FINANCIAL STATEMENTS

THE PHILLIPS COLLECTION

FOR THE YEARS ENDED JULY 31, 2012 AND 2011

THE PHILLIPS COLLECTION

CONTENTS

GELMAN, ROSENBERG
& FREEDMAN
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
The Phillips Collection
Washington, D.C.

We have audited the accompanying statements of financial position of The Phillips Collection (the Collection) as of July 31, 2012 and 2011, and the related statements of activities and changes in net assets, functional expenses and cash flows for the years then ended. These financial statements are the responsibility of the Collection's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Collection's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Collection as of July 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Gelman Rosenberg & Freedman

October 25, 2012

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THE PHILLIPS COLLECTION

STATEMENTS OF FINANCIAL POSITION
AS OF JULY 31, 2012 AND 2011

ASSETS

	2012	2011
Cash and cash equivalents	$ 174,552	$ 167,659
Receivables (Notes 3 and 14):		
Trade	262,531	243,002
Gifts and grants	1,178,170	2,935,254
Pledges - CSMA campaign, net of allowance for doubtful accounts of $6,628 and $297,000 in 2012 and 2011, respectively	708,962	919,739
Pledges - endowment, net of allowance for doubtful accounts of $39,985 and $139,985 in 2012 and 2011, respectively	1,709,707	2,330,821
Total receivables	3,859,370	6,428,816
Merchandise inventory	309,042	246,191
Prepaid expenses	108,807	117,350
Property and equipment, net of accumulated depreciation and amortization of $14,855,354 and $13,658,143 in 2012 and 2011, respectively (Notes 4, 7 and 8)	32,069,466	33,193,644
Investments (Notes 2 and 15)	48,804,798	50,831,346
TOTAL ASSETS	**$ 85,326,035**	**$ 90,985,006**

LIABILITIES AND NET ASSETS

	2012	2011
LIABILITIES		
Line of credit (Note 6)	$ 160,000	$ 795,000
Accounts payable and accrued expenses	576,368	429,072
Accrued compensation	385,903	278,033
Deferred revenue	324,823	99,724
Capital lease obligation (Note 7)	129,226	193,837
Gift annuity debt (Note 14)	196,107	212,447
Bonds payable (Note 8)	12,465,000	12,900,000
Interest rate swap obligation (Notes 8 and 15)	1,442,644	1,344,559
Total liabilities	15,680,071	16,252,672
NET ASSETS		
Unrestricted	12,603,597	15,191,065
Temporarily restricted (Note 9)	22,868,406	25,545,715
Permanently restricted (Notes 4 and 16)	34,173,961	33,995,554
Total net assets	69,645,964	74,732,334
TOTAL LIABILITIES AND NET ASSETS	**$ 85,326,035**	**$ 90,985,006**

See accompanying notes to financial statements.

THE PHILLIPS COLLECTION

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JULY 31, 2012 AND 2011

	2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUE				
Gifts, grants and corporate support, net of expenses of $290,198 and $333,952 in 2012 and 2011, respectively (Notes 3 and 14)	$ 3,999,708	$ 1,053,121	$ 254,611	$ 5,307,440
Fees from exhibitions and loaned art	959,023	-	-	959,023
Admissions	1,006,913	-	-	1,006,913
Shop revenue, net of cost of goods sold of $427,005 and $310,981 in 2012 and 2011, respectively	382,845	-	-	382,845
Other revenue (Note 2)	211,910	-	-	211,910
Contributed services and materials (Note 4 and 10)	401,200	-	-	401,200
Endowment earnings transfer (Note 2)	2,036,449	-	-	2,036,449
Net assets released from donor restrictions (Note 9)	2,814,678	(2,814,678)	-	-
Total revenue	11,812,726	(1,761,557)	254,611	10,305,780
EXPENSES				
Personnel (Note 12)	6,464,798	-	-	6,464,798
Exhibitions	1,591,815	-	-	1,591,815
Contractual services	586,110	-	-	586,110
Insurance	256,546	-	-	256,546
Utilities	576,849	-	-	576,849
Other facility costs (Note 11)	484,183	-	-	484,183
Administrative expenses	559,417	-	-	559,417
Printing and publications	321,270	-	-	321,270
Information technology expenses	262,363	-	-	262,363
Fundraising activities and institutional events	261,154	-	-	261,154
Marketing and advertising	37,844	-	-	37,844
Contributed goods and services (Notes 4 and 10)	401,200	-	-	401,200
Total expenses	11,803,549	-	-	11,803,549
Changes in net assets from operations before other items	9,177	(1,761,557)	254,611	(1,497,769)
OTHER ITEMS				
Non-operating investment (losses) earnings (Note 2)	(2,057,250)	317,509	-	(1,739,741)
Non-operating net assets released from restriction (Note 9)	1,233,261	(1,233,261)	-	-
Bond-related expenses (Note 8)	(513,508)	-	-	(513,508)
Depreciation of non-operating assets (Note 4)	(1,037,139)	-	-	(1,037,139)
Art collection acquisitions (Note 5)	-	-	(76,204)	(76,204)
Unrealized (loss) gain on interest rate swap (Note 8)	(98,085)	-	-	(98,085)
House restoration expenses (Note 4)	-	-	-	-
Fire-related activities (Note 4)	-	-	-	-
Campaign expenses	(123,924)	-	-	(123,924)
Changes in net assets	(2,587,468)	(2,677,309)	178,407	(5,086,370)
Net assets at beginning of year	15,191,065	25,545,715	33,995,554	74,732,334
NET ASSETS AT END OF YEAR	**$ 12,603,597**	**$ 22,868,406**	**$ 34,173,961**	**$ 69,645,964**

