KPMG

HONOLULU ACADEMY OF ARTS

Financial Statements and Schedule

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

The Board of Trustees
Honolulu Academy of Arts:

We have audited the accompanying statements of financial position of Honolulu Academy of Arts (the Academy) as of June 30, 2011 and 2010, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Academy's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Academy's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Honolulu Academy of Arts as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in note 14 to the financial statements, subsequent to June 30, 2011, certain assets of The Contemporary Museum were gifted to the Academy.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information included in the schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

June 20, 2012

HONOLULU ACADEMY OF ARTS

Statements of Financial Position

June 30, 2011 and 2010

Assets		**2011**	**2010**
Cash	$	1,167,622	1,479,240
Inventories		402,744	380,883
Contributions receivable, net		117,500	126,370
Prepaid expenses and other		643,442	221,529
Contributed rent		601,484	730,140
Land, buildings, and equipment, net of accumulated depreciation		27,792,725	28,280,752
Long-term investments		51,712,785	45,214,715
Beneficial interest in perpetual trusts		16,161,327	14,096,002
Total assets	$	98,599,629	90,529,631
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses	$	1,245,494	881,493
Liabilities under split-interest agreements		2,549,673	2,656,339
Debt		4,017,381	3,926,613
Deferred revenue		690,813	865,262
Pension and other retirement obligations		4,666,941	5,769,200
Other		50,529	64,106
Total liabilities		13,220,831	14,163,013
Net assets:			
Unrestricted:			
Undesignated		18,459,220	16,063,893
Temporarily restricted		4,020,680	2,936,004
Permanently restricted		62,898,898	57,366,721
Total net assets		85,378,798	76,366,618
Commitments and contingencies			
Total liabilities and net assets	$	98,599,629	90,529,631

See accompanying notes to financial statements.

HONOLULU ACADEMY OF ARTS

Statement of Activities

Year ended June 30, 2011

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Gifts and bequests	$ 1,739,838	972,719	177,713	2,890,270
Net realized and unrealized loss on investments	4,071,765	658,958	3,289,139	8,019,862
Gain on sale of property, plant, and equipment	208,887	—	—	208,887
Change in value of split-interest agreements	(237,009)	5,693	2,065,325	1,834,009
Dividends and interest, net of investment fees and expenses of $354,575	229,665	130,927	—	360,592
Sales of the Academy shop	751,781	—	—	751,781
Trusts:				
R. Allerton Acquisition Fund and R. Allerton Trust	638,263	43,730	—	681,993
Others	252,988	23,531	—	276,519
Membership fees	869,448	—	—	869,448
Tuition and fees	967,242	—	—	967,242
Pavilion cafe	599,339	—	—	599,339
Admissions	234,079	—	—	234,079
Governmental grants	13,389	—	—	13,389
Special events and other	1,549,962	198	—	1,550,160
Net assets released from restrictions – satisfaction of program and art and equipment acquisitions restrictions	751,080	(751,080)	—	—
Total revenues, gains, and other support	12,640,717	1,084,676	5,532,177	19,257,570
Expenses:				
Program services:				
Education	2,926,508	—	—	2,926,508
Special exhibitions	1,790,917	—	—	1,790,917
Curatorial and conservation	1,209,316	—	—	1,209,316
Auxiliary services:				
Academy shop	648,655	—	—	648,655
Pavilion cafe	734,232	—	—	734,232
Art acquisitions	29,502	—	—	29,502
Total program services	7,339,130	—	—	7,339,130
Supporting services:				
Management and general	2,229,672	—	—	2,229,672
Development	1,636,520	—	—	1,636,520
Total supporting services	3,866,192	—	—	3,866,192
Total expenses	11,205,322	—	—	11,205,322
Change in net assets, before retirement plan changes other than net periodic benefit cost	1,435,395	1,084,676	5,532,177	8,052,248
Retirement plan changes other than net periodic benefit cost	959,932	—	—	959,932
Change in net assets	2,395,327	1,084,676	5,532,177	9,012,180
Net assets at beginning of year	16,063,893	2,936,004	57,366,721	76,366,618
Net assets at end of year	$ 18,459,220	4,020,680	62,898,898	85,378,798

See accompanying notes to financial statements.

