

**NATIONAL GALLERY OF ART**



**FINANCIAL STATEMENTS**  
**for the year ended September 30, 2008**  
**AND**  
**REPORT THEREON**



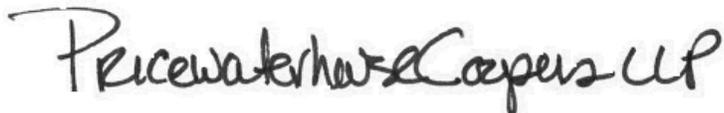
**Report of Independent Auditors**

To the Board of Trustees of  
The National Gallery of Art

In our opinion, the accompanying statements of financial position and the related statements of activities and cash flows, present fairly, in all material respects, the financial position of the National Gallery of Art (the Gallery) at September 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

These financial statements are the responsibility of the Gallery's management; our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Gallery's 2007 financial statements, and in our report dated November 9, 2007 we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States, which 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 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, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In accordance with Government Auditing Standards, we have also issued a report dated November 13, 2008, on our consideration of the Gallery's internal control structure and its compliance with laws and regulations.



November 13, 2008

**NATIONAL GALLERY OF ART**  
**STATEMENTS OF FINANCIAL POSITION**  
**September 30, 2008 and 2007**

ASSETS	2008	2007
	<u>          </u>	<u>          </u>
Cash and cash equivalents	\$ 38,537,082	\$ 34,331,102
Accounts receivable, net	2,487,440	1,817,339
Pledges receivable, net	21,739,700	39,090,880
Investments	609,641,948	724,092,677
Trusts held by others	11,439,562	19,063,039
Publications inventory, net	1,671,784	1,612,308
Deferred charges	1,253,084	1,204,710
Fixed assets, net	191,790,381	183,234,343
Art collections	-	-
	<u>          </u>	<u>          </u>
Total assets	<u>\$ 878,560,981</u>	<u>\$ 1,004,446,398</u>
<b>LIABILITIES AND NET ASSETS</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 42,419,962	\$ 39,736,611
Capital lease obligation	1,883,955	2,037,403
Contractual obligations	31,808,398	39,435,357
Asset retirement obligation	19,149,837	19,368,200
	<u>          </u>	<u>          </u>
Total liabilities	<u>95,262,152</u>	<u>100,577,571</u>
Net assets:		
Unrestricted		
Designated for collections and art purchases	15,054,671	21,869,501
Designated for special exhibitions	10,292,464	10,424,172
Designated for capital projects	-	25,926,161
Designated for education and public programs	5,346,311	24,239,280
Designated for other operating purposes	41,184,478	67,663,091
Designated for publications, including systematic catalogues	20,562,474	26,510,524
Designated for fixed assets	189,906,426	181,350,388
	<u>          </u>	<u>          </u>
Total unrestricted	<u>282,346,824</u>	<u>357,983,117</u>
Temporarily restricted	128,223,946	177,040,132
Permanently restricted	372,728,059	368,845,578
	<u>          </u>	<u>          </u>
Total net assets	<u>783,298,829</u>	<u>903,868,827</u>
Total liabilities and net assets	<u>\$ 878,560,981</u>	<u>\$ 1,004,446,398</u>

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

**NATIONAL GALLERY OF ART  
STATEMENTS OF ACTIVITIES**

**for the years ended September 30, 2008 and 2007  
with summarized financial information  
for the year ended September 30, 2007**