See accompanying notes to financial statements.

2011			
Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
$ 3,806,014	$ 2,657,852	$ 902,826	$ 7,366,692
583,344	-	-	583,344
689,649	-	-	689,649
275,173	-	-	275,173
245,720	-	-	245,720
491,883	-	-	491,883
1,912,721	-	-	1,912,721
2,936,953	(2,936,953)	-	-
10,941,457	(279,101)	902,826	11,565,182
6,264,706	-	-	6,264,706
1,140,758	-	-	1,140,758
602,083	-	-	602,083
259,466	-	-	259,466
550,269	-	-	550,269
479,595	-	-	479,595
451,151	-	-	451,151
277,985	-	-	277,985
232,025	-	-	232,025
268,151	-	-	268,151
100,460	-	-	100,460
491,883	-	-	491,883
11,118,532	-	-	11,118,532
(177,075)	(279,101)	902,826	446,650
2,654,854	891,815	-	3,546,669
2,117,609	(2,117,609)	-	-
(500,874)	-	-	(500,874)
(1,038,960)	-	-	(1,038,960)
(24,196)	-	(50,788)	(74,984)
20,789	-	-	20,789
(889,982)	-	-	(889,982)
27,392	-	-	27,392
(1,342)	-	-	(1,342)
2,188,215	(1,504,895)	852,038	1,535,358
13,002,850	27,050,610	33,143,516	73,196,976
$ 15,191,065	**$ 25,545,715**	**$ 33,995,554**	**$ 74,732,334**

See accompanying notes to financial statements.

THE PHILLIPS COLLECTION

STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JULY 31, 2012

	Program Services	Supporting Services: Management and General	Supporting Services: Fundraising	Total Expenses
Personnel (Note 12)	$ 4,092,999	$ 1,353,903	$ 1,017,896	$ 6,464,798
Exhibitions	1,586,386	2,186	3,243	1,591,815
Contractual services	314,490	242,118	29,502	586,110
Insurance	177,750	78,796	-	256,546
Utilities	13,012	562,486	1,351	576,849
Other facility costs (Note 11)	58,439	425,744	-	484,183
Administrative expenses	334,284	148,260	76,873	559,417
Printing and publications	260,664	15,542	45,156	321,362
Information technology expenses	116,821	141,327	4,215	262,363
Fundraising activities and institutional events	133,871	14,178	113,013	261,062
Marketing and advertising	33,502	4,342	-	37,844
Contributed goods and services (Notes 4 and 10)	248,789	77,186	75,225	401,200
Sub-total	7,371,007	3,066,068	1,366,474	11,803,549
Overhead allocation	2,209,677	(2,432,533)	222,856	-
TOTAL	**$ 9,580,684**	**$ 633,535**	**$ 1,589,330**	**$ 11,803,549**

See accompanying notes to financial statements.

