

**Children's Discovery Museum of San Jose**

Financial Statements

August 31, 2016



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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Children's Discovery Museum of San Jose  
San Jose, California

We have audited the accompanying financial statements of Children's Discovery Museum of San Jose (a California nonprofit corporation) (the "Museum"), which comprise the statement of financial position as of August 31, 2016, 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 (the "U.S."); 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.

### **Auditor's 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 U.S. 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial 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 Children's Discovery Museum of San Jose as of August 31, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the U.S.

A handwritten signature in black ink that reads "Armanino LLP".

Armanino<sup>LLP</sup>  
San Jose, California

February 10, 2017

Children's Discovery Museum of San Jose  
Statement of Financial Position  
August 31, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	2016 Total
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	\$ 1,604,810	\$ 517,396	\$ -	\$ 2,122,206
Contributions receivable	119,049	1,496,513	-	1,615,562
Donated rent receivable, current portion	-	135,074	-	135,074
Inventory	33,171	-	-	33,171
Prepaid expenses	129,566	-	-	129,566
Other current assets	3,870	-	-	3,870
Total current assets	<u>1,890,466</u>	<u>2,148,983</u>	<u>-</u>	<u>4,039,449</u>
Property and equipment, net	6,604,997	-	-	6,604,997
Other assets				
Investments	4,946,185	14,095	1,161,095	6,121,375
Donated rent receivable, net of current portion	-	8,621,296	-	8,621,296
Total other assets	<u>4,946,185</u>	<u>8,635,391</u>	<u>1,161,095</u>	<u>14,742,671</u>
Total assets	<u>\$ 13,441,648</u>	<u>\$ 10,784,374</u>	<u>\$ 1,161,095</u>	<u>\$ 25,387,117</u>
<b>LIABILITIES AND NET ASSETS</b>				
Current liabilities				
Accounts payable and accrued liabilities	\$ 117,104	\$ -	\$ -	\$ 117,104
Accrued payroll and related benefits	498,717	-	-	498,717
Deferred revenue	59,759	-	-	59,759
Customer deposits	48,300	-	-	48,300
Total current liabilities	<u>723,880</u>	<u>-</u>	<u>-</u>	<u>723,880</u>
Net assets				
Unrestricted				
Board designated				
Endowment	3,112,771	-	-	3,112,771
Operating reserve	2,000,000	-	-	2,000,000
Fixed asset reserve	1,000,000	-	-	1,000,000
Total board-designated	<u>6,112,771</u>	<u>-</u>	<u>-</u>	<u>6,112,771</u>
Property and equipment	6,604,997	-	-	6,604,997
Total unrestricted	<u>12,717,768</u>	<u>-</u>	<u>-</u>	<u>12,717,768</u>
Temporarily restricted	-	10,784,374	-	10,784,374
Permanently restricted	-	-	1,161,095	1,161,095
Total net assets	<u>12,717,768</u>	<u>10,784,374</u>	<u>1,161,095</u>	<u>24,663,237</u>
Total liabilities and net assets	<u>\$ 13,441,648</u>	<u>\$ 10,784,374</u>	<u>\$ 1,161,095</u>	<u>\$ 25,387,117</u>

