

NATIONAL GALLERY OF ART

Financial Statements

September 30, 2020

(With Independent Auditors' Reports Thereon)



KPMG LLP
Suite 900
8350 Broad Street
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, 2020, 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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Gallery as of September 30, 2020, and the changes in net assets and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 2(t) to the financial statements, in fiscal year 2020 the Gallery adopted new accounting guidance, Accounting Standards Update (ASU) 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. Our opinion is not modified with respect to this matter.



Report on Summarized Comparative Information

We have previously audited the Gallery's 2019 financial statements, and we expressed an unmodified audit opinion on those financial statements in our report dated November 14, 2019. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2019 is consistent, in all material respects, with the audited financial statements from which it has been derived before the adjustments to adopt ASU 2016-18. As part of our audit of the 2020 financial statements, we also audited the adjustments described in Note 2(s) that were applied to adopt ASU 2016-18 retrospectively in the 2019 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

Other Matters

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the basic 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 data 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 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 13, 2020 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 13, 2020

NATIONAL GALLERY OF ART

Statement of Financial Position

September 30, 2020

(with summarized financial information as of September 30, 2019)

(In thousands)

Assets	2020			2019
	Private	Federal	Total	Total
Cash and cash equivalents	\$ 6,331	111,672	118,003	121,588
Accounts receivable and other assets, net	3,749	–	3,749	4,483
Pledges receivable, net	18,289	–	18,289	14,424
Investments and trusts held by others	1,083,406	–	1,083,406	993,753
Property, plant and equipment, net	57,227	283,805	341,032	318,116
Art collections (Note 2)	–	–	–	–
Total assets	\$ 1,169,002	395,477	1,564,479	1,452,364
Liabilities and Net Assets				
Liabilities:				
Accounts payable and other liabilities	\$ 34,095	31,741	65,836	65,099
Unexpended federal multi-year appropriations	–	36,015	36,015	39,163
Environmental liability	–	28,660	28,660	26,423
Total liabilities	34,095	96,416	130,511	130,685
Net assets:				
Without donor restrictions	390,673	206,001	596,674	570,729
With donor restrictions	744,234	93,060	837,294	750,950
Total net assets	1,134,907	299,061	1,433,968	1,321,679
Total liabilities and net assets	\$ 1,169,002	395,477	1,564,479	1,452,364

See accompanying notes to financial statements.

NATIONAL GALLERY OF ART

Statement of Activities

Year ended September 30, 2020

(with summarized financial information for the year ended September 30, 2019)

(In thousands)

	Without donor restrictions			With donor restrictions	Total 2020	Total 2019
	Private	Federal	Total			
Operating:						
Support and revenue:						
Federal appropriations	\$ -	129,436	129,436	8,679	138,115	136,557
Gifts and grants	2,636	-	2,636	1,935	4,571	7,446
Gallery shops sales, net	3,739	-	3,739	-	3,739	6,789
Spending policy appropriated for operations	4,033	-	4,033	20,514	24,547	22,730
Royalties and other income	590	-	590	-	590	1,383
	<u>10,998</u>	<u>129,436</u>	<u>140,434</u>	<u>31,128</u>	<u>171,562</u>	<u>174,905</u>
Net assets released from restrictions to fund operating expenses	20,600	7,169	27,769	(27,769)	-	-
Total support and revenue	<u>31,598</u>	<u>136,605</u>	<u>168,203</u>	<u>3,359</u>	<u>171,562</u>	<u>174,905</u>
Expenses:						
Collections	3,406	48,087	51,493	-	51,493	53,031
Special exhibitions	3,753	16,742	20,495	-	20,495	24,473
Education, Gallery shops and public programs	14,373	29,501	43,874	-	43,874	44,424
Editorial and photography	1,397	6,186	7,583	-	7,583	7,171
General and administrative	6,579	35,014	41,593	-	41,593	40,394
Development	2,559	2,128	4,687	-	4,687	4,522
Total operating expenses	<u>32,067</u>	<u>137,658</u>	<u>169,725</u>	<u>-</u>	<u>169,725</u>	<u>174,015</u>
Change in net assets from operating activities	<u>(469)</u>	<u>(1,053)</u>	<u>(1,522)</u>	<u>3,359</u>	<u>1,837</u>	<u>890</u>
Non-operating:						
Federal appropriations	-	16,947	16,947	21,184	38,131	23,722
Endowment gifts	-	-	-	11,885	11,885	7,122
Gifts for art acquisitions	-	-	-	5,783	5,783	6,869
Spending policy appropriated for art acquisitions	184	-	184	3,121	3,305	6,154
Change in value of split-interest agreements	(211)	-	(211)	522	311	(571)
Investment return less amounts appropriated for operations and art acquisitions	30,114	-	30,114	49,727	79,841	(14,709)
Acquisitions of works of art	(8,570)	-	(8,570)	-	(8,570)	(13,035)
Depreciation and amortization expense	(4,248)	(13,012)	(17,260)	-	(17,260)	(15,410)
Income tax expense	(201)	-	(201)	-	(201)	(205)
Environmental liability accretion	-	(1,306)	(1,306)	-	(1,306)	(1,188)
Environmental liability change in value	-	(1,467)	(1,467)	-	(1,467)	(5,402)
Net assets released from restrictions to fund non-operating expenses	8,386	851	9,237	(9,237)	-	-
Change in net assets from non-operating activities	<u>25,454</u>	<u>2,013</u>	<u>27,467</u>	<u>82,985</u>	<u>110,452</u>	<u>(6,653)</u>
Increase (decrease) in net assets	24,985	960	25,945	86,344	112,289	(5,763)
Net assets at beginning of year	365,688	205,041	570,729	750,950	1,321,679	1,327,442
Net assets at end of year	<u>\$ 390,673</u>	<u>206,001</u>	<u>596,674</u>	<u>837,294</u>	<u>1,433,968</u>	<u>1,321,679</u>

