NATIONAL GALLERY OF ART

Financial Statements

September 30, 2014

(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, 2014, 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. 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, 2014, 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 2013 financial statements, and we expressed an unmodified audit opinion on those financial statements in our report dated December 13, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2013 is consistent, in all material respects, with the audited financial statements from which it has been derived.

KPMG LLP

November 14, 2014

NATIONAL GALLERY OF ART

Statement of Financial Position

September 30, 2014
(with summarized financial information as of September 30, 2013)

(In thousands)

		2014		2013
Assets	**Private**	**Federal**	**Total**	**Total**
Cash and cash equivalents	$ 18,075	49,843	67,918	51,374
Accounts receivable and other assets, net	5,738	—	5,738	6,496
Pledges receivable, net	13,605	—	13,605	22,847
Investments and trusts held by others	817,404	—	817,404	761,194
Property, plant and equipment, net	56,409	232,574	288,983	285,775
Art collections	—	—	—	—
Total assets	$ 911,231	282,417	1,193,648	1,127,686
Liabilities and Net Assets				
Liabilities:				
Accounts payable and other liabilities	$ 10,735	22,659	33,394	44,148
Capital lease obligation	—	605	605	868
Unexpended federal one-year appropriations	—	18,116	18,116	9,589
Environmental liability	—	23,782	23,782	23,908
Total liabilities	10,735	65,162	75,897	78,513
Net assets:				
Unrestricted	308,094	194,163	502,257	474,587
Temporarily restricted	192,265	23,092	215,357	194,414
Permanently restricted	400,137	—	400,137	380,172
Total net assets	900,496	217,255	1,117,751	1,049,173
Total liabilities and net assets	$ 911,231	282,417	1,193,648	1,127,686

See accompanying notes to financial statements.

NATIONAL GALLERY OF ART

Statement of Activities

Year ended September 30, 2014
(with summarized financial information for the year ended September 30, 2013)

(In thousands)

	Unrestricted private	Unrestricted federal	Total Unrestricted	Temporarily restricted	Permanently restricted	Total 2014	Total 2013
Operating:							
Support and revenue:							
Federal appropriations	$ —	102,819	102,819	7,315	—	110,134	107,949
Gifts and grants	2,478	—	2,478	7,008	—	9,486	9,467
Gallery shops sales, net	8,811	—	8,811	—	—	8,811	9,662
Spending policy appropriated for operations	2,665	—	2,665	14,946	—	17,611	17,299
Royalties and other income	3,338	—	3,338	—	—	3,338	2,441
	17,292	102,819	120,111	29,269	—	149,380	146,818
Net assets released from restrictions to fund operating expenses	17,895	6,781	24,676	(24,676)	—	—	—
Total support and revenue	35,187	109,600	144,787	4,593	—	149,380	146,818
Expenses:							
Collections	3,470	41,320	44,790	—	—	44,790	43,726
Special exhibitions	4,208	13,315	17,523	—	—	17,523	21,557
Education, gallery shops, and public programs	15,823	23,129	38,952	—	—	38,952	38,518
Editorial and photography	1,431	4,650	6,081	—	—	6,081	5,959
General and administrative	5,241	26,216	31,457	—	—	31,457	30,445
Development	2,366	1,734	4,100	—	—	4,100	4,410
Total operating expenses	32,539	110,364	142,903	—	—	142,903	144,615
Change in net assets from operating activities	2,648	(764)	1,884	4,593	—	6,477	2,203
Nonoperating:							
Federal appropriations	—	2,681	2,681	11,218	—	13,899	15,597
Nonoperating gifts and grants	5	—	5	7,058	639	7,702	17,793
Spending policy appropriated for art acquisitions	742	—	742	226	—	968	27,429
Changes in value of trusts held by others	(226)	—	(226)	16	392	182	106
Investment return less amounts appropriated for operations and art acquisitions	24,048	—	24,048	19,058	13,896	57,002	44,531
Acquisitions of works of art	(8,914)	—	(8,914)	—	—	(8,914)	(31,940)
Depreciation and amortization expense	(3,477)	(9,990)	(13,467)	—	—	(13,467)	(12,456)
Income tax benefit	50	—	50	—	—	50	514
Environmental liability expense	—	(571)	(571)	—	—	(571)	(2,945)
Gifts transferred from Corcoran	—	—	—	2,020	3,230	5,250	—
Reclassifications of net asset balances	(1,458)	—	(1,458)	(350)	1,808	—	—
Net assets released from restrictions to fund nonoperating expenses	13,037	9,859	22,896	(22,896)	—	—	—
Increase in net assets from nonoperating activities	23,807	1,979	25,786	16,350	19,965	62,101	58,629
Increase in net assets	26,455	1,215	27,670	20,943	19,965	68,578	60,832
Net assets at beginning of year	281,639	192,948	474,587	194,414	380,172	1,049,173	988,341
Net assets at end of year	$ 308,094	194,163	502,257	215,357	400,137	1,117,751	1,049,173