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

Children's Discovery Museum of San Jose  
Statement of Activities  
For the Year Ended August 31, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support and revenue				
Support				
Grants and contributions	\$ 1,015,046	\$ 1,914,962	\$ -	\$ 2,930,008
Donations in-kind	774,179	-	-	774,179
Special events, net	<u>1,154,020</u>	<u>-</u>	<u>-</u>	<u>1,154,020</u>
Total support	<u>2,943,245</u>	<u>1,914,962</u>	<u>-</u>	<u>4,858,207</u>
Revenue				
Admissions	1,957,339	-	-	1,957,339
Membership	870,164	-	-	870,164
Net realized and unrealized gain on investments	544,582	268	-	544,850
Retail services	306,330	-	-	306,330
Program fees	133,940	-	-	133,940
Other income	410,137	-	-	410,137
Interest and dividends	145,533	11,392	-	156,925
Exhibit rental	43,021	-	-	43,021
Loss on disposition of property and equipment	<u>(5,328)</u>	<u>-</u>	<u>-</u>	<u>(5,328)</u>
Total revenue	<u>4,405,718</u>	<u>11,660</u>	<u>-</u>	<u>4,417,378</u>
Total support and revenue	<u>7,348,963</u>	<u>1,926,622</u>	<u>-</u>	<u>9,275,585</u>
Net assets released from restriction	<u>1,513,449</u>	<u>(1,513,449)</u>	<u>-</u>	<u>-</u>
Total support and revenue	<u>8,862,412</u>	<u>413,173</u>	<u>-</u>	<u>9,275,585</u>
Functional expenses				
Program services				
Exhibits	2,188,585	-	-	2,188,585
Educational programs	3,733,731	-	-	3,733,731
Retail services	<u>407,022</u>	<u>-</u>	<u>-</u>	<u>407,022</u>
Total program services	<u>6,329,338</u>	<u>-</u>	<u>-</u>	<u>6,329,338</u>
Supporting services				
Management and general	1,375,201	-	-	1,375,201
Development and fundraising	<u>460,284</u>	<u>-</u>	<u>-</u>	<u>460,284</u>
Total supporting services	<u>1,835,485</u>	<u>-</u>	<u>-</u>	<u>1,835,485</u>
Total functional expenses	<u>8,164,823</u>	<u>-</u>	<u>-</u>	<u>8,164,823</u>
Change in net assets	697,589	413,173	-	1,110,762
Net assets, beginning of year	<u>12,020,179</u>	<u>10,371,201</u>	<u>1,161,095</u>	<u>23,552,475</u>
Net assets, end of year	<u>\$ 12,717,768</u>	<u>\$ 10,784,374</u>	<u>\$ 1,161,095</u>	<u>\$ 24,663,237</u>

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

Children's Discovery Museum of San Jose  
Statement of Functional Expenses  
For the Year Ended August 31, 2016

	Program Services				Supporting Services			
	Exhibits	Educational Programs	Retail Services	Total Program Services	Management and General	Development and Fundraising	Total Supporting Services	Total
Expenses								
Salaries and benefits								
Salaries	\$ 429,513	\$ 1,954,541	\$ 110,968	\$ 2,495,022	\$ 672,813	\$ 264,657	\$ 937,470	\$ 3,432,492
Employee benefits	36,305	96,179	20,070	152,554	99,960	14,620	114,580	267,134
Payroll taxes	<u>32,283</u>	<u>148,156</u>	<u>8,484</u>	<u>188,923</u>	<u>48,016</u>	<u>17,536</u>	<u>65,552</u>	<u>254,475</u>
Total salaries and benefits	498,101	2,198,876	139,522	2,836,499	820,789	296,813	1,117,602	3,954,101
Occupancy	324,000	288,000	14,400	626,400	72,000	21,600	93,600	720,000
Repairs and maintenance	247,327	277,791	14,701	539,819	60,694	18,213	78,907	618,726
Small equipment	187,382	325,689	-	513,071	19,752	3,304	23,056	536,127
Outside services	75,917	149,056	23,435	248,408	214,987	32,194	247,181	495,589
Printing	635	196,642	435	197,712	1,980	1,503	3,483	201,195
Utilities	77,928	87,670	3,896	169,494	19,482	5,845	25,327	194,821
Cost of goods sold	-	-	157,122	157,122	-	-	-	157,122
Travel	10,422	45,639	389	56,450	1,764	-	1,764	58,214
Insurance	24,619	24,572	1,092	50,283	5,460	1,638	7,098	57,381
Conferences and meetings	2,892	20,571	8,879	32,342	13,832	10,343	24,175	56,517
Office supplies	3,819	5,033	1,783	10,635	5,702	12,670	18,372	29,007
Telephone	5,718	6,534	2,884	15,136	7,135	5,289	12,424	27,560
Postage and shipping	1,450	6,971	7,042	15,463	1,243	2,096	3,339	18,802
Dues and subscriptions	2,278	3,667	1,259	7,204	4,732	1,268	6,000	13,204
Training	-	-	-	-	6,977	-	6,977	6,977
Automobile	3,531	851	-	4,382	-	-	-	4,382
Miscellaneous	<u>-</u>	<u>73</u>	<u>-</u>	<u>73</u>	<u>20</u>	<u>-</u>	<u>20</u>	<u>93</u>
Expenses before depreciation	1,466,019	3,637,635	376,839	5,480,493	1,256,549	412,776	1,669,325	7,149,818
Depreciation	<u>722,566</u>	<u>96,096</u>	<u>30,183</u>	<u>848,845</u>	<u>118,652</u>	<u>47,508</u>	<u>166,160</u>	<u>1,015,005</u>
Total expenses	<u>\$ 2,188,585</u>	<u>\$ 3,733,731</u>	<u>\$ 407,022</u>	<u>\$ 6,329,338</u>	<u>\$ 1,375,201</u>	<u>\$ 460,284</u>	<u>\$ 1,835,485</u>	<u>\$ 8,164,823</u>
Percentage of total	<u>26.8 %</u>	<u>45.8 %</u>	<u>5.0 %</u>	<u>77.6 %</u>	<u>16.8 %</u>	<u>5.6 %</u>	<u>22.4 %</u>	<u>100.0 %</u>