See accompanying notes to financial statements.

NATIONAL GALLERY OF ART

Statement of Cash Flows

Year ended September 30, 2020

(with summarized financial information for the year ended September 30, 2019)

(In thousands)

	<u>Private</u>	<u>Federal</u>	<u>Total 2020</u>	<u>Total 2019</u>
Cash flows from operating activities:				
Federal operating appropriations	\$ –	134,967	134,967	144,683
Operating gifts and grants	5,899	–	5,899	8,749
Gallery shops sales	3,731	–	3,731	6,847
Investment income and dividends, net	895	–	895	745
Royalties and other income	1,098	–	1,098	1,212
Payments to employees	(22,964)	(90,246)	(113,210)	(110,511)
Payments to suppliers	(10,155)	(48,828)	(58,983)	(59,681)
Income tax payments	(201)	–	(201)	(205)
Net cash used in operating activities	<u>(21,697)</u>	<u>(4,107)</u>	<u>(25,804)</u>	<u>(8,161)</u>
Cash flows from investing activities:				
Purchase of investments	(279,962)	–	(279,962)	(324,013)
Proceeds from sale of investments	309,547	–	309,547	334,739
Proceeds from sale of property in trust held by others	–	–	–	700
Acquisitions of works of art	(10,505)	–	(10,505)	(8,478)
Purchase of property, plant and equipment	–	(34,854)	(34,854)	(7,659)
Net cash provided by (used in) investing activities	<u>19,080</u>	<u>(34,854)</u>	<u>(15,774)</u>	<u>(4,711)</u>
Cash flows from financing activities:				
Contributions and net investment income for donor restricted investments	9,281	–	9,281	11,522
Federal appropriations for capital projects	–	38,131	38,131	23,722
Gifts and grants for art acquisitions	3,148	–	3,148	7,195
Net cash provided by financing activities	<u>12,429</u>	<u>38,131</u>	<u>50,560</u>	<u>42,439</u>
Net change in cash and cash equivalents	9,812	(830)	8,982	29,567
Cash and cash equivalents at beginning of year	16,278	112,502	128,780	99,213
Cash and cash equivalents at end of year	\$ <u>26,090</u>	<u>111,672</u>	<u>137,762</u>	<u>128,780</u>
Cash and cash equivalents reconciliation:				
Cash and cash equivalents included in Statement of Financial Position	\$ 6,331	111,672	118,003	121,588
Cash included in investments	19,759	–	19,759	7,192
Total cash and cash equivalents	\$ <u>26,090</u>	<u>111,672</u>	<u>137,762</u>	<u>128,780</u>

See accompanying notes to financial statements.