See accompanying notes to financial statements.

NATIONAL GALLERY OF ART

Statement of Cash Flows

Year ended September 30, 2014
(with summarized financial information for the year ended September 30, 2013)

(In thousands)

	Private	Federal	Total 2014	Total 2013
Cash flows from operating activities:				
Increase in net assets	$ 65,470	3,108	68,578	60,832
Adjustments to reconcile increase in net assets to net cash used in operating activities:				
Depreciation and amortization	3,477	9,990	13,467	12,456
Amortization of discount on pledges receivable	(324)	—	(324)	(453)
Contributions and net investment income for permanently restricted investments	(5,240)	—	(5,240)	(3,160)
Federal appropriations for capital projects	—	(13,899)	(13,899)	(15,597)
Gifts and grants for art acquisitions and capital projects	(19,187)	—	(19,187)	(9,720)
Acquisitions of works of art	17,445	—	17,445	23,534
Realized and unrealized gains on investments, net	(71,332)	—	(71,332)	(81,684)
Donated investment securities	(5,508)	—	(5,508)	(1,334)
Proceeds from donated investment securities	5,533	—	5,533	
Change in value of trusts held by others	(262)	—	(262)	210
Change in accounts receivable and other assets, net	736	22	758	(895)
Change in pledges receivable, net	8,990	—	8,990	(3,520)
Change in accounts payable and other liabilities	(10,456)	(639)	(11,095)	9,420
Change in unexpended one-year federal appropriations	—	8,527	8,527	(2,259)
Change in environmental liability	—	(126)	(126)	2,883
Net cash (used in) provided by operating activities	(10,658)	6,983	(3,675)	(9,287)
Cash flows from investing activities:				
Purchase of investments	(150,258)	—	(150,258)	(112,557)
Proceeds from sale of investments	166,193	—	166,193	134,750
Acquisitions of works of art	(17,445)	—	(17,445)	(23,534)
Purchase of property, plant and equipment	(4,423)	(11,911)	(16,334)	(39,709)
Net cash used in investing activities	(5,933)	(11,911)	(17,844)	(41,050)
Cash flows from financing activities:				
Contributions and net investment income for permanently restricted investments	5,240	—	5,240	3,160
Federal appropriations for capital projects	—	13,899	13,899	15,597
Gifts and grants for art acquisitions and capital projects	19,187	—	19,187	9,720
Principal payment on capital lease obligation	—	(263)	(263)	(242)
Net cash provided by financing activities	24,427	13,636	38,063	28,235
Net change in cash and cash equivalents	7,836	8,708	16,544	(22,102)
Cash and cash equivalents, at beginning of year	10,239	41,135	51,374	73,476
Cash and cash equivalents, at end of year	$ 18,075	49,843	67,918	51,374
Supplemental disclosure of cash flow information:				
Cash paid during the year for:				
Interest on capital lease	$ —	79	79	102
Supplemental disclosure of noncash information:				
Capital additions included in accounts payable	$ 916	1,727	2,643	2,302

See accompanying notes to financial statements.

NATIONAL GALLERY OF ART

Notes to Financial Statements

September 30, 2014

(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 nonoperating activities such as nonoperating gifts and grants (endowment gifts, gifts for art acquisitions, and capital projects), investment return less 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 note 4).

