

REPORT OF INDEPENDENT AUDITORS

To the Board of Trustees of The Metropolitan Museum of Art:

In our opinion, the accompanying statement of financial position and the related statements of activities and cash flows present fairly, in all material respects, the financial position of The Metropolitan Museum of Art (“the Museum”) at June 30, 2004, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Museum’s management; our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Museum’s 2003 financial statements; and in our report dated September 4, 2003, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

New York, New York
August 27, 2004

PricewaterhouseCoopers LLP

Statement of Financial Position

June 30, 2004, with comparative totals as of June 30, 2003 (in thousands)

	<u>2004</u>	<u>2003</u>		
ASSETS:				
Cash and cash equivalents (Notes A and I)	\$ 6,126	\$ 10,519		
Investment trades receivable	8,369	19,160		
Merchandise inventories, net (Note A)	13,137	10,575		
Accounts receivable and other assets (Note B)	14,741	14,557		
Pledges receivable (Notes C and I)	99,344	96,188		
Charitable remainder and other trust assets (Note J)	42,445	39,345		
Investments (Notes A, G, I, J and M)	2,042,070	1,793,182		
Fixed assets (Notes A and E)	<u>257,620</u>	<u>251,477</u>		
TOTAL ASSETS	<u><u>\$2,483,852</u></u>	<u><u>\$2,235,003</u></u>		
LIABILITIES:				
Investment trades payable	\$ 24,840	\$ 47,034		
Accounts payable and accrued expenses	21,931	19,955		
Accrued salaries and benefits	26,365	19,679		
Deferred income (Note A)	3,725	3,388		
Notes payable (Notes I and L)	29,600	29,300		
Annuity and other split-interest obligations (Notes I and J)	22,085	20,940		
Pension and other accrued retirement obligations (Note K)	24,561	29,747		
Loans payable and other long-term liabilities (Notes I and M)	<u>39,775</u>	<u>43,341</u>		
TOTAL LIABILITIES	<u>192,882</u>	<u>213,384</u>		
NET ASSETS:				
	<u>Long-Term Investment</u>	<u>Other Funding</u>		
Unrestricted (Note A)	\$ 687,227	\$159,680	846,907	691,993
Temporarily restricted (Notes A and N)	273,149	476,355	749,504	650,100
Permanently restricted (Notes A and N)	<u>694,559</u>	<u>—</u>	<u>694,559</u>	<u>679,526</u>
TOTAL NET ASSETS	<u><u>\$1,654,935</u></u>	<u><u>\$636,035</u></u>	<u>2,290,970</u>	<u>2,021,619</u>
TOTAL LIABILITIES AND NET ASSETS			<u><u>\$2,483,852</u></u>	<u><u>\$2,235,003</u></u>

The accompanying notes are an integral part of the financial statements.

Statement of Activities

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

	<i>Unrestricted</i>	<i>Temporarily Restricted</i>	<i>Permanently Restricted</i>	<i>Total 2004</i>	<i>Total 2003</i>
OPERATING					
REVENUE AND SUPPORT:					
Admissions and membership (Note M)	\$ 39,230			\$ 39,230	\$ 38,843
Gifts and grants	16,394	\$ 15,612		32,006	24,823
Operating appropriations from the City of New York. . .	21,197			21,197	20,831
Endowment support for current activities (Note G)	49,591	6,779		56,370	43,477
Auxiliary activities	100,509			100,509	92,059
Other income.	4,746			4,746	6,881
Net assets released from donor restrictions to fund operating expenses	22,653	(22,653)		—	—
TOTAL REVENUE AND SUPPORT	254,320	(262)		254,058	226,914
EXPENSES:					
Curatorial.	61,594			61,594	57,360
Education and libraries.	12,129			12,129	12,607
Development and membership.	12,635			12,635	12,777
Operations	61,919			61,919	59,629
General administration.	17,693			17,693	17,702
Auxiliary activities	97,343			97,343	90,436
Interest on debt service.	489			489	669
TOTAL EXPENSES	263,802			263,802	251,180
Transfers of designated non-operating funds.	4,671			4,671	4,532
CHANGE IN NET ASSETS FROM OPERATING ACTIVITIES	(4,811)	(262)		(5,073)	(19,734)
NON-OPERATING					
Museum-designated and donor-restricted gifts	8,930	41,155		50,085	49,671
Endowment gifts	368	421	\$ 10,653	11,442	9,487
Endowment support for current activities (Note G)	9,882	12,493		22,375	16,549
Investment return in excess of current support (Note G)..	131,944	91,795	148	223,887	11,696
Depreciation and non-capitalized expenditures.	(27,279)			(27,279)	(23,920)
Change in value of split-interest agreements.	271	(395)	3,646	3,522	(796)
Transfers of designated revenue to operating.	(4,671)			(4,671)	(4,532)
Other revenue, charges and reclassifications	562	(2,613)	586	(1,465)	2,422
Net assets released from time restrictions	10,839	(10,839)		—	—
Net assets released from donor restrictions to fund non-operating activities	52,027	(52,027)		—	—
Change in net assets before collection items not capitalized and other adjustments	178,062	79,728	15,033	272,823	40,843
Purchases of art (Note D).	(28,200)			(28,200)	(32,894)
Proceeds from sales of art		676		676	1,675
Proceeds from fine arts insurance		19,000		19,000	—
Minimum pension liability adjustment (Note K)	4,499			4,499	(6,177)
Change in fair value of interest rate exchange agreement and effect of interest rate swap (Note M)	553			553	(2,766)
CHANGE IN NET ASSETS	154,914	99,404	15,033	269,351	681
NET ASSETS AT THE BEGINNING OF THE YEAR	691,993	650,100	679,526	2,021,619	2,020,938
NET ASSETS AT THE END OF THE YEAR	\$846,907	\$749,504	\$694,559	\$2,290,970	\$2,021,619

The accompanying notes are an integral part of the financial statements.