OPERATING	Unrestricted	Temporarily Restricted	Permanently Restricted	2008 Total	2007 Total
Support and revenue:					
U.S. Government appropriation	\$ 97,774,544	\$ 3,297,740	\$ -	\$ 101,072,284	\$ 97,209,375
Gifts and grants	3,692,673	6,318,917	-	10,011,590	22,047,628
Gallery shop sales, net	10,048,393	-	-	10,048,393	8,305,760
Investment return designated for operations	(12,173,559)	13,210,000	-	1,036,441	32,409,770
Royalties and other income	2,244,907	-	-	2,244,907	1,664,013
	<u>101,586,958</u>	<u>22,826,657</u>	<u>-</u>	<u>124,413,615</u>	<u>161,636,546</u>
Net assets released from restrictions to fund operating expenses	21,172,266	(21,172,266)	-	-	-
Total support and revenue	<u>122,759,224</u>	<u>1,654,391</u>	<u>-</u>	<u>124,413,615</u>	<u>161,636,546</u>
Operating expenses:					
Program services:					
Collections	42,798,945	-	-	42,798,945	41,942,996
Special exhibitions	22,238,131	-	-	22,238,131	19,752,982
Education, gallery shops and public programs	46,035,516	-	-	46,035,516	42,149,679
Editorial and photography	5,254,117	-	-	5,254,117	5,001,047
Total program services	<u>116,326,709</u>	<u>-</u>	<u>-</u>	<u>116,326,709</u>	<u>108,846,704</u>
Supporting services:					
General and administrative	30,524,240	-	-	30,524,240	31,047,779
Development	4,620,012	-	-	4,620,012	4,143,646
Total supporting services	<u>35,144,252</u>	<u>-</u>	<u>-</u>	<u>35,144,252</u>	<u>35,191,425</u>
Total expenses	<u>151,470,961</u>	<u>-</u>	<u>-</u>	<u>151,470,961</u>	<u>144,038,129</u>
(Decrease) increase in net assets from operating activities	<u>(28,711,737)</u>	<u>1,654,391</u>	<u>-</u>	<u>(27,057,346)</u>	<u>17,598,417</u>
<b>NON-OPERATING</b>					
U.S. Government appropriation	-	17,735,935	-	17,735,935	15,961,659
Non-operating gifts and grants	-	10,387,060	8,254,689	18,641,749	37,725,898
Provision for bad debts	(685)	(1,924,890)	(2,000,000)	(3,925,575)	-
Changes in value of trusts held by others	387,717	(18,350)	(1,714,644)	(1,345,277)	865,777
Investment return in excess of amount designated for operations	(67,292,573)	(44,533,825)	-	(111,826,398)	74,601,799
Reclassification of net asset balances	186,506	471,058	(657,564)	-	-
Net assets released from restrictions to fund non-operating expenses	32,587,565	(32,587,565)	-	-	-
Change in net assets from non-operating activities before acquisitions of works of art	<u>(34,131,470)</u>	<u>(50,470,577)</u>	<u>3,882,481</u>	<u>(80,719,566)</u>	<u>129,155,133</u>
Acquisitions of works of art	<u>(12,793,086)</u>	<u>-</u>	<u>-</u>	<u>(12,793,086)</u>	<u>(62,001,543)</u>
(Decrease) increase in net assets	<u>(75,636,293)</u>	<u>(48,816,186)</u>	<u>3,882,481</u>	<u>(120,569,998)</u>	<u>84,752,007</u>
Net assets at beginning of year	<u>357,983,117</u>	<u>177,040,132</u>	<u>368,845,578</u>	<u>903,868,827</u>	<u>819,116,820</u>
Net assets at end of year	<u>\$ 282,346,824</u>	<u>\$ 128,223,946</u>	<u>\$ 372,728,059</u>	<u>\$ 783,298,829</u>	<u>\$ 903,868,827</u>

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

**NATIONAL GALLERY OF ART**  
**STATEMENTS OF CASH FLOWS**  
for the years ended September 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
(Decrease) increase in net assets	\$ (120,569,998)	\$ 84,752,007
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,818,788	8,553,942
Amortization of discount on pledges receivable	(760,552)	(255,858)
Amortization of discount on contractual obligations	1,342,008	109,710
Provision for bad debts	3,925,575	-
Contributions and net investment income for permanently restricted investments	(14,259,480)	(10,845,022)
U.S. Government appropriations for renovation projects	(17,735,935)	(15,961,659)
Gifts and grants for art acquisitions and capital projects	(16,731,959)	(25,963,617)
Acquisitions of works of art	20,257,030	23,886,365
Realized gains on sale of investments	(59,884,398)	(37,198,886)
Unrealized losses (gains) on investments	179,208,408	(55,006,638)
Realized loss on sale of securities in trust held by others	700,241	-
Decrease (increase) in value of trusts held by others	2,028,984	(10,466,648)
Increase in accounts receivable, net	(670,786)	(182,167)
Decrease (increase) in pledges receivable, net	14,186,842	(20,894,960)
(Increase) decrease in publications inventory, net	(59,476)	66,213
Increase in deferred charges	(48,374)	(459,859)
Increase in accounts payable and accrued expenses	1,343,016	8,081,448
Increase in contractual obligations	844,033	37,749,987
Increase in asset retirement obligation	913,608	872,444
Asset retirement remediation payment	(1,131,971)	-
Net cash provided by (used in) operating activities	2,715,604	(13,163,198)
Cash flows from investing activities:		
Purchase of investments	(411,936,037)	(249,431,432)
Proceeds from sale of investments	407,062,756	257,376,870
Proceeds from sale of securities in trusts held by others	4,894,252	-
Acquisitions of works of art	(20,257,030)	(23,886,365)
Purchase of fixed assets	(17,034,491)	(21,120,064)
Net cash used in investing activities	(37,270,550)	(37,060,991)
Cash flows from financing activities:		
Contributions and net investment income for permanently restricted investments	14,259,480	10,845,022
U.S. Government appropriations for renovation projects	17,735,935	15,961,659
Gifts and grants for art acquisitions and capital projects	16,731,959	25,963,617
Principal payment on capital lease obligation	(153,448)	(140,087)
Payment on contractual obligations	(9,813,000)	-
Net cash provided by financing activities	38,760,926	52,630,211
Net increase in cash and cash equivalents	4,205,980	2,406,022
Cash and cash equivalents, at beginning of year	34,331,102	31,925,080
Cash and cash equivalents, at end of year	\$ 38,537,082	\$ 34,331,102
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest on capital lease	\$ 186,422	\$ 199,240
Income taxes	\$ 250,000	\$ 135,000
Supplemental disclosure of non-cash information:		
Donated investment securities	\$ 4,621,498	\$ 1,025,961
Fixed asset additions included in accounts payable	\$ 2,094,682	\$ 754,347