(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 for the year ended September 30, 2013, from which the summarized information was derived.

(d) 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 stipulations. The unrestricted net assets of federal funds consist primarily of the Gallery's net investment in building improvements and other equipment purchased or constructed using federal funds less unfunded liabilities. 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 stipulations on the expenditure or other use of the contributed funds. In addition, the Gallery's "no-year" federal appropriations for special exhibitions and for the repair, renovation and restoration of its buildings are classified as temporarily restricted net assets.

  Temporary 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 capital expenditures are incurred.
- *Permanently restricted* net assets have donor-imposed stipulations that require 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.

(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 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 4).

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 2.2% to 4.5%. 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 4).

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 "changes in value of trusts held by others" in the statement of activities.

(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.

In 2014, the District of Columbia Attorney General and the District of Columbia Superior Court approved a cy pres petition by the Corcoran Gallery of Art to authorize specific contracts between the Corcoran Gallery of Art, the National Gallery of Art, and George Washington University. Upon execution of these contracts, the Corcoran Gallery of Art transferred to the National Gallery of Art the custody, care and possession of all of the Corcoran's artworks, together with certain related gift and endowment assets. The National Gallery's Board of Trustees will accession appropriate works of art into its collection, and

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the remainder of the artwork in its custody and care will be distributed by the surviving Corcoran entity to other art museums or entities.

(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 after five years. The remaining unexpended balances of these funds are classified as a liability on the statement of financial position.

(l) Employee Benefits

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; therefore the excess financing costs are not recognized in the statement of activities. This amount is considered imputed financing by the Gallery.

All permanent employees of the Gallery, both federal and nonfederal, 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).

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 for these paid claims.

The actuarial FECA liability represents the liability for expected future workers' compensation benefits, which includes the liability 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 period, wage inflation factors, medical inflation factors and other variables. These actuarially computed projected annual benefit payments are discounted to present value using discount rates derived from the Treasury Nominal Coupon-Issue Yield Curve based on an average of the quarterly spot rates presented from September 30, 2013, through June 30, 2014. Specific rates were selected by interpolation for Treasury notes with maturities that matched average FECA compensation and medical cash flow duration. The change in the projected FECA liability is reported in the statement of activities. The FECA actuarial liability is recorded for financial reporting purposes only. This liability constitutes an extended future estimate of cost which will not be obligated against budgetary resources until the fiscal year in which DOL actually 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 are paid out of funds appropriated to other federal agencies. As an example, the law requires certain costs of retirement programs to be paid by OPM and certain legal judgments against the Gallery to be paid from the Judgment Fund maintained by U.S. Treasury. Costs that are identifiable to the Gallery and directly attributable to the Gallery's operations are paid by these federal agencies; however, imputed costs and offsetting federal funding amounts are not recognized in the statement of activities.

Imputed costs and offsetting federal funding amounts for pension and post-retirement health and life insurance benefits are computed and presented in note 12.

(n) 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 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.

(o) Functional Allocation of Expenses

The cost of providing various programs and other activities summarized on a functional basis is shown in note 10. Certain costs including depreciation, utilities, building maintenance, security, information systems 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 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.

(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) Reclassifications

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

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(In thousands)

(3) Pledges Receivable, Net

As of September 30, 2014 and 2013, pledges receivable, net, consisted of the following:

		2014	2013
Due in one year or less	$	10,887	6,162
Due between one year and five years		3,044	17,288
Subtotal		13,931	23,450
Less discounts of $176 and $453 and allowances of $150 and $150, respectively		(326)	(603)
Total	$	13,605	22,847

As of September 30, 2014 and 2013, $7,062 and $13,173 of the pledge receivable balance was receivable from related parties.

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

As of September 30, 2014 and 2013, investments and trust held by others consisted of the following:

		2014	2013
Investments	$	799,236	743,864
Trusts held by others		13,168	12,330
Subtotal		812,404	756,194
Loan to U.S. Treasury		5,000	5,000
Total	$	817,404	761,194

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 2014). Interest income on this loan was $203 and $203 for the fiscal years ended September 30, 2014 and 2013, respectively. The fair value of the loan to the U.S. Treasury approximates the carrying value.

