



# **JOHN P. MCGOVERN MUSEUM OF HEALTH & MEDICAL SCIENCE**

Report of Independent Auditor and Financial  
Statements

Years ended December 31, 2017 and 2016

PMB Helin Donovan

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**  
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December 31, 2017 and 2016

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## Report of Independent Auditor

To: The Board of Directors  
John P. McGovern Museum of Health & Medical Science  
Houston, Texas

We have audited the accompanying financial statements of John P. McGovern Museum of Health & Medical Science (a nonprofit organization), which comprise the statements of financial position as of December 31, 2017 and 2016, the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

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

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

### *Auditor's Responsibility*

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

An audit includes 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 John P. McGovern Museum of Health & Medical Science as of December 31, 2017 and 2016 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**PMB HELIN DONOVAN, LLP**

*PMB Helin Donovan, LLP*

June 1, 2018

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**  
Statements of Financial Position  
December 31, 2017 and 2016

	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,056,054	\$ 1,413,595
Accounts receivable	34,181	13,075
Pledges receivable	30,000	-
Prepaid expenses	87,433	37,676
Inventory	34,609	18,503
Investments - endowment funds	14,436,850	13,041,599
Property and equipment, net	8,417,943	9,175,971
TOTAL ASSETS	\$ 24,097,070	\$ 23,700,419
 <b>LIABILITIES AND NET ASSETS</b>		
Liabilities		
Accounts payable and accrued expenses	\$ 167,782	\$ 161,933
Due to related parties, net	50,262	30,348
Deferred revenue	90,938	49,220
Total Liabilities	308,982	241,501
Net Assets		
Unrestricted	9,505,301	9,255,153
Temporarily restricted	-	-
Permanently restricted	14,282,787	14,203,765
Total Net Assets	23,788,088	23,458,918
TOTAL LIABILITIES AND NET ASSETS	\$ 24,097,070	\$ 23,700,419

See accompanying notes to financial statements and report of independent auditor

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**  
Statement of Activities and Changes in Net Assets  
For the Year Ended December 31, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>Operating revenue</b>				
Contributions	\$ 1,174,693	\$ -	\$ -	\$ 1,174,693
Admission fees	1,342,440	-	-	1,342,440
Special events (net of direct benefits of \$51,961)	131,935	-	-	131,935
Membership revenue	67,350	-	-	67,350
Gift shop merchandise sales	179,993	-	-	179,993
Rental fees and other income	260,852	-	-	260,852
Interest and dividends, net	<u>260,597</u>	<u>-</u>	<u>88,430</u>	<u>349,027</u>
 Total operating revenue	 <u>3,417,860</u>	 <u>-</u>	 <u>88,430</u>	 <u>3,506,290</u>
<b>Net assets released from restriction</b>				
Program or time restrictions accomplished	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
 Total	 <u>3,417,860</u>	 <u>-</u>	 <u>88,430</u>	 <u>3,506,290</u>
<b>Operating expenses</b>				
Museum programs	3,205,050	-	-	3,205,050
Gift shop expenses	130,589	-	-	130,589
Management and general	363,944	-	-	363,944
Fundraising	<u>751,298</u>	<u>-</u>	<u>-</u>	<u>751,298</u>
 Total operating expenses	 <u>4,450,881</u>	 <u>-</u>	 <u>-</u>	 <u>4,450,881</u>
<b>Changes in net assets from operations</b>	(1,033,021)	-	88,430	(944,591)
<b>Other changes in net assets</b>				
Net realized and unrealized gain (loss) on investments	<u>1,283,169</u>	<u>-</u>	<u>(9,408)</u>	<u>1,273,761</u>
<b>Change in net assets</b>	250,148	-	79,022	329,170
<b>Net assets, beginning of year</b>	<u>9,255,153</u>	<u>-</u>	<u>14,203,765</u>	<u>23,458,918</u>
<b>Net assets, end of year</b>	<u>\$ 9,505,301</u>	<u>\$ -</u>	<u>14,282,787</u>	<u>\$ 23,788,088</u>

See accompanying notes to financial statements and report of independent auditor.