HONOLULU ACADEMY OF ARTS

Statement of Activities

Year ended June 30, 2010

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Gifts and bequests	$ 1,662,409	604,467	124,536	2,391,412
Net realized and unrealized loss on investments	1,207,474	204,970	1,119,028	2,531,472
Gain on sale of property, plant, and equipment	963,050	—	—	963,050
Change in value of split-interest agreements	(258,312)	5,690	272,487	19,865
Dividends and interest, net of investment fees and expenses of $233,899	333,656	178,415	—	512,071
Sales of the Academy shop	937,602	—	—	937,602
Trusts:				
R. Allerton Acquisition Fund and R. Allerton Trust	687,156	48,279	—	735,435
Others	230,180	24,148	—	254,328
Membership fees	916,248	—	—	916,248
Tuition and fees	889,166	—	—	889,166
Pavilion cafe	627,378	—	—	627,378
Admissions	257,186	—	—	257,186
Governmental grants	52,843	—	—	52,843
Special events and other	1,989,166	—	—	1,989,166
Net assets released from restrictions – satisfaction of program and art and equipment acquisitions restrictions	813,212	(813,212)	—	—
Total revenues, gains, and other support	11,308,414	252,757	1,516,051	13,077,222
Expenses:				
Program services:				
Education	2,799,940	—	—	2,799,940
Special exhibitions	1,942,419	—	—	1,942,419
Curatorial and conservation	1,229,260	—	—	1,229,260
Auxiliary services:				
Academy shop	958,038	—	—	958,038
Pavilion cafe	742,357	—	—	742,357
Art acquisitions	111,648	—	—	111,648
Total program services	7,783,662	—	—	7,783,662
Supporting services:				
Management and general	2,090,897	—	—	2,090,897
Development	1,550,756	—	—	1,550,756
Total supporting services	3,641,653	—	—	3,641,653
Total expenses	11,425,315	—	—	11,425,315
Change in net assets, before retirement plan changes other than net periodic benefit cost	(116,901)	252,757	1,516,051	1,651,907
Retirement plan changes other than net periodic benefit cost	(1,576,813)	—	—	(1,576,813)
Change in net assets	(1,693,714)	252,757	1,516,051	75,094
Net assets at beginning of year	17,757,607	2,683,247	55,850,670	76,291,524
Net assets at end of year	$ 16,063,893	2,936,004	57,366,721	76,366,618

See accompanying notes to financial statements.

HONOLULU ACADEMY OF ARTS

Statements of Cash Flows

Years ended June 30, 2011 and 2010

		2011	2010
Cash flows from operating activities:			
Change in net assets	$	9,012,180	75,094
Adjustments to reconcile change in net assets to net cash used in operating activities:			
Depreciation and amortization		1,044,061	1,057,553
Net realized and unrealized gain on investments		(8,019,862)	(2,531,471)
Gain on sale of land, buildings, and equipment		(208,887)	(963,050)
Change in value of split-interest agreements		(1,834,009)	(19,866)
Increase (decrease) in inventories		(21,861)	276,318
Decrease in contributions receivable		8,870	562,472
Increase (decrease) in prepaid expenses and other		(421,913)	23,608
Increase (decrease) in accounts payable and accrued expenses		364,001	(88,799)
Decrease in liabilities under split-interest agreements		(337,982)	(334,276)
Increase (decrease) in deferred revenue		(174,449)	25,956
Increase (decrease) in pension and other retirement obligations		(1,102,259)	1,393,756
Decrease in other liabilities		(13,577)	(3,696)
Contributions restricted for long-term investment		(278,778)	(211,881)
Art acquisitions		5,000	94,300
Net cash used in operating activities		(1,979,465)	(643,982)
Cash flows from investing activities:			
Proceeds from sale of investments		10,531,702	13,591,727
Purchase of investments		(9,009,910)	(14,247,816)
Purchases of buildings and equipment		(702,708)	(564,390)
Proceeds from sale of land, buildings, and equipment		484,217	2,655,635
Art acquisitions		(5,000)	(94,300)
Net cash provided by investing activities		1,298,301	1,340,856
Cash flows from financing activities:			
Proceeds from issuance of debt		105,136	3,926,613
Payments on debt		(14,368)	(3,450,091)
Proceeds from contributions restricted for:			
Investment in endowment		177,713	124,536
Investment in land, buildings, and equipment		101,065	87,345
Net cash provided by financing activities		369,546	688,403
Net increase (decrease) in cash		(311,618)	1,385,277
Cash at beginning of year		1,479,240	93,963
Cash at end of year	$	1,167,622	1,479,240
Supplemental cash flow information:			
Interest paid	$	74,927	50,704

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

(a) General

The Honolulu Academy of Arts (the Academy) was founded in 1927 to provide educational and cultural enrichment in the arts. It is a private, nonprofit institution accredited by the American Association of Museums. The Academy's operations are conducted in the State of Hawaii.

(b) Financial Statement Presentation

Net assets and revenues, gains, and other support and expenses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Academy and changes therein are classified and reported as follows:

Unrestricted Net Assets – Net assets not subject to donor-imposed stipulations.

Temporarily Restricted Net Assets – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Academy and/or the passage of time.

Permanently Restricted Net Assets – Net assets subject to donor-imposed stipulations that must be maintained permanently by the Academy. The donors of these assets permit the Academy to use all of the income earned on related investments for general or specific purposes.