Statement of Cash Flows

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

	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 269,351	\$ 681
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	30,237	27,274
Contributions for capital expenditures	(11,277)	(14,356)
Contributions for long-term investment	(11,321)	(10,611)
Net realized and unrealized gains	(271,330)	(45,269)
Acquisitions and sales of art, net	27,524	31,219
Proceeds from fine arts insurance	(19,000)	—
Changes in assets and liabilities:		
Merchandise inventories, net	(2,562)	406
Investment trades receivable	10,791	(17,555)
Accounts receivable and other assets	(226)	1,812
Pledges receivable	(3,156)	(2,036)
Charitable remainder and other trust assets	(3,100)	544
Investment trades payable	(22,194)	23,875
Accounts payable and accrued expenses	1,976	4,578
Accrued salaries and benefits	6,686	(240)
Deferred income	337	(919)
Annuity and other split-interest obligations	1,145	274
Pension and other accrued retirement obligations	(5,186)	9,153
Loans payable and other long-term liabilities	(1,726)	1,613
Net cash (used by) provided by operating activities	<u>(3,031)</u>	<u>10,443</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in fixed assets, net	(36,338)	(35,926)
Proceeds from sales of investments	2,153,680	1,870,499
Purchases of investments	(2,131,238)	(1,833,697)
Acquisitions of art	(28,200)	(32,894)
Proceeds from sales of art	676	1,675
Proceeds from fine arts insurance	19,000	—
Net cash used by investing activities	<u>(22,420)</u>	<u>(30,343)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions for capital expenditures	11,277	14,356
Contributions for long-term investment	11,321	10,611
Proceeds from notes payable	5,300	2,000
Payment of notes payable	(5,000)	(4,216)
Payment of loans payable	(1,840)	(1,755)
Net cash provided by financing activities	<u>21,058</u>	<u>20,996</u>
Net (decrease) increase in cash and cash equivalents	(4,393)	1,096
Cash and cash equivalents, beginning of the year	<u>10,519</u>	<u>9,423</u>
CASH AND CASH EQUIVALENTS, END OF THE YEAR	<u>\$ 6,126</u>	<u>\$ 10,519</u>

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The Museum classifies all financial transactions into three net asset categories in accordance with donor-imposed restrictions: permanently restricted, temporarily restricted, and unrestricted.

- Permanently restricted net assets have donor-imposed restrictions which stipulate that the corpus of the gifts be maintained permanently but permit the Museum to expend net income and gains earned on contributed assets for either specified or unspecified purposes. (Also, see Note N.)
- Temporarily restricted net assets carry donor-imposed restrictions on the expenditure of the contributed assets. Temporary restrictions may expire with the passage of time or as a result of actions taken by the Museum which fulfill donors' restrictions. When temporarily restricted net assets are released from restrictions, they are transferred to unrestricted net assets and shown as "Net assets released from restrictions" in the Statement of Activities. Transfers from temporarily restricted to unrestricted net assets occur even if the contributions are received and spent within the same year.
- Unrestricted net assets are not restricted by donors. A portion of the unrestricted net assets has been designated by the Museum for specific purposes, including long-term investment, leasehold improvements, and various curatorial activities.

Measure of Operations - The Museum includes in its measure of operations all revenue and expenses that are integral to its programs and supporting activities, net assets released from donor restrictions to support operating expenditures, and transfers from Board-designated non-operating funds to support current operating activities. The measure of operations includes support for operating activities from restricted net assets and unrestricted net assets designated for long-term investment (the endowment) according to the Museum's spending policy, which is detailed in Note G. The measure of operations excludes endowment support for non-operating and restricted operating activities; investment return in excess of/less than amounts made available for current support; additions to restricted and designated net assets; adjustments to the minimum pension liability; changes in net assets of split-interest agreements, after providing for any operating revenue or support; changes in net assets pertaining to acquisition and deaccession of collection items, and related insurance settlements; depreciation of capital expenditures, except for those related to auxiliary activities, and acquired computer systems and equipment; fees received for art-lending activities; the entire effect of the interest rate swap; and interest income relating to the Building and Equipment Reserve and Construction Funds, which pertain to the Dormitory Authority loan agreements (see Note M).

Collections - The Museum's collections comprise more than two million works of art from ancient, medieval, and modern times and from all areas of the world. They offer a survey of considerable breadth of art from the ancient civilizations of Asia, Africa, South America, the Pacific Islands, Egypt, the Near East, and Greece and Rome, to the present time. The Museum's collections include European paintings, medieval art and architecture, arms and armor, prints, photographs, drawings, costumes, musical instruments, sculpture, textiles, and decorative arts from the Renaissance to the present time, as well as one of the foremost collections of American art in the world. The Museum also maintains some of the most comprehensive art and architecture libraries in the United States. The collections are maintained for public exhibition, education, and research in furtherance of public service, rather than for financial gain.

In conformity with accounting policies generally followed by art museums, the value of the Museum's collections has been excluded from the Statement of Financial Position, and gifts of art objects are excluded from revenue in the Statement of Activities. Purchases of art objects by the Museum are recorded as decreases in net assets in the Statement of Activities. Pursuant to state law and Museum policy, proceeds from the sale of art and related insurance settlements, are recorded as temporarily restricted net assets for the acquisition of art.

