

**NATIONAL GALLERY OF ART**

Financial Statements

September 30, 2018

(With Independent Auditors' Reports Thereon)



KPMG LLP  
1676 International Drive  
McLean, VA 22102

## Independent Auditors' Report

The Board of Trustees  
The National Gallery of Art:

### Report on the Financial Statements

We have audited the accompanying financial statements of the National Gallery of Art (the Gallery), which comprise the statement of financial position as of September 30, 2018, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

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

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

#### *Auditors' Responsibility*

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

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

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

#### *Opinion on the Financial Statements*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the National Gallery of Art as of September 30, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



*Report on Summarized Comparative Information*

We have previously audited the Gallery's 2017 financial statements, and we expressed an unmodified audit opinion on those financial statements in our report dated November 14, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2017 is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Emphasis of Matter*

As discussed in Note 2(r) to the basic financial statements, during 2018 the Gallery adopted Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

**Other Matters**

*Supplementary and Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary private and federal information on the financial statements is presented for purposes of additional analysis and is not a required part of the financial statements.

The information included in the supplementary private and federal information on the financial statements was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit 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 supplementary private and federal information on the financial statements is fairly stated in all material respects in relation to the financial statements as a whole.

**Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2018 on our consideration of the Gallery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Gallery's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Gallery's internal control over financial reporting and compliance.

**KPMG LLP**

McLean, Virginia  
November 14, 2018

**NATIONAL GALLERY OF ART**

Statement of Financial Position

September 30, 2018

(with summarized financial information as of September 30, 2017)

(In thousands)

<b>Assets</b>	2018			2017
	Private	Federal	Total	Total
Cash and cash equivalents	\$ 4,434	85,452	89,886	69,926
Accounts receivable and other assets, net	5,363	–	5,363	5,847
Pledges receivable, net	23,617	–	23,617	20,151
Investments and trusts held by others	994,526	–	994,526	936,470
Property, plant and equipment, net	65,436	259,557	324,993	331,427
Art collections (Note 2)	–	–	–	–
Total assets	<u>\$ 1,093,376</u>	<u>345,009</u>	<u>1,438,385</u>	<u>1,363,821</u>
<b>Liabilities and Net Assets:</b>				
Liabilities:				
Accounts payable and other liabilities	\$ 36,721	23,322	60,043	62,957
Unexpended federal one-year and two-year appropriations	–	31,037	31,037	20,734
Environmental liability	–	19,863	19,863	22,978
Total liabilities	<u>36,721</u>	<u>74,222</u>	<u>110,943</u>	<u>106,669</u>
Net assets:				
Without donor restrictions	370,346	218,317	588,663	576,934
With donor restrictions	686,309	52,470	738,779	680,218
Total net assets	<u>1,056,655</u>	<u>270,787</u>	<u>1,327,442</u>	<u>1,257,152</u>
Total liabilities and net assets	<u>\$ 1,093,376</u>	<u>345,009</u>	<u>1,438,385</u>	<u>1,363,821</u>

See accompanying notes to financial statements.

**NATIONAL GALLERY OF ART**

Statement of Activities

Year ended September 30, 2018

(with summarized financial information for the year ended September 30, 2017)

(In thousands)

	Without donor restrictions			With donor restrictions	Total 2018	Total 2017
	Private	Federal	Total			
<b>Operating:</b>						
Support and revenue:						
Federal appropriations	\$ -	122,205	122,205	8,310	130,515	126,584
Gifts and grants	2,839	-	2,839	7,060	9,899	11,856
Gallery shops sales, net	8,639	-	8,639	-	8,639	8,085
Spending policy appropriated for operations	2,723	-	2,723	18,224	20,947	19,685
Royalties and other income	1,250	-	1,250	-	1,250	1,374
	15,451	122,205	137,656	33,594	171,250	167,584
Net assets released from restrictions to fund operating expenses						
	23,597	7,446	31,043	(31,043)	-	-
Total support and revenue	39,048	129,651	168,699	2,551	171,250	167,584
<b>Expenses:</b>						
Collections	3,749	47,476	51,225	-	51,225	50,940
Special exhibitions	7,523	14,900	22,423	-	22,423	21,149
Education, Gallery shops and public programs	17,231	28,024	45,255	-	45,255	42,777
Editorial and photography	1,446	5,955	7,401	-	7,401	7,071
General and administrative	5,711	31,297	37,008	-	37,008	37,748
Development	2,661	1,816	4,477	-	4,477	4,064
Total operating expenses	38,321	129,468	167,789	-	167,789	163,749
Change in net assets from operating activities	727	183	910	2,551	3,461	3,835
<b>Non-operating:</b>						
Federal appropriations	-	5,397	5,397	19,513	24,910	22,701
Endowment gifts	-	-	-	17,746	17,746	18,450
Gifts for art acquisitions	-	-	-	6,399	6,399	5,235
Spending policy appropriated for art acquisitions	-	-	-	4,918	4,918	399
Change in value of split-interest agreements	295	-	295	382	677	46
Investment return less amounts appropriated for operations and art acquisitions	16,879	-	16,879	22,553	39,432	86,332
Acquisitions of works of art	(14,871)	-	(14,871)	-	(14,871)	(6,274)
Depreciation and amortization expense	(4,363)	(10,974)	(15,337)	-	(15,337)	(16,289)
Income tax expense	(160)	-	(160)	-	(160)	(50)
Environmental liability accretion	-	(1,183)	(1,183)	-	(1,183)	(1,150)
Environmental liability change in value	-	4,298	4,298	-	4,298	1,153
Reclassification of net asset balances	(96)	-	(96)	96	-	-
Net assets released from restrictions to fund non-operating expenses	14,808	789	15,597	(15,597)	-	-
Change in net assets from non-operating activities	12,492	(1,673)	10,819	56,010	66,829	110,553
Increase (decrease) in net assets	13,219	(1,490)	11,729	58,561	70,290	114,388
Net assets at beginning of year	357,127	219,807	576,934	680,218	1,257,152	1,142,764
Net assets at end of year	\$ 370,346	218,317	588,663	738,779	1,327,442	1,257,152

See accompanying notes to financial statements.