NATIONAL GALLERY OF ART

Notes to Financial Statements
September 30, 2020
(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 fostering 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
September 30, 2020
(In thousands)

amounts designated for operations, acquisitions of works of art, depreciation and income tax expense, and changes in the environmental liability.

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 10).

(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, 2019, 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 from restriction 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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Notes to Financial Statements
September 30, 2020
(In thousands)

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 consist 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 4.6%. 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 that the underlying asset values agree with quoted market prices. Due to the inherent uncertainties of valuation of alternative investments, estimated values may differ from values that would have been used had a readily available 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, 2020
(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 Multi-Year Appropriations

The Gallery's federal multi-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 two-year obligation

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Notes to Financial Statements

September 30, 2020

(In thousands)

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

(I) Revenue Recognition

In accordance with ASC 606, *Revenue from Contracts with Customers*, the Gallery recognizes revenue upon delivery of goods or services in an amount that reflects the consideration the Gallery expects to receive in exchange for the goods or services. The Gallery's revenue streams that fall under this guidance are derived primarily from membership dues and Gallery shops sales and other auxiliary services.

Membership Dues

Annual memberships with varying contribution amounts, anniversary dates, and levels of donor benefits are offered to the public. The valuation of benefits provided to donors is based on the fair value of the benefits offered for each membership level. The Gallery recognizes contribution revenue for the entire amount of the membership dues received, as the recognition of the benefit portion of the membership has been determined to be materially consistent with the recognition of the benefit portion as computed on a pro-rata basis over the varying membership periods.

Auxiliary Services

Revenue from auxiliary activities primarily includes sales from the Gallery's retail shops and commissions from contracted restaurant operations. Revenues from retail operations are recognized at the time of sale to the customer. Potential returns of merchandise under the Gallery's sales return policy are considered insubstantial in amount and are therefore not reflected in the Gallery's financial statements. Royalties from restaurant sales are received on a monthly basis and accrued as appropriate.

The Gallery's revenue streams falling outside the scope of ASC 606 include investment earnings, donor contributions, and federal appropriations. Recognition of investment earnings is described in note 2(g). Dividend and interest income and realized and unrealized gains and losses are recognized as either net assets without donor restrictions or net assets with donor restrictions, in accordance with applicable donor and legal requirements.

Donor Gifts

Donor contributions and unconditional pledges are recognized in the statement of activities according to the existence or absence of donor restrictions when received from the donor. Recognition of conditional donor pledges is deferred until the underlying conditions are substantially satisfied. See also note 2(f).

Federal Appropriations

Multi-year appropriations received from the federal government are conditional contributions as defined in ASU 2018-08, *Not-for-Profit Entities: Clarifying the Scope and the Accounting*

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(In thousands)

Guidance for Contributions Received and Contributions Made. Multi-year appropriation revenue is recognized when qualifying expenditures are incurred and conditions of the appropriations are met. The unexpended balances are deferred until expended or returned to the federal government. See also note 2(k). Federal no-year appropriations are recognized as unconditional contributions restricted for the support of the Gallery's special exhibitions and for the repair, renovation, and restoration of its buildings. These appropriations are recognized in full as restricted revenue when received from the federal government.

(m) 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

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(In thousands)

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 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.

(n) 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.

(o) 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.

(p) 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

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(In thousands)

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.

(q) 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.

(r) Risks and Uncertainties

In March 2020, the World Health Organization declared the novel coronavirus (COVID-19) a pandemic. Since this time, the Gallery has followed the operating guidelines of the federal Centers for Disease Control and Prevention and the government of the District of Columbia. Extensive measures have been implemented to protect the health and safety of both the Gallery's employees and its visitors. While some staff are currently working on-site to ensure continuity of essential operations and in conjunction with the process of a gradual, orderly re-opening to the public, most Gallery employees have transitioned to working remotely. Given the uncertainty over the progression of the virus and governmental directives, there is no clear timetable for when Gallery operations will return to pre-pandemic status. COVID-19 has not materially impacted the Gallery's financial condition or financial statement presentation.

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.