Cash and Cash Equivalents - Cash equivalents are short-term, highly liquid investments with original maturities of three months or less.

Merchandise Inventories - Merchandise inventories are carried at the lower of average cost or market value using the retail inventory method of accounting.

Investments - Investments in short-term instruments, fixed income securities, and equity securities are carried at quoted market prices and exchange rates, if applicable. Investments in investment funds and limited partnerships are carried at fair value. Publicly traded securities held in these commingled investment vehicles are based on third-party quoted market prices. Certain of these investment vehicles, particularly limited partnerships investing in private equity and real estate, include investments in non-marketable securities for which there are no readily obtainable market values. Values for these investments are provided by the general partner, and may be based on historical cost, appraisals, obtainable prices for similar assets, or other estimates. The assumptions and methods used to arrive at these valuations are reviewed by the Museum's investment office.

Purchase and sale of short-term instruments, fixed income securities, and equity securities are reflected on a trade date basis. Gains and losses on the sale of securities are based on the difference between the sale price and the average historical cost basis, where such basis represents the cost of securities purchased or the fair market value at the date of receipt for securities received by donation. Investment income and gains are recorded on the accrual basis. Investments denominated in foreign currency are translated using the fiscal year-end spot rate.

Fixed Assets - The building occupied by the Museum on Fifth Avenue is owned by the City of New York and is leased free of charge to the Museum pursuant to a capital lease. The value of the original building is not included on the Statement of Financial Position since it is fully depreciated. The Museum has adopted a policy of implying a time restriction that expires over the useful life of long-lived assets acquired or constructed with contributions restricted for that purpose.

Building and leasehold improvements relating to auxiliary activities and certain equipment are capitalized and reported as fixed assets. The Cloisters in Fort Tryon Park and other buildings that are the property of the Museum are included as fixed assets, and are stated at cost. Amortization of leasehold improvements of the Fifth Avenue building and depreciation of buildings and equipment are computed on a straight-line basis over the estimated useful lives of the assets. Amortization of leasehold improvements related to auxiliary activities is computed on a straight-line basis over the shorter of the remaining term of the lease or estimated useful lives of the assets.

Deferred Income - Membership dues received from individuals and corporations pertaining to all membership categories are recognized ratably as income over the membership period of up to 24 months. Amounts not yet earned by the end of the fiscal year are reported as deferred income.

Contributions, Contributed Utilities and Support - Contributions, including cash, in-kind contributions, and unconditional promises to give (pledges), are recorded as revenue in the period in which they are received. Conditional contributions are recognized as revenue when the conditions on which they depend have been substantially met. Contributions are recorded at fair value, and in the case of pledges, net of estimated uncollectible amounts, and discounted if due in over one year.

The heat, light, and power costs of the Fifth Avenue building are paid for by the City of New York. The value of such costs is reported as income and a corresponding amount is included as an expense in the Statement of Activities. The City of New York also provides funds for guardianship and maintenance, including reimbursement for salaries, Social Security, and pension contributions.

The Museum has volunteers who provide administrative assistance in various areas of the Museum. Such contributed services do not meet the criteria for recognition of contributed services contained in generally accepted accounting principles and, accordingly, are not reflected in the accompanying financial statements.

Functional Allocation of Expenses - The costs of providing Museum programs and supporting services are detailed in Note O. Programs include curatorial activities, conservation, and exhibition; education; libraries; public services; and auxiliary activities. Curatorial costs include gallery maintenance and renovation, collections care and maintenance, scholarly research and publications, and special exhibitions. Supporting services include fundraising, and management and general administrative costs. Fundraising costs include expenses associated with individual and corporate memberships, annual appeals, benefit events, capital campaign, and other fundraising efforts. Management and general administrative costs include expenses for executive management, financial administration, information systems, human resources, legal services, and investment management fees. Depreciation, interest, utilities, building maintenance, security, and other operating costs are allocated to the above program areas and supporting services.

Advertising - Advertising expenses pertaining to merchandising activities, mostly attributable to the production and distribution of catalogues, amounted to \$5.9 million and \$5.2 million in fiscal years 2004 and 2003, respectively. Other advertising expenses incurred primarily in support of special exhibitions, the permanent collection, and concerts and lectures totaled \$2.3 million and \$3.1 million in fiscal years 2004 and 2003, respectively. The latter amounts include gifts-in-kind of \$0.4 million and \$1.2 million in fiscal years 2004 and 2003, respectively.

Interest Expense - Interest on borrowings applicable to major construction projects in progress is capitalized and depreciated. Total interest paid during fiscal years 2004 and 2003 was \$1.9 million and \$2.1 million, respectively, of which \$1.2 million each year relates to the amount paid under the interest rate swap agreement. Interest not capitalized is charged to operating expenses or, as related to the swap agreement, to non-operating activities.

Income Tax Status - The Museum is a nonprofit organization exempt from income tax under Section 501(c)(3) of the Internal Revenue Code.

Estimates - The preparation of 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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Prior Year Comparisons and Reclassifications - The Museum has included both current and prior year financial data in its financial statements. To facilitate the comparison on the Statement of Activities, the Museum has chosen to present the prior year information in summary form, without segregation of the data by net asset values. As a result, that particular historical information is not presented in compliance with generally accepted accounting principles. It should therefore be reviewed in conjunction with the more detailed information set forth in the audited financial statements for fiscal year 2003, the source from which the summary information was derived.

Certain amounts in fiscal year 2003 have been reclassified to conform to the fiscal year 2004 statement presentation.