**NATIONAL GALLERY OF ART**

Statement of Cash Flows

Year ended September 30, 2018

(with summarized financial information for the year ended September 30, 2017)

(In thousands)

	<u>Private</u>	<u>Federal</u>	<u>Total 2018</u>	<u>Total 2017</u>
Cash flows from operating activities:				
Federal operating appropriations	\$ -	140,819	140,819	132,427
Operating gifts and grants	11,427	-	11,427	11,033
Gallery shops sales	8,612	-	8,612	8,085
Investment income and dividends, net	3,299	-	3,299	4,266
Royalties and other income	1,187	-	1,187	2,402
Payments to employees	(20,964)	(88,359)	(109,323)	(106,660)
Payments to suppliers	(17,314)	(41,224)	(58,538)	(50,786)
Income tax payments	(160)	-	(160)	(50)
Net cash provided by (used in) operating activities	<u>(13,913)</u>	<u>11,236</u>	<u>(2,677)</u>	<u>717</u>
Cash flows from investing activities:				
Purchase of investments	(355,761)	-	(355,761)	(164,235)
Proceeds from sale of investments	360,601	-	360,601	138,618
Acquisitions of works of art	(14,764)	-	(14,764)	(12,366)
Purchase of property, plant and equipment	(220)	(8,906)	(9,126)	(20,282)
Net cash used in investing activities	<u>(10,144)</u>	<u>(8,906)</u>	<u>(19,050)</u>	<u>(58,265)</u>
Cash flows from financing activities:				
Contributions and net investment income for donor restricted investments	10,242	-	10,242	38,691
Federal appropriations for capital projects	-	24,910	24,910	22,701
Gifts and grants for art acquisitions	6,535	-	6,535	11,308
Net cash provided by financing activities	<u>16,777</u>	<u>24,910</u>	<u>41,687</u>	<u>72,700</u>
Net change in cash and cash equivalents	(7,280)	27,240	19,960	15,152
Cash and cash equivalents at beginning of year	11,714	58,212	69,926	54,774
Cash and cash equivalents at end of year	\$ <u>4,434</u>	<u>85,452</u>	<u>89,886</u>	<u>69,926</u>

See accompanying notes to financial statements.

## NATIONAL GALLERY OF ART

Notes to Financial Statements  
September 30, 2018  
(In thousands)

### (1) Organization

The National Gallery of Art (the Gallery) was created in 1937 for the people of the United States of America by a joint resolution of Congress, accepting the gift of financier and art collector Andrew W. Mellon. The Gallery is a nonprofit organization exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

The Gallery serves the United States in a national role by preserving, collecting, exhibiting, and encouraging the understanding by the American public of original, great works of art. This mission and standard of excellence is central to every activity of the Gallery, from caring for and strengthening the collection to presenting special exhibitions and organizing public programs.

A substantial portion of the Gallery's operations is funded from annual federal appropriations. Since its founding, federal funds ensure the operation and maintenance and the protection and care of the nation's art collection enabling the Gallery to remain open 363 days a year at no charge to visitors. The Gallery also receives federal appropriations for the repair and restoration of its facilities.

In addition to federal appropriations, the Gallery receives private donations and earns income from investments. Private donations from individuals, foundations and corporations have provided support for art acquisitions and conservation, scholarly and scientific research, exhibitions, and education outreach programs.

### (2) Summary of Significant Accounting Policies

#### (a) General

The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (U.S. GAAP) under *FASB ASC 958, Not-for-Profit Presentation of Financial Statements*.

The Gallery receives annual federal appropriations to cover its core programs and renovation of its buildings 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 donors for other specific expenditures. 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".

#### (b) Measure of Operations

The Gallery includes in its measure of operations 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 (endowment gifts and gifts for art acquisitions and capital projects), investment return less

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Notes to Financial Statements  
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amounts designated for operations, acquisitions of works of art, and income tax and depreciation expense.

The Gallery's Board of Trustees appropriates only a portion of the Gallery's cumulative investment return for support of current operations and art acquisitions; the remainder is retained to support operations of future years and to offset potential market declines. The amount appropriated is computed under the Gallery's spending policy and is appropriated for use based on the underlying donor-imposed restrictions (see notes 5 and 9).

### (c) **Summarized Financial Information**

The financial statements include certain summarized prior-year information in total only. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. GAAP. Accordingly, such information should be read in conjunction with the Gallery's financial statements as of and for the year ended September 30, 2017, from which the summarized information was derived.

### (d) **Net Assets**

The Gallery's net assets, support and revenue, expenses, and 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:

- *Without donor restrictions* – Net assets without donor restrictions consist of the Gallery's net investment in building improvements and other equipment purchased or constructed using federal funds less unfunded liabilities, and all other resources which are not subject to donor-imposed restrictions. 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.
- *With donor restrictions* – Net assets with donor restrictions carry specific donor-imposed stipulations on the expenditure or other use of the contributed funds, including unexpended "no-year" federal appropriations received for special exhibitions and for the repair, renovation and restoration of its buildings. Donor-imposed restrictions may expire by the passage of time or as a result of fulfillment of the donor's stipulations. For gifts restricted for capital additions, net assets are released when assets are placed in service.

Other net assets with donor restrictions include net assets with stipulations that require that the corpus of the gifts be retained permanently with only the income to be used to support operations or another specified purpose.

### (e) **Cash and Cash Equivalents**

Cash and cash equivalents include interest-bearing demand deposits and appropriated amounts yet to be disbursed remaining on deposit with the U.S. Department of Treasury (or U.S. Treasury). The Gallery considers all highly liquid investments with an original maturity of

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three months or less at the date of purchase to be cash equivalents, except where such cash equivalents are held as part of a long-term investment strategy (see note 5).

The fund balances with U.S. Treasury consists of appropriated funds that are available to pay current liabilities and finance authorized purchase commitments of the Gallery. The Gallery's fund balances with U.S. Treasury are carried forward until such time as goods or services are received and payments are made, or until the funds are returned to the U.S. Treasury.