As of September 30, 2014 and 2013, 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. Investments consist of limited partnerships and limited liability companies where the underlying investments are, for the most part, marketable securities. The Gallery receives monthly statements from the investment managers but has limited visibility of the underlying securities of certain Level 2 investment funds.
- *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. Investments consist of limited partnership and limited liability companies where the underlying investments include private equity, venture capital, hedge funds, and private real estate for which there is no active market and for which the inputs into the fair value estimate are unobservable. The portfolio holdings of underlying funds in Level 3 investments may not be disclosed; therefore the Gallery relies on the investment manager to provide a valuation estimate which is generally based on the most current NAV adjusted for cash flows when the reported NAV is not at the measurement date. Trusts held by others are also 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.

(In thousands)

The following tables summarize the fair value of investments and trusts held by others as of September 30, 2014 and 2013 for financial assets by pricing observability levels:

	Prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Fair value at September 30, 2014
U.S. equities	$ 118,507	84,070	—	202,577
International equities:				
Developed market equities	59,507	69,214	—	128,721
Emerging market equities	21,933	47,037	—	68,970
Real estate	17,414	—	4,613	22,027
Inflation hedging securities	—	33,817	—	33,817
Private equity and venture capital funds	—	—	53,585	53,585
Hedge fund of funds	—	—	160,312	160,312
Multi-asset fund	—	—	49,201	49,201
Fixed income securities	8,121	65,520	—	73,641
Charitable gift annuities and other	6,385	—	—	6,385
Trusts held by others	—	—	10,622	10,622
Assets measured at fair value on a recurring basis	231,867	299,658	278,333	809,858
Trusts held by others measured on a nonrecurring basis	—	—	2,546	2,546
Total	$ 231,867	299,658	280,879	812,404

(In thousands)

	Prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Fair value at September 30, 2013
U.S. equities	$ 110,292	74,525	—	184,817
International equities:				
Developed market equities	59,966	65,601	—	125,567
Emerging market equities	13,729	44,098	—	57,827
Real estate	16,723	—	5,007	21,730
Inflation hedging securities	—	33,347	—	33,347
Private equity and venture capital funds	—	—	51,235	51,235
Hedge fund of funds	—	—	155,679	155,679
Multi-asset fund	—	—	45,926	45,926
Fixed income securities	61,588	—	—	61,588
Charitable gift annuities and other	6,148	—	—	6,148
Trusts held by others	—	—	9,784	9,784
Assets measured at fair value on a recurring basis	268,446	217,571	267,631	753,648
Trusts held by others measured on a nonrecurring basis	—	—	2,546	2,546
Total	$ 268,446	217,571	270,177	756,194

(In thousands)

The following table summarizes the changes in Level 3 assets, measured at fair value on a recurring basis, as of September 30, 2014:

	Real estate	Private equity and venture capital funds	Hedge fund of funds	Multi-asset fund	Trusts held by others	Total
Fair value of Level 3 assets at September 30, 2013	$ 5,007	51,235	155,679	45,926	9,784	267,631
(Expenses) net of dividends and interest	95	(1,106)	(541)	(429)	—	(1,981)
Realized and unrealized gains	515	11,690	10,874	6,110	859	30,048
Proceeds from sales, redemptions and distributions	(1,123)	(14,183)	(5,700)	(2,406)	(453)	(23,865)
Purchase of investments	119	5,949	—	—	432	6,500
Fair value of Level 3 assets at September 30, 2014	$ 4,613	53,585	160,312	49,201	10,622	278,333

For the year ended September 30, 2014, there was approximately $4,042 of unrealized gains included in the change in net assets that were attributable to Level 3 assets, measured at fair value on a recurring basis, still held at September 30, 2014.