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

Children's Discovery Museum of San Jose  
Statement of Cash Flows  
For the Year Ended August 31, 2016

Cash flows from operating activities	
Change in net assets	\$ 1,110,762
Adjustments to reconcile change in net assets to net cash provided by operating activities	
Net realized and unrealized gain on investments	(544,850)
Depreciation	1,015,005
Donated rent receivable	126,616
Donated property and equipment	(169,785)
Loss on disposition of property and equipment	5,328
Changes in operating assets and liabilities	
Contributions receivable	(632,753)
Inventory	(2,368)
Prepaid expenses	(50,775)
Other current assets	13,563
Accounts payable and accrued liabilities	(184,154)
Accrued payroll and related benefits	69,404
Deferred revenue	5,637
Customer deposits	(9,420)
Net cash provided by operating activities	<u>752,210</u>
Cash flows from investing activities	
Purchase of investments	(2,179,700)
Proceeds from sale of investments	2,169,681
Purchase of property and equipment	(893,339)
Net cash used in investing activities	<u>(903,358)</u>
Net decrease in cash and cash equivalents	(151,148)
Cash and cash equivalents, beginning of year	<u>2,273,354</u>
Cash and cash equivalents, end of year	<u><u>\$ 2,122,206</u></u>

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

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

1. NATURE OF OPERATIONS

Children's Discovery Museum of San Jose ("the Museum" or "CDM") is a California nonprofit public benefit corporation organized in 1982 and incorporated in 1983. The Museum operates a children's museum which addresses the educational needs of youngsters and their families in Santa Clara County through participatory exhibits and programs that engage the senses and challenge the mind.

Exhibits

Children's Discovery Museum of San Jose has served over 8.2 million adults and children since opening its doors in the spring of 1990. In the 2015-2016 fiscal year, the Museum provided engaging learning opportunities to over 327,140 families and 36,300 group visitors.

The Museum offers 28,000 square feet of exhibition space in 13 dedicated galleries, each housing 8-10 interactive exhibits which respond to the distinctive need for children to learn through concrete interactions. Therefore, the Museum's exhibits encourage touching, exploring, manipulating and experimenting and cut across the disciplines of art, science and the humanities. The Museum's theme is connections; the context is community - the myriad relationships within and between the man-made and natural worlds and the way those relationships are expressed here in its own backyard. Whether children are role-playing a firefighter on the authentic fire engine in the Streets of San Jose exhibit, using colorful plastic balls to study how water rushes and flows in WaterWays, or experimenting with surface tension by playing with bubbles in Bubbalogna, they are actively engaged in learning, inspired by their own curiosity to investigate how things work and understand more about the world we live in. While the majority of exhibits focus on children to age 10 and their parents and caregivers, The Wonder Cabinet serves the needs of the Museum's youngest visitors as an early learning environment with exhibits designed to support the cognitive, emotional and social development of infants, toddlers and preschoolers.