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

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**1. Summary of significant accounting policies**

**General**

The National Gallery of Art (the Gallery) receives an annual appropriation to cover its core programs as part of the budget approved annually by Congress and signed by the President. This is supplemented with income from endowments designated for current operating expenditures as well as gifts and grants designated by the donors for specific programmatic activity. (All monies, related activities and balances from federal sources are referred to herein as "federal", while all other monies, related activities and balances are referred to herein as "private".) All identified inter-fund transactions have been eliminated from the financial statements.

**Measure of operations**

The Gallery includes in its measure of operations all federal and private support and revenue and expenses that are integral to its core program services: collections; special exhibitions; education, gallery shops and public programs; and editorial and photography. The measure of operations excludes certain non-operating activities such as non-operating gifts and grants, investment return in excess of amounts designated for operations and acquisitions of works of art.

The Gallery's Board of Trustees designates only a portion of the Gallery's cumulative investment return for support of current operations; the remainder is retained to support operations of future years and offset potential market declines. The amount designated (a portion of which is computed under the spending policy) and all interest income earned by investing cash in excess of daily requirements are used to support current operations (see Note 5).

**Summarized financial information**

The financial statements include certain summarized prior-year information in total only, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Gallery's financial statements for the year ended September 30, 2007 from which the summarized information was derived.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**Net assets**

The Gallery's net assets, support and revenue, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Gallery are classified and reported as follows:

- *Unrestricted* net assets include "one-year" federal appropriations and all other resources, which are not subject to donor-imposed restrictions. One-year federal appropriations which are not obligated or expended are retained by the Gallery in accordance with federal guidelines. At the discretion of the Gallery's Board of Trustees, private funds which are not expended for operating activities may be set aside in designated reserves and earmarked to cover future program costs or other contingencies.
- *Temporarily restricted* net assets carry specific donor-imposed restrictions on the expenditure or other use of the contributed funds. In addition, the Gallery's "no-year" federal appropriations for special exhibitions, emergency response, and for the repair, renovation and restoration of its buildings are classified as temporarily restricted net assets.

Temporary restrictions may expire as a result of fulfillment of the donor's wishes or the passage of time. Net assets released from temporarily restricted net assets to unrestricted net assets occur when contributions are expended or time restrictions lapse and are reported as net assets released from restrictions in the statement of activities.

- *Permanently restricted* net assets have donor-imposed restrictions which stipulate that the corpus of the gifts be retained permanently. In some cases, the donor has also permanently restricted the use of excess income and any realized or unrealized gains attributable to the corpus.

**Cash and cash equivalents**

Cash and cash equivalents include interest-bearing demand deposits and appropriated amounts remaining on deposit with the U.S. Treasury. The Gallery considers all highly liquid investments with an original maturity of three months or less to be cash equivalents, except where such cash equivalents are held as part of a long-term investment strategy (see Notes 2 and 5).

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**Pledges receivable**

Unconditional promises to contribute to the Gallery in the future (pledges receivable) are recorded at the present value of future cash flows, using a risk-free rate of return, after providing an allowance for uncollectibility. Conditional promises to give are recognized as income when the conditions stipulated by the donor are substantially met.

**Investments**

Investments are generally carried at fair value. Certain investments (including marketable alternative investments) are valued using readily determinable market prices, while non-marketable alternative investments are carried at the estimated fair value as provided by the investment managers. The Gallery reviews and evaluates the values provided by its investment managers and agrees with the valuation methods and assumptions they used in determining the fair value. The fair value of non-marketable alternative investments may be based on historical cost, appraisals, obtainable prices for similar assets, or other assets, or other estimates. Because of the uncertainty of valuation of these non-marketable alternative investments, their values may differ from values that would have been used had a ready market for the investments existed.