The following table summarizes the changes in Level 3 assets, measured at fair value on a recurring basis, as of September 30, 2013:

	Real estate	Private equity and venture capital funds	Hedge fund of funds	Multi-asset fund	Trusts held by others	Total
Fair value of Level 3 assets at September 30, 2012	$ 4,926	52,850	144,914	44,411	9,994	257,095
(Expenses) net of dividends and interest	175	(678)	(580)	920	—	(163)
Realized and unrealized gains	398	4,869	17,023	2,861	1,084	26,235
Proceeds from sales, redemptions and distributions	(830)	(11,546)	(5,678)	(2,266)	(1,295)	(21,615)
Purchase of investments	338	5,740	—	—	1	6,079
Fair value of Level 3 assets at September 30, 2013	$ 5,007	51,235	155,679	45,926	9,784	267,631

For the year ended September 30, 2013, there was approximately $8,011 of unrealized gains included in the change in net assets that were attributable to Level 3 assets, measured at fair value on a recurring basis, still held at September 30, 2013.

(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, 2014:

		Fair value	Commitments	Redemption frequency	Redemption notice period
U.S. equities	(a)	$ 84,070	—	Quarterly	60 days
International equities:	(b)				
Developed market equities		69,214	—	Daily to semi-monthly	6 to 20 days
Emerging market equities		47,037	—	Monthly	30 to 120 days
Real estate	(c)	4,613	650	N/A	N/A
Inflation hedging securities	(d)	33,817	—	Monthly	30 days
Private equity and venture capital funds	(e)	53,585	14,468	N/A	N/A
Hedge fund of funds	(f)	160,312	—	Semi-annually to annually	90 to 95 days
Multi-asset fund	(g)	49,201	—	Annually	365 days
Fixed income securities	(h)	65,520	—	Monthly	7 days
Total		$ 567,369	15,118		

The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2013:

		Fair value	Commitments	Redemption frequency	Redemption notice period
U.S. equities	(a)	$ 74,525	—	Quarterly	60 days
International equities:	(b)				
Developed market equities		65,601	—	Daily to semi-monthly	6 to 20 days
Emerging market equities		44,098	—	Monthly	30 to 120 days
Real estate	(c)	5,007	806	N/A	N/A
Inflation hedging securities	(d)	33,347	—	Monthly	30 days
Private equity and venture capital funds	(e)	51,235	20,421	N/A	N/A
Hedge fund of funds	(f)	155,679	—	Semi-annually to two years	90 to 95 days
Multi-asset fund	(g)	45,926	—	Annually	365 days
Total		$ 475,418	21,227		

(a) U.S. equities: Investments in equity securities of large cap and small cap U.S. companies comprised of a fund that invests long and short in U.S. equities.

(b) International equities: Investments in equity securities of international companies in both developed and emerging markets comprised of investments in mutual funds, limited partnerships and limited liability companies.

(c) Real estate: Investments in privately held real estate comprised of investments in private limited partnerships.

(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, and U.S. Treasury Inflation Protected Securities (TIPS) 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 start-ups. The limited partnerships are organized as funds of funds.

(f) Hedge fund of funds: Investments in limited partnerships which invest in shares of hedge funds which employ strategies such as long/short equity, credit and distressed assets, and multi-strategy.

(g) Multi-asset fund: Investment in a limited partnership which invests in shares of funds engaged in all asset classes, including U.S. and international equities, fixed income, 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.

(Continued)

(In thousands)

The following schedule summarizes the investment return and its classification in the statement of activities for the years ended September 30, 2014 and 2013:

	2014				
	Unrestricted	Temporarily restricted	Permanently restricted	Total	2013 Total
Dividends and interest (net of expenses of $5,175 and $4,292, respectively)	$ 1,193	1,647	1,409	4,249	7,575
Net investment appreciation	26,262	32,583	12,487	71,332	81,684
	27,455	34,230	13,896	75,581	89,259
Appropriated for operations	(2,665)	(14,946)	—	(17,611)	(17,299)
Appropriated for art acquisitions	(742)	(226)	—	(968)	(27,429)
Investment return less amounts appropriated for operations and art acquisitions	$ 24,048	19,058	13,896	57,002	44,531