THE PHILLIPS COLLECTION

STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JULY 31, 2011

		Supporting Services		
	Program Services	Management and General	Fundraising	Total Expenses
Personnel (Note 12)	$ 4,008,898	$ 1,263,764	$ 992,044	$ 6,264,706
Exhibitions	1,138,667	2,091	-	1,140,758
Contractual services	323,581	251,082	27,420	602,083
Insurance	176,438	83,028	-	259,466
Utilities	8,420	539,731	2,118	550,269
Other facility costs (Note 11)	31,383	447,450	762	479,595
Administrative expenses	223,885	152,240	75,026	451,151
Printing and publications	220,857	6,848	50,280	277,985
Information technology expenses	49,993	177,106	4,926	232,025
Fundraising activities and institutional events	173,552	21,424	73,175	268,151
Marketing and advertising	94,923	3,661	1,876	100,460
Contributed goods and services (Notes 4 and 10)	260,554	177,671	53,658	491,883
Sub-total	6,711,151	3,126,096	1,281,285	11,118,532
Overhead allocation	2,223,644	(2,442,592)	218,948	-
TOTAL	**$ 8,934,795**	**$ 683,504**	**$ 1,500,233**	**$ 11,118,532**

See accompanying notes to financial statements.

THE PHILLIPS COLLECTION

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JULY 31, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in net assets	$ (5,086,370)	$ 1,535,358
Adjustments to reconcile changes in net assets to net cash (used) provided by operating activities:		
Depreciation and amortization	1,197,211	1,194,020
Gain on disposal of property and equipment	-	(9,756)
Net realized and unrealized loss (gain) on investments	136,257	(4,979,381)
Amortization of discount on gift annuity agreements	(13,016)	(12,276)
Unrealized loss (gain) on interest rate swap	98,085	(20,789)
Art acquisitions	76,204	24,196
Change in discount on gifts, and grants receivables	(23,899)	(7,646)
Change in discount on CSMA campaign and endowment pledges receivable	2,518	(131,875)
(Increase) decrease in:		
Trade, gifts, and grants receivables	1,761,454	746,761
CSMA campaign and endowment pledges receivable	829,373	3,249,331
Merchandise inventory	(62,851)	(27,118)
Prepaid expenses	8,543	31,377
Increase (decrease) in:		
Accounts payable and accrued expenses	147,296	45,738
Accrued compensation	107,870	27,880
Deferred revenue	225,099	(95,583)
Net cash (used) provided by operating activities	(596,226)	1,570,237
CASH FLOWS FROM INVESTING ACTIVITIES		
Net sale (purchase) of investments	1,890,291	(771,710)
Purchase of property and equipment	(73,033)	(73,627)
Proceeds from sale of property and equipment	-	1,025
Art acquisitions	(76,204)	(24,196)
Net cash provided (used) by investing activities	1,741,054	(868,508)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net payments on line of credit	(635,000)	(195,000)
Payments on capital lease obligations	(64,611)	(55,583)
Payments under gift annuity agreements	(3,324)	(3,131)
Payments on bonds payable	(435,000)	(420,000)
Net cash used by financing activities	(1,137,935)	(673,714)
Net increase in cash and cash equivalents	6,893	28,015
Cash and cash equivalents at beginning of year	167,659	139,644
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 174,552	$ 167,659

See accompanying notes to financial statements.

THE PHILLIPS COLLECTION

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JULY 31, 2012 AND 2011**

	2012	2011
SUPPLEMENTAL INFORMATION		
Interest Paid	$ 529,213	$ 621,000
Equipment Acquired Under Capital Lease	$ -	$ 156,163

See accompanying notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION

Organization -

The Phillips Collection (the Collection) was incorporated in 1920. It opened to the public in 1921 and is known as the first museum of modern art in the United States. The Phillips Collection is an intimate museum combined with an experiment station. At its heart is an exceptional collection of modern and contemporary art around which the museum has created a dynamic environment for looking, learning, and enjoyment.

Basis of presentation -

The accompanying financial statements are presented on the accrual basis of accounting, and in accordance with FASB ASC 958, *Not-for-Profit Entities*.

Cash and cash equivalents -

The Collection considers demand accounts held with financial institutions to be cash equivalents. Amounts held in investment portfolios, regardless of their maturities, are not considered cash equivalents.

Through December 31, 2012, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all Federal Deposit Insurance Corporation (FDIC) - insured depository institutions (the "Dodd-Frank Deposit Insurance Provision"). The Collection maintains its cash balances at financial institutions in noninterest-bearing accounts; thereby, all of the cash balances are protected by FDIC under this Act.