**(f) Pledges Receivable**

Unconditional promises to give to the Gallery in the future (pledges receivable) are recorded at the fair value of future cash flows, after providing an allowance for uncollectibility (Level 3 inputs). For unconditional promises to give recognized prior to October 1, 2008, a risk-free rate of return at the date of the gift was used. For unconditional promises to give recognized on or after October 1, 2008, a discount rate approximating the current market rate at the date of the gift is used. The resulting discount rates range from 2.5% to 4.3%. Conditional promises to give are recognized as income when the conditions stipulated by the donor are substantially met.

**(g) Investments and Trusts Held by Others**

Investments are generally reported at fair value. Common and preferred stocks and mutual funds are valued using readily determinable market prices. Alternative investments are reported at the estimated fair value as provided by the investment managers. The Gallery reviews and evaluates valuation methods and assumptions the investment managers use in determining the fair value. For investments valued based on manager reported net asset values, the Gallery applies procedures to assess the valuation including comparing performance to relevant market indices and verifying the underlying asset values to quoted market prices. Due to the uncertainty of valuation of alternative investments, 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 when earned 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).

The Gallery has been named as beneficiary in several irrevocable charitable trusts held by third parties. The Gallery's share of these trusts is generally 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 "change in value of split-interest agreements" in the statement of activities.

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Notes to Financial Statements  
September 30, 2018  
(In thousands)

### **(h) Property, Plant and Equipment**

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. Property, plant and equipment with a cost of \$50 or more is capitalized at cost and depreciated using the straight-line method over the useful life of the assets. These assets have been assigned a useful life as follows:

Buildings	50 years
Building improvements	up to 25 years
Equipment under capital lease	14 years
Equipment	5 - 10 years
Computer software	3 - 5 years

Other property items are expensed when purchased. Normal repairs and maintenance are charged to expense as incurred.

### **(i) Art Collections**

The Gallery's art collections focus upon European and American paintings, sculpture, decorative arts, works on paper and photographs. In conformity with accounting policies 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 donations-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.

### **(j) 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.

### **(k) Unexpended Federal One-Year and Two-Year Appropriations**

The Gallery's federal one-year and two-year appropriations are recognized as revenue as expenditures are incurred throughout the year. The portion of these appropriations which are not obligated or expended are retained by the Gallery in accordance with federal guidelines and returned to the U.S. Department of Treasury five years after the expiration of the obligation

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Notes to Financial Statements  
September 30, 2018  
(In thousands)

period. The remaining unexpended balances of these funds are classified as a liability on the statement of financial position.

### **(l) Employee Benefits**

The Gallery offers its employees a comprehensive set of benefits including pension, health and life insurance, and workers compensation for injuries sustained on the job. All permanent employees of the Gallery, both federal and nonfederal, hired subsequent to January 1, 1984 participate in 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.

The FERS retirement plan provides benefits from three sources: a basic defined benefit plan, social security, and the Thrift Savings Plan (TSP), a defined contribution plan similar to a 401(k). The TSP is administered by the Federal Retirement Thrift Investment Board, an independent agency of the U.S. government. All employees have the option to make tax-deferred contributions to the TSP and, in some instances, receive a matching portion from the Gallery.

The Gallery's current year contributions to the pension plans are recognized in the statement of activities, using rates established by the Office of Personnel Management (OPM), the agency with Government-wide responsibility for the oversight and administration of the plans. Consistent with reporting under multi-employer pension plans, the Gallery does not report CSRS and FERS assets, accumulated plan benefits or future liabilities, if any, applicable to its employees. This data is reported for plan participants by OPM (see note 14).

Gallery employees are also eligible to participate in the Federal Employees Health Benefit (FEHB) and the Federal Employees Group Life Insurance (FEGLI) programs, and may continue to participate in these programs after retirement. The Gallery's current year contributions to the retirement and healthcare and life insurance programs are recognized in the statement of activities.

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from the Gallery.

Expense recognized in the Gallery's financial statements includes current amounts invoiced and amounts expected to be invoiced by DOL, as well as the change in the actuarially determined cost of expected future benefits. The actuarial FECA liability represents the liability for expected future benefits for death, disability, medical, and miscellaneous costs for approved cases. The actuarial liability is determined by DOL annually, as of September 30, using a method that utilizes historical benefits payment patterns related to a specific incurred

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period, wage inflation factors, medical inflation factors and other variables. This liability constitutes an extended future estimate of cost which will not be obligated against budgetary resources until the fiscal year in which DOL bills the cost to the Gallery. The cost associated with this liability cannot be met by the Gallery without further appropriation action.

### **(m) *Imputed Financing Sources***

In certain cases, costs of the Gallery, such as post-retirement pension and benefits, are paid out of funds appropriated to other federal agencies. As an example, OPM is required to administer and pay the costs of federal post-retirement pension programs. Actuarially derived cost factors are provided annually by OPM to the Gallery for use in the calculation of current period service cost. The excess of the computed service cost over employee withholding and amounts contributed by the Gallery represents imputed costs to be financed directly through the Civil Service Retirement and Disability Fund administered by OPM. Similarly, OPM provides cost factors to the Gallery for use in the calculation of the estimated cost of providing health and life insurance benefits to retired employees.

Imputed costs and offsetting federal funding sources for pension and post-retirement health and life insurance benefits are computed by the Gallery and presented in note 14. The Gallery does not recognize these imputed costs and off-setting financing sources in the statement of activities, as the amounts represent costs to be funded in future years by OPM.

### **(n) *Contributed Services and Donated Assets***

Volunteers provide assistance to various departments of the Gallery. The services provided by such volunteers do not meet the criteria for recognition of contributed services, and accordingly are not reflected in the accompanying financial statements.

Donated assets other than donations of art are recorded at fair value on the date of the gift. Gifts of long-lived assets are recorded as unrestricted revenue in the absence of donor-imposed restrictions.

### **(o) *Functional Allocation of Expenses***

The cost of providing various programs and other activities summarized on a functional and natural basis is shown in note 13. Included under the Collections category are the costs of the care and display of the Gallery's collections. Special exhibition expenses include 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 shops' cost of goods sold and expenses. Editorial and photography expenses include the costs to produce the many publications produced by the Gallery. General and administrative expenses include costs for executive management, financial administration, human resources and legal services. Development expenses include those costs associated with individual and corporate gifts and grants, annual appeals and other fundraising efforts.