B. ACCOUNTS RECEIVABLE AND OTHER ASSETS

Accounts receivable and other assets consist of (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Accounts receivable, net	\$ 3,100	\$ 2,961
Dividends and interest receivable	2,758	4,008
Prepaid expenses and other	6,269	3,970
Intangible pension assets	<u>2,614</u>	<u>3,618</u>
Total	<u>\$14,741</u>	<u>\$14,557</u>

C. PLEDGES RECEIVABLE

Unconditional promises to contribute to the Museum are recorded as pledges receivable at the present value of future cash flows, net of an allowance for uncollectibility. Present value discount rates used were 3.20% and 1.85% for fiscal years 2004 and 2003, respectively. Pledges are expected to be realized as follows (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Less than one year	\$ 42,106	\$ 47,693
Between one and five years	65,537	56,431
Over five years	2,750	1,325
Total	<u>110,393</u>	<u>105,449</u>
Less:		
Allowance for uncollectibility	(3,048)	(2,534)
Discount for present value	<u>(8,001)</u>	<u>(6,727)</u>
Net	<u>\$ 99,344</u>	<u>\$ 96,188</u>

D. ACQUISITIONS OF ART

Acquisitions of art were funded from the following sources (in thousands):

	<u>2004</u>	<u>2003</u>
Gifts of cash and securities	\$13,416	\$12,442
Gains and income from long-term investment:		
For designated curatorial departments	3,874	5,430
Undesignated as to curatorial department	7,726	11,536
Proceeds from fine arts insurance and the sale of art objects	<u>3,184</u>	<u>3,486</u>
Total	<u>\$28,200</u>	<u>\$32,894</u>

E. FIXED ASSETS

Fixed assets consist of (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Land	\$ 1,015	\$ 1,015
Buildings	25,075	21,917
Leasehold improvements—auxiliary activities	32,868	31,451
Leasehold improvements—Fifth Avenue building	456,910	429,487
Machinery and equipment	<u>47,131</u>	<u>43,324</u>
Total	562,999	527,194
Less accumulated depreciation and amortization	<u>(305,379)</u>	<u>(275,717)</u>
Net	<u>\$ 257,620</u>	<u>\$ 251,477</u>

The above amounts include construction in progress of \$17.5 million and \$20.5 million at June 30, 2004 and 2003, respectively. Depreciation and amortization expense was \$30.2 million for fiscal year 2004 and \$27.2 million for fiscal year 2003. In fiscal year 2004 fully depreciated fixed assets of \$0.5 million were retired, and other fixed assets were written down by \$1.6 million.

The estimated useful lives of fixed assets are as follows:

	<u>No. of Years</u>
Buildings	20-40
Leasehold improvements—auxiliary activities	4-40
Leasehold improvements—Fifth Avenue building:	
Building improvements and wings	20-30
Galleries and major improvements	5-15
Equipment and minor improvements	5-10
Machinery and equipment	3-20

F. CAPITAL EXPENDITURES

The principal capital projects in progress during fiscal year 2004 were as follows (in thousands):

	<u>Prior Years' Expenditures</u>	<u>2004 Expenditures</u>	<u>Total Expenditures</u>
Greek and Roman, Wing K renovation, and interdependent projects	\$118,746	\$ 18,724	\$137,470
Egyptian Galleries	2,464	3,246	5,710
The Cloisters (1)		3,189	
Construction related to auxiliary activities (1)		2,607	
Other capital projects (1)		<u>12,972</u>	
Total (2)		40,738	
Less cost of capitalized projects		<u>(37,971)</u>	
Net		<u>\$ 2,767</u>	

(1) These projects are normally completed within one fiscal year. Accordingly, since prior year and current year projects are not comparable, no prior year or total expenditure is given.

(2) The Museum has outstanding purchase commitments of approximately \$58.4 million related to construction projects at June 30, 2004.

G. INVESTMENTS

The carrying values of the Museum's investment portfolio categories were as follows (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Equities:		
Securities	\$ 331,920	\$ 331,743
Investment funds	<u>466,967</u>	<u>408,242</u>
Subtotal	<u>798,887</u>	<u>739,985</u>
Fixed income:		
Government bonds	169,237	110,351
Corporate debt	80,878	154,793
Mortgage backed	70,267	80,495
Investment fund	35,042	—
Other	<u>21,094</u>	<u>39,560</u>
Subtotal	<u>376,518</u>	<u>385,199</u>
Short-term investments	<u>166,971</u>	<u>117,806</u>
Limited partnerships and other:		
Absolute return	334,973	219,722
Alternative assets	331,347	305,587
Real assets	<u>33,374</u>	<u>24,883</u>
Subtotal	<u>699,694</u>	<u>550,192</u>
Total	<u>\$2,042,070</u>	<u>\$1,793,182</u>

The cost value of the total investment portfolio was \$1,834.7 million and \$1,784.2 million as of June 30, 2004 and 2003, respectively.

At June 30, 2004, the Museum had approximately \$324.2 million in remaining capital commitments to investment funds and limited partnerships.

The Museum maintains a highly diversified portfolio of investments that is designed to preserve the inflation-adjusted purchasing power of invested funds while providing a stream of earnings for current use. Investment objectives and policies are established by the Museum's Trustee Investment Committee and are achieved in partnership with external investment managers.

Certain of the Museum's investment managers incorporate the use of financial instruments with off-balance sheet risk in Museum accounts as part of their investment strategies, primarily to hedge against equity, currency, or interest rate risk. These include equity and fixed income futures and options, and foreign currency options and forward contracts. These instruments are either traded on organized exchanges or entered into with creditworthy financial institutions.

