233,511	-
Total	\$ 10,775,508	\$ 11,084,583

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 3 INVESTMENTS (CONTINUED)

Investment income, which includes realized and unrealized gains and losses that are included as part of the change in unrestricted net assets consist of the following:

	2018	2017
Net Realized/Unrealized Investment Gains	\$ 621,443	\$ 785,839
Dividend and Interest Income	235,771	162,725
Investment Advisory Fees	(93,377)	(67,993)
Total	\$ 763,837	\$ 880,571

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS

In determining fair value, the Museum uses various valuation approaches within the fair value measurement framework. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Museum has the ability to access.

Level 2 – Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable, such as pricing models, discounted cash flow models and similar techniques not based on market, exchange, dealer or broker-traded transactions.

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

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Following is a description of the valuation methodologies used for assets measured at fair value:

Equity Securities, Mutual Funds, Corporate Bonds and Alternative Investments: Valued at the last sales price, or if there is no sale and the market is still considered active, at the last transaction price before year-end. Such securities are classified within level 1 of the valuation hierarchy.

Pooled Investments: The Heard also invests in the Arizona Community Foundation, Inc. (ACF) pool. The fair value of these investment is based on its investment percentage in the investment pool. The ACF pool is invested in cash, equity securities, bonds, and other investments. This investment is classified within Level 3 of the valuation hierarchy.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Heard 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 fair value measurement at the reporting date.

The following table presents assets and liabilities measured at fair value by classification within the fair value hierarchy as of September 30, 2018:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity Securities	\$ 4,696,706	\$ -	\$ -	\$ 4,696,706
Mutual Funds:				
Equity Funds	2,343,869	-	-	2,343,869
Bond Funds	2,719,631	-	-	2,719,631
Corporate Bonds	338,452	9,206	-	347,658
Alternative Assets:				
Hedge Funds	233,511	-	-	233,511
Pooled Investments:				
Arizona Community Foundation	-	-	89,354	89,354
Total	<u>\$ 10,332,169</u>	<u>\$ 9,206</u>	<u>\$ 89,354</u>	<u>\$ 10,430,729</u>

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 4 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following table presents assets and liabilities measured at fair value by classification within the fair value hierarchy as of September 30, 2017:

	Level 1	Level 2	Level 3	Total
Equity Securities	\$ 4,174,903	\$ -	\$ -	\$ 4,174,903
Mutual Funds:				
Equity Funds	1,704,576	-	-	1,704,576
Bond Funds	3,393,931	-	-	3,393,931
Corporate Bonds	1,065,685	9,181	-	1,074,866
Pooled Investments:				
Arizona Community Foundation	-	-	89,601	89,601
Total	<u>\$ 10,339,095</u>	<u>\$ 9,181</u>	<u>\$ 89,601</u>	<u>\$ 10,437,877</u>

The Museum did not have any other assets or liabilities subject to fair value measurement at September 30, 2018 and 2017.

The table below presents the change in fair value measurements that used Level 3 inputs during the year ended September 30:

	2018	2017
Balance on October 1,	\$ 89,601	\$ 83,973
Net Realized/Unrealized Investment Gains	2,884	8,716
Dividend and Interest Income	1,286	1,262
Investment Advisory Fees	(717)	(650)
Investment Draw	(3,700)	(3,700)
Balance on September 30	<u>\$ 89,354</u>	<u>\$ 89,601</u>

NOTE 5 PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	2018	2017
Land and Buildings	\$ 22,512,378	\$ 22,512,378
Buildings Improvements	6,886,321	6,746,972
Furniture, Fixtures, and Equipment	3,783,884	3,694,309
Long-Term Exhibits	9,492,774	9,492,774
Software	130,472	130,472
Construction in Progress	90,458	9,588
Total	<u>42,896,287</u>	<u>42,586,493</u>
Less: Accumulated Depreciation and Amortization	<u>(27,192,352)</u>	<u>(25,414,727)</u>
Total Property and Equipment, Net	<u>\$ 15,703,935</u>	<u>\$ 17,171,766</u>

THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017

NOTE 5 PROPERTY AND EQUIPMENT (CONTINUED)

Depreciation and amortization expense charged to operations for the year ended September 30, 2018 and 2017 was \$1,778,728 and \$1,727,321, respectively.

Construction in progress as of September 30, 2018 relates primarily to upgrades in the boarding school exhibit. Construction in progress as of September 30, 2017 related primarily to upgrades in the boarding school exhibit. Interest expense has not been capitalized on the construction in progress due to its immateriality.

NOTE 6 LINES OF CREDIT, BANK

As of September 30, 2017, the Museum had a revolving line of credit with a maximum borrowing limit of \$800,000 and a nonrevolving line of credit with a maximum borrowing limit of \$603,541. The lines of credit were closed in January 2018 prior to the set maturity date, and were secured by receivables, merchandise inventory, and property and equipment, and interest was payable monthly at a rate equal to the index (prime rate). The index for the year ended September 30, 2017 was 4.25%. The lines of credit were subject to certain financial covenants. The outstanding balance on the revolving line of credit and the nonrevolving line of credit was \$300,000 and \$500,536, respectively, at September 30, 2017.