(5) Property, Plant and Equipment, Net

As of September 30, 2014 and 2013, net property, plant and equipment consisted of the following:

	2014			
	Private funds	Federal funds	Total	2013 Total
Buildings and improvements	$ 156,309	263,419	419,728	330,649
Equipment and computer software	6,616	71,465	78,081	74,981
Construction-in-progress	7,819	8,250	16,069	91,573
Equipment under capital lease	—	2,962	2,962	2,962
Subtotal	170,744	346,096	516,840	500,165
Less accumulated depreciation and amortization	(114,335)	(113,522)	(227,857)	(214,390)
Total	$ 56,409	232,574	288,983	285,775

(In thousands)

(6) Accounts Payable and Other Liabilities

As of September 30, 2014 and 2013, accounts payable and other liabilities consisted of the following:

		2014			
		Private funds	Federal funds	Total	2013 Total
Accounts payable and accrued expenses	$	2,639	6,284	8,923	18,566
Employee-related liabilities		4,515	15,987	20,502	21,161
Other accrued liabilities		3,581	388	3,969	4,421
Total	$	10,735	22,659	33,394	44,148

(7) 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.

As of September 30, 2014 and 2013 the net remediation costs included in the Gallery's property, plant and equipment consists of the following:

		2014	2013
Remediation costs	$	4,201	4,201
Less accumulated depreciation		(3,358)	(3,275)
Net remediation costs	$	843	926

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

		2014	2013
Beginning balance	$	23,908	21,025
Liability recorded for the period		571	2,945
Remediation costs incurred		(697)	(62)
Total	$	23,782	23,908

(In thousands)

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.

(8) 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 2014 salaries and expenses appropriation includes $3,533 for no-year special exhibitions funding.

The Gallery's federal appropriations received in the fiscal years ending 2014 and 2013 are reconciled to federal appropriation revenue recognized as follows:

	2014			
	Salaries and expenses	**Repairs, restoration and renovation**	**Total**	**2013**
Federal appropriations received	$ 118,000	15,000	133,000	121,662
Unexpended appropriations	(14,836)	—	(14,836)	(6,205)
Amounts expended from prior years' appropriations	5,869	—	5,869	8,089
Federal appropriation revenue recognized	$ 109,033	15,000	124,033	123,546
Operating	$ 106,352	3,782	110,134	107,949
Nonoperating	2,681	11,218	13,899	15,597
Total federal appropriation revenue recognized	$ 109,033	15,000	124,033	123,546

(In thousands)

(9) 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:

	2014			2013
	Private	**Federal**	**Total**	**Total**
Collections	$ 2,303	—	2,303	2,283
Special exhibitions	2,525	2,999	5,524	9,904
Education and public programs	5,553	—	5,553	4,741
Editorial and photography	10	—	10	661
Operations	7,504	3,782	11,286	10,110
Subtotal operating	17,895	6,781	24,676	27,699
Acquisition of art	7,952	—	7,952	21,107
Capital projects	5,085	9,859	14,944	26,250
Subtotal nonoperating	13,037	9,859	22,896	47,357
Total	$ 30,932	16,640	47,572	75,056

(In thousands)

(10) Functional Classification of Expenses

Expenses by functional classification for fiscal years 2014 and 2013 are shown below:

	2014			2013
	Private	Federal	Total	Total
Total operating expenses from the statement of activities	$ 32,539	110,364	142,903	144,615
Expenses included in the nonoperating section of the statement of activities:				
Depreciation and amortization	3,477	9,990	13,467	12,456
Environmental liability	—	571	571	2,945
Income tax benefit	(50)	—	(50)	(514)
Total expenses	$ 35,966	120,925	156,891	159,502
Program services:				
Collections	$ 5,159	46,464	51,623	51,308
Special exhibitions	4,637	14,562	19,199	23,425
Education, Gallery shops and public programs	16,495	25,131	41,626	41,443
Editorial and photography	1,509	4,911	6,420	6,321
Subtotal program expenses	27,800	91,068	118,868	122,497
Supporting services:				
General and administrative	5,757	27,983	33,740	32,404
Development	2,409	1,874	4,283	4,601
Subtotal supporting services	8,166	29,857	38,023	37,005
Total expenses	$ 35,966	120,925	156,891	159,502

(11) Endowments and Net Asset Classifications

The Gallery's endowment consists of eighty-eight individual funds established for a variety of purposes. Included in the funds are eleven endowment funds transferred from the Corcoran Gallery of Art during FY 2014. The contributed value of these eleven funds is reported separately in the Statement of Activities.