(s) Reclassifications

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

(t) Recent Accounting Pronouncements

In fiscal year 2020, the Gallery adopted FASB Accounting Standards Update (ASU) 2018-08, *Not-for-Profit Entities: Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU is intended to clarify and further the consistent treatment of accounting for grants and other transactions as contributions versus exchange transactions, and to improve guidance to better distinguish between conditional and unconditional contributions.

The Gallery has determined that its accounting treatment and financial statement presentation of federal appropriations, donor contributions, and other transactions are consistent with the guidance in ASU 2018-08, and as a result the adoption of this guidance has no impact on the Gallery's financial statements.

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The Gallery also adopted ASC 606, *Revenue from Contracts with Customers*, as amended, during the fiscal year. This guidance provides the framework for recognizing revenue from the delivery of goods and services in an amount that reflects the consideration expected to be received in exchange for those goods and services, and is intended to improve the consistency and comparability of revenue recognition practices across both for-profit and not-for-profit entities. The core principle of ASC 606 requires the recognition of revenue from the transfer of promised goods or services to customers as the entity's identified performance obligations are satisfied.

The Gallery has determined that its revenue recognition practices are materially consistent with the requirements of ASC 606, and therefore adoption of this standard has no impact on the Gallery's financial statements. However, revenue disclosures have been enhanced in accordance with the guidance in this standard.

ASU 2016-18, *Statement of Cash Flows: Restricted Cash*, was adopted during the fiscal year. The standard requires the inclusion of all cash balances in total cash and cash equivalents presented in the statement of cash flows, irrespective of classification on the balance sheet and irrespective of restrictions. Therefore, the cash balance in the Gallery's investment portfolio held by a custodian for future investment or operating purposes is included in total cash and cash equivalents presented in the statement of cash flows. The provisions of the ASU have been applied retrospectively to all periods presented.

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Notes to Financial Statements
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(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, 2020 and 2019 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.

	2020		
	Private	Federal	Total
Financial assets:			
Cash and cash equivalents	\$ 6,331	111,672	118,003
Investments and trusts held by others	1,083,406	–	1,083,406
Pledges and accounts receivable	18,843	–	18,843
Total financial assets at year-end	1,108,580	111,672	1,220,252
Less financial assets unavailable for general expenditure within one year:			
Financial assets with donor restrictions	(774,285)	–	(774,285)
Trust held by others and charitable gift annuity assets	(6,987)	–	(6,987)
Board designations:			
Quasi-endowments	(66,684)	–	(66,684)
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	\$ 115,624	111,672	227,296

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	2019		
	Private	Federal	Total
Financial assets:			
Cash and cash equivalents	\$ 9,086	112,502	121,588
Investments and trusts held by others	993,753	–	993,753
Pledges and accounts receivable	15,774	–	15,774
Total financial assets at year-end	<u>1,018,613</u>	<u>112,502</u>	<u>1,131,115</u>
Less financial assets unavailable for general expenditure within one year:			
Financial assets with donor restrictions	(711,847)	–	(711,847)
Trust held by others and charitable gift annuity assets	(6,794)	–	(6,794)
Board designations:			
Quasi-endowments	(62,045)	–	(62,045)
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	<u>\$ 92,927</u>	<u>112,502</u>	<u>205,429</u>

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.

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(4) Pledges Receivable, Net

As of September 30, 2020 and 2019, net pledges receivable consisted of the following:

	2020	2019
Due in one year or less	\$ 14,823	6,975
Due between one year and five years	3,398	7,731
Due in more than five years	800	800
Subtotal	19,021	15,506
Less discounts of \$582 and \$932 and allowances of \$150 and \$150, respectively	(732)	(1,082)
Total	\$ 18,289	14,424

As of September 30, 2020 and 2019, \$6,280 and \$857 of the pledges receivable balance was receivable from related parties.

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

As of September 30, 2020 and 2019, investments and trusts held by others consisted of the following:

	2020	2019
Pooled investment portfolio	\$ 1,051,254	961,990
Trusts held by others	13,777	13,204
Charitable gift annuities and other	13,375	13,559
Subtotal	1,078,406	988,753
Loan to U.S. Treasury	5,000	5,000
Total	\$ 1,083,406	993,753

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 2020). Interest income on this loan was \$203 for the fiscal years ended September 30, 2020 and 2019. The fair value of the loan to the U.S. Treasury approximates the carrying value.

