Report of the Chief Financial Officer

Like so many cultural institutions, The Metropolitan Museum of Art faced difficult financial challenges during fiscal year 2004 and for the third time in a row ended the year with a deficit. But while encountering challenges such as a decrease in revenues, the escalating cost of insurance, pensions, health benefits, and other costs beyond the Museum's control, and the absence of significant growth in City funding—conditions that will likely continue for the foreseeable future—the Met also began a number of projects that testify to the vitality of the institution and that will allow it to emerge stronger in the long term. We are investing in building and technology infrastructure, and are undertaking capital projects such as the new Leon Levy and Shelby White Court for Roman and Etruscan art, the renovation of the Ruth and Harold D. Uris Center for Education, and the expansion and renovation of gallery space in several areas. These projects are proceeding at the same time that the Met pursues its commitment to bring revenues and expenses into balance. Also significant is the return on the Museum's long-term investment portfolio, which, at 18.6 percent for the year, exceeded the performance benchmarks against which it is measured. The Museum's net assets increased by 13.3 percent over last year, mainly as a result of outstanding investment returns and the continued success of The Fund for the Met campaign.

Thus, while the Museum's financial picture continues to be a challenging one that will require it to implement additional cost-cutting and revenue-enhancing initiatives to achieve a balanced budget by fiscal year 2006, the forecast contains positive developments. Projects now under way related to the Museum's resources, infrastructure, and capital; growing revenue from membership, merchandising, and gifts and grants; and an increase in assets and decline in liabilities demonstrate that the institution's strength and preeminence are not jeopardized by its commitment to a goal of financial stability.

A more detailed discussion of the Museum's financial situation for fiscal year 2004 is provided below.

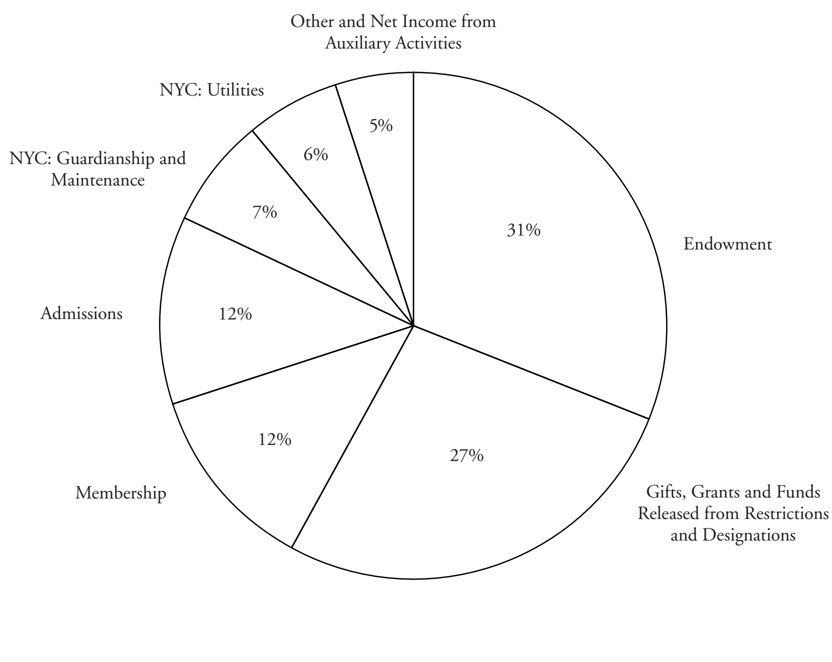
Operating Results

The Museum ended fiscal year 2004 with a deficit of $4.8 million, following deficits of $1.8 million and $5.2 million for the two previous years. Total operating revenue for fiscal year 2004, including net results from auxiliary activities and transfers of designated non-operating funds, totaled $161.6 million, an increase of $2.7 million, or 1.7 percent, over fiscal year 2003. Despite lower admissions revenue, the Museum experienced revenue growth in several key areas, including membership, merchandising, and gifts and grants. The number of visitors to the main building and The Cloisters declined from 4.9 million in fiscal year 2003 to 4.7 million this year. A marked improvement in the U.S. and global economies brought a return of international travelers to New York City during the second half of the fiscal year, which mitigated declines experienced during the first half of the fiscal year. However, attendance still remains below the pre-September 11th level of 5.4 million visitors yearly. The smaller number of visitors resulted in a 1.1 percent reduction in admissions income and a 7.1 percent decline in audience-dependent income such as that from the restaurants and the garage.