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH MEDICAL SCIENCE**  
Statement of Activities and Changes in Net Assets  
For the Year Ended December 31, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>Operating revenue</b>				
Contributions	\$ 1,045,956	\$ -	\$ -	\$ 1,045,956
Admission fees	926,014	-	-	926,014
Special events (net of direct benefits of \$62,000)	387,475	-	-	387,475
Membership revenue	74,263	-	-	74,263
Gift shop merchandise sales	105,351	-	-	105,351
Rental fees and other income	155,042	-	-	155,042
Interest and dividends, net	<u>160,118</u>	<u>-</u>	<u>71,186</u>	<u>231,304</u>
 Total operating revenue	 <u>2,854,219</u>	 <u>-</u>	 <u>71,186</u>	 <u>2,925,405</u>
<b>Net assets released from restriction</b>				
Program or time restrictions accomplished	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
 Total	 <u>2,854,219</u>	 <u>-</u>	 <u>71,186</u>	 <u>2,925,405</u>
<b>Operating expenses</b>				
Museum programs	2,685,264	-	-	2,685,264
Gift shop expenses	164,409	-	-	164,409
Management and general	450,930	-	-	450,930
Fundraising	<u>679,152</u>	<u>-</u>	<u>-</u>	<u>679,152</u>
 Total operating expenses	 <u>3,979,755</u>	 <u>-</u>	 <u>-</u>	 <u>3,979,755</u>
<b>Changes in net assets from operations</b>	(1,125,536)	-	71,186	(1,054,350)
<b>Other changes in net assets</b>				
Net realized and unrealized gain (loss) on investments	<u>311,523</u>	<u>-</u>	<u>(87,817)</u>	<u>223,706</u>
<b>Change in net assets</b>	(814,013)	-	(16,631)	(830,644)
<b>Net assets, beginning of year</b>	<u>10,069,166</u>	<u>-</u>	<u>14,220,396</u>	<u>24,289,562</u>
<b>Net assets, end of year</b>	<u>\$ 9,255,153</u>	<u>\$ -</u>	<u>\$ 14,203,765</u>	<u>\$ 23,458,918</u>

See accompanying notes to financial statements and report of independent auditor.

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH MEDICAL SCIENCE**

Statement of Cash Flows  
For the Year Ended December 31, 2017

	<b>2017</b>	<b>2016</b>
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 329,170	\$ (830,644)
Adjustments to reconcile change in net assets to net cash (used in) operating activities:		
Reinvested interest and dividend income	(260,597)	(160,118)
Interest and dividends restricted for permanent endowment	(88,430)	(71,186)
Net unrealized (gain) loss on investments	(1,273,761)	(223,706)
Depreciation	847,057	852,417
Contributions restricted to capital projects	-	194,058
Changes in operating assets and liabilities:		
Accounts receivable	(21,106)	(3,417)
Pledges receivable	(30,000)	127,245
Prepaid expenses	(49,757)	39,488
Inventory	(16,106)	650
Accounts payable and accrued expenses	5,849	(30,477)
Due to related parties, net	19,914	29,302
Deferred revenue	41,718	(9,064)
Net cash (used in) operating activities	(496,049)	(85,452)
<b>Cash flows from investing activities</b>		
Purchases of museum exhibits, furniture and equipment	(89,029)	(352,639)
Purchases of investments	(2,480,169)	(3,103,605)
Liquidations of investments	2,707,706	3,596,214
Net cash provided by investing activities	138,508	139,970
Net (decrease) increase in cash and cash equivalents	(357,541)	54,518
<b>Cash and cash equivalents</b>		
Beginning of year	1,413,595	1,359,077
End of year	\$ 1,056,054	\$ 1,413,595
Cash paid for income taxes	\$ -	\$ -
Cash paid for interest	\$ -	\$ -

See accompanying notes to financial statements and report of independent auditor.

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 1 - ORGANIZATION AND NATURE OF ACTIVITIES**

John P. McGovern Museum of Health & Medical Science (the “Museum”) is an interactive and entertaining science experience for all ages that promotes understanding and appreciation of the human body, mind and spirit and inspires a lifelong commitment to health and wellness. The Museum is a Texas non-profit 501(c)(3) corporation located in the Museum district in Houston, Texas.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation** – The Museum’s financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America (GAAP). For financial statement purposes, the Museum distinguishes between contributions of unrestricted assets, temporarily restricted assets, and permanently restricted assets as follows:

*Unrestricted* – Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be used for any purpose or designated for specific purposes by action of the Board of Directors.