Receivables -

Short-term receivables are stated at their carrying amounts, which approximate fair value due to the relatively short period of time between their obligation and expected realization. Long-term receivables are stated at their fair value, measured as the present value of their future cash flows. The allowance for doubtful accounts is determined based upon a review of account balances, including management's knowledge of the customer, relationship with the customer, and the age of the receivable balance. As a result of these reviews, management has established an allowance as a best estimate of probable losses. All accounts, or portions thereof, that are deemed to be uncollectable, or that require excessive collection cost, are written off.

Merchandise inventory -

Merchandise inventory, which consists of merchandise held for resale by the Collection's Museum Shop, is stated at the lower of cost or estimated market value using the average cost method.

Investments -

Investments are recorded at readily determinable fair values. Investment earnings (losses) include interest, dividends, realized and unrealized gains and losses, net of investment expenses.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

Investments (continued) -

The fair value of financial instruments is determined by reference to various market data and other valuation techniques as appropriate. Credit risk from financial instruments relates to the possibility that invested assets within a particular industry segment may experience loss due to market conditions.

The Collection has diversified its financial instruments to help ensure that no one industry segment represents a significant concentration of risk.

Although management uses its best judgment at estimating fair value of the underlying assets for its investments, there are inherent limitations in any valuation technique. Therefore, the value is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of fair value could be material.

Property and equipment -

Property and equipment in excess of $1,000 are capitalized and stated at cost. Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the related assets: building and building renovations – 40 years; and furniture and equipment – 3, 5, or 10 years. Bond issuance costs are amortized over the life of the bond, currently 30 years. The cost of maintenance and repairs is recorded as expenses are incurred.

Income taxes -

The Collection is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Collection is not a private foundation.

Although the Collection is organized as a non-profit corporation, revenue derived from its flexible capital and private equity partnerships is considered unrelated business income and subject to taxation by the Internal Revenue Service and the District of Columbia. As a result of these activities, the Collection incurred approximately $2,600 of unrelated business income taxes during the year ended July 31, 2011 and has accrued an equivalent amount in anticipation of filing its returns for the year ending July 31, 2012.

Uncertain tax positions -

In June 2006, the Financial Accounting Standards Board (FASB) released FASB ASC 740-10, *Income Taxes*, that provides guidance for reporting uncertainty in income taxes. For the years ended July 31, 2012 and 2011, the Collection has documented its consideration of FASB ASC 740-10 and determined that no material uncertain tax positions qualify for either recognition or disclosure in the financial statements. The Federal Form 990, *Return of Organization Exempt from Income Tax*, is subject to examination by the Internal Revenue Service, generally for three years after it is filed.

Deferred revenue -

Deferred revenue consists of facilities rental fees and exhibition fees for upcoming events. The Collection recognizes these fees when the related event has occurred.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

Net asset classification -

The net assets are reported in three self-balancing groups as follows:

- **Unrestricted net assets** include unrestricted revenue and contributions received without donor-imposed restrictions. These net assets are available for the operation of the Collection and include both internally designated and undesignated resources.

- **Temporarily restricted net assets** include revenue and contributions subject to donor-imposed stipulations that will be met by the actions of the Collection and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statements of Activities and Changes in Net Assets as net assets released from restrictions.

- **Permanently restricted net assets** represent funds restricted by the donor to be maintained in-perpetuity by the Collection. At July 31, 2012 and 2011, the balance of permanently restricted net assets that is restricted for the purchase of accessioned art is $1,638,669 and $1,714,873, respectively. Earnings and losses from the investment of permanently restricted net assets are considered unrestricted revenue or expense.

Program services -

The Collection's programmatic activities include those associated primarily with the preservation and exhibition of the collection, such as curatorial, conservation, registrar, and library functions. A second category includes those activities designed to inform the public about the collection and its history, such as education, communications, publications, and the music program. The Center for the Study of Modern Art (CSMA), a research arm of the Museum, is the third major category of programmatic activity. Lastly, the Museum includes visitor amenities and services associated with its public outreach under the programmatic heading.

Spending rate methodology -

The Collection uses a spending rate methodology to determine the amount of endowment investment income included in operating revenue as described in the total return policy. Endowment investment income in excess of the spending rate is reported as a non-operating activity. In addition, activities relating to the bond and the Collection's buildings and improvements are reported as non-operating income or expense.

Operating activities are defined to encompass transactions that relate directly to the mission of the Collection. These included soliciting contributions and sponsoring museum programs.