Purchases and sales of securities are reflected on a trade-date basis. Gains and losses on sales of securities are based on average historical value (cost of securities if purchased or the fair market value at the date of gift if received by donation). Dividend and interest income is recorded on an accrual basis. In accordance with the policy of stating investments at fair value, the net change in unrealized appreciation or depreciation for the year is reflected in the statement of activities (see Note 5).

**Trusts held by others**

The Gallery has been named as beneficiary in several irrevocable charitable trusts held by third parties. The Gallery's share of these trusts is recorded at current fair value. Income distributions from these trusts are recorded as investment income and changes in the value of these trusts are recorded as "changes in the value of trusts held by others" in the statement of activities.

**Publications inventory**

Publications inventory is carried at the lower of cost or market. Cost is determined using the average cost method.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**Deferred charges**

Deferred charges represent private expenses incurred in connection with future special exhibitions and other activities and are recognized in the period in which the exhibition or activity occurs.

**Fixed assets**

The land occupied by the Gallery's buildings was appropriated and reserved by the Congress of the United States for that purpose. No value has been assigned in the accompanying financial statements. Buildings are recorded at cost and depreciated on a straight-line basis over the estimated useful life of fifty years. Building improvements, equipment, furniture and computer software are also recorded at cost and depreciated on a straight-line basis over estimated useful lives ranging from five to twenty-five years. Upon retirement of fixed assets, the related cost and accumulated depreciation are removed from the accounts (see Note 7).

**Art collections**

The Gallery's art collections focus upon European and American paintings, sculpture and works on paper. In conformity with accounting procedures generally followed by art museums, the value of art has been excluded from the statement of financial position. The Gallery's collections are maintained for public exhibition, education and research in furtherance of public service, rather than for financial gain.

The Gallery acquires its art collections through purchase or by donation-in-kind. Only current year purchases made from specifically designated funds, not donations-in-kind, are reflected in the statement of activities. The Gallery does not deaccession any of its permanent collections.

**Accrued leave**

Annual leave is accrued as it is earned by employees and is included in personnel compensation and benefit costs. An unfunded liability as of the date of the financial statements is recognized for earned but unused annual leave by federal employees since this annual leave will be paid from future federal appropriations when the leave is used by employees. The amount accrued is based upon current pay of the employees.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**Employee benefits**

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards No. 5 (SFFAS No. 5), "Accounting for Liabilities of the Federal Government", which requires employing agencies to recognize the cost of pensions and other retirement benefits during their employees' active years of service. The pension expense recognized in the Gallery's financial statements is equal to the current service cost for the Gallery's employees for the accounting period less the amount contributed by the employees. The measurement of the pension service cost requires the use of an actuarial cost method and assumptions with factors applied by the Gallery. These factors are supplied by the Office of Personnel Management (OPM), the agency that administers the plan. The excess of the recognized pension expense over the amount contributed by the Gallery represents the amount being financed directly through the Civil Service Retirement and Disability Fund administered by OPM. This amount is considered imputed financing by the Gallery.

All permanent employees of the Gallery, both federal and non-federal, hired subsequent to January 1, 1984 participate in both the Social Security Retirement System and the Federal Employees' Retirement System (FERS). Employees hired prior to January 1, 1984 had the option of remaining under the Civil Service Retirement System (CSRS) or electing FERS. All employees have the option to make tax-deferred contributions to a Thrift Savings Plan and, in some instances, receive a matching portion from the Gallery. The Gallery funds all retirement contributions on a current basis, and accordingly there are no unfunded retirement costs (see Note 12).

SFFAS No. 5 also requires that the Gallery recognize a current-period expense for the future cost of post-retirement health benefits and life insurance for its employees while they are still working. The Gallery accounts for and reports this expense in its financial statements in a manner similar to that used for pension expense, with the exception that employees and the Gallery do not make current contributions to fund these future benefits.

**Imputed financing sources**

In certain cases, the operating costs of the Gallery are paid out of funds appropriated to other Federal agencies. As an example, the law requires certain costs of retirement programs be paid by OPM and certain legal judgments against the Gallery be paid from the Judgment Fund maintained by Treasury. Costs that are identifiable to the Gallery and directly attributable to the Gallery's operations are paid by these Federal agencies.

# NATIONAL GALLERY OF ART

## NOTES TO FINANCIAL STATEMENTS

---

### **Contributed services and donated assets**

The Gallery has volunteers who provide assistance in various departments. Such contributed services do not meet the criteria for recognition of contributed services contained in Statement of Financial Accounting Standards No. 116, "Accounting for Contributions Received and Contributions Made", and, accordingly, are not reflected in the accompanying financial statements.