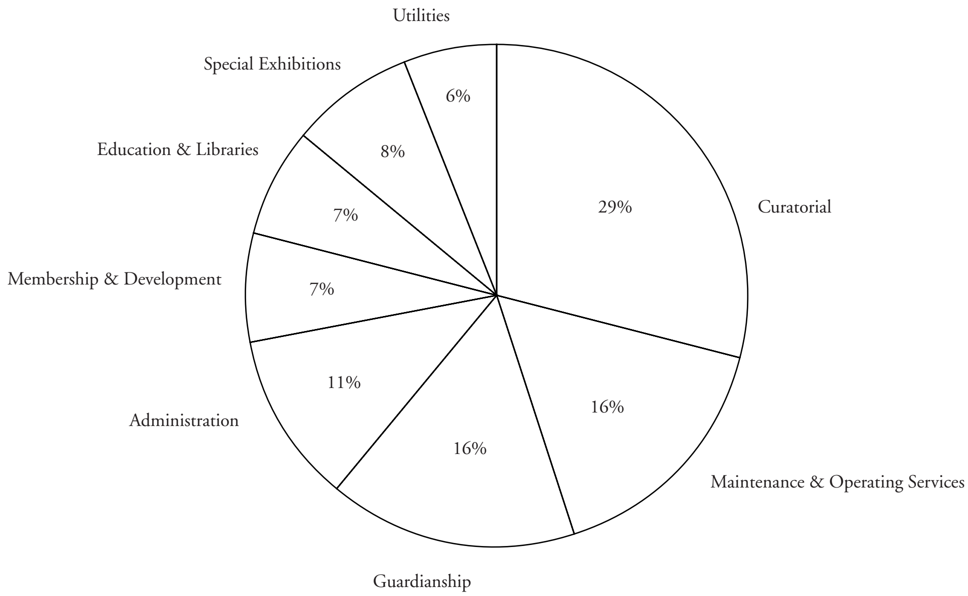
Membership income increased by 3.1 percent and reached an all-time high of $20.2 million in fiscal year 2004. The overall number of members grew by almost 1 percent to 117,805, up from 116,974 in the previous year. Once again the greatest growth in membership was in the Met Net category, which experienced a 12 percent increase.

Even in a challenging fund-raising environment, donors responded to the Museum's efforts with strong contributions, especially for the sponsorship of special exhibitions. Special exhibitions obtained the highest funding to date in fiscal year 2004, largely

2004 Sources of Operating Revenue, Support, and Transfers
$161.6 Million



2004 Operating Expenses
(Excluding Auxiliary Activities)
$166.5 Million



because of several highly acclaimed exhibitions that included *El Greco* and *Byzantium: Faith and Power (1261–1557)*. Other individual giving programs—the Chairman's Council, Friends Groups, Met Family Circle, and Travel with the Met—continued to show healthy growth in fiscal year 2004. And fund-raising events organized through The Costume Institute as well as Real Estate, Corporate, and Family benefits also raised significant amounts to support the Museum's activities.

The Museum's operating strategy for merchandising continues to be effective, producing a 10 percent growth in fiscal year 2004 through significant expansion in sales from all distribution channels, including satellite stores, mail order, wholesale, and the e-commerce portion of the Museum's Web site, www.metmuseum.org. Merchandise sales in the main building increased despite the decline in attendance because of higher per capita visitor spending. Outside the Museum, three new retail shops opened in high-traffic tourist areas that include Newark Airport and Bush Intercontinental Airport in Houston.

Despite its own fiscal problems, the City of New York maintained its operating support to the Museum at levels close to those of the previous year. The Museum is grateful to the City as well for retaining its commitment to fund ongoing capital renovations at The Cloisters and for providing additional funding for other capital projects.

Endowment support increased by 2.9 percent in fiscal year 2004, compared to an increase of 6 percent in 2003. Endowment support was calculated using the Museum's spending policy of 5.25 percent of the average market value of the endowment measured over the 12 quarters ending December 31, 2002.

Operating expenses, excluding auxiliary activities, increased faster than revenues despite the Museum's efforts to control costs. Expenses increased by $5.8 million, or 3.6 percent, to $166.5 million, mainly because of the strain of expenses beyond the Museum's control, such as pensions and benefits and the escalating costs of producing special exhibitions. In addition, the expense total for fiscal year 2004 included an increase in union salary outlay, the result of a contract agreement reached between the City of New York and District Council 37, some of whose members are Museum staff.

These higher expenses were partially offset by measures taken in other areas of the Museum. During fiscal year 2004, for example, the Museum implemented several initiatives to reduce its deficit, including the Holiday Monday program, Monday viewings for selected special exhibitions at $50 per person, alternate gallery closings, and an increased Corporate Member fee. In addition, we managed to cut back the growth in insurance and health care costs by renegotiating contracts.