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Notes to Financial Statements  
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(In thousands)

**(p) 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 amounts of assets and liabilities, disclosures of contingencies at the date of the financial statements, and the reported amounts of support and revenue and expenses during the reporting period. Actual results could differ from these estimates.

**(q) Risks and Uncertainties**

The Gallery invests in a variety of investment securities. Investment securities are exposed to risks such as interest rate, market, and credit risks. As a result, changes in the values of investment securities may occur that could materially affect the value of the Gallery's investments and its financial position.

**(r) Recent Accounting Pronouncements**

*Not-for-Profit Financial Statement Presentation*

In August 2016, the FASB issued Accounting Standards Update No. 2016-14 (ASU 2016-14), *Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is placed in service; and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also requires enhanced disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity, and the presentation of expenses by both their natural and functional classification.

ASU 2016-14 is effective for the Gallery's fiscal year beginning after December 15, 2017, with early application permitted. The Gallery elected to early adopt the provisions of ASU 2016-14 in fiscal year 2018 and has applied the amendments retrospectively as required by the standard. A presentation of net assets as previously reported as of September 30, 2016 and 2017, and as required under ASU 2016-14 follows:

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### Notes to Financial Statements September 30, 2018 (In thousands)

	As previously presented	September 30, 2016 Presentation under ASU 2016-14		
		Without donor restrictions	With donor restrictions	Total
Net assets:				
Unrestricted	\$ 549,768	\$ 549,768	–	549,768
Temporarily restricted	184,801	–	184,801	184,801
Permanently restricted	408,195	–	408,195	408,195
Total net assets	\$ 1,142,764	\$ 549,768	592,996	1,142,764
Restatement due to change in accounting for releases of donor restricted net assets for capital expenses		(1,634)	1,634	–
Restatement due to change in accounting for underwater endowments		2,607	(2,607)	–
Net assets as restated in accordance with ASU 2016-14		\$ 550,741	592,023	1,142,764

  

	As previously presented	September 30, 2017 Presentation under ASU 2016-14		
		Without donor restrictions	With donor restrictions	Total
Net assets:				
Unrestricted	\$ 582,387	\$ 582,387	–	582,387
Temporarily restricted	224,724	–	224,724	224,724
Permanently restricted	450,041	–	450,041	450,041
Total net assets	\$ 1,257,152	\$ 582,387	674,765	1,257,152
Restatement due to change in accounting for releases of donor restricted net assets for capital expenses		(5,453)	5,453	–
Net assets as restated in accordance with ASU 2016-14		\$ 576,934	680,218	1,257,152

Prior to the adoption of ASU 2016-14, the Gallery released gifts restricted for capital additions as capital expenditures were incurred. Restatements above reclassify net assets without donor restrictions to net assets with donor restrictions for releases made for capital expenditures not placed in service as of September 30, 2016 and 2017, as required under the provisions of ASU 2016-14. In addition, the underwater endowment balance of \$2,607 at September 30, 2016 is reclassified to reduce net assets with donor restrictions and restore net assets without donor restrictions as required under ASU 2016-14. There were no underwater endowment deficiencies at September 30, 2017.

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Notes to Financial Statements  
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(In thousands)

### (3) Financial Assets and Liquidity Resources

Federal appropriations provide for the daily operations and maintenance of the Gallery, in addition to support for special exhibitions and renovation and repair of the Gallery's buildings. Private donor endowments and gifts support Gallery programmatic activities and all art acquisitions. The Gallery maintains a policy of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due. Cash required to meet operating needs of the Gallery is invested in short-term accounts.

Following is a reconciliation of the Gallery's total financial assets as of September 30, 2018 to financial assets available to fund the Gallery's general expenditures for the following fiscal year. General expenditures include all programmatic and supporting operating expenses, including expenditures for capital renovations but not including art acquisitions.

	Private	Federal	Total
Financial assets:			
Cash and cash equivalents	\$ 4,434	85,452	89,886
Investments and trusts held by others	994,526	–	994,526
Pledges and accounts receivable	26,245	–	26,245
Total financial assets at year-end	1,025,205	85,452	1,110,657
Less financial assets unavailable for general expenditure within one year:			
Financial assets with donor restrictions	(717,385)	–	(717,385)
Trust held by others and charitable gift annuity assets	(8,274)	–	(8,274)
Board designations:			
Quasi-endowments	(64,340)	–	(64,340)
Operating reserve	(115,000)	–	(115,000)
Capital reserve	(30,000)	–	(30,000)
Financial assets available to meet cash needs for general expenditure within one year	\$ 90,206	85,452	175,658

Quasi-endowment assets include unrestricted funds designated by the Gallery's Board of Trustees to function as endowment funds supporting Gallery programs and operations, including the production of catalogues documenting the Gallery's collection, and operations of the library and music program, among others. The operating reserve has been established to provide necessary resources in the event of the following: 1) potential extended market declines, as it is the Gallery's policy to not spend from underwater endowment funds, 2) shortfalls in donor support and earned revenue during periods of economic recession, and 3) risk of potential losses for damage or theft of art works on loan to the Gallery in excess of insurance coverage. Capital reserves are required for non-federal capital additions and renovations and related obligations.

## NATIONAL GALLERY OF ART

Notes to Financial Statements  
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### (4) Pledges Receivable, Net

As of September 30, 2018 and 2017, pledges receivable, net, consisted of the following:

	2018	2017
Due in one year or less	\$ 8,564	7,970
Due between one year and five years	15,583	12,945
Due in more than five years	650	200
Subtotal	24,797	21,115
Less discounts of \$1,030 and \$814 and allowances of \$150 and \$150, respectively	(1,180)	(964)
Total	\$ 23,617	20,151

As of September 30, 2018 and 2017, \$1,726 and \$626 of the pledges receivable balance was receivable from related parties.