In operation for over 25 years, the Museum and its staff strive to enhance the visitor experience continuously. In early 2016, the exhibits staff occupied the Builder Building, a 3,200 square foot addition adjacent to the Museum, which will house the fabrication work for future exhibits further supporting the Museum's in-house exhibit design and build competency. One example of this approach is Voyage to Vietnam, an exhibit funded by the Association of Children's Museums and the Freeman Foundation Asian Culture Exhibit Series, fabricated largely in-house. This exhibit is focused on the celebration of Tet, and is now on its 3-year national tour with stops at other children's museums in Pittsburgh, Miami, New Orleans, Bettendorf, Wichita, Providence and Portland.



Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

1. NATURE OF OPERATIONS (continued)

Exhibits (continued)

Building upon recent initiatives that promote healthy eating and a understanding of where our food originates, the Museum enlisted the services of Baldauf Catton Von Eckartsberg Architects, Karp Resources and Gourmet Lunch to design a new café. To help visitors make educational connections about the food served, the café's name is named Foodshed, a term used to describe a region of food flows, from the area where it is produced, to the place where it is consumed, including: the land it grows on, the route it travels, the markets it passes through, and the tables it ends up on. In April 2016, CDM assumed management of café operations and continues to develop further the connections between Museum exhibits and programs and healthy eating by providing fresh and healthy food options.

Beginning with a contribution from the Agilent Technologies Foundation to recognize the retirement of its CEO Bill Sullivan, the plan for CDM's new 27,000 square foot outdoor learning center, Bill's Backyard: Bridge to Nature, was launched. When it opens in summer 2017, this new activity area will essentially double the Museum's current exhibit space, providing an innovative nature play area for children and role modeling planet-saving strategies, like rain harvesting, solar energy and drought tolerant landscaping, for adults. The success of the project has been supported by visionary major donors, which include the City of San Jose, the California State Coastal Conservancy, the Santa Clara Valley Open Space Authority and FIRST 5 Santa Clara County. Beyond the support of its visionary donors, CDM will call upon numerous strategic partners and the community-at-large to bring Bill's Backyard to its highly-anticipated opening in summer 2017.

Educational Programs

The Museum provides on-site programs which complement its exhibits and support visitor interactions and learning opportunities. In 2015-2016, the Museum provided programs for over 45,000 participants. The on-site Art Studio in The Wonder Cabinet and Art Loft are examples of the Museum's commitment to visual arts education experiences, while the Lee and Diane Brandenburg Theatre and Cadence Amphitheatre offer performing experiences. The Museum employs a three-pronged approach to the arts: engagement with and viewing the work of professional artists; exploring the other children's art; and individually creating their own works of art in various formats. Throughout the year, the Museum invites the community to participate in various cultural festivals, which represent our region's composition. These events include weekend events, such as Diwali, Dia de los Tres Reyes Magos, Lunar New Year, Children of the Dragon, single day or evening events, such as Dia de los Muertos, the Lantern Festival, Lunada Familiar and Menorahs and Miracles: A Hanukkah Celebration.

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

1. NATURE OF OPERATIONS (continued)

Educational Programs (continued)

Beyond Children's Discovery Museum of San Jose's exhibit galleries, the educational programs bring resources and innovative learning techniques to schools; encourage young adults to become active citizens by impacting their environment and serving their community; stimulate curiosity and promote inquiry based learning; and reach the children and youth in our community most in need of extra support, with experiences designed to ensure that children know their own worth, respect their own knowledge, and achieve their greatest potential. Highly successful programs, such as BioSITE (Students Investigating Their Environment), engage high school students in mentoring elementary school students to value their local river by gathering important water quality information and sharing the information with the scientific research community; Summer of Service provides middle school youth volunteer opportunities at local food banks and shelters, senior centers, parks and preschools. Throughout the year, the Museum opens during evening hours for Play Your Way events, which welcome families with children on the autism spectrum the opportunity to explore and engage with the exhibits in a quieter period, as well as showcasing area resources for these families. With funding from the Institute of Museum and Library Services, Museum staff has worked with a group of community participants from five different immigrant communities over the past 3 years to co-develop 2 different interactive experiences designed to introduce children to different traditions from around the world and to help them to see the similarities between their own cultural traditions and those of others. Changing monthly, The World Theater includes objects and outfits from Mexico, India, China, Vietnam or the Philippines, and invites children to dress up and dance to lively traditional music from those countries. The World Market presents five different market stand kiosks that feature interactive experiences and video demonstrations of different cooking items from each of the featured countries.