(c) Cash Equivalents

For purposes of the statements of cash flows, the Academy considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

(d) Inventories

Merchandise inventories consist of gift shop and pavilion cafe items and are recorded at the lower of cost (specific identification) or market.

(e) Investments

Marketable securities are reported at fair value with unrealized gains and losses included in the accompanying statements of activities. Fair value is based on quoted market prices.

In January 2009, the Academy entered into alternative investments. The Academy's alternative investments include hedge funds and "fund of funds," which may be invested in less liquid assets. Fair value is generally based on information provided by the respective external investment managers that is reviewed by management. The Academy believes that the carrying amount of these alternative investments is a reasonable estimate of fair value as of the respective balance sheet dates. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investment existed. Such differences could be material. As described in note 1(p), the Academy utilized the net asset value per share at the respective balance sheet dates for certain alternative investments as a practical expedient for the estimation of the fair value of these investments.

(Continued)

Gains and losses on investments are reported in the statements of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are capitalized at cost, if purchased, or at fair market value at the date of the donation. Assets contributed for which the fair value is not determinable at the date of donation are recorded, as support, if and when such values are determined.

The Academy reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Academy reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Depreciation on buildings and equipment is calculated on the straight-line method over the estimated useful lives of the assets.

(g) Contributions

Contributions are recorded in the period received. Unconditional promises to give (contributions receivable) that are expected to be collected within one year are recorded at net realizable value. Contributions receivable that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using interest rates commensurate with the associated risks to the years in which promises are received. Amortization of the discounts is included in gifts and bequests. Conditional contributions are recorded at their estimated fair value in the period the conditions are met or in the period received if there is only a remote likelihood that those conditions will not be met.

The Academy provides an allowance for uncollectible contributions based upon historical experience with its donors as well as individual donor circumstances.

The Academy reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statements of activities as net assets released from restrictions.

(h) Charitable Remainder Trusts

The Academy reports charitable remainder trust arrangements, where a donor establishes and funds a trust with specified distributions to be made to designated beneficiaries over the trust’s term, as contributions in the period in which the trust is established. The assets held in the trust are recorded at fair value, and the obligations to beneficiaries are recorded as liabilities at the present value of the estimated future payments to be distributed.

(Continued)

(i) Perpetual Trusts

The Academy is also the beneficiary of certain perpetual trusts held and administered by others. The present values of the estimated future cash receipts from the trust are recognized as assets and contribution revenues at the dates the trusts are established. Distributions from the trusts are recorded as investment return, and the carrying value, of the assets are adjusted for changes in the estimates of future receipts.

(j) Charitable Gift Annuities

The Academy recognizes contribution revenues of charitable gift annuities at the date the agreements are established after recording liabilities for the present value (computed at rates ranging from 3% to 7% as of June 30, 2011 and 2010) of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted during the term of the agreements for changes in the value of the assets, accretion of the discount, and other changes in the estimates of future benefits. The assets held in conjunction with the charitable gift annuities are included in investments in the accompanying statements of financial position.

(k) Art Collection

The Academy's art collection comprises works of art, which are held for exhibition, research, and educational purposes. Each of the items is cataloged, preserved, and cared for, and activities verifying their existence and assessing their condition are performed continuously. The collections are subject to a policy that requires proceeds from their sales to be used to acquire other items for the collection.

Works of art in the Academy's collection are not recognized as assets in the accompanying statements of financial position. Purchases of art are recorded as decreases in unrestricted net assets in the year in which the items are acquired.

(l) Pension and Other Postretirement Plans

The Academy has a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. The benefits are based on age, years of service, and the level of compensation during the five years before retirement. The Academy also sponsors a defined benefit postretirement plan for select employees.

The Academy records annual amounts relating to its pension and postretirement plans based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, and turnover rates. The Academy reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The Academy believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions. The effect of modifications to those assumptions is recorded in its changes in unrestricted net assets and amortization to net periodic cost over future periods. The Academy uses a measurement date of June 30.

(Continued)

The net periodic costs are recognized as employees render the services necessary to earn the pension and postretirement benefits.

(m) Deferred Revenue

Deferred revenue represents annual membership dues collected for future periods subsequent to June 30, 2011 and 2010, for clarity and exhibition fees received as deposits for traveling exhibitions organized by the Academy.

(n) Long-Lived Assets

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, the Academy first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques, including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary.

(o) Income Taxes

The Academy is an organization exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and is generally not subject to federal income taxes. However, the Academy is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

The Academy recognizes the effect of income tax positions only if such positions are more likely than not of being sustained.