As of September 30, 2020 and 2019, 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

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capital, and real estate are valued based on the most current net asset value (NAV) adjusted for cash flows when the reported NAV is not at the measurement date.

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. 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.

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Notes to Financial Statements September 30, 2020 (In thousands)

The following tables summarize the fair values of investments and trusts held by others as of September 30, 2020 and 2019 for financial assets by pricing observability levels:

	2020				Fair value at September 30, 2020
	Prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Investments measured at net asset value ¹	
U.S. equities	\$ 159,214	–	–	185,916	345,130
International equities:					
Developed market equities	80,338	–	–	113,585	193,923
Emerging market equities	–	–	–	107,356	107,356
Real estate:					
Private Investments	–	–	–	507	507
Private equity and venture capital funds	–	–	–	19,376	19,376
Hedge funds	–	–	–	262,106	262,106
Multi-asset fund	–	–	–	13,266	13,266
Fixed income securities	–	–	–	30,482	30,482
Cash	19,759	–	–	–	19,759
Money market fund	59,349	–	–	–	59,349
Trusts held by others	–	–	13,777	–	13,777
Charitable gift annuities and other	13,375	–	–	–	13,375
Total	<u>\$ 332,035</u>	<u>–</u>	<u>13,777</u>	<u>732,594</u>	<u>1,078,406</u>

¹ 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, 2020 (In thousands)

	2019				Fair value at September 30, 2019
	Prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)	Investments measured at net asset value ¹	
U.S. equities	\$ 150,275	–	–	138,813	289,088
International equities:					
Developed market equities	80,086	–	–	109,040	189,126
Emerging market equities	–	–	–	99,024	99,024
Real estate:					
Private Investments	–	–	–	571	571
Private equity and venture capital funds	–	–	–	26,075	26,075
Hedge funds	–	–	–	243,613	243,613
Multi-asset fund	–	–	–	17,957	17,957
Fixed income securities	–	–	–	28,658	28,658
Cash	7,192	–	–	–	7,192
Money market fund	60,686	–	–	–	60,686
Trusts held by others	–	–	13,204	–	13,204
Charitable gift annuities and other	13,559	–	–	–	13,559
Total	\$ 311,798	–	13,204	663,751	988,753

¹ 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, 2020 and 2019:

	2020	2019
Fair value of Level 3 assets, beginning of year	\$ 13,204	14,144
Unrealized (losses)/gains	573	(240)
Proceeds from distributions	–	(700)
Fair value of Level 3 assets, end of year	\$ 13,777	13,204

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The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2020:

		<u>Fair value</u>	<u>Commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
U.S. equities	(a)	\$ 138,813	–	Monthly to quarterly	30 to 60 days
International equities:	(b)				
Developed market equities		109,040	–	Weekly to monthly	3 to 30 days
Emerging market equities		99,024	–	Monthly	7 to 30 days
Real estate:	(c)				
Private Investments		571	461	N/A	N/A
Private equity and venture capital funds	(d)	26,075	6,314	N/A	N/A
Hedge funds	(e)	243,613	–	Quarterly to rolling three years	45 to 181 days
Multi-asset fund	(f)	17,957	–	N/A	N/A
Fixed income securities	(g)	28,658	–	Daily	2 days
Total		<u>\$ 663,751</u>	<u>6,775</u>		

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The fair values of the following investments have been estimated using the net asset value per share of the investments as of September 30, 2019:

		<u>Fair value</u>	<u>Commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
U.S. equities	(a)	\$ 138,813	–	Monthly to quarterly	30 to 60 days
International equities:	(b)				
Developed market equities		109,040	–	Weekly to monthly	3 to 30 days
Emerging market equities		99,024	–	Monthly	7 to 30 days
Real estate:	(c)				
Private Investments		571	461	N/A	N/A
Private equity and venture capital funds	(d)	26,075	6,314	N/A	N/A
Hedge funds	(e)	243,613	–	Monthly to rolling three years	45 to 181 days
Multi-asset fund	(f)	17,957	–	N/A	N/A
Fixed income securities	(g)	28,658	–	Daily	2 days
Total		<u>\$ 663,751</u>	<u>6,775</u>		

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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.
- (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) 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.
- (e) 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.
- (f) 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.
- (g) Fixed income securities: Investment in a limited partnership which invests in investment grade fixed income securities issued by U.S. government and corporate entities.