As of January 31, 2018, the lines of credit were refinanced with a different lender and the previous lines of credit were closed. The Museum established a revolving line of credit with a maximum borrowing limit of \$800,000 and interest only payments due monthly until maturity in January 2019 at which time any outstanding advances and accrued interest are due in full. In January 2019, the revolving line of credit was renewed under essentially the same terms and conditions and extending the maturity date to January 2020. Additionally, a term loan was established in the amount of \$369,000 with interest only payments due for one year and then principal and interest payments due for five years until maturity in January 2024. Interest on both the revolving line of credit and term loan is based on a floating rate equal to the Wall Street Journal prime rate minus 0.75%, which was 4.50% as of September 30, 2018. The line of credit and term loan are secured by a first priority lien on all chattel paper, accounts, equipment, fixtures, general intangibles, and all nonaccessioned shop inventory and are subject to certain financial covenants. The outstanding balance on the revolving line of credit and the term loan was \$100,000 and \$369,000, respectively, at September 30, 2018.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 7 SPLIT-INTEREST AGREEMENTS

Charitable gift annuities are arrangements between a donor and the Museum in which the donor contributes assets in exchange for a promise from the Museum to pay the donor a fixed amount for a specified period of time. Assets received have been recognized at fair value, and an annuity payment liability has been recognized at the present value of the future cash flows expected to be paid. Contribution support is recognized as the difference between these two amounts. The life expectancy tables published by the Internal Revenue Service and a 3.20% discount rate were used to calculate the present value of the charitable gift annuities. As of September 30, 2018 and 2017, the annuity payable was \$20,904 and \$22,678, respectively.

The Museum reports contribution support from split-interest agreements in contributions and donations in the accompanying consolidated statements of activities. The change in investment valuation of split-interest agreements is reported in investment income in the accompanying consolidated statements of activities.

NOTE 8 UNRESTRICTED BOARD DESIGNATED NET ASSETS

Unrestricted board designated net assets consist of amounts designated as long-term investments for the purpose of building an endowment fund to secure the future of the Museum's mission. The earnings from the long-term investments are currently being reinvested and are also designated for this purpose. Additionally, unrestricted board designated net assets consist of amounts that are held in investment accounts for purposes as designated by the board. Interest income earned on these accounts is also designated for this purpose.

NOTE 9 TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of amounts restricted for the following:

	2018	2017
Collections	\$ 283,618	\$ 346,918
Nichols Publications	50,774	64,136
Building Improvements	131,092	16,976
Exhibits and Events	1,469,841	917,129
Gift Annuities	20,904	22,678
Heard Perpetual Trust Accumulated Earnings	318,592	241,373
Other Accumulated Earnings	468,533	222,268
Total Temporarily Restricted Net Assets	<u>\$ 2,743,354</u>	<u>\$ 1,831,478</u>

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 10 PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of amounts restricted for the following:

	2018	2017
Collections Endowment	\$ 580,406	\$ 579,906
Endowment	351,202	351,202
Heard Tomorrow Endowment	298,189	298,189
Hearst Fund	200,000	200,000
Roger Lyon Scholarship Fund	131,100	131,100
S D O'Conner Publishing Fund	190,000	190,000
Steele Foundation fund	100,000	100,000
Heard Perpetual Trust	2,642,288	2,642,288
Nichols Collection Fund	301,321	301,321
Cowie Heard North Programming Endowment	111,000	105,000
Baguley Fund	50,661	50,661
Jay Kahn Memorial Fund	15,662	15,662
Dickey Family Director Endowment	2,400,000	2,400,000
Total Permanently Restricted Net Assets	\$ 7,371,829	\$ 7,365,329

Permanently restricted net assets consist of funds for which the donors stipulated the principal is to be maintained in perpetuity. The earnings on these funds are temporarily restricted for specific purposes by the endowment donors and are unrestricted once appropriated for expenditure. Net appreciation on permanently restricted funds is included as a change in temporarily restricted net assets.

NOTE 11 ENDOWMENTS

The Museum's endowments consist of several funds established for a variety of purposes. The endowment funds include both donor-restricted and board designated endowment funds. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The executive committee of the board of trustees of the Museum has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) 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 SPMIFA.

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 11 ENDOWMENTS (CONTINUED)

In accordance with SPMIFA, the Museum considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds are as follows:

1. The duration and preservation of the fund
2. The purposes of the Museum and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Museum
7. The investment policies of the Museum

As of September 30, 2018, endowment net assets consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor Restricted Endowment Net Assets	\$ -	\$ 787,125	\$ 7,371,829	\$ 8,158,954
Board-Designated Endowment Net Assets	1,638,407	-	-	1,638,407
Total	<u>\$ 1,638,407</u>	<u>\$ 787,125</u>	<u>\$ 7,371,829</u>	<u>\$ 9,797,361</u>