(p) Fair Value Measurements

The Academy utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Academy determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.
- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

(q) Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued new guidance on the disclosure requirements for fair value measurements and provided clarification of the existing disclosure requirements. This guidance requires separate disclosures for significant transfers into and out of Levels 1 and 2 fair value measurements and the reasons for the transfers. In the reconciliation for Level 3 fair value measurements, the new guidance requires separate disclosures for purchases, sales, issuances, and settlements on a gross basis. This guidance revises the existing disclosure requirements to provide an increased level of disaggregation for classes of assets and liabilities measured at fair value, and requires disclosures about the valuation techniques and inputs for fair value measurements using Level 2 and Level 3 inputs. This guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements, which are effective for interim and annual reporting periods beginning after December 15, 2010. The impact of the requirements applied for the reporting period beginning after December 15, 2009 did not have a material impact on the financial statements, and the Academy expects that the adoption of the requirements of the authoritative guidance effective for the period beginning after December 15, 2010 will not have a material impact on the financial statements.

(r) Use of Estimates

The preparation of the financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management of the Academy to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Significant items subject to such estimates and assumptions include the carrying amounts of land, buildings, and equipment, valuation of contributions and other receivables, investments, beneficial interest in perpetual trusts, liabilities under split-interest agreements, and assets and obligations related to retirement plans. Actual results could differ from those estimates. The current economic environment has increased the degree of uncertainty inherent in these estimates.

(2) Contributions Receivable

Contributions receivable consisted of the following at June 30, 2011 and 2010:

	2011	2010
Contributions to be received within one year	$ 117,500	107,820
Contributions to be received in one to five years	—	20,000
	117,500	127,820
Less discount to present value (3%)	—	1,450
	$ 117,500	126,370

(3) Contributed Rent

The Academy leases land and a building for its Art Center at Linekona from the State of Hawaii. The lease is for a term of 55 years, through November 30, 2041. For the 10-year period beginning December 1, 2006, the lease is payable in annual installments of $480. The annual rent will then be renegotiated at the expiration of the thirtieth (2016), fortieth (2026), and fiftieth (2036) year.

Contributed rent represents the net present value of the difference between the fair rental value of the property and the stated amount of the lease payments, which does not exceed the fair value of the real property at the lease commencement date. The amount is considered a temporarily restricted asset and will be released to unrestricted over the lease term.

Contributed rent at June 30, 2011 and 2010 is $601,484 and $730,140, respectively, and the related amortization for the years ended June 30, 2011 and 2010 is $128,656 and $134,840, respectively. The contribution is discounted using the risk-free rate on the lease amendment date of 4.81%.

(4) Investments

At June 30, 2011 and 2010, investments are classified as permanently restricted net assets of $51,712,785 and $45,214,715, respectively.

A summary of the fair values of investments at June 30, 2011 and 2010 is as follows:

		2011	2010
Cash	$	10,867	66,023
Money market fund		149,489	953,750
U.S. Treasury obligations		1,185,683	1,218,981
U.S. government agency bonds		711,798	1,831,211
Corporate stocks		—	3,339
Domestic equities		229,162	185,410
Corporate bonds		2,131,290	3,209,524
Mutual funds		14,971,252	12,329,137
Open ended interval fund		862,809	—
Hedge funds		19,122,700	14,549,562
Fund of funds		12,337,735	10,867,778
	$	51,712,785	45,214,715

The Academy invests in various types of investment securities. Investment securities 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 the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of financial position.

(5) Land, Buildings, and Equipment

A summary of land, buildings, and equipment at June 30, 2011 and 2010 is as follows:

	Depreciable lives	Cost 2011	Cost 2010
Depreciable assets:			
Land improvements	20 years	$ 267,983	267,983
Buildings	20-50 years	33,366,020	33,269,322
Equipment	5-10 years	4,662,628	4,627,625
		38,296,631	38,164,930
Less accumulated depreciation		13,817,520	12,954,966
		24,479,111	25,209,964
Land		2,343,276	2,600,954
Construction in progress		970,338	469,834
		$ 27,792,725	28,280,752

(6) Art Collection

The Academy does not estimate the value of art objects acquired by gift. The cost of objects purchased was $5,000 and $94,300 for the years ended June 30, 2011 and 2010, respectively, and was charged to net assets in the accompanying statements of activities.

Gifts of cash or other property restricted by donors for the purchase of art and artifacts for the collection or proceeds from deaccessions are recognized as income in temporarily restricted net assets and are only available to purchase art and artifacts for the Academy's collection. There were no proceeds from sale of collection items during the years ended June 30, 2011 and 2010. Unexpended gifts are included in the temporarily restricted net assets at June 30, 2011 and 2010.