The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. 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.

(In thousands)

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 Gallery classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the 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

Endowment net assets were comprised of the following as of September 30, 2014 and 2013:

		2014		2013	
		Donor-restricted endowment funds	**Board-designated endowment funds**	**Donor-restricted endowment funds**	**Board-designated endowment funds**
Unrestricted	$	35	9,820	—	11,135
Temporarily restricted		79,544	—	62,719	—
Permanently restricted		400,137	—	380,172	—
Total	$	479,716	9,820	442,891	11,135

(In thousands)

The following table summarizes the change in the endowment funds during the years ended September 30, 2014 (with summarized comparative totals for 2013):

		2014				
		Unrestricted	Temporarily restricted	Permanently restricted	Total	2013 Total
Endowment net assets as of October 1,	$	11,135	62,719	380,172	454,026	440,930
Investment return:						
Investment income		49	1,452	1,409	2,910	4,818
Net appreciation		902	26,304	12,879	40,085	46,635
Total investment return		951	27,756	14,288	42,995	51,453
Contributions		4	2,026	3,869	5,899	1,956
Appropriation of endowment assets for expenditures		(948)	(12,477)	—	(13,425)	(40,884)
Reclassifications		(1,287)	(480)	1,808	41	571
Endowment net assets as of September 30,	$	9,855	79,544	400,137	489,536	454,026

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Gallery to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were $8 as of September 30, 2014. These deficiencies were the result of unfavorable market fluctuations that occurred after the investment of the new Corcoran contributions. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

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 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.

(In thousands)

The following table summarizes the purpose of the net asset restrictions as of September 30, 2014 (with summarized comparative totals for 2013):

		2014			
		Temporarily restricted	**Permanently restricted**	**Total**	**2013 Total**
Acquisition of art	$	35,266	80,049	115,315	104,308
Collections		9,704	42,912	52,616	45,564
Special exhibitions		28,141	31,851	59,992	53,949
Education and public programs		46,842	90,016	136,858	130,619
Editorial and photography		519	5,772	6,291	4,685
Capital projects		22,131	—	22,131	26,539
Federal repair and renovation projects		23,092	—	23,092	21,215
Operations		49,662	149,537	199,199	187,707
Total	$	215,357	400,137	615,494	574,586

(12) Employee Benefits

Total pension expense recognized in the Gallery’s financial statements was $7,676 and $7,644 for the years ended September 30, 2014 and 2013, respectively. These amounts do not include pension expense financed by OPM and imputed to the Gallery of $2,267 and $1,899, 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, 2014 and 2013, were $2,540 and $2,472, 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 2014 and 2013, the Gallery contributed $5,873 and $5,788, 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 $5,112 and $4,960 during fiscal years 2014 and 2013, 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 2014 and 2013 total $101 and $258, respectively, and is recognized as an expense in the

(Continued)

(In thousands)

statement of activities and as a liability included in accounts payable and other liabilities 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.

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.

(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 April 30, 2024. 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:

	2014	
	Capital lease	**Operating lease**
2015	$ 344	4,957
2016	345	4,820
2017	—	4,851
2018	—	4,968
2019	—	2,283
Thereafter	—	6,734
Total minimum lease payments	689	$ 28,613
Less amount representing interest	(84)	
Present value of minimum capital lease payments	$ 605	

Rental expense was approximately $4,834 and $4,884 for the years ended September 30, 2014 and 2013, respectively.

(15) Subsequent Events

The Gallery has performed an evaluation of subsequent events through November 14, 2014 which is the date the financial statements were available to be issued, noting no events which affect the financial statements as of September 30, 2014.