*Temporarily Restricted* - Net assets that are subject to donor-imposed stipulations that can be fulfilled by actions of the Museum pursuant to those stipulations or that expire by the passage of time. The Museum had no temporarily restricted net assets as of December 31, 2017 and 2016.

*Permanently Restricted* - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Museum.

**Use of Estimates** - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates for the Museum include the depreciable life of property and equipment, potential impairment of long-lived assets, the fair value of financial instruments, and the allocation of expenses by function. Actual results could differ from those estimated.

**Cash and Cash Equivalents** - For purposes of the statement of cash flows, cash and cash equivalents consist of cash held in bank deposit accounts and short-term, highly liquid investments with purchased maturities of 90 days or less. For purposes of cash flows, the restricted cash for capital projects and cash held in endowment is excluded from cash and cash equivalents.

**Accounts Receivable** - Accounts receivable are stated at cost, less an allowance for amounts which are in excess of net realizable value, which approximates fair value. Management evaluates the collectability of receivables based upon payment history and other factors and establishes an allowance for doubtful accounts when no longer considered collectible. An allowance was not deemed necessary as of December 31, 2017 and 2016.

**Pledges Receivable** - Promises to give (pledges) are recorded as revenue in the year that the pledges are received, unless they contain a conditional promise to give. Pledges receivable that are expected to be collected within one year are recorded at net realizable value. Amounts expected to be collected in more than one year are discounted to estimate the present value of future cash flows. Amortization of discounts is included in contributions revenue and is reported within the asset class in which the pledge was originally reported.

**Inventory** - Inventory consists of merchandise in the gift shop. Inventory is stated at the lower of average cost or market.



**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Investments and Investment Income*** - Investments are reported at fair value with gains and losses included in the statements of activities as non-operating revenues and expenses. The fair values of investments are based upon quoted market prices. Investment income, including unrealized gains and losses, is included as a change to unrestricted net assets unless otherwise specified by donor restrictions.

***Property, Equipment and Depreciation*** - Purchased property and equipment is recorded at cost while contributed property is recorded at fair value at the time of contribution. Minor additions and replacements are expensed in the year incurred. Major additions and replacements are capitalized and depreciated over their estimated useful lives. Depreciation is provided on the straight-line method, based on the estimated useful lives of assets, ranging from three to forty years. Museum exhibits are depreciated on the straight-line method, based on the estimated useful life of ten years.

***Long-lived Assets*** - The Museum evaluates long-lived assets for impairment using a discounted cash flows method whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. During the years ended December 31, 2017 and 2016, management determined that no such impairment has occurred.

***Revenue Recognition*** - The Museum recognizes revenue when the related services are provided. Amounts received for future services or periods, including membership fees, are included in the statements of financial position as deferred revenue.

***Contributions*** - Contributions are recorded as revenue at fair value when an unconditional commitment is received from the donor. Contributions received and pledges receivable with donor stipulations that limit their use are recorded as restricted support; however, contributions whose restrictions are met in the same reporting period as they are received are reported as unrestricted support. Contributions received which are part of the Museum's ongoing major or central activities are recognized as revenue. Contributions which are peripheral or incidental are recognized as gains. Conditional pledges are recognized as the conditions upon which they depend are substantially met. As of December 31, 2017 and 2016, there were no conditional pledges.

***Non-Cash Contributions*** - Donated materials and use of facilities are recorded at fair value as contributions when an unconditional commitment is received from the donor. The related expense is recorded as the item is used. Contributions of services are recognized when services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. In addition, many individuals volunteer their time to assist the Museum, providing services that do not meet the criteria for recognition as contributed services; and therefore, have not been recorded in the accompanying financial statements. Additionally, for materials provided where fair value cannot be reasonably determined, no amounts have been recorded in the accompanying financial statements.

***Functional Expenses*** - The expense information contained in the statements of activities is presented on a functional basis. Accordingly, certain expenses are allocated between functional categories based on management's estimates.

***Advertising*** - Advertising costs are charged to operations when incurred. Advertising expense was \$208,460 \$147,573 for the years ended December 31, 2017 and 2016, respectively.