Donated assets, which do not become part of the Gallery's art collections, are recorded at their fair value at the date of the gift. The Gallery does not imply time restrictions for gifts of long-lived assets. As a result, in the absence of donor-imposed restrictions, gifts of long-lived assets are reported as unrestricted revenue.

### **Functional allocation of expenses**

The cost of providing various programs and other activities has been summarized on a functional basis in the statement of activities. Certain costs including depreciation, utilities, building maintenance, security and other operating costs have been allocated among program and supporting services.

Included under the Collections category are the costs of the care and display of the Gallery's collections. Special exhibitions includes travel, transportation of items and other services necessary for the display of special exhibitions. Education, gallery shops and public programs includes the cost of providing a wide array of lectures, tours, films, music, symposia and academic programs to the general public, in addition to gallery shop cost of goods sold and expenses. Editorial and photography includes the costs to produce the many publications produced by the Gallery. General and administrative includes expenses for executive management, financial administration, information systems, human resources and legal services. Development includes the expenses associated with individual and corporate gifts and grants, annual appeals and other fundraising efforts.

### **Estimates**

The preparation of the financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of support and revenue and expenses at the date of the financial statements and during the reporting period. Actual results could differ from these estimates.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**Reclassifications**

Certain prior year balances have been reclassified to conform to current year presentation.

**2. Cash and cash equivalents**

As of September 30, 2008 and 2007, cash and cash equivalents include federal cash of \$29,816,769 and \$30,036,016, respectively, on deposit with the U.S. Treasury representing appropriated amounts yet to be disbursed. There are no reconciling items between the amounts recorded by the Gallery and on deposit with the U.S. Treasury.

The Gallery places its cash in a financial institution that is federally insured for \$250,000 under the Federal Depository Insurance Corporation Act. At September 30, 2008 and 2007, the aggregate balances were in excess of the insurance and therefore bear some risk since they are not collateralized.

**3. Accounts receivable, net**

As of September 30, 2008 and 2007 accounts receivable consisted of the following:

	<u>2008</u>	<u>2007</u>
Accrued investment income	\$ 531,732	\$ 621,671
Special exhibition and other program receivables	1,536,391	1,067,631
Other	<u>453,053</u>	<u>176,773</u>
Subtotal	2,521,176	1,866,075
Less: allowances	<u>(33,736)</u>	<u>(48,736)</u>
Total	<u>\$ 2,487,440</u>	<u>\$ 1,817,339</u>

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

**4. Pledges receivable, net**

As of September 30, 2008 and 2007, pledges receivable consisted of the following:

	2008	2007
Due in one year or less	\$ 13,670,214	\$ 14,215,500
Due between one year and five years	11,045,908	26,504,455
Due in more than five years	368,750	650,000
Subtotal	25,084,872	41,369,955
Less: discounts of \$1,180,172 and \$2,129,075 and allowances of \$2,165,000 and \$150,000, respectively	(3,345,172)	(2,279,075)
Total	\$ 21,739,700	\$ 39,090,880

As of September 30, 2008, and September 30, 2007, \$3,008,821 and \$4,050,000 of the pledge receivable balance were receivable from related parties. The Gallery has received conditional promises to give of \$6,085,866 and \$11,959,747 as of September 30, 2008 and 2007, respectively.

**5. Investments**

As of September 30, 2008 and 2007, investments consisted of the following:

	2008		2007	
	Cost	Fair Value	Cost	Fair Value
Loan to the U.S. Treasury	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000
Government obligations, cash and money market funds	7,441,668	7,441,668	29,852,136	29,826,373
Common and preferred stocks	77,346,161	71,069,921	121,870,386	147,102,146
Mutual funds	156,461,111	146,359,756	217,847,666	260,272,250
Alternative investments	369,094,103	379,770,603	175,760,526	281,891,908
Total	\$ 615,343,043	\$ 609,641,948	\$ 550,330,714	\$ 724,092,677

In 1942, the Gallery, under authority of an Act of Congress, made a \$5,000,000 permanent loan to the U.S. Treasury. This loan bears interest at 1/4% below the average monthly rate for long-term funds paid by the U.S. Treasury (ranging from 4.0% to 4.6% during fiscal year 2008). Interest income on this loan was \$213,993 and \$237,587 for the years ended September 30, 2008 and 2007, respectively.

Investments in common and preferred stocks and mutual funds, limited partnerships and

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

limited liability companies consist of the Gallery's ownership interest in externally managed investment funds, which invest in market-traded equity and fixed income securities.

The Gallery has capital commitments outstanding related to various limited partnership interests it owns as of September 30, 2008 totaling \$52,494,805.