Gifts, grants and corporate support -

Contributions and grants are recorded as revenue in the year notification is received from the donor. Temporarily restricted contributions and grants are recognized as unrestricted support only to the extent of actual expenses incurred in compliance with the donor-imposed restrictions and satisfaction of time restrictions.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

Gifts, grants and corporate support (continued) -

Temporarily restricted contributions and grants received in excess of expenses incurred are shown as temporarily restricted net assets in the accompanying financial statements.

Expenses for member trips and the gala fundraiser are netted against the respective revenue in gifts, grants and corporate support. Member trip expenses totaled $53,265 and $68,150 for the years ended July 31, 2012 and 2011, respectively, and would otherwise be included in fundraising activities and events. The gala fundraiser expenses for the years ended July 31, 2012 and 2011, are $236,933 and $265,802, respectively, and are substantially comprised of costs that would otherwise be classified in contractual services, printing and publications, and fundraising activities and institutional events.

Donations of property and equipment and services are recorded as contributions at their estimated fair value at the date of the donation.

Shop revenue -

Shop revenue is recorded net of cost of goods sold, and includes shipping revenue on customer mail orders. Shipping and handling costs for customer orders are included in administrative program expenses in the accompanying Statements of Activities and Changes in Net Assets and Statements of Functional Expenses.

Use of estimates -

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

Functional allocation of expenses -

The costs of providing the various programs and other activities have been summarized on a functional basis in the Statements of Functional Expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Risks and uncertainties -

The Collection invests in various investment securities. Investment securities are exposed to various risks such as interest rates, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

Fair value measurements -

The Collection adopted the provisions of FASB ASC 820, *Fair Value Measurements and Disclosures*.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION (Continued)

Fair value measurements (continued) -

FASB ASC 820 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs (assumptions that market participants would use in pricing assets and liabilities, including assumptions about risk) used to measure fair value, and enhances disclosure requirements for fair value measurements. The Collection accounts for a significant portion of its financial instruments at fair value or considers fair value in their measurement.

Reclassification -

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation. These reclassifications had no effect on the previously reported changes in net assets.

2. INVESTMENTS

Investments, at readily determinable fair value, consisted of the following at July 31, 2012 and 2011:

	Market Value	
	2012	**2011**
Money market funds	$ 468,726	$ 415,884
Fixed income and blended mutual funds	8,144,237	11,091,018
Domestic equity mutual funds	1,172,748	1,254,677
International equity mutual funds	4,613,536	5,177,344
Global equity mutual funds	1,193,039	1,250,304
TIFF multi-asset fund	3,122,664	3,109,851
Alternative funds	30,089,848	28,532,268
TOTAL INVESTMENTS	**$ 48,804,798**	**$ 50,831,346**

Subsequent to July 31, 2012, the fair market value of the investment portfolio has increased approximately $1.3 million as a result of current economic conditions.

Of the investment portfolio balance as of July 31, 2012 and 2011, $143,044 and $148,036, respectively, are pledged under the bond reimbursement agreement (Note 8). As such, these funds may only be utilized by the Collection for purposes stipulated in the bond agreement.

The Collection has been admitted as a limited partner in several private equity funds. Under the terms of the partnership agreements, the Collection is required to contribute $8,780,878 of total capital to the partnerships as of July 31, 2012. Included is a commitment of 400,000 Euros ($530,878 as of July 31, 2012). The actual USD commitment is based upon the exchange rate at the time of the capital calls. Capital contributions are due and payable when requested by the partnerships. As of July 31, 2012, the Collection had contributed a total of $5,038,770. The remaining capital commitment of $3,742,108 at July 31, 2012 will be paid when requested by the partnerships.

2. INVESTMENTS (Continued)

Alternative investments within the portfolio are comprised of the following at July 31, 2012:

Investment Type	Amount	Redemption Period	Liquidity
Private equity	$ 4,527,693	None	End of partnership
Flexible capital	3,136,778	Bi-annual	December 31, 2012-December 31, 2013
Flexible capital	10,236,440	Annual	December 31, 2012-December 31, 2014
Flexible capital	11,169,412	Quarterly	September 30, 2012-December 31, 2012
Flexible capital	1,019,525	Monthly	September 30, 2012
ALTERNATIVE INVESTMENTS	**$30,089,848**		

Alternative investments within the portfolio are comprised of the following at July 31, 2011:

Investment Type	Amount	Redemption Period	Liquidity
Private equity	$ 3,739,312	None	End of partnership
Flexible capital	2,635,692	Bi-annual	December 31, 2012-December 31, 2013
Flexible capital	9,589,089	Quarterly	September 30, 2012 - March 31, 2014
Flexible capital	12,568,175	Quarterly	September 30, 2011 - March 31, 2012
ALTERNATIVE INVESTMENTS	**$28,532,268**		

The Collection received proceeds of $7,819,492 and $10,905,776 on the sale of long-term investments during the years ended July 31, 2012 and 2011, respectively.