(7) Debt

Debt at June 30, 2011 and 2010 consists of the following:

		2011	2010
Borrowings under a $3,500,000 term loan with a bank, various interest rate options available at bank's base rate or LIBOR (1.21% at June 30, 2011), accrued interest due monthly, with principal due January 2015.	$	3,459,663	3,459,663
Borrowings under an adjustable rate term loan with a bank, interest at 6.15% through May 10, 2020, with a new fixed rate determined based on prevailing rates, interest-only payments for the first 12 months, with equal monthly installments of principal and interest of $17,398, final payment due May 2021.		557,718	466,950
Total debt	$	4,017,381	3,926,613

(8) Leases

(a) As Lessor

The Academy is lessor under month-to-month operating leases for residential and commercial property in Honolulu. The commercial leases require that the lessee pay common area maintenance costs. Total rental income and common area recoveries for the years ended June 30, 2011 and 2010 were $14,675 and $46,532, respectively.

(b) As Lessee

The Academy leases land, building, and improvements from the State of Hawaii for its Linekona Art Center under an operating lease agreement that expires in 2041. The Academy also leased storage space under various operating leases, which either expired or were terminated as of June 30, 2010.

Total rent expense under operating leases for the years ended June 30, 2011 and 2010 was $480 and $106,110, respectively.

Future minimum lease commitments under operating leases as of June 30, 2011 are as follows:

Year ending June 30:		
2012	$	480
2013		480
2014		480
2015		480
2016		480
Thereafter		12,200
	$	14,600

(Continued)

(9) Temporarily Restricted Net Assets

Temporarily restricted net assets at June 30, 2011 and 2010 are available for the following purposes:

		2011	2010
Education	$	1,186,367	1,113,127
Management and general		874,966	712,288
Curatorial and conservation		468,006	318,851
Special exhibitions		560,613	199,988
Art acquisitions		930,728	591,750
	$	4,020,680	2,936,004

Net assets in the amount of $751,080 and $813,212 for the years ended June 30, 2011 and 2010, respectively, were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows:

		2011	2010
Education	$	322,356	322,811
Curatorial and conservation		251,853	276,263
Management and general		115,693	67,701
Special exhibitions		39,878	56,709
Auxiliary		16,300	—
Art acquisitions		5,000	89,728
	$	751,080	813,212

(10) Permanently Restricted Net Assets

At June 30, 2011 and 2010, permanently restricted net assets (e.g., endowment funds) consisted of the following:

		2011	2010
Management and general	$	47,571,153	42,268,866
Art acquisitions		7,547,161	7,434,842
Curatorial and conservation		3,403,355	3,338,332
Education		2,980,171	2,956,671
Special exhibitions		1,397,058	1,368,010
	$	62,898,898	57,366,721

(11) Retirement Plans Benefits

The Academy has a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. The benefits are based on age, years of service, and the level of compensation during the five years before retirement. The Academy makes annual contributions to the plan consistent with the funding requirements of the Employee Retirement Income Security Act. The pension plan was frozen on June 1, 2009, and no participants have accrued any benefits under the pension plan after the plan's freeze.

The Academy also sponsors a noncontributory defined benefit supplemental retirement plan that provides retirement benefits to select full-time employees.

Actuarial gains and losses are generally amortized subject to the corridor, over the average remaining service life of the Academy's active employees. The Academy uses a June 30 measurement date.

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at June 30, 2011 and 2010:

	2011		2010	
	Pension benefits	**Supplemental retirement plan benefits**	**Pension benefits**	**Supplemental retirement plan benefits**
Benefit obligation	$ 11,431,150	719,339	11,622,202	719,475
Fair value of plan assets	7,483,548	—	6,572,477	—
Funded status	$ 3,947,602	719,339	5,049,725	719,475
Amounts recognized in the statements of financial position consist of:				
Liabilities	$ 3,947,602	719,339	5,049,725	719,475

Amounts recognized in change in net assets consist of the following:

	2011		2010	
	Pension benefits	**Supplemental retirement plan benefits**	**Pension benefits**	**Supplemental retirement plan benefits**
Net periodic benefit cost	$ (219,886)	(31,926)	(166,212)	(36,162)
Net gain (loss)	977,054	(17,122)	(1,710,347)	133,534
	$ 757,168	(49,048)	(1,876,559)	97,372

Weighted average assumptions used to determine benefit obligations for 2011 and 2010 were as follows:

	2011		2010	
	Pension benefits	**Supplemental retirement plan benefits**	**Pension benefits**	**Supplemental retirement plan benefits**
Discount rate	5.50%	4.97%	5.44%	5.22%
Rate of compensation increase	—	—	—	4.00

Weighted average assumptions used to determine net benefits cost for 2011 and 2010 were as follows:

	2011		2010	
	Pension benefits	**Supplemental retirement plan benefits**	**Pension benefits**	**Supplemental retirement plan benefits**
Discount rate	5.44%	5.22%	6.51%	6.40%
Expected long-term rate of return on plan assets	7.50	N/A	7.50	N/A
Rate of compensation increase	—	—	4.00	4.00

The Academy's overall expected long-term rate of return on assets is 7.5%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the return on individual asset categories. The return is based exclusively on historical returns, without adjustments.