### (5) Investments, Trusts Held by Others and Fair Value Measurement

As of September 30, 2018 and 2017, investments and trust held by others consisted of the following:

	2018	2017
Investments	\$ 975,382	918,479
Trusts held by others	14,144	12,991
Subtotal	989,526	931,470
Loan to U.S. Treasury	5,000	5,000
Total	\$ 994,526	936,470

In 1942, the Gallery, under authority of an Act of Congress, made a \$5,000 permanent loan to the U.S. Treasury. This loan bears interest at the higher of 4.00% or 0.25% below the average monthly rate for long-term funds paid by the U.S. Treasury (4% during fiscal year 2018). Interest income on this loan was \$203 for the fiscal years ended September 30, 2018 and 2017. The fair value of the loan to the U.S. Treasury approximates the carrying value.

As of September 30, 2018 and 2017, the carrying value of the Gallery's cash, cash equivalents and balances with U.S. Treasury, receivables, deferred charges and other assets, and accounts payable and accrued expenses approximate their fair values because of the terms and relatively short maturity of these assets and liabilities. The Gallery's investments in private equity, venture capital, and real estate are generally valued based on the most current net asset value (NAV) adjusted for cash flows when the reported NAV is not at the measurement date.

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The fair value of a financial instrument is the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The Gallery applies a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy consists of three broad levels:

- *Level 1* – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Gallery has the ability to access as of the reporting date. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment. Investments include investments in equity, real estate, and fixed income mutual funds that are traded in an active exchange market.
- *Level 2* – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly as of the reporting date.
- *Level 3* – Valuations based on inputs that are unobservable and significant to the overall fair value measurement as of the reporting date. The determination of fair value for these financial instruments requires one or more inputs subject to significant management judgment or estimation. Trusts held by others are valued using Level 3 inputs. One trust is invested in real property and has been recorded at the value of the real property as of the date of the gift based on property valuations that involved significant judgments and estimation. Another trust is a perpetual trust invested in equity, fixed income securities, and mutual funds where the Gallery receives annual distributions but will never receive the trust's principal. The remainder of the trusts are invested in cash equivalents, mutual funds, and publicly traded equities.

## NATIONAL GALLERY OF ART

### Notes to Financial Statements September 30, 2018 (In thousands)

The following tables summarize the fair values of investments and trusts held by others as of September 30, 2018 and 2017 for financial assets by pricing observability levels:

	FY 2018				Fair value at September 30, 2018
	Prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Investments measured at net asset value <sup>1</sup>	
U.S. equities	\$ 154,889	–	–	156,004	310,893
International equities:					
Developed market equities	70,232	–	–	110,939	181,171
Emerging market equities	41,485	–	–	51,694	93,179
Real estate:					
Mutual fund	17,098	–	–	–	17,098
Private Investments	–	–	–	1,035	1,035
Private equity and venture capital funds	–	–	–	31,629	31,629
Hedge funds	–	–	–	214,724	214,724
Multi-asset fund	–	–	–	21,577	21,577
Fixed income securities	–	–	–	82,111	82,111
Cash and money market fund	9,379	–	–	–	9,379
Charitable gift annuities and other	12,586	–	–	–	12,586
Trusts held by others	–	–	14,144	–	14,144
Total	\$ 305,669	–	14,144	669,713	989,526

<sup>1</sup> Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

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### Notes to Financial Statements September 30, 2018 (In thousands)

	FY 2017				Fair value at September 30, 2017
	Prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Investments measured at net asset value <sup>1</sup>	
U.S. equities	\$ 144,803	–	–	126,452	271,255
International equities:					
Developed market equities	68,289	–	–	106,160	174,449
Emerging market equities	47,406	–	–	53,260	100,666
Real estate:					
Mutual fund	26,179	–	–	–	26,179
Private Investments	–	–	–	1,246	1,246
Inflation hedging securities	–	–	–	22,585	22,585
Private equity and venture capital funds	–	–	–	36,888	36,888
Hedge funds	–	–	–	133,066	133,066
Multi-asset fund	–	–	–	28,186	28,186
Fixed income securities	–	–	–	73,855	73,855
Money market fund	37,836	–	–	–	37,836
Charitable gift annuities and other	12,268	–	–	–	12,268
Trusts held by others	–	–	12,991	–	12,991
Total	\$ 336,781	–	12,991	581,698	931,470

<sup>1</sup> Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

The following table summarizes the changes in Level 3 assets, Trusts held by others, measured at fair value on a recurring basis for the years ended September 30, 2018 and 2017:

	2018	2017
Fair value of Level 3 assets, beginning of year	\$ 12,991	12,409
Unrealized gains	1,502	1,139
Proceeds from distributions	(349)	(557)
Fair value of Level 3 assets, end of year	\$ 14,144	12,991

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### Notes to Financial Statements September 30, 2018 (In thousands)

The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2018:

		<u>Fair value</u>	<u>Commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
U.S. equities	(a)	\$ 156,004	–	Monthly to quarterly	30 to 60 days
International equities:	(b)				
Developed market equities		110,939	–	Semi-monthly to monthly	8 to 30 days
Emerging market equities		51,694	–	Monthly to quarterly	30 to 120 days
Real estate:	(c)				
Private Investments		1,035	484	N/A	N/A
Private equity and venture capital funds	(e)	31,629	6,546	N/A	N/A
Hedge funds	(f)	214,724	19,986	Monthly to rolling three years	45 to 95 days
Multi-asset fund	(g)	21,577	–	Annually	365 days
Fixed income securities	(h)	82,111	–	Daily	2 days
Total		<u>\$ 669,713</u>	<u>27,016</u>		

## NATIONAL GALLERY OF ART

### Notes to Financial Statements September 30, 2018 (In thousands)

The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2017:

		<u>Fair value</u>	<u>Commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
U.S. equities	(a)	\$ 126,452	–	Monthly to quarterly	30 to 60 days
International equities:	(b)				
Developed market equities		106,160	–	Semi-monthly to monthly	8 to 30 days
Emerging market equities		53,260	–	Monthly	30 to 120 days
Real estate:	(c)				
Private Investments		1,246	519	N/A	N/A
Inflation hedging securities	(d)	22,585	–	Monthly	30 days
Private equity and venture capital funds	(e)	36,888	7,705	N/A	N/A
Hedge funds	(f)	133,066	–	Semi-annually to triennially	90 to 95 days
Multi-asset fund	(g)	28,186	–	Annually	365 days
Fixed income securities	(h)	73,855	–	Daily	2 days
Total		<u>\$ 581,698</u>	<u>8,224</u>		