Capital Spending

During the past year the Museum opened four reinstalled galleries of Egyptian art, redesigned admissions desks in the Great Hall and equipped them with new technology, continued with the facade renovation, and installed more extensive security systems. In addition the Museum continued its work on the new galleries for Roman and Etruscan art as part of its launch of the "21st-Century Met" construction plan for building from within. Capital expenditures for fiscal year 2004 totaled $40.7 million, an increase of $0.9 million, or 2.3 percent, over the previous year. Of this figure, $18.7 million was connected to the "21st-Century Met" plan and $3.2 million was used to complete the renovation of the Egyptian galleries.

The Metropolitan entered the second year of a three-year project to restore and clean the Museum's facade, an effort partially funded by the City of New York. Thanks to additional funding from the City, the Museum was able to complete an electrical system upgrade and replace a roof in the main building and also to continue with its long-range plan to address major infrastructure needs at The Cloisters.

Investments in information technology accounted for $2.2 million of the year's capital expenditures. These included ongoing work on the new human resources and payroll information system, a new loan automation program, a new ticketing system for concerts and lectures, and upgrades to the Museum's network and financial systems.

Statement of Financial Position

During fiscal year 2004 the Museum's financial position strengthened, with a growth in assets of $248.8 million, or 11.1 percent, and a decline in liabilities of $20.5 million, or 9.6 percent. The increase in the Museum's assets reflects the continued success of The Fund for the Met campaign and the outstanding investment returns generated this year. The Fund for the Met campaign exceeded its goal of $650 million and launched a new goal of $900 million. The Museum's long-term investment portfolio, which includes most of the Museum's investment assets, generated a return of 18.6 percent for fiscal year 2004. The portfolio's return exceeded by significant margins both the Museum's performance benchmarks and the median return of other endowed institutions, based on data supplied by Cambridge Associates. The portfolio is managed by outside investment managers and is highly diversified across a range of asset classes. Total investments amounted to $2.0 billion at June 30, 2004, compared to $1.8 billion at June 30, 2003.

Total liabilities, excluding the $22.2 million decline in investment trades payable, increased by $1.7 million, or 1 percent, primarily because of changes in the timing of accounts payable and accrued expenses, as well as higher accrued salaries and benefits. These increases were partially offset by reductions in pension and other accrued retirement obligations, loans payable, and notes payable. Pension and other accrued retirement obligations declined as corresponding pension assets grew because of positive investment returns, and funding obligations decreased due to changes in the discount rates used in calculating the pension liability.

Even with an active capital program, the Museum was able to reduce its overall debt during the year. The debt, which totaled $69.4 million at year end, consisted of $37.3 million in tax-exempt bonds used for capital projects, $2.5 million fair value of an interest rate exchange agreement related to the 1993 Series A tax-exempt bonds, and $29.6 million in bank debt used to finance merchandise assets and working capital needs. Total debt declined by $3.3 million, mainly because of a mandatory payment of $1.8 million on the 1993 Series A tax-exempt bonds and a $1.7 million decrease in the fair value of the interest rate exchange agreement.

Statement of Operations

for the year ended June 30, 2004, with comparative totals for 2003 (in thousands)

	2004	*2003**
REVENUE AND SUPPORT		
Admissions	$ 19,042	$ 19,262
Memberships	20,188	19,581
Gifts and grants, net assets released from restrictions, and transfers	43,718	42,524
Appropriation from the City of New York:		
Funds for guardianship and maintenance	11,947	11,452
Value of utilities provided	9,250	9,379
Endowment support	49,591	48,213
Revenue of auxiliary activities:		
Merchandising	79,748	72,781
Restaurant, parking garage, auditorium, and other	20,761	19,278
Other income	4,746	6,881
TOTAL REVENUE, SUPPORT, AND TRANSFERS	258,991	249,351
EXPENSES		
Curatorial:		
Curatorial departments, conservation, cataloguing, and scholarly publications	43,005	42,923
Operations of The Cloisters	5,413	4,920
Special exhibitions.	13,176	9,517
Education, community programs, and libraries	12,129	12,607
Development	6,287	6,367
Membership services	6,348	6,410
Operations:		
Guardianship	26,700	24,871
Maintenance	15,322	15,679
Operating services	10,647	9,700
Value of utilities provided by the City of New York	9,250	9,379
Communications	3,510	4,202
Financial, legal, and other administrative functions	14,183	13,500
Cost of sales and expenses of auxiliary activities:		
Merchandising	77,796	72,465
Restaurant, parking garage, auditorium, and other	19,547	17,971
Interest on debt service	489	669
TOTAL EXPENSES	263,802	251,180
(DEFICIT) FROM OPERATIONS	$ (4,811)	$ (1,829)

*Fiscal year 2003 amounts have been reclassified to conform with current year presentation.