Investment earnings from endowment investments, less the calculated draw for operations (see Note 1), are recorded as non-operating investment (losses) earnings in the Statements of Activities and Changes in Net Assets.

2. INVESTMENTS (Continued)

The following summarizes total investment (loss) income and how it is reported based on the total return policy in the Statements of Activities and Changes in Net Assets for the year ended July 31, 2012:

	Unrestricted	Temporarily Restricted	Total
Interest and dividends	$ 422,319	$ 148,456	$ 570,775
Net realized and unrealized (loss) gain	(311,768)	175,511	(136,257)
Less: Investment fees	(117,027)	(6,458)	(123,485)
TOTAL INVESTMENT INCOME	**$ (6,476)**	**$ 317,509**	**$ 311,033**

	Unrestricted	Temporarily Restricted	Total
As Reported in the Statements of Activities and Changes in Net Assets:			
Earnings included in other revenue	$ 14,325	$ -	$ 14,325
Endowment earnings for operations	2,036,449	-	2,036,449
Non-operating investment (losses) earnings	(2,057,250)	317,509	(1,739,741)
	$ (6,476)	**$ 317,509**	**$ 311,033**

The following summarizes total investment income and how it is reported based on the total return policy in the Statements of Activities and Changes in Net Assets for the year ended July 31, 2011:

	Unrestricted	Temporarily Restricted	Total
Interest and dividends	$ 498,228	$ 120,365	$ 618,593
Net realized and unrealized gains	4,201,002	778,379	4,979,381
Less: Investment fees	(114,244)	(6,929)	(121,173)
TOTAL INVESTMENT INCOME	**$ 4,584,986**	**$ 891,815**	**$ 5,476,801**

	Unrestricted	Temporarily Restricted	Total
As Reported in the Statements of Activities and Changes in Net Assets:			
Earnings included in other revenue	$ 17,411	$ -	$ 17,411
Endowment earnings for operations	1,912,721	-	1,912,721
Non-operating investment earnings	2,654,854	891,815	3,546,669
	$ 4,584,986	**$ 891,815**	**$ 5,476,801**

3. TRADE, GIFTS, GRANTS AND PLEDGES RECEIVABLE

The Collection receives promises to contribute from donors. Promises to contribute primarily consist of pledges, bequests, grants, and charitable remainder trusts. Promises to contribute related to the CSMA campaign are recorded as temporarily restricted revenue.

Promises to contribute related to the Collection’s endowment campaign are recorded as permanently restricted revenue. Management periodically reviews the status of all pledge receivable balances for collectability.

Each receivable balance is assessed based on management's knowledge of the donor, relationship with the donor, and the age of the receivable balance. The loss on uncollectable pledges recorded in gifts, grants and corporate support in the Statements of Activities and Changes in Net Assets totaled $46,307 and $27,000 for the years ended July 31, 2012 and 2011, respectively.

All pledges receivable due in more than one year have been discounted to their net present value at July 31, 2012 and 2011. The discount rates range from 0.68% to 6.00% and are determined using the U.S. Treasury Daily Treasury Yield Curve Rate for the term closest to time period of expected receipt on the day the Collection was notified of the pledge.

Trade, gifts, grants, and pledges receivables are due as follows at July 31, 2012 and 2011:

	2012	2011
Less than one year	$ 1,921,698	$ 4,022,285
One to five years	1,851,501	2,805,008
Beyond five years	250,000	250,000
Total trade, gifts, grants and pledges receivables	4,023,199	7,077,293
Less: Present value discount	(117,216)	(211,492)
Less: Allowance for doubtful pledges	(46,613)	(436,985)
TOTAL RECEIVABLES	**$ 3,859,370**	**$ 6,428,816**

4. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at July 31, 2012 and 2011:

	2012	2011
Land	$ 833,240	$ 833,240
Buildings	42,742,930	42,742,930
Equipment	3,348,650	3,275,617
Total property and equipment	46,924,820	46,851,787
Less: Accumulated depreciation and amortization	(14,855,354)	(13,658,143)
PROPERTY AND EQUIPMENT, NET	**$ 32,069,466**	**$ 33,193,644**

4. PROPERTY AND EQUIPMENT (Continued)

Included in the cost basis of the property and equipment at July 31, 2012 and 2011 is $1,463,005 of permanently restricted fixed assets. These fixed assets may not be sold or disposed of by the Collection and are considered to be an historical asset as it represents the location of the first museum of modern art in America. As such, in accordance with FASB ASC 360, *Fixed Assets*, the Collection does not depreciate these items because the economic benefit or service potential is used up so slowly that their estimated useful lives are extraordinarily long. During the year ended July 31, 2011, the Collection had house restoration expenses in the amount of $889,982, which were expensed as incurred. All other property and equipment are considered non-operating or operating assets and are depreciated over the useful life.

Depreciation and amortization expense for unrestricted fixed assets consisted of the following for the years ended July 31, 2012 and 2011:

	2012	2011
Depreciation of operating assets	$ 160,072	$ 155,060
Depreciation of non-operating assets	1,037,139	1,038,960
TOTAL DEPRECIATION AND AMORTIZATION	**$ 1,197,211**	**$ 1,194,020**

On September 2, 2010, a construction-related fire occurred on the roof of the original Phillips house. No one was injured, and no art was lost. The Collection maintains significant insurance coverage which reimbursed all necessary repair costs and lost revenue during the period when the Museum could not be fully open to the public. During the year ended July 31, 2011, the Collection received insurance proceeds in the amount of $1,366,907 and incurred expenses in the amount of $1,339,515, resulting in net income in the amount of $27,392. This amount is included under other items in the accompanying Statements of Activities and Changes in Net Assets and Statements of Functional Expenses.

During the year ended July 31, 2011, one of the Collection’s law firms agreed to credit the Museum with approximately $93,000 of legal fees, which is properly recorded as contributed goods and services in the accompanying Statements of Activities and Changes in Net Assets and Statements of Functional Expenses.

5. ART COLLECTION

Works of art in the Museum's collection are not recognized as assets on the Statements of Financial Position. Purchases of art are recorded as decreases in unrestricted net assets if purchased with unrestricted assets and are recorded as decreases in temporarily restricted or permanently restricted net assets if purchased with donor-restricted assets.

Contributions of collection items are not recognized in the Statements of Activities and Changes in Net Assets; however, certain contributions are recorded as increases in temporarily restricted net assets if a donor makes a contribution intended to fund the subsequent purchase of art. Proceeds from the sale of deaccessions or insurance recoveries are reflected on the Statements of Activities and Changes in Net Assets based on the absence or existence and nature of donor-imposed restrictions. There were no deaccessions during each of the years ended July 31, 2012 and 2011.

6. LINE OF CREDIT

The Collection has an unsecured line of credit payable to a bank with a $3,000,000 limit. The line's expiration date is January 31, 2013. The line bears an interest rate of LIBOR plus 1.75%. The interest rate at July 31, 2012 and 2011 was 1.74% and 1.94%, respectively. Outstanding balances under the line of credit agreement for the years ended July 31, 2012 and 2011 were $160,000 and $795,000, respectively. Interest expense on the line of credit of $19,748 and $25,799 is included under Administrative expenses in the accompanying Statements of Activities and Changes in Net Assets during the years ended July 31, 2012 and 2011, respectively.

7. CAPITAL LEASE OBLIGATION

The Collection leases certain office equipment that has been capitalized and included in property and equipment in the Statements of Financial Position.

The equipment obtained under capital leases consists of the following at July 31, 2012 and 2011:

	2012	2011
Cost	$ 274,881	$ 276,768
Less: Accumulated amortization	(139,620)	(75,891)
	$ 135,261	**$ 200,877**

Future minimum lease payments under capital lease obligations at July 31, 2012 are as follows:

Year Ending July 31,	
2013	$ 69,962
2014	61,741
2015	3,459
	135,162
Less: Interest	(5,936)
CAPITAL LEASE OBLIGATION	**$ 129,226**

Interest expense for the years ended July 31, 2012 and 2011 was $6,724 and $10,113, respectively.