## NATIONAL GALLERY OF ART

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- (a) U.S. equities: Investments in limited partnerships and limited liability companies that invest in the equity securities of U.S. companies and master limited partnerships.
- (b) International equities: Investments in equity securities of international companies in both developed and emerging markets comprised of investments in limited partnerships and limited liability companies.
- (c) Real estate: Investments in limited partnerships which invest in privately held real estate. The limited partnerships are organized as funds of funds.
- (d) Inflation hedging securities: Investments in securities which are expected to perform well in periods of high inflation, including precious metals, energy, commodities, natural resources, U.S. Treasury Inflation Protected Securities (TIPS) and energy infrastructure master limited partnerships (MLPs) comprised of an investment in a limited partnership.
- (e) Private equity and venture capital funds: Investments in limited partnerships which invest in shares of operating companies that are not listed on a publicly traded stock exchange, including leveraged buyouts, growth capital, distressed investments, and venture capital. The limited partnerships are organized as funds of funds.
- (f) Hedge funds: Investments in limited partnerships and limited liability companies which employ investment strategies such as long/short equity, long/short credit, and distressed assets or that are organized as funds of funds.
- (g) Multi-asset fund: Investment in a side pocket of a limited partnership which contains shares of funds engaged in private equity, venture capital, hedge funds, real estate, and natural resources.
- (h) Fixed income securities: Investment in a limited partnership which invests in investment grade fixed income securities issued by U.S. government and corporate entities.

## NATIONAL GALLERY OF ART

Notes to Financial Statements  
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The following schedule summarizes the investment return, net of expenses, and its classification in the statement of activities for the years ended September 30, 2018 and 2017:

	2018			2017 Total
	Without donor restrictions	With donor restrictions	Total	
Dividends and interest	\$ 2,499	10,769	13,268	8,849
Net realized and unrealized gains	17,103	34,926	52,029	97,567
Total investment return	19,602	45,695	65,297	106,416
Appropriated for operations	(2,723)	(18,224)	(20,947)	(19,685)
Appropriated for art acquisitions	-	(4,918)	(4,918)	(399)
Investment return less amounts appropriated for operations and art acquisitions	\$ 16,879	22,553	39,432	86,332

### (6) Property, Plant and Equipment, Net

As of September 30, 2018 and 2017, net property, plant and equipment consisted of the following:

	2018			2017 Total
	Private funds	Federal funds	Total	
Buildings and improvements	\$ 187,252	317,295	504,547	502,026
Equipment and computer software	8,669	90,359	99,028	94,873
Construction-in-progress	-	8,104	8,104	5,877
Equipment under capital lease	-	2,962	2,962	2,962
Subtotal	195,921	418,720	614,641	605,738
Less accumulated depreciation and amortization	(130,485)	(159,163)	(289,648)	(274,311)
Total	\$ 65,436	259,557	324,993	331,427

## NATIONAL GALLERY OF ART

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### (7) Accounts Payable and Other Liabilities

As of September 30, 2018 and 2017, accounts payable and other liabilities consisted of the following:

	2018			2017 Total
	Private funds	Federal funds	Total	
Refundable advances	\$ 22,670	–	22,670	25,000
Employee-related liabilities	6,064	16,751	22,815	22,547
Accounts payable and accrued expenses	2,128	6,546	8,674	9,198
Other liabilities	5,859	25	5,884	6,212
Total	\$ <u>36,721</u>	<u>23,322</u>	<u>60,043</u>	<u>62,957</u>

Refundable advances represent a donor gift received in FY 2017 contingent upon the Gallery satisfying matching requirements by March 31, 2021 in accordance with the donor agreement. The donor accepted \$2,330 of matching gifts in FY 2018.

### (8) Environmental Liability

In 2006 the Gallery, in conjunction with third party consultants, determined the cost of removing asbestos and other hazardous materials from the Gallery's buildings pursuant to the Clean Air Act as amended. The environmental liability was initially recorded at the estimated fair value calculated using inflation rates ranging from 1.9% to 2.6% and discount rates ranging from 4.6% to 4.9% (Level 3 inputs). The cost of the remediation is amortized over the useful life of the asset. The actual cost may vary from the current estimated cost at completion in the future due to inflation and the timing of implementing the various remedies. Management annually updates the total estimated costs for completion.

The Gallery's financial statements reflect an unfunded liability for environmental remediation clean-up costs as follows:

	2018	2017
Beginning balance	\$ 22,978	22,981
Remediation accretion	1,183	1,150
Change in liability valuation	(4,298)	(1,153)
Total	\$ <u>19,863</u>	<u>22,978</u>

## NATIONAL GALLERY OF ART

### Notes to Financial Statements September 30, 2018 (In thousands)

As of September 30, 2018 and 2017, the net remediation costs included in the Gallery's property, plant and equipment consists of the following:

	2018	2017
Remediation costs	\$ 4,201	4,201
Less accumulated depreciation	(3,692)	(3,609)
Net capitalized remediation costs	\$ 509	592

### (9) Net Assets

As of September 30, 2018 and 2017, net assets consisted of the following:

	2018			2017		
	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
Donor restricted endowment funds	\$ -	568,581	568,581	6	537,418	537,424
Add pledges receivable	-	17,726	17,726	-	12,456	12,456
Less refundable advances	-	(22,670)	(22,670)	-	(25,000)	(25,000)
Net donor restricted endowment funds	-	563,637	563,637	6	524,874	524,880
Perpetual trust held by a third party	-	10,377	10,377	-	10,234	10,234
Permanent loan from U.S. Treasury	-	5,000	5,000	-	5,000	5,000
Total funds restricted in perpetuity	-	579,014	579,014	6	540,108	540,114
Board-designated endowment funds	64,296	-	64,296	9,379	-	9,379
Total net assets subject to spending rules	64,296	579,014	643,310	9,385	540,108	549,493
Net assets with donor restrictions available for:						
Gallery programs and operations	-	108,093	108,093	-	107,162	107,162
Federal repair and renovation	-	43,646	43,646	-	27,495	27,495
Net investment in property, plant and equipment	316,967	8,026	324,993	325,968	5,453	331,421
Future-funded federal liabilities	(33,214)	-	(33,214)	(36,511)	-	(36,511)
Other board-designated net assets:						
Operating reserves	115,000	-	115,000	-	-	-
Capital reserves	30,000	-	30,000	-	-	-
Undesignated	95,614	-	95,614	278,092	-	278,092
Total	\$ 588,663	738,779	1,327,442	576,934	680,218	1,257,152

Donor restricted endowment funds include accumulated appreciation of \$303,332 and \$282,735 for the years ended September 30, 2018 and 2017, respectively. Future-funded federal liabilities represent accrued vacation and workers compensation liabilities to be funded with future fiscal year federal appropriations. Board designated reserves have been established to provide necessary resources in the event of potential extended market declines, as well as shortfalls in

## NATIONAL GALLERY OF ART

### Notes to Financial Statements September 30, 2018 (In thousands)

donor support and earned revenue during periods of economic recession, and to offset potential losses for damage or theft of art works on loan to the Gallery in excess of insurance coverage. Capital reserves fund non-federal capital additions and renovations and related obligations.

Net assets with donor restrictions are restricted as follows as of September 30, 2018 and 2017:

	2018				
	Restricted in perpetuity subject to spending policy	Subject to purpose restriction	Subject to release for assets placed in service	Subject to time restriction	Total
Acquisition of art	\$ 119,260	3,439	–	–	122,699
Collections	67,401	1,620	–	–	69,021
Special exhibitions	55,753	19,430	–	–	75,183
Education and public programs	156,036	79,394	–	–	235,430
Editorial and photography	6,321	278	–	–	6,599
Operations	174,243	2,310	–	447	177,000
Capital projects	–	1,175	–	–	1,175
Federal repair and renovation projects	–	43,646	8,026	–	51,672
Total	\$ 579,014	151,292	8,026	447	738,779
	2017				
	Restricted in perpetuity subject to spending policy	Subject to purpose restriction	Subject to release for assets placed in service	Subject to time restriction	Total
Acquisition of art	\$ 114,022	6,150	–	–	120,172
Collections	58,276	3,003	–	–	61,279
Special exhibitions	52,645	17,559	–	–	70,204
Education and public programs	140,495	76,519	–	–	217,014
Editorial and photography	6,065	317	–	–	6,382
Operations	168,605	2,316	–	–	170,921
Capital projects	–	1,298	–	–	1,298
Federal repair and renovation projects	–	27,495	5,453	–	32,948
Total	\$ 540,108	134,657	5,453	–	680,218

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### (10) Endowment Funds

The Gallery's endowment consists of 112 individual funds established for a variety of purposes. The endowment includes donor-restricted endowment funds and four funds designated by the Board of Trustees to function as endowment funds supporting Gallery programs and operations. As required by U.S. GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

#### *Interpretation of Relevant Law*

The Gallery's Board of Trustees has resolved to be guided by the standards in the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as enacted by the District of Columbia on January 23, 2008, in the management, investment, and expenditure of Gallery endowment funds although it is not required to do so as a matter of law. The Board has interpreted UPMIFA as allowing the Gallery to appropriate for expenditure or accumulate so much of an endowment fund as the Gallery determines is prudent for the uses, purposes and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. Unless stated otherwise in the gift instrument, the assets in an endowment fund shall be donor-restricted assets until appropriated for expenditure by the Gallery. The corpus of the Gallery's endowment funds consist of (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) changes to the permanent endowment made in accordance with the direction of the applicable donor gift instrument. Earnings and accumulated appreciation of the endowment funds remain restricted until appropriated for expenditure by the Gallery in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Gallery considers the following factors when making a determination to appropriate or accumulate donor-restricted funds:

- The duration and preservation of the fund
- The purposes of the Gallery and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Gallery
- The investment policies of the Gallery

The Gallery has adopted investment and spending policies for endowment assets that are intended to provide a predictable stream of funding for programs while maintaining the purchasing power of the endowment. Under the investment policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that reduces risk through diversification while

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### Notes to Financial Statements September 30, 2018 (In thousands)

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

The Gallery's spending policy is based on an annual endowment spending rate of 5% of the average fair value of endowment investments at the end of the previous five years. This spending rate constitutes the Board's annual appropriation for spending endowment earnings to support both the purchase of art and support of operations. Funds appropriated for art acquisition may exceed the 5% based on the availability of works of art for acquisition.

The following table summarizes the change in the Gallery's endowment funds during the years ended September 30, 2018 and 2017:

	2018			2017		
	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
Endowment net assets at beginning of year	\$ 9,385	537,418	546,803	8,047	450,852	458,899
Additional designation of quasi-endowment funds	52,918	-	52,918	-	-	-
Contributions received	28	10,242	10,270	626	38,691	39,319
Investment return	4,503	39,702	44,205	1,035	62,096	63,130
Appropriation of endowment assets for expenditures	(2,538)	(18,781)	(21,319)	(323)	(14,221)	(14,545)
Endowment net assets at end of year	\$ 64,296	568,581	632,877	9,385	537,418	546,803

### Funds with Deficiencies

From time to time the fair value of assets of individual donor-restricted endowment funds may fall below the level required to be maintained in perpetuity in accordance with UPMIFA or the applicable donor gift document, creating an "underwater" endowment fund. It is the policy of the Gallery not to spend from underwater funds. Two of the Gallery's newly established endowment funds were underwater as of September 30, 2018 as follows:

	2018
Fair value of endowment funds	\$ 4,379
Original gift corpus	(4,388)
Underwater deficiency	\$ (9)

Underwater deficiencies in the amount of \$2,607 as of September 30, 2016 were fully recovered during FY 2017. No endowment funds were underwater as of September 30, 2017.