CDM continues to support a satellite location at Educare California at Silicon Valley ("Educare"), a model early learning school and the region's leading professional development and research institute located in the Santee neighborhood of San Jose. CDM has installed an updated version of its Out on a Limb exhibit, featuring local animals, trees and plants, and program staff will continue to provide program activity support. After opening Bill's Backyard: A Bridge to Nature, CDM will install a related set of activities and programs at the Educare site.

Retail Services

Located at the entrance to the Museum, the retail store offers educationally-based products for sale, which support and extend the activities encountered through interaction with Museum exhibits and programs. Custom products and licensed exhibit- and program-related items are also featured.

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation and financial statement presentation

The financial statements of Children's Discovery Museum of San Jose have been prepared on the accrual basis of accounting.

The Museum reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

- *Unrestricted net assets* - include those assets over which the Board of Directors has discretionary control in carrying out the operations of the Museum. Under this category, the Museum maintains an operating fund, any net assets designated by the Board for specific purposes and the unrestricted property and equipment fund. The Board has established a goal to include a full six months of the coming year's estimated expense in Operating Reserve. Board designations are not donor-imposed restrictions and are subject to change at the Board's discretion.
- *Temporarily restricted net assets* - include those assets which are subject to donor restriction and for which the applicable restriction was not met as of the year end of the current reporting period.
- *Temporarily restricted net assets* - include those assets which are subject to a non-expiring donor restriction, such as endowments.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes. The Museum maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Museum has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Inventory

Inventory consists of gift shop merchandise. The merchandise is stated at the lower of cost or market on a first-in/first-out basis. The reported inventory cost as of August 31, 2016, was \$33,171.

Investments

Investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values on the statement of financial position. Unrealized gains and losses are included in the change in net assets.

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments (continued)

Fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

A hierarchy has been established to prioritize the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). Observable inputs are those that market participants would use in pricing the asset based on market data obtained from sources independent of the Museum. Unobservable inputs reflect the Museum's assumption about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

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

- *Level 1* - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.
- *Level 2* - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.
- *Level 3* - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Museum's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Property and equipment

Property and equipment are recorded at cost or estimated fair value for donated items. Equipment purchases over \$1,000 are capitalized. Costs related to the development and construction of exhibits are capitalized. The Museum does not recognize depreciation on capitalized individual works of art whose economic benefit or service potential is used up so slowly that the estimated useful life of the assets is extraordinarily long. The cost of repairs and maintenance which do not improve or extend the lives of the respective assets are expensed currently. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 3 to 40 years. Depreciation is charged to the activity benefiting from the use of the property or equipment.

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accrued vacation

Accrued vacation represents vacation earned, but not taken as of August 31, 2016, and is included in "accrued payroll and related benefits" on the statement of financial position. The accrued vacation balance as of August 31, 2016 was \$223,870.

Deferred revenue

As of August 31, 2016, the Museum had deferred revenue of \$37,196 from advance admissions and the sale of gift cards and \$22,563 for an operating grant payment received in advance from the City of San Jose.

Customer deposits

As of August 31, 2016, the Museum has received deposits of \$48,300 for future pinscreen sales and birthday party and facility rentals.

Revenue recognition

The Museum recognizes support and revenue on the accrual basis of accounting. Revenue from grants which have been classified as "exchange transactions" and program fees are recognized as revenue in the period in which the service is provided.