Alternative investments include investments in limited partnerships of \$181,337,449 and \$222,954,565, as of September 30, 2008 and 2007, respectively, which are considered to be "marketable alternative investments" because they invest in marketable equity and fixed income securities. Alternative investments also include "non-marketable alternative investments", which consist of the gallery's ownership interest in externally managed private equity, venture capital and hedge funds which are organized as limited partnerships. These investments may include certain types of financial instruments (among which are futures and forward contracts, options, and securities sold not yet purchased) intended to hedge against changes in their market value. These financial instruments, which involve varying degrees of off-balance sheet risk, may result in losses due to changes in the market. Market values of investments may decline for a number of reasons, including changes in prevailing market and interest rates, increase in defaults and credit rating downgrades.

The following table summarizes the Gallery's holdings in alternative investments as of September 30, 2008 and 2007.

Alternative Investment Type	2008		2007	
	Number of Funds	Fair Value	Number of Funds	Fair Value
Public equity and income funds	5	\$ 181,337,449	5	\$222,954,565
Hedge funds	2	121,826,975	1	36,889,902
Multi asset class	1	43,487,298	-	-
Private equity	11	25,305,363	8	17,062,184
Venture capital	3	7,813,518	3	4,985,257
Total	22	\$379,770,603	17	\$281,891,908

According to the Gallery's spending policy set by the Board of Trustees, only a portion of the total investment return derived from investments is available to support current operations, while the remainder is reinvested. Under this spending policy, 5% of the average fair value of endowment investments at the end of the previous three-and-one quarter years is available to support operations.

The following schedule summarizes the investment return and its classification in

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

the statement of activities:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2008 Total</u>	<u>2007 Total</u>
Investment return designated for operations					
Interest on short-term investments	\$ 463,663	\$ -	\$ -	\$ 463,663	\$ 545,725
Investment return not designated by spending policy for operations	(14,902,222)	-	-	(14,902,222)	17,665,545
Investment return designated by spending policy for operations	<u>2,265,000</u>	<u>13,210,000</u>	<u>-</u>	<u>15,475,000</u>	<u>14,198,500</u>
Total investment return designated for operations	<u>\$ (12,173,559)</u>	<u>\$ 13,210,000</u>	<u>\$ -</u>	<u>\$ 1,036,441</u>	<u>\$ 32,409,770</u>
Investment return in excess of amount designated for operations					
Dividends and interest (net of expenses of \$3,862,965 and \$1,621,407, respectively)	\$ 4,111,792	\$ 4,658,838	\$ -	\$ 8,770,630	\$ 14,260,319
Net investment (depreciation) appreciation	<u>(84,041,587)</u>	<u>(35,982,663)</u>	<u>-</u>	<u>(120,024,250)</u>	<u>92,205,525</u>
Total return on long-term investments	(79,929,795)	(31,323,825)	-	(111,253,620)	106,465,844
Investment return not designated by spending policy for operations	14,902,222	-	-	14,902,222	(17,665,545)
Investment return designated by spending policy for operations	<u>(2,265,000)</u>	<u>(13,210,000)</u>	<u>-</u>	<u>(15,475,000)</u>	<u>(14,198,500)</u>
Investment return in excess of amount designated for operations	<u>\$ (67,292,573)</u>	<u>\$ (44,533,825)</u>	<u>\$ -</u>	<u>\$ (111,826,398)</u>	<u>\$ 74,601,799</u>

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**6. Publications inventory, net**

As of September 30, 2008 and 2007 net publications inventory consisted of the following:

	2008	2007
Retail	\$ 1,381,530	\$ 1,607,295
Work-in-process	421,017	67,861
Consignment	302,224	390,902
	2,104,771	2,066,058
Less: allowance for obsolescence	(432,987)	(453,750)
Total	\$ 1,671,784	\$ 1,612,308

**7. Fixed assets, net**

As of September 30, 2008 and 2007, net fixed assets consisted of the following:

	2008	2007
Buildings and improvements	\$ 272,384,133	\$ 271,861,649
Equipment	50,109,755	47,682,066
Construction-in-progress	25,827,965	10,403,312
Equipment under capital lease	2,962,381	2,962,381
	351,284,234	332,909,408
Less: accumulated depreciation and amortization	(159,493,853)	(149,675,065)
Total	\$ 191,790,381	\$ 183,234,343

Depreciation and amortization expense was \$9,818,788 and \$8,553,942 for fiscal years 2008 and 2007, respectively.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**8. Contractual obligations**

The Gallery has entered into a number of contractual obligations with various parties for the acquisition of art for its collection. These contractual obligations are unsecured, non-interest bearing and require annual payments.