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Income Taxes*** - The Museum is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Unrelated business income, of which the Museum had no significant amounts for the years ended December 31, 2017 and 2016, is subject to federal income taxes. The Museum is also exempt from Texas state tax. Accordingly, there is no provision or liability for federal or state income taxes in the accompanying financial statements. The Museum has adopted the provisions of FASB ASC 740, which requires recognition and disclosure of uncertain tax positions in the financial statements and footnotes. Management of the Museum believes it has no material uncertain tax positions and, accordingly, it has not recognized any liability for unrecognized tax benefits. The Museum is subject to examination for its prior three years of information returns filed, but has not received any such notice from the IRS or the State of Texas.

***Concentration of Credit Risk*** - Financial instruments which potentially subject the Museum to concentrations of credit risk consists principally of cash and cash equivalents, investments, and receivables. The Museum's cash is deposited in financially stable institutions. At times, such deposits may be in excess of the Federal Deposit Insurance Corporation ("FDIC") insurance limit. At December 31, 2017 and 2016, the Company had \$548,102 and \$899,625 respectively, in cash deposits in excess of the FDIC insurance limit. The Company has not experienced any losses on such accounts, nor does it anticipate any losses. As of December 31, 2017 and 2016, investments consist primarily of mutual funds, private equity investments and money market funds. Management believes that the Museum has reduced its investment risk through diversification into investments in a variety of industries. Pledges receivable represent unconditional promises to give and are monitored by the Museum for potential losses.

***Recently Issued Accounting Principles*** - In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. This ASU requires a lessee to recognize a right-of-use asset and a lease liability under most operating leases in its balance sheet. This ASU is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The Museum has elected not to early adopt this ASU as of December 31, 2017, but is currently assessing the impact of the new standard on its financial reporting.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which decreases the number of net asset classes from three to two. The new classes will be net assets with donor restrictions and net assets without donor restrictions. The standard also:

Requires reporting of the underwater amounts of donor-restricted endowment funds in net assets with donor restrictions and enhances disclosures about underwater endowments.

- Continues to allow preparers to choose between the direct method and indirect method for presenting operating cash flows, eliminating the requirement for those who use the direct method to perform reconciliation with the indirect method.
- Requires a not-for-profit to provide in the notes qualitative information on how it manages its liquid available resources and liquidity risks. Quantitative information that communicates the availability of a not-for-profit's financial assets at the balance sheet date to meet cash needs for general expenditures within one year is required to be presented on the face of the financial statement and/or in the notes.
- Requires reporting of expenses by function and nature, as well as an analysis of expenses by both function and nature.

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The standard will take effect for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Application to interim financial statements is permitted but not required in the initial year of application, and early application of the standard is permitted. The Museum has elected not to early adopt this ASU as of December 31, 2017, but is currently assessing the impact of the new standard on its financial reporting.

In addition, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments are effective for non-public entities for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. The amendments should be applied using a retrospective transition method to each period presented. The Museum is currently assessing the impact of this new standard on its future financial statements.

Other recently issued ASU's were assessed and determined to be either not applicable or are expected to have minimal impact on its financial position and results of operations.

**Subsequent Events** - Management has evaluated subsequent events through June 1, 2018, the date which the financial statements were available to be issued.

**NOTE 3 - INVESTMENTS**

The Museum's investments are managed by an independent advisory firm and held by an independent custodian. The investments make up the assets of the Museum's endowment fund, as further discussed at Note 6. Investments consist of the following at December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Mutual funds	\$ 14,084,422	\$ 12,607,063
Private equity investment	331,674	380,577
Money market funds and cash	<u>20,754</u>	<u>53,959</u>
Total investments	<u>\$ 14,436,850</u>	<u>\$ 13,041,599</u>

Investment return includes earnings on cash and cash equivalents and consists of the following:

	<u>2017</u>	<u>2016</u>
Interest and dividends	\$ 395,917	\$ 293,389
Investment management fees	<u>(46,890)</u>	<u>(62,085)</u>
Interest and dividends, net	<u>\$ 349,027</u>	<u>\$ 231,304</u>
Realized gain (loss) on investments	\$ (37,134)	\$ (346,534)
Unrealized gain (loss) on investments	<u>1,310,895</u>	<u>570,240</u>
Net realized and unrealized gain (loss) on investments	<u>\$ 1,273,761</u>	<u>\$ 223,706</u>