Contributions

Contributions are recognized when the donor makes a pledge to give that is, in substance, an unconditional promise. Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted depending on the nature of donor restrictions. Restricted contributions are reported as increases in restricted net assets. When the restriction is met the amount is shown as a reclassification of restricted net assets to unrestricted net assets.

Donations in-kind

Donated equipment and other donated goods are recorded at their estimated fair value as of the date of the donation. Donated rent is recorded at its estimated fair value based on prevailing rent rates when lease agreements are entered into and / or amended. Contributed services, which require a specialized skill and which the Museum would have paid for if not donated, are recorded at the estimated fair value at the time the services are rendered.

Allocation of functional expenses

Directly identifiable expenses are charged to program and supporting services. Expenses related to more than one function are charged to program and supporting services on the basis of square footage of occupied space or number of employees per department.

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Advertising

The Museum's policy is to expense advertising costs as the costs are incurred. Advertising expenses for the year ended August 31, 2016 was \$151,483.

Income taxes

Children's Discovery Museum of San Jose is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and state income taxes under Section 23701(d) of the California Revenue Taxation Code. However, income from certain activities not directly related to the Museum's tax-exempt purpose is subject to taxation as unrelated business income. In addition, the Museum qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the Internal Revenue Code.

Uncertainty in income taxes

Generally accepted accounting principles provide accounting and disclosure guidance about positions taken by an organization in its tax returns that might be uncertain. Management has considered its tax positions and believes that all of the positions taken by the Museum in its federal and state exempt organization tax returns are more likely than not to be sustained upon examination.

The Museum's federal returns for the years ended August 31, 2015, 2014 and 2013 could be subject to examination by federal taxing authorities, generally for three years after they are filed. The Museum's state returns for the years ended August 31, 2015, 2014, 2013 and 2012 could be subject to examination by state taxing authorities, generally for four years after they are filed.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of support, revenue and expenses during the period. Accordingly, actual results could differ from those estimates.

Subsequent events

Management of the Museum has evaluated events and transactions subsequent to August 31, 2016 for potential recognition or disclosure in the financial statements. The Museum did not have subsequent events that required recognition or disclosure in the financial statements for the fiscal year ended August 31, 2016. Subsequent events have been evaluated through the date the financial statements became available to be issued, February 10, 2017.

Children's Discovery Museum of San Jose  
Notes to Financial Statements  
August 31, 2016

3. INVESTMENTS

The following table sets forth by level, within the fair value hierarchy, the Museum's assets at fair value as of August 31, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Stocks and mutual funds	\$ 5,996,328	\$ -	\$ -	\$ 5,996,328
Venture capital funds	-	-	113,807	113,807
Cash and cash equivalents	7,937	-	-	7,937
Interest receivable	<u>3,303</u>	<u>-</u>	<u>-</u>	<u>3,303</u>
	<u>\$ 6,007,568</u>	<u>\$ -</u>	<u>\$ 113,807</u>	<u>\$ 6,121,375</u>

Fair values for investments, except venture capital funds, are determined by reference to quoted market prices and other relevant information generated by market transactions. Fair values for investments in venture capital funds are determined by the fund managers based on the estimated values of underlying investment holdings.

The following table sets forth a summary of changes in the fair value of Level 3 investments for the year ended August 31, 2016:

	<u>ENF III Fund</u>	<u>ENF VII Fund</u>	<u>Total</u>
Balance, beginning of year	\$ 9,632	\$ 138,203	\$ 147,835
Net gain (loss)	<u>(3,441)</u>	<u>(30,587)</u>	<u>(34,028)</u>
Balance, end of year	<u>\$ 6,191</u>	<u>\$ 107,616</u>	<u>\$ 113,807</u>

The net loss in venture capital funds investments included in the change in unrestricted net assets is composed of \$34,028 in unrealized losses.

Investment earnings (losses) during the year consist of the following:

Interest and dividends	\$ 156,925
Net realized and unrealized gain on investments	<u>544,850</u>
	<u>\$ 701,775</u>

4. CONTRIBUTIONS RECEIVABLE

Contributions receivable represent unconditional promises given by donors and are recorded at net realizable value.