According to the Museum's spending policy, a portion of the total investment return on restricted and unrestricted net assets designated for long-term investment is available to support current programs, while the remainder is reinvested. Distributions available for spending are limited to a range of 4.5% to 5.5% of a lagged average market value of endowment assets over a specified period set by the Board of Trustees. For fiscal years 2004 and 2003, the spending rate was set by the Board at 5.25%. The value used to calculate the spending rate for fiscal year 2004 was the average of the twelve quarters ended December 31, 2002.

As a result of market declines, the fair market value of certain permanently restricted endowments is less than the historical cost of such funds. The losses on these endowment funds were not material to the net assets of the Museum at June 30, 2004, and are recorded as reductions in unrestricted net assets. To the extent that these losses are recovered by increases in the market value of endowments, unrestricted net assets are increased (see below).

The following schedule summarizes investment return by net asset classification (in thousands):

	<u>2004</u>			<u>2003</u> <u>Total</u>
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	
Net investment income	\$ 15,852	\$ 15,396	\$ 54	\$ 31,302
Realized gains (losses)	51,778	21,060	67	72,905
Changes in unrealized appreciation	79,383	119,015	27	198,425
Total return on investments	<u>147,013</u>	<u>155,471</u>	<u>148</u>	<u>302,632</u>
Transfer of losses recovered on endowment funds . . .	44,404	(44,404)	—	—
Investment return allocated for current activities . . .	(59,473)	(19,272)	—	(78,745)
Investment return in excess of current support	<u>\$131,944</u>	<u>\$ 91,795</u>	<u>\$148</u>	<u>\$ 223,887</u>
	<u>\$ 11,696</u>			<u>\$ 11,696</u>

H. LEASE COMMITMENTS

At June 30, 2004, the Museum is committed to minimum future rentals under noncancellable operating leases for the merchandising warehouse and retail sales shops, which expire at various dates through January 2017. The rental payments will be charged against future revenue from sales of books, reproductions of works of art, and similar reproductions sold through the Museum shops and mail-order system. Rent expense included in merchandising activities relating to these operating leases amounted to \$5.2 million and \$4.8 million in fiscal years 2004 and 2003, respectively, and includes contingent rent based on sales. The Museum has the right to extend the lease for the warehouse with a minimum of six months' prior notice to the lessor. In addition, there are operating leases for storage, office space, equipment, and other items, which expire at various dates through June 2007. Rent expense relating to these operating leases amounted to \$0.4 million and \$0.3 million in fiscal years 2004 and 2003, respectively.

Minimum rental commitments consist of the following at June 30, 2004 (in thousands):

<u>Year Ending June 30</u>	<u>Total</u>
2005	\$ 4,711
2006	4,628
2007	4,363
2008	4,465
Thereafter	<u>31,117</u>
Total	<u>\$49,284</u>

I. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments appearing on the Statement of Financial Position, for which it is practicable to estimate that value (for all categories listed, carrying value approximates fair value):

Cash and Cash Equivalents - These assets consist mainly of cash in banks and investments in short-term, interest-bearing instruments which are carried at cost plus accrued interest.

Pledges Receivable - Fair value, after allowances for uncollectible pledges, was determined by discounting the expected future cash flows by a risk-free short-term borrowing rate.

Investments - The fair value of investments, which consist mainly of equity securities, debt securities, investment funds, and limited partnerships, was based principally upon quoted market prices or, if unavailable, was determined by general partners of limited partnerships.

Split-Interest Agreements - Fair value of the related liabilities was determined by the difference between the gift and the actuarial computation of remainder value.

Notes Payable and Loans Payable & Other Long-Term Liabilities - Fair value of these liabilities was based upon discounting of future cash flows.

J. LIFE INCOME FUNDS AND OTHER TRUSTS

Life income funds consist of charitable remainder trusts, gift annuities, pooled income funds, and other trust assets. These funds are held in trust for one or more beneficiaries, and generally pay lifetime income to those beneficiaries, after which the principal is made available to the Museum in accordance with donor intentions. The value of these and other trust agreements, excluding new gifts and distributions, increased by \$3.1 million and decreased by \$0.5 million in fiscal years 2004 and 2003, respectively. Present value discount rates applied to these funds ranged from 6.75% to 5.0% in fiscal years 2004 and 2003.

Trusts invested on behalf of others:

- In 1993, a \$9.0 million charitable lead trust was established, and the funds were invested in the Museum's pooled investments. The Museum receives a stipulated annual amount from the trust and is obliged to pay the \$9.0 million plus any accumulated income pursuant to a note payable to the trustee in 2007.
- In 1997, a perpetual trust of \$3.6 million was transferred to the Museum to manage in its pooled investments. The Museum receives annual endowment support from the trust and pays expenses on behalf of the trust.

The following displays the value of the assets and liabilities recognized on these agreements (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Assets:		
Charitable remainder and other trust assets	\$42,445	\$39,345
Gift annuities, pooled income funds, and trusts invested on behalf of others (included in investments in the Statement of Financial Position)	<u>31,193</u>	<u>29,363</u>
Total	<u>\$73,638</u>	<u>\$68,708</u>
Liabilities:		
Trusts invested on behalf of others	\$18,487	\$16,955
Gift annuities and pooled income funds	<u>3,598</u>	<u>3,985</u>
Total	<u>\$22,085</u>	<u>\$20,940</u>

K. PENSION PLANS AND POSTRETIREMENT HEALTH CARE BENEFITS

The following section briefly describes the Museum's various pension and postretirement plans, with supporting data in the schedules below.