As of September 30, 2008 and 2007, contractual obligations consisted of the following:

	2008	2007
Contractual obligations	\$ 34,101,000	\$ 43,050,000
Less: discounts on contractual obligations	(2,292,602)	(3,614,643)
Total	\$ 31,808,398	\$ 39,435,357

Annual payments due during the next four years on contractual obligations are as follows:

	Annual Payments
2009	\$ 9,213,000
2010	8,613,000
2011	8,325,000
2012	7,950,000
Total	\$ 34,101,000

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

**9. Unexpended appropriations**

The Gallery's unexpended federal appropriations as of September 30, 2008 and 2007 are as follows:

	One-year Funds	No-year Renovation Funds	No-year Special Exhibition Funds	No-Year Emergency Response Funds	Total 2008 Federal Appropriated Funds	Total 2007 Federal Appropriated Funds
Balance beginning of period:						
Available	\$ -	\$ 2,244,367	\$ 201,130	\$ 2,006	\$ 2,447,503	\$ 951,512
Unavailable	537,552	-	-	-	537,552	402,010
Total beginning unexpended appropriations	<u>537,552</u>	<u>2,244,367</u>	<u>201,130</u>	<u>2,006</u>	<u>2,985,055</u>	<u>1,353,522</u>
Unavailable authority returned to U.S. Treasury	(1,873,488)	(281,065)	-	-	(2,154,553)	(208,759)
U.S. Government funds provided for prior years	-	-	-	-	-	(13,361)
Current appropriation received	98,420,260	18,017,000	3,297,740	-	119,735,000	111,728,105
Obligations incurred:						
Art care	(28,271,446)	-	-	-	(28,271,446)	(29,947,941)
Operations and maintenance	(31,263,893)	-	-	-	(31,263,893)	(25,076,506)
Security	(19,026,693)	-	-	-	(19,026,693)	(18,203,961)
General and administrative	(17,967,491)	-	-	-	(17,967,491)	(19,067,967)
Special exhibitions	-	-	(3,414,754)	-	(3,414,754)	(2,913,792)
Renovation and equipment	-	(14,099,695)	-	-	(14,099,695)	(14,664,285)
Total obligations incurred	<u>(96,529,523)</u>	<u>(14,099,695)</u>	<u>(3,414,754)</u>	<u>-</u>	<u>(114,043,972)</u>	<u>(109,874,452)</u>
Net change	<u>17,249</u>	<u>3,636,240</u>	<u>(117,014)</u>	<u>-</u>	<u>3,536,475</u>	<u>1,631,533</u>
Balance end of period:						
Available	-	5,880,607	84,116	2,006	5,966,729	2,447,503
Unavailable	554,801	-	-	-	554,801	537,552
Total ending unexpended appropriations	<u>\$ 554,801</u>	<u>\$ 5,880,607</u>	<u>\$ 84,116</u>	<u>\$ 2,006</u>	<u>\$ 6,521,530</u>	<u>\$ 2,985,055</u>

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

**10. Net assets released from restrictions**

Net assets are released from donor restrictions when the expenses are incurred to satisfy the restricted purposes as specified by donors. The donor-specified restrictions that were met in the reporting period are as follows:

	2008		2007	
	Operating	Non-operating	Operating	Non-operating
Acquisition of art	\$ -	\$ 12,587,415	\$ -	\$ 61,801,564
Collections	3,484,590	-	1,781,871	-
Special exhibitions	8,230,448	-	6,529,100	-
Education and public programs	5,234,295	-	4,816,638	-
Editorial and photography	262,131	-	73,148	-
Capital projects	-	20,000,150	-	13,687,087
Operations	3,960,802	-	4,060,637	-
Total	<u>\$ 21,172,266</u>	<u>\$ 32,587,565</u>	<u>\$ 17,261,394</u>	<u>\$ 75,488,651</u>

**11. Analysis of restricted net assets**

As of September 30, 2008 and 2007, temporarily restricted net assets and the investment income from permanently restricted net assets are restricted to support the following purposes:

	2008		2007	
	Temporarily Restricted	Permanently Restricted	Temporarily Restricted	Permanently Restricted
Acquisition of art	\$ 38,451,601	\$ 69,754,988	\$ 63,964,432	\$ 69,305,882
Collections	5,076,307	34,715,009	6,740,601	34,715,009
Special exhibitions	10,210,276	30,363,249	16,327,065	27,189,799
Education and public programs	30,633,588	89,377,115	39,317,376	89,117,190
Editorial and photography	627,646	-	324,276	-
Capital projects	12,596,818	-	14,780,481	-
Operations	30,627,710	148,517,698	35,585,901	148,517,698
Total	<u>\$ 128,223,946</u>	<u>\$ 372,728,059</u>	<u>\$ 177,040,132</u>	<u>\$ 368,845,578</u>