The following table summarizes employer contributions and benefits paid during the years ended June 30, 2011 and 2010:

	2011		2010	
	Pension benefits	**Supplemental retirement plan benefits**	**Pension benefits**	**Supplemental retirement plan benefits**
Employer contributions	$ 344,955	53,420	332,011	53,420
Benefits paid	(575,722)	(53,420)	(567,036)	(53,420)

(a) Plan Assets

The asset allocations of the Academy's pension benefits as of the June 30 measurement date were as follows:

	2011	2010
Asset category:		
Equity securities	60.00%	57.00%
Debt securities	38.00	34.00
Other	2.00	9.00
Total	100.00%	100.00%

The Academy's investment policies and strategies for the pension benefits plan do not use target allocations for the individual asset categories. The Academy's investment goals are to maximize returns subject to specific risk management policies. Its risk management policies permit investments in mutual funds, debt and equity securities, and prohibits investments in derivative financial instruments, commodities and foreign securities, other than those listed on a major U.S. security exchange. The Academy addresses diversification by the use of mutual fund investments whose underlying investments are in domestic and international fixed-income securities and domestic and international equity securities. These mutual funds are readily marketable and can be sold to fund benefit payment obligations as they become payable.

The following tables summarize the asset allocations of the Academy's pension plan assets as of June 30, 2011 and 2010:

	Fair value measurements June 30, 2011			
	Pension benefits – plan assets			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Asset category:				
Cash	$ 136,702	136,702	—	—
U.S. Treasury obligations	36,867	36,867	—	—
U.S. government agencies	645,643	645,643	—	—
Municipal obligations	76,704	76,704	—	—
Mutual funds	2,951,013	2,951,013	—	—
Corporate bonds	926,063	926,063	—	—
Corporate stock	2,710,556	2,710,556	—	—
Total	$ 7,483,548	7,483,548	—	—

		Fair value measurements June 30, 2010			
		Pension benefits – plan assets			
		Total	Quoted prices in active markets for identical assets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Asset category:					
Cash	$	593,185	593,185	—	—
U.S. Treasury obligations		421,532	421,532	—	—
U.S. government agencies		862,000	862,000	—	—
Mutual funds		1,526,679	1,526,679	—	—
Corporate bonds		819,870	819,870	—	—
Corporate stock		2,349,211	2,349,211	—	—
Total	$	6,572,477	6,572,477	—	—

(b) Cash Flows

The Academy expects to contribute $477,177 to its pension plan and $53,420 to its supplemental retirement plan in fiscal year 2012.

The benefits expected to be paid from the pension plan in each year from 2012 to 2016 are $624,000, $621,000, $632,000, $673,000, and $713,000, respectively. The aggregate benefits expected to be paid in the five years from 2017 to 2021 are $4,026,000. The expected benefits are based on the same assumptions used to measure the Academy's benefit obligation at June 30 and include estimated future employee service.

The benefits expected to be paid for the supplemental retirement plan in each year from 2012 to 2016 are $53,000, $53,000, $52,000, $52,000, and $51,000, respectively. The aggregate benefits expected to be paid in the five years from 2017 to 2021 are $278,000. The expected benefits are based on the same assumptions used to measure the Academy's benefit obligation at June 30 and include estimated future employee service.

(12) Endowment

The Academy's endowment consists of approximately 50 individual donor-restricted funds established for a variety of purposes. As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. At June 30, 2011 and 2010, the endowment fund amounted to $59,230,965 and $51,495,217, respectively.

For the years ended June 30, 2011 and 2010, the changes in endowment net assets are as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, June 30, 2009	$ (6,646,021)	640,067	55,850,670	49,844,716
Investment return:				
Dividends and interest, net of management fees and expenses	260,094	175,676	—	435,770
Net realized and unrealized losses	866,915	296,550	1,083,886	2,247,351
Total net investment return	1,127,009	472,226	1,083,886	2,683,121
Change in value of split-interest agreements	—	—	272,487	272,487
Gifts and bequests	—	—	124,536	124,536
Donor-restricted funds below historic dollar value	(35,142)	—	35,142	—
Appropriation of endowment assets for expenditures	(1,066,951)	(362,692)	—	(1,429,643)
Endowment net assets, June 30, 2010	(6,621,105)	749,601	57,366,721	51,495,217
Investment return:				
Dividends and interest, net of management fees and expenses	184,935	129,108	—	314,043
Net realized and unrealized losses	3,193,733	980,564	2,550,241	6,724,538
Total net investment return	3,378,668	1,109,672	2,550,241	7,038,581
Change in value of split-interest agreements	—	—	2,065,325	2,065,325
Gifts and bequests	—	—	177,713	177,713
Donor-restricted funds below historic dollar value	(738,898)	—	738,898	—
Appropriation of endowment assets for expenditures	(1,182,255)	(363,616)	—	(1,545,871)
Endowment net assets, June 30, 2011	$ (5,163,590)	1,495,657	62,898,898	59,230,965