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 4 - FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Museum's financial instruments are recorded at fair value. In accordance with GAAP, 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 measure date (exit price). GAAP characterizes inputs used in determining fair value using a hierarchy that prioritizes inputs depending on the degree to which they are observable. The 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 maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

To estimate fair value, the Museum utilizes observable market data when available, or models that utilize observable market data. In addition to market information, the Museum incorporates transaction-specific details that, in management's judgment, market participants would utilize in a fair value measurement.

Other financial instruments that are not valued on a recurring or nonrecurring basis are cash, receivables and payables. Management believes the carrying amounts of these financial instruments approximate their fair values.

The three levels of the fair value hierarchy are as follows:

Level 1 - Inputs include quoted prices that are available in active markets for identical investments as of the reporting date. The type of investments in Level 1 include listed equities, options and government obligations. As required by GAAP, the Museum does not adjust the quoted price for these investments, even in situations where a fund holds a large position and a sale could reasonably impact the quoted price.

Level 2 - Pricing inputs are other-than-quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Investments which are generally included in this category are securities such as infrequently traded corporate bonds, certain municipal bonds, commercial loans, less liquid and restricted equity securities, and certain over-the-counter (OTC) derivatives.

Level 3 - Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation. Investments that are included in this category generally include private equity investments, long-term OTC options, certain OTC derivatives and certain bonds for which there is not an actively trading market.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in valuation methodologies for the years ended December 31, 2017 and 2016.

*Mutual funds:* Valued at the daily closing price as reported by the fund. Mutual funds held by the Museum are mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Museum are deemed to be actively traded.

*Private equity investment:* Valued at estimated fair market based on management's judgment using investee's audited financial statements.

*Money market funds and cash:* Valued at cost plus accrued interest, which approximates market.

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 4 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while management believes the 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 the Museum's fair value hierarchy for those assets measured at fair value on a recurring basis at December 31, 2017:

	<u>Level 1</u>		<u>Level 2</u>		<u>Level 3</u>		<u>Total</u>
Mutual funds:							
Fixed income fund	\$ 6,765,219	\$	-	\$	-	\$	6,765,219
Large growth fund	4,407,652		-		-		4,407,652
Small blended fund	734,902		-		-		734,902
International large value fund	2,176,649		-		-		2,176,649
Total mutual funds	<u>14,084,422</u>		<u>-</u>		<u>-</u>		<u>14,084,422</u>
Private equity investment	-		-		331,674		331,674
Money market funds and cash	<u>20,754</u>		<u>-</u>		<u>-</u>		<u>20,754</u>
Total at fair value	<u>\$ 14,105,176</u>	\$	<u>-</u>	\$	<u>331,674</u>	\$	<u>14,436,850</u>

The following table presents the Museum's fair value hierarchy for those assets measured at fair value on a recurring basis at December 31, 2016:

	<u>Level 1</u>		<u>Level 2</u>		<u>Level 3</u>		<u>Total</u>
Mutual funds:							
Fixed income fund	\$ 6,974,967	\$	-	\$	-	\$	6,974,967
Large growth fund	3,493,897		-		-		3,493,897
Small blended fund	730,597		-		-		730,597
International large value fund	1,407,602		-		-		1,407,602
Total mutual funds	<u>12,607,063</u>		<u>-</u>		<u>-</u>		<u>12,607,063</u>
Private equity investment	-		-		380,577		380,577
Money market funds and cash	<u>53,959</u>		<u>-</u>		<u>-</u>		<u>53,959</u>
Total at fair value	<u>\$ 12,661,021</u>	\$	<u>-</u>	\$	<u>380,577</u>	\$	<u>13,041,599</u>

**JOHN P. MCGOVERN**  
**MUSEUM OF HEALTH & MEDICAL SCIENCE**

Notes to Financial Statements  
December 31, 2017 and 2016

**NOTE 4 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

The table below sets forth the reconciliation of all assets and liabilities measured and recognized at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2017 and 2016.