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4. CONTRIBUTIONS RECEIVABLE (continued)

Contributions receivable consist of the following:

Receivable in less than one year	\$ <u>1,615,562</u>
	1,615,562
Contributions receivable	<u>(1,615,562)</u>
	<u><u>\$ -</u></u>

Of the contributions receivable at August 31, 2016, 28%, 20 and 19% are due from three donors.

5. DONATED RENT RECEIVABLE

The Museum entered into a non-cancelable lease with the Redevelopment Agency of the City of San Jose in June 1987 and amended the lease in February 1990. Under this agreement for no rental payments, the Museum operates, maintains and manages the Museum facility and site with the exception of structural components, which are maintained by the City of San Jose. The initial term of the lease is 55 years with four renewal options of 11 years each.

As the lease is non-cancelable, the Museum recognized the benefit of this lease agreement as donated rent receivable and temporarily restricted support. The Museum has established the fair market value of the rent under the agreement at \$720,000 per year. The annual rent expense is included in the statement of activities. The net present value of the future contribution benefit has been computed at a discount rate of 6.68% based upon prevailing rates when the lease agreement was entered into and is recorded as donated rent receivable on the statement of financial position.

Donated rent receivable consisted of the following:

<u>Year ending August 31,</u>	
2017	\$ 135,074
2018	144,097
2019	153,723
2020	163,992
2021	174,947
Thereafter	<u>7,984,537</u>
	8,756,370
Current portion	<u>(135,074)</u>
	<u><u>\$ 8,621,296</u></u>



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6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

Exhibits	\$ 6,287,735
Equipment	1,945,866
Leasehold improvements	3,177,708
Furniture and fixtures	149,635
Vehicles	37,494
Construction in progress	996,939
Art	<u>311,973</u>
	12,907,350
Accumulated depreciation	<u>(6,302,353)</u>
	<u><u>\$ 6,604,997</u></u>

Depreciation expense for the year ended August 31, 2016 was \$1,015,005.

7. RETIREMENT PLAN

The Museum maintains a tax deferred 403(b) retirement plan to provide retirement benefits for all eligible employees. The Plan provides for Museum employees to contribute an amount from their compensation, subject to limitations set by the Internal Revenue Code. The Museum has a separate defined contribution retirement plan, which allows the Museum to make an employer contribution up to a maximum of 5% of all eligible employee compensation. Participants are immediately vested in their salary deferral and employer contributions. There were no employer contributions made during the year ended August 31, 2016.

8. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consist of the following:

Donated rent receivable	\$ 8,756,370
Programs and exhibits	1,597,292
Endowment accumulated earnings - unappropriated	<u>430,712</u>
	<u><u>\$ 10,784,374</u></u>

Temporarily restricted net assets released from restriction during the year were as follows:

Donated rent receivable	\$ 126,617
Programs and exhibits	1,300,746
Endowment accumulated earnings - appropriated	<u>86,086</u>
	<u><u>\$ 1,513,449</u></u>

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9. PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of endowment fund investments which represent the principal amount of gifts and bequests accepted with the donor stipulation that the principal be maintained intact in perpetuity or for a specified period, with only the income to be utilized for operations (see Note 13).

10. DONATIONS IN-KIND

The estimated fair value of rent, fixtures and furnishings, computer software and hardware, professional services and supplies received are recorded as donations.

Donations in-kind were received by the Museum as follows:

Rent	\$ 593,383
Equipment	<u>169,785</u>
	763,168
Special event supplies and services	<u>11,011</u>
	<u><u>\$ 774,179</u></u>

11. CONTINGENCIES

Grants and contracts awarded to Children's Discovery Museum of San Jose are subject to the funding agencies' criteria, contract terms and regulations under which expenditures may be charged and are subject to audit under such terms, regulations and criteria. Occasionally, such audits may determine that certain costs incurred against the grants do not comply with the established criteria that govern them. In such cases, the Museum could be held responsible for repayments to the funding agency for the costs or be subject to the reductions of future funding in the amount of the costs. Management does not anticipate any material questioned costs for the contracts and grants administered during the period.