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Notes to Financial Statements September 30, 2020 (In thousands)

The following schedule summarizes the investment return, net of expenses, and its classification in the statement of activities for the years ended September 30, 2020 and 2019:

	2020			2019 Total
	Without donor restrictions	With donor restrictions	Total	
Total net investment return	\$ 34,331	73,362	107,693	14,175
Appropriated for operations	(4,033)	(20,514)	(24,547)	(22,730)
Appropriated for art acquisitions	(184)	(3,121)	(3,305)	(6,154)
Investment return less amounts appropriated for operations and art acquisitions	<u>\$ 30,114</u>	<u>49,727</u>	<u>79,841</u>	<u>(14,709)</u>

(6) Property, Plant and Equipment, Net

As of September 30, 2020 and 2019, net property, plant and equipment consisted of the following:

	2020			2019 Total
	Private funds	Federal funds	Total	
Buildings and improvements	\$ 187,252	319,942	507,194	504,807
Equipment and computer software	9,098	98,318	107,416	102,428
Construction-in-progress	-	45,778	45,778	12,977
Equipment under capital lease	-	2,962	2,962	2,962
Subtotal	196,350	467,000	663,350	623,174
Less accumulated depreciation and amortization	(139,123)	(183,195)	(322,318)	(305,058)
Total	<u>\$ 57,227</u>	<u>283,805</u>	<u>341,032</u>	<u>318,116</u>

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(7) Accounts Payable and Other Liabilities

As of September 30, 2020 and 2019, accounts payable and other liabilities consisted of the following:

	2020			2019 Total
	Private funds	Federal funds	Total	
Employee-related liabilities	\$ 5,709	19,098	24,807	22,945
Refundable advances	19,535	–	19,535	19,535
Accounts payable and accrued expenses	3,475	8,764	12,239	15,704
Other liabilities	5,376	3,879	9,255	6,915
Total	\$ 34,095	31,741	65,836	65,099

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 \$3,135 of matching gifts in FY 2019.

(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:

	2020	2019
Beginning balance	\$ 26,423	19,863
Remediation accretion	1,306	1,188
Change in liability valuation	1,467	5,402
Remediation costs incurred	(536)	(30)
Total	\$ 28,660	26,423

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As of September 30, 2020 and 2019, the net remediation costs included in the Gallery's property, plant and equipment consists of the following:

	2020	2019
Remediation costs	\$ 4,201	4,201
Less accumulated depreciation	(3,851)	(3,775)
Net capitalized remediation costs	\$ 350	426

(9) Net Assets

As of September 30, 2020 and 2019, net assets consisted of the following:

	2020			2019		
	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
Donor restricted endowment funds	\$ —	624,296	624,296	—	569,367	569,367
Add pledges receivable	—	12,795	12,795	—	10,191	10,191
Less refundable advances	—	(19,535)	(19,535)	—	(19,535)	(19,535)
Net donor restricted endowment funds	—	617,556	617,556	—	560,023	560,023
Perpetual trust held by a third party	—	11,133	11,133	—	10,284	10,284
Permanent loan from U.S. Treasury	—	5,000	5,000	—	5,000	5,000
Total funds restricted in perpetuity	—	633,689	633,689	—	575,307	575,307
Board-designated endowment funds	66,663	—	66,663	62,014	—	62,014
Total net assets subject to spending rules	66,663	633,689	700,352	62,014	575,307	637,321
Net assets with donor restrictions available for:						
Gallery programs and operations	—	111,984	111,984	—	104,355	104,355
Federal repair and renovation	—	56,681	56,681	—	59,264	59,264
Net investment in property, plant and equipment	306,093	34,940	341,033	306,092	12,024	318,116
Future-funded federal liabilities	(42,865)	—	(42,865)	(39,576)	—	(39,576)
Other board-designated net assets:						
Operating reserves	115,000	—	115,000	115,000	—	115,000
Capital reserves	30,000	—	30,000	30,000	—	30,000
Undesignated	121,783	—	121,783	97,199	—	97,199
Total	\$ 596,674	837,294	1,433,968	570,729	750,950	1,321,679

Donor restricted endowment funds include accumulated appreciation of \$334,134 and \$288,031 for the years ended September 30, 2020 and 2019, respectively. Future-funded federal liabilities represent environmental remediation, 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 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.