As of September 30, 2017, endowment net assets consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor Restricted Endowment Net Assets	\$ -	\$ 463,641	\$ 7,365,329	\$ 7,828,970
Board Designated Endowment Net Assets	2,191,828	-	-	2,191,828
Total	<u>\$ 2,191,828</u>	<u>\$ 463,641</u>	<u>\$ 7,365,329</u>	<u>\$ 10,020,798</u>

Changes in endowment net assets for the year ended September 30, 2018, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets - Beginning of Year	\$ 2,191,828	\$ 463,641	\$ 7,365,329	\$ 10,020,798
Contributions	-	-	6,500	6,500
Release of collateral reserve funds	(605,239)	-	-	(605,239)
Investment Returns:				
Investment Income and Gains and Losses	115,459	644,510	-	759,969
Appropriation of Assets for Expenditures	(63,641)	(321,026)	-	(384,667)
Endowment Net Assets - End of Year	<u>\$ 1,638,407</u>	<u>\$ 787,125</u>	<u>\$ 7,371,829</u>	<u>\$ 9,797,361</u>

**THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017**

NOTE 11 ENDOWMENTS (CONTINUED)

Changes in endowment net assets for the year ended September 30, 2017, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets - Beginning of Year, as Restated	\$ 245,127	\$ 75,475	\$ 5,205,329	\$ 5,525,931
Contributions	1,850,566	-	2,410,000	4,260,566
Change in Donor Intent	-	-	(250,000)	(250,000)
Investment Returns:				
Investment Income and Gains and Losses	96,135	521,454	-	617,589
Appropriation of Assets for Expenditure	-	(133,288)	-	(133,288)
Endowment Net Assets - End of Year	<u>\$ 2,191,828</u>	<u>\$ 463,641</u>	<u>\$ 7,365,329</u>	<u>\$ 10,020,798</u>

From time-to-time, the fair value of assets associated with individual donor-restricted endowment funds may exceed or fall below the level that the donor or SPMIFA requires the Museum to retain as a fund of perpetual duration. There were no deficiencies of this nature that are reported in unrestricted or temporarily restricted net assets as of September 30, 2018 and 2017.

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 endowments. Under this policy, the endowment assets are invested in a manner that is intended to produce results while assuming a moderate level of investment risk.

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 consists of equity-based investments and fixed-income funds.

The Museum's annual appropriations are at the discretion of the board of trustees unless specific instructions were provided by the endowment donors.

NOTE 12 FUNCTIONAL EXPENSES

The costs of providing various programs and other activities consist of the following:

	2018	2017
Program	\$ 8,567,824	\$ 8,905,751
Management and General	2,154,242	2,254,858
Fundraising	904,869	862,857
Total Functional Expenses	<u>\$ 11,626,935</u>	<u>\$ 12,023,466</u>

THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017

NOTE 12 FUNCTIONAL EXPENSES (CONTINUED)

Certain costs have been allocated among program and supporting services benefited in the table above. Management and general include those expenses that are not directly identifiable with any specific program, but provide for the overall support and direction of the Museum. Any expenditure not directly chargeable to a functional expense category is allocated based on personnel activity and other appropriate allocation methods.

NOTE 13 LEASES

The Museum leases equipment under noncancellable operating leases with no renewal options maturing through August 2021.

Minimum future rental payments under noncancellable operating leases in excess of one year are as follows:

<u>Year Ending September 30,</u>	<u>Amount</u>
2019	\$ 17,272
2020	16,104
2021	14,762
Total Minimum Future Rental Payments	<u>\$ 48,138</u>

Total rental expense was \$21,568 and \$21,403 for the years ended September 30, 2018 and 2017, respectively.

NOTE 14 DEFINED CONTRIBUTION PLAN

The Museum has a discretionary employer contribution plan covering all employees who have completed one year of at least 1,000 hours of service. The Museum contributes to the Plan an amount determined by the board of trustees on an annual basis. The total employer contribution is allocated to the participants pro-rata based on the ratio that their eligible compensation bears to total eligible compensation for the Plan year. The participants are not required to make contributions to the Plan. There were no employer contributions for 2018 and 2017, respectively.

NOTE 15 RELATED PARTIES

During 2018 and 2017, the Museum received contributions from board members totaling \$201,795 and \$5,277,358, respectively.

THE HEARD MUSEUM AND AFFILIATE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018 AND 2017

NOTE 16 CONCENTRATION OF CREDIT RISKS

The Museum maintains all of its cash with banks located in Arizona. Balances on deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to specified limits. Balances in excess of FDIC limits are uninsured. The Museum, in the normal course of business, periodically maintains account balances in excess of the FDIC's insurance coverage limit.

At September 30, 2018, three donors made up 91% of the pledges receivable balance.

At September 30, 2017, one donor made up 100% of the pledges receivable balance. Another donor accounted for 28% of total revenue for the year ended September 30, 2017.

NOTE 17 CONTINGENCIES

From time-to-time, the Museum is contingently liable in respect to claims incidental to the ordinary course of its operations. In the opinion of management, the effect of such matters will not have a material adverse effect on the Museum's financial position, results of operations, or liquidity. Therefore, no provision has been made in the accompanying consolidated financial statements for losses, if any, that might result from the ultimate outcome of these matters.



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