During fiscal year 2008, management identified \$657,564 of investment income and gifts that were incorrectly allocated to permanently restricted net assets prior to fiscal year 2008. This amount was reclassified back to temporarily restricted net assets and unrestricted net assets in fiscal year 2008. This incorrect allocation and the subsequent correction in fiscal year 2008 had no impact on the Gallery's total net assets as of September 30, 2007 and 2008 or on the total change in net assets for the years ended September 30, 2007 and 2008.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**12. Employee benefits**

Total pension expense recognized in the Gallery's financial statements was \$6,318,146 and \$5,897,918 for the years ended September 30, 2008 and 2007, respectively. These amounts do not include pension expense financed by OPM and imputed to the Gallery of \$1,570,042 and \$1,548,729 respectively. To the extent that Gallery employees are covered by the thrift savings component of FERS, the Gallery's payments to the plan are recorded as operating expenses. The Gallery's costs associated with the thrift savings component of FERS for the years ended September 30, 2008 and 2007, were \$1,912,121 and \$1,760,932, respectively.

In addition, the Gallery makes matching contributions for all employees who are eligible for current health and life insurance benefits. The Gallery's contributions for active employees are recognized as operating expenses. During fiscal years 2008 and 2007, the Gallery contributed \$4,517,439 and \$4,357,199, respectively. Using the cost factors supplied by OPM, the Gallery has not recognized as an expense in its financial statements the future cost of post-retirement health benefits and life insurance for its employees. These costs amounted to approximately \$5,398,937 and \$5,443,663 during fiscal years 2008 and 2007 respectively, and are financed by OPM and imputed to the Gallery.

The Gallery has a commitment to certain key employees whereby the Gallery will pay those employees a specified amount at a future point in time. The cost of these benefits is accrued over the key employees' future years of service to the Gallery. The cost of these benefits for fiscal years 2008 and 2007 totals \$506,297 and \$526,865, respectively, and is recognized as an expense in the statement of activities and as a liability included in accounts payable and accrued expenses in the accompanying statement of financial position.

**13. Income taxes**

The Gallery is a nonprofit organization exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**14. Lease commitments**

During fiscal year 2002, the Gallery entered into a capital lease obligation in connection with the installation of equipment. The Gallery has also entered into several operating leases for warehouse and office space, which continue through January 31, 2013. The terms of these operating leases include additional rent for operating expenses, real estate taxes, utilities and maintenance. Future minimum lease payments under these leases for the fiscal years ended September 30 are as follows:

	Capital lease	Operating leases
2009	\$ 341,004	\$ 2,967,654
2010	341,597	2,782,938
2011	342,208	2,847,851
2012	342,837	2,914,361
2013	343,485	898,589
Thereafter	688,991	-
Total minimum lease payments	2,400,122	\$ 12,411,393
Less: amount representing interest	(516,167)	
Present value of minimum capital lease payments	\$ 1,883,955	

Rental expense was approximately \$4,527,833 and \$4,334,485 for the years ended September 30, 2008 and 2007, respectively.

**15. Transfer**

During fiscal year 2000, the Gallery received a gift to be used for the establishment of an endowment fund to be used to purchase works of art. The gift contained the option that the Board of Trustees in their discretion could use principal of such endowment to purchase works of art. During fiscal year 2007, the Board of Trustees [decided that they would exercise that option and](#) transferred \$23,325,696 from permanently restricted net assets to temporarily restricted net assets to reflect that condition of the gift.

**NATIONAL GALLERY OF ART**  
**NOTES TO FINANCIAL STATEMENTS**

---

**16. Recent Account Pronouncements**

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. Statement defines fair value, outlines a framework for measuring fair value, and details the Required disclosures about fair value measurements. For the Gallery, the provisions of the Statement are effective for fiscal year ending September 30, 2009.

In August 2008, the FASB issued Staff Position No. 117-1, *Endowments of Not-For-Profit Organizations: New Asset Classification of Funds Subject to an enacted Version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), and Enhanced Disclosures for all Endowment Funds*. The Staff Position provides guidance on the net asset classification of donor-restricted endowment funds for organizations subject to UPMIFA and expands disclosures about an organization's endowment; both donor-restricted and board-designated funds. For the Gallery, the provisions of the Staff Position are effective for fiscal year ending September 30, 2009.

Management is in the process of evaluating the impact of these pronouncements on the Gallery's financial position, changes in net assets and financial statement disclosures.