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Net assets with donor restrictions are restricted as follows as of September 30, 2020 and 2019:

	2020				Total
	Restricted in perpetuity subject to spending policy	Subject to purpose restriction	Subject to release for assets placed in service	Subject to time restriction	
Acquisition of art	\$ 123,004	4,389	–	–	127,393
Collections	74,489	652	–	–	75,141
Special exhibitions	60,415	19,295	–	–	79,710
Education and public programs	183,181	83,300	–	–	266,481
Editorial and photography	6,898	317	–	–	7,215
Operations	185,702	2,349	–	507	188,558
Capital projects	–	1,175	–	–	1,175
Federal repair and renovation projects	–	56,681	34,940	–	91,621
Total	\$ 633,689	168,158	34,940	507	837,294
	2019				
	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	\$ 113,747	3,679	–	–	117,426
Collections	68,509	810	–	–	69,319
Special exhibitions	54,600	17,376	–	–	71,976
Education and public programs	164,583	77,852	–	–	242,435
Editorial and photography	6,288	397	–	–	6,685
Operations	167,580	2,379	–	687	170,646
Capital projects	–	1,175	–	–	1,175
Federal repair and renovation projects	–	59,264	12,024	–	71,288
Total	\$ 575,307	162,932	12,024	687	750,950

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(10) Endowment Funds

The Gallery's endowment consists of 122 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 obtaining a competitive rate of return. To satisfy its long-term rate-of-return, the Gallery relies on

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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, 2020 and 2019:

	2020			2019		
	Without donor	With donor	Total	Without donor	With donor	Total
	restrictions	restrictions		restrictions	restrictions	
Endowment funds at beginning of year	\$ 62,014	569,367	631,381	64,296	568,581	632,877
Contributions received	205	9,281	9,486	-	11,522	11,522
Investment return	6,881	63,961	70,842	938	7,781	8,719
Appropriation of endowment assets for expenditures	(2,437)	(18,313)	(20,750)	(3,220)	(18,517)	(21,737)
Endowment funds at end of year	\$ 66,663	624,296	690,959	62,014	569,367	631,381

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.

There were no underwater endowment funds as of September 30, 2020. The following table summarizes the Gallery's funds with deficiencies as of September 30, 2019:

	2019
Fair value of endowment funds	\$ 4,597
Original gift corpus	(4,650)
Underwater deficiency	\$ (53)

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(In thousands)

(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, 2020 and 2019.

	2020			2019
	Private	Federal	Total	Total
Operating Releases				
Purpose-restricted gifts released for:				
Collections	\$ 244	–	244	481
Special exhibitions	1,208	2,150	3,358	8,387
Education and public programs	932	–	932	1,405
Editorial and photography	110	–	110	76
Operations	283	5,019	5,302	4,727
Total	2,777	7,169	9,946	15,076
Release of appropriated endowment spend without purpose restrictions	2,647	–	2,647	2,570
Release of appropriated endowment spend with purpose restrictions	15,176	–	15,176	14,482
Total operating releases	20,600	7,169	27,769	32,128
Non-operating Releases				
Purpose-restricted gifts released for:				
Acquisition of art	5,075	–	5,075	6,617
Capital projects	–	851	851	991
Total	5,075	851	5,926	7,608
Release of appropriated endowment spend with purpose restrictions	3,311	–	3,311	6,218
Total non-operating releases	8,386	851	9,237	13,826
Total releases	\$ 28,986	8,020	37,006	45,954

NATIONAL GALLERY OF ART

Notes to Financial Statements

September 30, 2020

(In thousands)

(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 2020 salaries and expenses appropriation includes \$3,660 for no-year special exhibitions funding.