12. RELATED PARTY TRANSACTIONS

The Museum's volunteer executive board members are active in both oversight of the fundraising events activities and in making private contributions. During the year ended August 31, 2016 in-kind donations received from the board members totaled \$21,732 and \$151,487 from their employers. During the year ended August 31, 2016, cash and stock contributions received from board members totaled \$374,689 and cash contributions from their employers or affiliation totaled \$428,550.

13. ENDOWMENT

The Museum's endowment consists of two individual funds. Its endowment includes donor-restricted and board-designated endowment funds. As required by Generally Accepted Accounting Principles (GAAP), net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

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13. ENDOWMENT (continued)

Interpretation of relevant law

The Board of Directors of the Museum has interpreted the California version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the 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 as 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 the California version of UPMIFA.

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

- (1) The duration and preservation of the fund
- (2) The 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

Investment Return Objectives, Risk Parameters and Strategies - Goals and Performance Measurement:

- Based on a Total Return Investment Objective, the primary goal for the Portfolio is to exceed the inflation rate as measured by the Consumer Price Index (CPI) by not less than four (4) percentage points on an annual (calendar) basis, net of investment management fees. A secondary goal is to exceed by not less than one (1) percentage point the return of the appropriate benchmark indices over a three (3) to five (5) year period, net of investment management fees. (70% Standard & Poor's Equity Index, and 30% Barclay's Intermediate Government/ Corporate Bond Index.)
- The performance results will be calculated in conformance with the Association for Investment Management and Research (AIMR) Performance Presentation Standards.
  1. Total returns, including realized and unrealized gains and losses plus income.
  2. Accrual accounting for fixed income securities.

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13. ENDOWMENT (continued)

Investment Return Objectives, Risk Parameters and Strategies - Goals and Performance Measurement: (continued)

3. Time-weighted rate of return using monthly valuation and geometric linking.
4. The pricing of all assets must be based on a reasonable estimate of current value. Standardized pricing quotations must be used when available.

Spending policy

Unless otherwise specified in a governing gift agreement, the payout policy for an endowed fund may be up to 5% of the fund's value, based on a 12 quarter rolling average calculated as of August 31, 2016. Where the fund has not been in existence for 12 quarters, the actual number of quarters that the fund has been in existence will be used. The intent of the policy is to set a maximum amount for spending, but not to mandate that such an amount be spent. Disbursements will be made in two installments, half at the end of December and half at the end of June.

The Board will review the spending policy annually, and update, if necessary.

Endowment composition

Endowment net asset composition by type is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 430,712	\$ 1,161,095	\$ 1,591,807
Board-designated endowment funds	<u>3,112,771</u>	<u>-</u>	<u>-</u>	<u>3,112,771</u>
	<u>\$ 3,112,771</u>	<u>\$ 430,712</u>	<u>\$ 1,161,095</u>	<u>\$ 4,704,578</u>

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13. ENDOWMENT (continued)

Endowment composition (continued)

Changes in donor-restricted endowment net assets for the year are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance, beginning of year	\$ -	\$ 505,138	\$ 1,161,095	\$ 1,666,233
Interest and dividends	-	11,392	-	11,392
Net unrealized gain on investments	-	268	-	268
Amounts appropriated for expenditure	-	(86,086)	-	(86,086)
	-	(74,426)	-	(74,426)
Balance, end of year	\$ -	\$ 430,712	\$ 1,161,095	\$ 1,591,807

Changes in board-designated endowment net assets for the fiscal year ended August 31, 2016 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance, beginning of year	\$ 2,457,973	\$ -	\$ -	\$ 2,457,973
Interest and dividends	53,428	-	-	53,428
Net unrealized gain on investments	211,508	-	-	211,508
Designated by board	389,862	-	-	389,862
	654,798	-	-	654,798
Balance, end of year	\$ 3,112,771	\$ -	\$ -	\$ 3,112,771