Defined benefit pension plan for union staff - The Museum has a qualified defined benefit pension plan for all union employees covered by a collective bargaining agreement. Benefits under this plan are based on years of service and the employees' final four years of compensation.

Supplemental defined benefit plans for certain non-union staff - The Museum has a supplemental qualified and a supplemental non-qualified defined benefit pension plan for certain non-union employees to provide future benefits at least equal to the benefits provided under a defined benefit pension plan that was terminated. The projected benefit obligation and accumulated benefit obligation of the supplemental defined benefit plan, which is unfunded and non-qualified, were \$3.5 million and \$2.4 million, respectively, as of June 30, 2004, and \$3.2 million and \$1.9 million, respectively, as of June 30, 2003.

Defined contribution plan for non-union staff - The Museum has a mandatory defined contribution pension plan for all non-union employees. The Museum's contributions under this plan are based on 6% of a participant's base pay during the year. The Museum also contributes 5.7% of base pay earnings that exceed the Social Security wage base during a calendar year. The cost of the defined contribution pension plan recognized in fiscal years 2004 and 2003 was \$3.6 million and \$3.3 million, respectively.

Defined contribution plan for union staff - The Museum has a voluntary defined contribution plan for all union employees covered by a collective bargaining agreement. The Museum contributes up to 2% of the participant's salary based on a schedule. The cost of this plan was less than \$0.1 million for each of the fiscal years 2004 and 2003.

Postretirement benefits - The Museum provides postretirement medical care benefit coverage to retired employees as outlined below.

- Non-union staff: Substantially all of the Museum's non-union employees become eligible for these benefits when they reach age 55 and have 15 years of service to the Museum.
- Union staff: The Museum's union employees are covered by postretirement medical care plans pursuant to a collective bargaining agreement between the Museum and Local 1503 of District Council 37 (member of the AFSCME and AFL-CIO). The Museum's union employees become eligible for these benefits when they reach age 52 and have 10 years of service or age 62 with 5 years of service to the Museum. The Museum made contributions to the union's postretirement medical care benefit plans of \$1.4 million for each of the fiscal years 2004 and 2003.

Funding policy - The Museum's funding policy is to contribute annually an amount that meets the minimum requirements of the Employee Retirement Income Security Act of 1974 (ERISA), using different assumptions from those used for financial reporting.

The tables below and on the following page set forth the net liability recognized in the Statement of Financial Position, the change in plan assets, the funded status, weighted-average assumptions, and other data for the pension plans and postretirement benefit plan (in thousands):

	<i>Pension Benefits</i>		<i>Postretirement Benefits</i>	
	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
CHANGE IN BENEFIT OBLIGATION:				
Benefit obligation at beginning of year	\$ 61,477	\$ 50,470	\$ 17,683	\$ 15,696
Service cost	2,004	1,340	870	729
Interest cost	3,784	3,455	1,098	1,119
Employee contributions	749	666	—	—
Amendments	—	—	—	(2,055)
Actuarial loss (gain)	1,076	8,254	(735)	2,753
Benefits paid	(2,640)	(2,995)	(567)	(559)
Settlements	58	287	—	—
Benefit obligation at end of year	<u>66,508</u>	<u>61,477</u>	<u>18,349</u>	<u>17,683</u>
CHANGE IN PLAN ASSETS:				
Fair value of plan assets at beginning of year . . .	33,250	31,008	—	—
Actual gain on plan assets	5,557	1,157	—	—
Employer contributions	6,802	3,414	567	559
Employee contributions	749	666	—	—
Benefits paid	(2,640)	(2,995)	(567)	(559)
Fair value of plan assets at end of year	<u>43,718</u>	<u>33,250</u>	<u>—</u>	<u>—</u>
Funded status (accrued liability)	(22,790)	(28,227)	(18,349)	(17,683)
Unamortized prior service cost	3,212	3,846	(4,056)	(4,468)
Unamortized net loss	<u>18,580</u>	<u>22,325</u>	<u>7,630</u>	<u>8,751</u>
Net amount recognized	<u>\$ (998)</u>	<u>\$ (2,056)</u>	<u>\$ (14,775)</u>	<u>\$ (13,400)</u>
Accrued benefit cost	\$ (9,786)	\$ (16,347)	\$ (14,775)	\$ (13,400)
Intangible assets	2,614	3,618	—	—
Accumulated other comprehensive income	<u>6,174</u>	<u>10,673</u>	<u>—</u>	<u>—</u>
Net amount recognized	<u>\$ (998)</u>	<u>\$ (2,056)</u>	<u>\$ (14,775)</u>	<u>\$ (13,400)</u>

The following table sets forth the components of the net pension and postretirement benefits cost for the years ended June 30 (in thousands):

	<i>Pension Benefits</i>		<i>Postretirement Benefits</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
Service cost	\$ 2,004	\$ 1,340	\$ 870	\$ 729
Interest cost	3,784	3,455	1,098	1,119
Expected return on plan assets	(2,770)	(2,828)	—	—
Amortization of prior service cost	634	634	(412)	(264)
Amortization of accumulated loss	1,889	811	386	260
Settlement loss	203	236	—	—
Net periodic benefit cost	<u>\$ 5,744</u>	<u>\$ 3,648</u>	<u>\$ 1,942</u>	<u>\$ 1,844</u>

WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATIONS AS OF JUNE 30:

Discount rate	6.25%	6.00%	6.25%	6.00%
Rate of compensation increase	4.00%	4.00%	N/A	N/A

WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE NET COST AS OF JUNE 30:

Discount rate	6.00%	7.00%	6.00%	7.00%
Expected return on plan assets	8.00%	9.00%	N/A	N/A
Rate of compensation increase	4.00%	4.00%	N/A	N/A

ADDITIONAL INFORMATION (in thousands):

Actual return on plan assets	\$ 5,557	\$ 1,157	N/A	N/A
Accumulated benefit obligation for all defined benefit pension plans	53,504	49,597	N/A	N/A
(Decrease) increase in minimum liability included in non-operating activities	(4,499)	6,177	N/A	N/A
(Decrease) increase in intangible assets	(1,004)	1,456	N/A	N/A

ASSUMED MEDICAL COST TREND RATES AT JUNE 30:

Health care cost trend rate assumed for next year	9.0%	9.5%
Rate that the cost trend gradually declines to	5.0%	5.0%
Year that the final trend rate is reached	2012	2012

The following data show the effect of a one percentage point health care cost trend rate increase (decrease) for fiscal year 2004 (in thousands):

	<i>Percentage Point Increase</i>	<i>Percentage Point (Decrease)</i>
Effect on total of service and interest cost	\$ 406	\$ (314)
Effect on postretirement benefit obligation	3,090	(2,466)

Investment strategies and basis for determining the overall expected long-term rate of return - Assets of the Museum's defined benefit plans are invested identically in diversified portfolios that are designed to generate returns sufficient to meet obligations to beneficiaries at acceptable levels of risk. Investment objectives and policies are established by the Museum's Trustee Investment Committee and are achieved in partnership with external investment managers. The target allocation of the plans is 60% to equity securities and 40% to fixed income securities. As of June 30, 2004, the plans' allocation to equities and fixed income was 60.6% and 39.4%, respectively. The allocation to fixed income included 0.8% in cash and cash equivalents. As of June 30, 2003, the plans' allocation to equities and fixed income was 61.4% and 38.6%, respectively. The allocation to fixed income included 1.1% in cash and cash equivalents. The expected return on the plans' assets has been developed in consultation with external advisors, taking into account such factors as long-term historical returns for equity and fixed income assets and long-term forecasts for inflation.

CASH FLOWS FOR THE FISCAL YEAR ENDING JUNE 30 (in thousands):

Employer Contributions:	<i>Pension Benefits</i>	<i>Postretirement Benefits</i>
2003 (actual)	\$ 3,414	\$ 559
2004 (actual)	6,802	567
2005	7,230	595

Contributions by participants to the pension benefit plans were \$0.7 million for each of the fiscal years 2004 and 2003.

PROJECTED BENEFIT PAYMENTS FOR THE FISCAL YEAR ENDING JUNE 30 (in thousands):

2003 (actual)	\$ 2,995	\$ 559
2004 (actual)	2,640	567
2005	3,799	595
2006	3,460	633
2007	4,180	701
2008	3,583	769
2009	4,215	835
2010–2014	20,389	5,362

Medicare - On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("the Act") was signed into law. The Act introduces a prescription drug benefit under Medicare Part D as well as a Federal subsidy to employers whose plans provide an "actuarial equivalent" prescription drug benefit. The Museum's postretirement prescription drug benefits may qualify for this subsidy and consequently the Museum will treat the effects of the Act as an actuarial gain.

FASB Staff Position FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" has also been issued and requires that employers recognize the Act no later than the first interim measurement date following June 15, 2004. Accordingly, the Museum has elected to reflect the Act in fiscal 2005, adopting the statement as of July 1, 2004. Management has not yet determined the impact of FAS 106-2 on the financial statements.

L. NOTES PAYABLE

At June 30, 2004 and 2003 the Museum had three credit facilities with two commercial banks. Under the largest credit facility, which is a \$50 million revolving line of credit, the Museum had borrowed \$29.6 million and \$29.3 million as of June 30, 2004 and 2003, respectively. Any amount borrowed under the revolving line of credit is payable in full on or before April 16, 2009. The borrowing bears interest at variable rates, and accrued interest is payable quarterly. Total interest expense on bank borrowings amounted to \$0.4 million and \$0.5 million in fiscal years 2004 and 2003, respectively. As of June 30, 2004, the interest rate on the outstanding debt was 1.66%. Under the loan agreement, the Museum has covenanted to maintain a ratio of Available Assets to General Liabilities, as defined, of not less than 2:1. The Museum was in compliance with this requirement at June 30, 2004, and 2003.

In addition to the revolving line of credit, the Museum has two lines of credit totaling \$30 million under which no borrowings were outstanding at June 30, 2004 and 2003. Borrowings under the lines of credit are payable on demand and bear interest at variable rates which are paid monthly. The Museum had letters of credit aggregating \$2.8 million at June 30, 2004 and 2003 under a sublimit for one of the lines of credit.

M. LOANS PAYABLE AND OTHER LONG-TERM LIABILITIES

In 1993, the Museum entered into two loan agreements with the Dormitory Authority of the State of New York ("the Authority") to finance the construction and equipping of certain of the Museum's facilities and to defease existing indebtedness. Pursuant to these loan agreements, the Authority issued Series 1993 Revenue Bonds consisting of \$41.7 million Series 1993A Variable Interest Rate Bonds, due serially to July 1, 2015, and \$22.1 million Series 1993B Variable Interest Rate Bonds, due by July 1, 2020. The Series 1993B Bonds are secured by the Museum's annual membership dues. The loan agreements require the Museum to maintain investments in certain defined securities having a market value of at least 120% of the aggregate principal amount of the Museum's outstanding short-term debt as defined in the agreements. Additionally, the Museum must maintain a ratio of Available Assets to General Liabilities, as defined, of not less than 2:1. The Museum was in compliance with these covenants at June 30, 2004 and 2003.