	2017	2016
Fair Value, January 1	\$ 380,577	\$ 412,276
Net unrealized gain (loss)	(48,903)	(7,733)
Purchases	-	-
Distributions	-	(23,966)
Sales	-	-
Transfers	-	-
Fair Value, December 31	<u>\$ 331,674</u>	<u>\$ 380,577</u>

There were no transfers between assets valued as Level 3 and assets valued as Level 1 or Level 2 during the years ended December 31, 2017 and 2016.

**NOTE 5 – PROPERTY**

Property consists of the following at December 31:

	2017	2016
Land	\$ 595,912	\$ 595,912
First floor of Museum building *	10,530,528	10,522,754
Museum exhibits	4,952,543	5,120,486
Furniture and equipment	302,489	336,444
Total property, at cost	16,381,472	16,575,596
Accumulated depreciation	<u>(7,963,529)</u>	<u>(7,399,625)</u>
Property, net	<u>\$ 8,417,943</u>	<u>\$ 9,175,971</u>

\* The second floor of the Museum building is owned by the Houston Academy of Medicine, a related party.

Depreciation expense for the years ended December 31, 2017 and 2016 was \$847,057 and \$852,417, respectively.

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**NOTE 6 - ENDOWMENT**

As required by GAAP, net assets associated with endowment funds, including any funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Directors 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 portion of earnings on the endowment fund that is not required to be added to the corpus and classified in permanently restricted net assets is classified as unrestricted net assets to be used for general operations of the Museum, in a manner consistent with the standard of prudence prescribed by SPMIFA.

In accordance with SPMIFA, 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. The terms of specific agreements with respect to endowment funds,
4. General economic conditions,
5. The possible effect of inflation and deflation,
6. The expected total return from income and the appreciation of investments,
7. Other resources of the Museum, and
8. The investment policies of the Museum.

The endowment net asset composition by type of fund as of December 31, 2017 is as follows:

	Surplus (Deficiency) <u>Unrestricted Net</u>	Permanently Restricted	<u>Total</u>
Endowment net assets, beginning of year	\$ (1,162,166)	\$ 14,203,765	\$ 13,041,599
Investment return, net:			
Investment income	-	88,430	88,430
Net appreciation (depreciation) (realized and unrealized)	<u>1,316,229</u>	<u>(9,408)</u>	<u>1,306,821</u>
Total investment return, net	<u>1,316,229</u>	<u>79,022</u>	<u>1,395,251</u>
Endowment net assets, end of year	<u>\$ 154,063</u>	<u>\$ 14,282,787</u>	<u>\$ 14,436,850</u>

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Notes to Financial Statements  
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**NOTE 6 - ENDOWMENT (CONTINUED)**

Permanently restricted net assets as of December 31, 2017 are as follows:

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by SPMIFA	\$ <u>14,282,787</u>
The endowment funds classified as permanently restricted net assets	\$ <u>14,282,787</u>

The endowment net asset composition by type of fund as of December 31, 2016 is as follows:

	<u>Unrestricted Net Assets</u>	<u>Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ <u>(1,162,166)</u>	\$ <u>14,203,765</u>	\$ <u>13,041,599</u>

The changes in endowment net assets for the year ended December 31, 2016 are as follows:

	<u>Surplus (Deficiency) Unrestricted Net Assets</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ <u>(1,141,198)</u>	\$ <u>14,220,396</u>	\$ <u>13,079,198</u>
Investment return, net:			
Investment income	-	71,186	71,186
Net appreciation (depreciation) (realized and unrealized)	<u>(20,968)</u>	<u>(87,817)</u>	<u>(108,785)</u>
Total investment return, net	<u>(20,968)</u>	<u>(16,631)</u>	<u>(37,599)</u>
Endowment net assets, end of year	\$ <u>(1,162,166)</u>	\$ <u>14,203,765</u>	\$ <u>13,041,599</u>

Permanently restricted net assets as of December 31, 2016 are as follows:

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by SPMIFA	\$ <u>14,203,765</u>
The endowment funds classified as permanently restricted net assets	\$ <u>14,203,765</u>

Funds with Surplus (Deficiency)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may rise above or fall below the level that the donor or SPMIFA requires the Museum to retain as a fund of perpetual duration. The fund value had a surplus of \$154,063 and a deficit of (\$1,162,166), as of December 31, 2017 and 2016, respectively, which were reported as unrestricted net assets.