The Gallery's federal appropriations received in the fiscal years ending 2020 and 2019 are reconciled to federal appropriation revenue recognized as follows:

	2020			
	Salaries and expenses	Repairs, restoration and renovation	Total	2019 Total
Federal appropriations received	\$ 147,022	26,203	173,225	168,405
Unexpended appropriations	(25,758)	-	(25,758)	(26,709)
Amounts expended from prior years' appropriations	28,779	-	28,779	18,583
Federal appropriation revenue recognized	\$ 150,043	26,203	176,246	160,279
Operating	\$ 133,096	5,019	138,115	136,557
Non-operating	16,947	21,184	38,131	23,722
Total federal appropriation revenue recognized	\$ 150,043	26,203	176,246	160,279

NATIONAL GALLERY OF ART

Notes to Financial Statements September 30, 2020 (In thousands)

(13) Functional Classification of Expenses

Expenses by functional and natural classification for the fiscal year ended September 30, 2020 and 2019 are shown below:

		2020						
		Collections	Special exhibitions	Education, Gallery shops and public programs	Editorial and photography	General and administrative	Development	Total
Compensation	\$	38,776	13,401	29,068	5,926	24,699	3,525	115,395
Contractual services		6,118	3,065	6,972	942	9,555	778	27,430
Occupancy		3,737	1,197	1,608	204	5,372	123	12,241
Office expenses		2,005	1,932	2,550	409	1,366	190	8,452
Cost of sales		–	376	1,998	–	–	–	2,374
Other		857	524	1,678	102	601	71	3,833
Total operating expenses		51,493	20,495	43,874	7,583	41,593	4,687	169,725
Art acquisitions		8,570	–	–	–	–	–	8,570
Depreciation expense		8,388	1,752	3,528	448	2,945	199	17,260
Environmental liability accretion		705	144	261	26	157	13	1,306
Income tax expense		–	–	–	–	201	–	201
Total expenses	\$	69,156	22,391	47,663	8,057	44,896	4,899	197,062
		2019						
		Collections	Special exhibitions	Education, Gallery shops and public programs	Editorial and photography	General and administrative	Development	Total
Compensation	\$	38,287	11,740	27,606	5,458	24,241	3,165	110,497
Contractual services		6,860	7,547	7,154	1,060	8,671	841	32,133
Occupancy		4,132	915	1,619	195	5,250	115	12,226
Office expenses		2,614	2,828	3,106	327	1,667	309	10,851
Cost of sales		–	326	2,978	19	–	–	3,323
Other		1,138	1,117	1,961	112	565	92	4,985
Total operating expenses		53,031	24,473	44,424	7,171	40,394	4,522	174,015
Art acquisitions		13,035	–	–	–	–	–	13,035
Depreciation expense		7,633	1,553	3,133	392	2,524	175	15,410
Environmental liability accretion		641	131	237	24	143	12	1,188
Income tax expense		–	–	–	–	205	–	205
Total expenses	\$	74,340	26,157	47,794	7,587	43,266	4,709	203,853

NATIONAL GALLERY OF ART

Notes to Financial Statements

September 30, 2020

(In thousands)

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 \$11,612 and \$9,724 for the years ended September 30, 2020 and 2019, respectively. These amounts do not include pension expense financed by OPM and imputed to the Gallery of \$555 and \$2,716, 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, 2020 and 2019, were \$3,300 and \$3,116, 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 2020 and 2019, the Gallery contributed \$6,740 and \$6,728, 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 \$5,801 and \$5,471 during fiscal years 2020 and 2019, 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 2020 and 2019 total \$200 and \$107, respectively, 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.

NATIONAL GALLERY OF ART

Notes to Financial Statements
September 30, 2020
(In thousands)

(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:	
2021	\$ 5,465
2022	5,589
2023	5,717
2024	3,914
2025	1,262
Thereafter	4,258
Total minimum lease payments	\$ <u>26,205</u>

Rental expense was approximately \$7,002 and \$6,607 for the years ended September 30, 2020 and 2019, respectively.

(17) Subsequent Events

The Gallery has performed an evaluation of subsequent events through November 12, 2020, which is the date the financial statements were available to be issued, noting no events which affect the financial statements as of September 30, 2020.



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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
The National Gallery of Art:

We have audited, in accordance with the 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, the financial statements of the National Gallery of Art (the Gallery), which comprise the statement of financial position as of September 30, 2020, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 13, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Gallery's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Gallery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Gallery's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Gallery's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Gallery's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Gallery's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

McLean, Virginia
November 13, 2020