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### (11) Net Assets Released from Restrictions

Net assets are released from donor restrictions as expenses are incurred to satisfy the restricted purposes or by occurrence of the passage of time or other events specified by donors. Restrictions of net assets were released by the Gallery as follows for the years ended September 30, 2018 and 2017.

	2018			2017
	Private	Federal	Total	Total
<b>Operating Releases</b>				
Purpose-restricted gifts released for:				
Collections	\$ 1,544	–	1,544	930
Special exhibitions	5,229	2,756	7,985	6,665
Education and public programs	1,349	–	1,349	1,137
Editorial and photography	135	–	135	22
Operations	75	4,690	4,765	4,593
Total	8,332	7,446	15,778	13,347
Release of appropriated endowment spend without purpose restrictions	2,495	–	2,495	2,423
Release of appropriated endowment spend with purpose restrictions	12,770	–	12,770	13,633
Total operating releases	23,597	7,446	31,043	29,403
<b>Non-operating Releases</b>				
Purpose-restricted gifts released for:				
Acquisition of art	9,167	–	9,167	5,377
Capital projects	138	789	927	6,902
Total	9,305	789	10,094	12,279
Release of appropriated endowment spend with purpose restrictions	5,503	–	5,503	691
Total non-operating releases	14,808	789	15,597	12,970
Total releases	\$ 38,405	8,235	46,640	42,373

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### (12) Federal Appropriations

The Gallery is funded primarily by two Congressional appropriations: one appropriation covers the Gallery's salaries, benefits and expenses, a portion of which is designated for special exhibitions, and the second appropriation provides funds necessary for the repair, restoration and renovation of the Gallery's buildings. The appropriation received for salaries, benefits and expenses is a two-year appropriation that must be obligated by the end of the second fiscal year, with the exception of the portion of the appropriation designated for special exhibitions expenses, which is available until it is expended. The appropriation for the repair, restoration, and renovation of the Gallery's buildings is available until expended. The fiscal year 2018 salaries and expenses appropriation includes \$3,620 for no-year special exhibitions funding.

The Gallery's federal appropriations received in the fiscal years ending 2018 and 2017 are reconciled to federal appropriation revenue recognized as follows:

	2018			
	Salaries and expenses	Repairs, restoration and renovation	Total	2017 Total
Federal appropriations received	\$ 141,790	24,203	165,993	155,525
Unexpended appropriations	(25,902)	-	(25,902)	(16,967)
Amounts expended from prior years' appropriations	15,334	-	15,334	10,727
Federal appropriation revenue recognized	\$ 131,222	24,203	155,425	149,285
Operating	\$ 125,825	4,690	130,515	126,584
Non-operating	5,397	19,513	24,910	22,701
Total federal appropriation revenue recognized	\$ 131,222	24,203	155,425	149,285

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(In thousands)

### (13) Functional Classification of Expenses

Expenses by functional and natural classification for the fiscal year ended September 30, 2018 are shown below:

	Collections	Special exhibitions	Education, Gallery shops and public programs	Editorial and photography	General and administrative	Development	Total
Compensation	\$ 38,525	11,426	28,355	5,581	22,406	2,997	109,290
Contractual services	5,647	6,250	5,939	923	7,271	911	26,941
Occupancy	3,582	807	1,726	243	5,259	150	11,767
Office expenses	2,390	1,986	3,317	510	1,528	300	10,031
Cost of sales	–	977	3,944	7	–	–	4,928
Other	1,081	977	1,974	137	544	119	4,832
Total operating expenses	<u>51,225</u>	<u>22,423</u>	<u>45,255</u>	<u>7,401</u>	<u>37,008</u>	<u>4,477</u>	<u>167,789</u>
Art acquisitions	14,871	–	–	–	–	–	14,871
Depreciation expense	7,570	1,535	3,116	393	2,548	175	15,337
Environmental liability accrual	639	130	236	24	142	12	1,183
Income tax expense	–	–	–	–	160	–	160
Total expenses	<u>\$ 74,305</u>	<u>24,088</u>	<u>48,607</u>	<u>7,818</u>	<u>39,858</u>	<u>4,664</u>	<u>199,340</u>

Certain costs including depreciation expense, utilities, building maintenance, security, information systems, and other operating costs have been allocated among program and supporting services. These costs are allocated based on various factors such as square footage, head count, direct labor dollars, and desktop locations.

### (14) Employee Benefits

Total pension expense recognized in the Gallery's financial statements was \$9,652 and \$9,459 for the years ended September 30, 2018 and 2017, respectively. These amounts do not include pension expense financed by OPM and imputed to the Gallery of \$2,387 and \$1,033, 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, 2018 and 2017, were \$3,031 and \$2,951, 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 2018 and 2017, the Gallery contributed \$6,797 and \$6,675, 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 \$5,541 and \$4,213 during fiscal years 2018 and 2017, respectively, and are financed by OPM and imputed to the Gallery.

## NATIONAL GALLERY OF ART

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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 2018 and 2017 total \$87 and is recognized as an expense in the statement of activities and as a liability included in accounts payable and other liabilities in the accompanying statement of financial position.

### (15) 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. As a 501(c)(3) organization, the Gallery is taxed only on unrelated business income. Investment earnings are the primary source of the Gallery's unrelated business income. Tax positions are recognized or derecognized based on a more-likely than-not threshold. This applies to positions taken or expected to be taken in a tax return. The Gallery is not aware of any uncertain tax positions.

### (16) Lease Commitments

The Gallery has entered into several operating leases for warehouse and office space, which continue through December 31, 2028. 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 are as follows:

Fiscal Year Ending:

2019	\$	4,197
2020		5,344
2021		5,465
2022		5,589
2023		5,717
Thereafter		9,434
Total minimum lease payments	\$	<u>35,746</u>

Rental expense was approximately \$6,613 and \$6,248 for the years ended September 30, 2018 and 2017, respectively.

**NATIONAL GALLERY OF ART**

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**(17) Subsequent Events**

The Gallery has performed an evaluation of subsequent events through November 14, 2018 which is the date the financial statements were available to be issued, noting no events which affect the financial statements as of September 30, 2018.