(Continued)

(a) Interpretation of Relevant Law

The Board of the Academy (Board) has interpreted Hawaii's Uniform Prudent Management of Institutional Funds Act (HUPMIFA), which was enacted by the State of Hawaii on July 1, 2009, 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 Academy 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 expended by the Academy in a manner consistent with the standard of prudence prescribed by HUPMIFA. In accordance with HUPMIFA, the Academy 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 Academy 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 Academy

(7) The investment policies of the Academy.

(b) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or HUPMIFA requires the Academy to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were $5,421,295 and $6,721,296 as of June 30, 2011 and 2010, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred due to the investment of permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board.

(c) Return Objectives and Risks Parameters

The Academy 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 Academy must hold in perpetuity or for donor-specified periods. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed certain published indexes while assuming a moderate level of investment risk.

(d) Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Academy 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 Academy 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.

(e) Spending Policy

The Academy's spending policy is to distribute 5.0% annually from the total endowment fund as calculated by a trailing 12-quarter moving average of the total fund as determined on June 30 of the fiscal year under consideration. Over the long term, the Academy expects the current spending policy to allow its endowment to be a balance between preserving the real (after inflation) purchasing power of the endowment principal with the need to make fund program-related expenses.

(13) Fair Value Measurements

(a) Fair Value of Financial Instruments

The fair values of the financial instruments represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Academy's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Academy based on the best information available in the circumstances.

The carrying amounts of cash, note receivable, accounts payable, and accrued expenses, and other liabilities approximate fair value because of the short maturity of those instruments.

The carrying amount of contributions receivable approximates fair value as the interest rates used to discount unconditional promises to give are commensurate with market interest rates at the periods then ended. The carrying amount of contributed rent approximates fair value as the discount rate used to calculate present value is the risk-free rate as of the date of lease amendment.

As of June 30, 2011 and 2010, the carrying and fair value of investments amounted to $51,712,785 and $45,214,715, respectively. As of June 30, 2011 and 2010, the carrying and fair value of the Academy's beneficial interest in perpetual trusts was $16,161,327 and $14,096,002, respectively. Refer to note 1(e) for discussion of valuation methods for investments. The fair value of beneficial interest in perpetual trusts is based on quoted market prices of the underlying investments.

As of June 30, 2011 and 2010, the carrying amount of debt approximates fair value as the interest rate is commensurate with interest rates currently offered by local lending institutions for loans with similar terms to companies with comparable credit risk. The carrying amount of liability under split-interest agreements approximates fair value as discount rates used are commensurate with published risk-free rates.

The fair values of other financial instruments are not determinable or are not significant to the financial statements.

(b) Fair Value Hierarchy

The following tables present assets and liabilities that are measured at fair value on a recurring basis at June 30, 2011 and 2010:

		Fair value measurements at reporting date using		
	June 30, 2011	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Cash	$ 10,867	10,867	—	—
Money market fund	149,489	—	149,489	—
U.S. Treasury obligations	1,185,683	1,185,683	—	—
U.S. government agency bonds	711,798	711,798	—	—
Domestic equities	229,162	229,162	—	—
Corporate bonds	2,131,290	2,131,290	—	—
Mutual funds	14,971,252	14,971,252	—	—
Open ended interval fund	862,809		862,809	—
Hedge funds	19,122,700	—	19,122,700	—
Fund of funds	12,337,735	—	12,337,735	—
Beneficial interest in perpetual trusts	16,161,327	—	16,161,327	—
Total	$ 67,874,112	19,240,052	48,634,060	—

	June 30, 2010	Fair value measurements at reporting date using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash	$ 66,023	66,023	—	—
Money market fund	953,750	—	953,750	—
U.S. Treasury obligations	1,218,981	1,218,981	—	—
U.S. government agency bonds	1,831,211	1,831,211	—	—
Corporate stocks	3,339	3,339	—	—
Domestic equities	185,410	185,410	—	—
Corporate bonds	3,209,524	3,209,524	—	—
Mutual funds	12,329,137	12,329,137	—	—
Hedge funds	14,549,562	—	14,549,562	—
Fund of funds	10,867,778	—	10,867,778	—
Beneficial interest in perpetual trusts	14,096,002	—	14,096,002	—
Total	$ 59,310,717	18,843,625	40,467,092	—