In summary, the Authority's bonds underlying the Museum's indebtedness comprised the following (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Series 1993A Variable Interest Rate Bonds due serially to July 1, 2015	\$30,535	\$32,375
Series 1993B Variable Interest Rate Bonds due by July 1, 2020	<u>6,780</u>	<u>6,780</u>
Total loans payable	37,315	39,155
Fair value of interest rate exchange agreement	<u>2,460</u>	<u>4,186</u>
Total	<u>\$39,775</u>	<u>\$43,341</u>

While the revenue bonds are not direct indebtedness of the Museum, the loan agreements with the Authority obligate the Museum to make payments equal to the interest and mandatory redemption requirements of such bonds. A liability equivalent to the principal amount of the Authority's outstanding revenue bonds, adjusted for fair value of future interest payments, is reflected in the Statement of Financial Position.

In 1993, the Museum entered into a 22-year interest rate exchange agreement with Morgan Stanley that effectively changes the Museum's interest rate exposure on the Series 1993A Variable Interest Rate Bonds to a fixed rate. The notional amount of the swap was initially set at \$41.7 million and amortizes according to a schedule that is similar to the mandatory redemption schedule of the Series 1993A Variable Interest Rate Bonds. Under the terms of the interest rate exchange agreement, Morgan Stanley pays to the Museum a variable rate consistent with the rate on the Series 1993A Bonds, and the Museum pays to Morgan Stanley a fixed rate of 4.77% per annum. As of June 30, 2004, the interest rate on the loan payable was 1.01%. Total interest in both fiscal years 2004 and 2003 amounted to \$1.5 million of which \$1.2 million relates to the interest rate swap agreement.

At June 30, 2004 and 2003, \$2.0 million and \$5.8 million of investments, respectively, were in the custody of a trustee in connection with the revenue bonds. At June 30, 2004, \$2.0 million was held by the trustee as a reserve for the payment of debt service. During fiscal year 2004 the Authority released \$3.8 million of funds previously held to defray the cost of damage to any construction project.

Debt service under the loan agreements, after giving effect to the interest rate swap, representing payments of principal and interest, is payable as follows (in thousands):

<u>Year Ending June 30</u>	<u>Principal Amount</u>	<u>Interest Payments*</u>	<u>Total Estimated Debt Services</u>
2005	\$ 1,930	\$ 1,757	\$ 3,687
2006	2,025	1,661	3,686
2007	2,125	1,560	3,685
2008	2,230	1,454	3,684
2009	2,335	1,343	3,678
Thereafter	<u>26,670</u>	<u>7,023</u>	<u>33,693</u>
Total	<u>\$37,315</u>	<u>\$14,798</u>	<u>\$52,113</u>

*On the Series 1993B Bonds, which are callable at par, there are no mandatory redemption requirements until 2018; an interest rate of 5% is assumed for all fiscal years.

N. ANALYSIS OF RESTRICTED NET ASSETS

Temporarily restricted net assets, including accumulated investment income of certain endowment funds, consist of the following (in thousands):

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Restricted by purpose:		
Acquisitions of art	\$189,733	\$159,757
Capital projects in process	111,100	103,078
Invested in fixed assets being depreciated	184,267	183,060
Undesignated	110,916	80,336
Fellowships	44,410	36,304
Gallery maintenance	29,799	23,320
Special exhibitions	25,505	15,830
Publications, public programs, and other	40,350	35,656
Total restricted by purpose	<u>736,080</u>	<u>637,341</u>
Restricted by time	<u>13,424</u>	<u>12,759</u>
Total	<u>\$749,504</u>	<u>\$650,100</u>

Permanently restricted net assets consist of the following (in thousands):

Endowment funds: income and gains restricted	\$577,006	\$565,849
Endowment funds: income and gains unrestricted	110,929	107,572
Interest in perpetual trusts	<u>6,624</u>	<u>6,105</u>
Total	<u>\$694,559</u>	<u>\$679,526</u>

O. FUNCTIONAL CLASSIFICATION OF EXPENSES

Expenses by functional classification for fiscal years 2004 and 2003, which are described in Note A, are shown below (in thousands):

	<u>2004</u>	<u>2003</u>
Total operating expenses from the Statement of Activities	\$263,802	\$251,180
Depreciation of capital improvements and other non-capitalized expenditures from the non-operating section of the Statement of Activities	27,279	23,920
Management and custodian fees, and other expenses included in net investment income	11,244	12,045
Special events included in the revenue section of the Statement of Activities	<u>602</u>	<u>843</u>
Total	<u>\$302,927</u>	<u>\$287,988</u>
Program expenses:		
Curatorial activities, conservation, and exhibition	\$134,953	\$127,329
Education	8,647	9,233
Libraries	5,645	5,231
Public services and other	15,879	14,873
Cost of sales and expenses of auxiliary activities:		
Merchandising	77,796	72,465
Restaurant, parking garage, auditorium, and other	<u>19,547</u>	<u>17,971</u>
Total program expenses	<u>262,467</u>	<u>247,102</u>
Supporting services:		
Management and general	31,529	31,379
Fundraising	<u>8,931</u>	<u>9,507</u>
Total supporting services	<u>40,460</u>	<u>40,886</u>
Total	<u>\$302,927</u>	<u>\$287,988</u>