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**NOTE 6 - ENDOWMENT (CONTINUED)**

Return Objectives and Risk Parameters

The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Museum must hold in perpetuity or for a donor- specified period as well as board-designated funds. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk.

Strategies Employed for Achieving Objectives

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

Spending Policy and How the Investment Objectives Relate to Spending Policy

The Museum has a policy of appropriating for distribution each year 5 percent of its endowment fund's average fair value over the prior 3 years through the calendar year-end proceeding the fiscal year in which the distribution is planned. In establishing this policy, the Museum considered the long-term expected return on its endowment. Accordingly, over the long term, the Museum expects the current spending policy to allow its endowment to grow at an average of 5 percent annually. This is consistent with the Museum's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

**NOTE 7 - LINE OF CREDIT**

The Museum had a \$500,000 unsecured revolving line of credit agreement with a commercial bank that expired on March 1, 2017 and was not renewed. The Museum did not have an outstanding balance under the revolving line of credit agreement as of December 31, 2017 or 2016.

**NOTE 8 - RELATED PARTY TRANSACTIONS**

The second floor of the Museum building houses offices of the Harris County Medical Society (the Society) and the Houston Academy of Medicine (the Academy). The Board of Trustees of the Harris County Medical Society (the Society) appoints nine of the forty-one members of the board of the Museum. The Society's Board of Trustees also serves as the board of the Houston Academy of Medicine (the Academy). The Academy is responsible for building management and pays for related maintenance expenses. Other operating costs are also allocated based on a cost-share method between organizations. Costs exclusive to an organization are directly billed and are not allocated between organizations. When one organization incurs expense on behalf of another, it bills the other entity.

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**NOTE 8 - RELATED PARTY TRANSACTIONS (CONTINUED)**

The Museum paid the Academy approximately \$75,000 and \$76,000 in 2017 and 2016, respectively, for rental of space on the second floor of the Museum building owned by the Academy. The rental rate is based upon estimated market rental rates plus operating costs. At December 31, 2017, the Museum has an outstanding commitment of \$74,592 related to this lease for fiscal year 2018. In addition, for the years ended December 31, 2017 and 2016, the Museum paid approximately \$165,000 and \$159,999 to the Academy, respectively, for its share of allocated building operating costs, and approximately \$115,000 and \$26,000 as reimbursement of direct and other shared operating costs. In total, the Museum paid approximately \$280,000 and \$185,000, net, respectively, in 2017 and 2016 for building and other operating costs.

The Academy made contributions of approximately \$150,000 and \$130,000 to the Museum for the fiscal years 2017 and 2016, respectively. As of December 31, 2017, and 2016, the Museum owed the Society and the Academy a total of \$50,262 and \$30,348, respectively, for rents and reimbursement of expenses.

Members of the Board of Directors of the Museum contributed a total of approximately \$97,000 and \$154,000 to the Museum for the years ended December 31, 2017 and 2016, respectively.

**NOTE 9 - EMPLOYEE BENEFIT PLANS**

The Museum maintains a tax deferred annuity plan that qualifies under section §403(b) of the Internal Revenue Code. The plan is an arrangement whereby an amount to be determined year-to-year at the employer's discretion is paid to an annuity contract owned by the employee. The Museum contributed \$29,173 and \$36,439 in 2017 and 2016, respectively, net of forfeitures, to the annuity plan on behalf of participants.

**NOTE 10 - COMMITMENTS AND CONTINGENCIES**

Contractual obligations

As of December 31, 2017, the Museum had entered into written agreements for traveling and permanent exhibits. Future minimum payments under outstanding commitments for these agreements are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2018	<u>\$ 84,029</u>
Total	<u>\$ 84,029</u>

As of December 31, 2017, the Museum had paid \$84,029 in relation to this agreement, which is included in prepaid expenses as of December 31, 2017.

Claims

The Museum is occasionally subject to various claims and legal proceedings that arise in the normal course of its business activities. The claims are typically covered by the insurance carried by the Museum. In the opinion of management, the ultimate disposition of any such matters will not have a material adverse effect on the Museum's financial position, results of operations, or liquidity.