The following table presents the Academy's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurement*, for the year ended June 30, 2011:

	Assets: Fund of funds
Balance at June 30, 2009	$ 8,170,342
Total gains included in income:	
Realized	
Unrealized	897,436
Purchases, issuance, and settlements (net)	1,800,000
Transfers into and/or out of Level 3 (net) (1)	(10,867,778)
Balance at June 30, 2010	—

(Continued)

		Assets
		Fund of funds
Total gains included in income:		
Realized	$	—
Unrealized		—
Purchases, issuance, and settlements (net)		—
Transfers into and/or out of Level 3 (net) (1)		—
Balance at June 30, 2011	$	—

(1) The balance consists of the following transfer out of Level 3:

a. Fund of fund investment of $10,867,778 previously classified as Level 3, which was reclassified to Level 2 due to the Academy's ability to redeem its investments at net asset value per share (or its equivalent) at the measurement date.

All realized and unrealized gains (or losses) for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC Topic 820 are reported in net realized and unrealized income (loss) on investments in the accompanying statement of activities.

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended June 30, 2011.

The Academy did not have any financial assets or liabilities measured at fair value on a nonrecurring basis at June 30, 2011 and 2010.

(14) Subsequent Events

On July 1, 2011, subject to the restrictions and conditions of a gift agreement signed by The Contemporary Museum (TCM) and the Academy, TCM gifted artwork, real property, cash, and investments, to the extent transferable, to the Academy. Total amount of real property, which is based on appraisals, and investments transferred in July 2011 amounted to $14,800,000 and $7,763,000, respectively. Upon donor or Attorney General's approval, subsequent TCM gifts of unrestricted, temporarily and/or permanently restricted net assets amounting to approximately $3,142,000 were received in FY 2012. These gifts were recorded as donations by the Academy based on restrictions stipulated by the donor, if any.

The Company has evaluated subsequent events from the balance sheet date through June 20, 2012, the date at which the financial statements were available to be issued, and determined there were no other items to disclose.

HONOLULU ACADEMY OF ARTS

Schedule of Functional Expenses

Year ended June 30, 2011

	Program services						Supporting services			Total program and supporting services
	Education	Special exhibitions	Curatorial and conservation	Auxiliary	Art acquisitions	Total	Management and general	Development	Total	
Salaries and wages	$ 1,194,036	609,244	718,844	522,141	—	3,044,265	695,961	622,122	1,318,083	4,362,348
Utilities	278,025	339,216	67,273	57,101	—	741,615	187,503	118,452	305,955	1,047,570
Depreciation and amortization	382,360	299,473	58,783	39,718	—	780,334	159,666	104,061	263,727	1,044,061
Employee benefits	211,486	141,603	155,839	113,884	—	622,812	275,569	133,834	409,403	1,032,215
Professional and other services	233,977	39,001	2,855	2,079	6,455	284,367	520,767	217,878	738,645	1,023,012
Purchases for resale	—	—	—	499,292	—	499,292	—	—	—	499,292
Repairs and maintenance	103,980	80,146	25,946	30,017	—	240,089	95,727	40,273	136,000	376,089
Retirement plans	38,676	48,975	29,461	31,028	—	148,140	70,564	33,108	103,672	251,812
Publicity and printing	112,370	15,774	4,497	12,777	—	145,418	27,103	121,400	148,503	293,921
General	22,055	35,897	9,000	14,665	—	81,617	30,412	72,508	102,920	184,537
Supplies	81,961	23,403	24,719	13,083	2,978	146,144	12,985	25,749	38,734	184,878
Insurance	15,424	34,820	59,755	4,618	—	114,617	30,665	12,099	42,764	157,381
Travel	113,442	22,665	5,977	6,394	4,799	153,277	655	1,082	1,737	155,014
Postage and freight	28,682	60,413	6,416	(448)	15,270	110,333	5,271	26,136	31,407	141,740
Hospitality	24,656	2,997	2,946	4,865	—	35,464	26,391	66,380	92,771	128,235
Education and theatre	60,137	513	2,293	523	—	63,466	568	3,260	3,828	67,294
Security	14,474	22,415	5,089	2,973	—	44,951	11,951	7,789	19,740	64,691
Conservation	—	8,985	29,006	2,320	—	40,311	—	—	—	40,311
Books	10,281	—	543	100	—	10,924	196	143	339	11,263
Art acquisitions	—	5,000	—	—	—	5,000	—	—	—	5,000
Other	486	377	74	25,757	—	26,694	77,718	30,246	107,964	134,658
	$ 2,926,508	1,790,917	1,209,316	1,382,887	29,502	7,339,130	2,229,672	1,636,520	3,866,192	11,205,322

See accompanying independent auditors' report.