8. BONDS PAYABLE

In July 2003, the District of Columbia issued $27,000,000 in revenue bonds, the proceeds of which were loaned to the Collection for the acquisition, renovation, and equipping of the property at 1618 21st Street, N.W., Washington, D.C. The bonds were issued in two tranches representing different repayment schedules.

8. BONDS PAYABLE (Continued)

Principal payments made under Tranche A are balloon payments and represent $12,000,000 of the bonds. Principal payments made under Tranche B are amortized over the life of the bonds and represent $15,000,000 of the bonds. In order to facilitate the issuance and marketability of the bonds, the Collection obtained an irrevocable letter of credit which is currently valued at $12,608,433 (the bond principal plus 35 days' interest) that expires in July 2016. Obligations of the bonds are paid first from the letter of credit and then reimbursed by the Collection from the Collection's reserves. There was no outstanding balance payable on the letter of credit at July 31, 2012 and 2011. The bonds bear interest at a weekly rate, to be determined by the Remarketing Agent. These rates were 0.48% and 0.22% as of July 31, 2012 and 2011, respectively. Interest and bank fees incurred on the bond were capitalized as a development cost until the property at 1618 21st Street was completed and available for use, which occurred during 2006.

Total interest and fees incurred on the bonds for the years ended July 31, 2012 and 2011 was $502,741 and $585,088, respectively.

Terms of the repayment are such that the Collection made interest-only payments for the first 34 months and principal payments commenced February 1, 2006. Principal payments under Tranche B are due each May 1 and November 1, in varying amounts over the remaining term of the bond as set forth in the bond agreement. The final principal payment under Tranche A was made in February 2009.

During fiscal year 2010, the Collection renegotiated its bond debt covenants with the bank. The Collection is in compliance with these new covenants as of July 31, 2012 and 2011.

The Collection's future maturities on the bond payable are as follows:

Year Ending July 31,	
2013	$ 460,000
2014	480,000
2015	505,000
2016	525,000
2017	550,000
2018 and Thereafter	9,945,000
BONDS PAYABLE	**$ 12,465,000**

The Collection has entered into two interest rate swap agreements. The first agreement converted $15,000,000 of the variable rate liabilities related to the bond payable for the period July 17, 2003 to July 17, 2013 to a fixed rate. The fixed rate obtained was 3.1075%.

The second swap converts the variable rate on the scheduled notional amount of $12,005,000 into a fixed rate of 3.695% for the period July 17, 2013 to July 17, 2016. These interest rate swap agreements qualify as derivative instruments and are used to mitigate the effect of interest rate fluctuations. The Collection does not hold or issue derivative instruments for speculative purposes.

8. BONDS PAYABLE (Continued)

The Collection accounts for the interest rate swaps as fair value hedges whereby the fair value of the interest rate swaps are determined using a pricing model and are reflected in the Statements of Financial Position with the change in fair value recorded as a hedge gain or loss in the Statements of Activities and Changes in Net Assets. The interest rate swap obligation at July 31, 2012 and 2011 was $1,442,644 and $1,344,559, respectively.

Bond-related expenses consist primarily of bond interest expenses, net of the effects of the interest rate swaps, letter of credit fees, and ongoing attorney fees.

In July 2012, the Collection accepted a proposal from Capital One Bank to convert the outstanding bonds and existing swaps to a non-bank qualified fixed rate loan and a variable rate term loan. This transaction is expected to be consummated before the end of calendar 2012 and will eliminate the necessity for a letter of credit and the associated credit risk (see Note 17).

9. TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets consisted of the following at July 31, 2012 and 2011:

	2012	2011
Program services	$ 21,887,749	$ 22,585,053
Time restricted	980,657	2,960,662
TOTAL TEMPORARILY RESTRICTED NET ASSETS	**$ 22,868,406**	**$ 25,545,715**

The following temporarily restricted net assets were released from donor restrictions by incurring expenses (or through the passage of time) which satisfied the restricted purposes specified by the donors:

	2012	2011
Program services	$ 809,678	$ 994,953
Passage of time	2,005,000	1,942,000
TOTAL NET ASSETS RELEASED FROM DONOR RESTRICTIONS	**$ 2,814,678**	**$ 2,936,953**
TOTAL NON-OPERATING NET ASSETS RELEASED FROM RESTRICTION	**$ 1,233,261**	**$ 2,117,609**

10. CONTRIBUTED GOODS AND SERVICES

A significant amount of goods and services were donated to the Collection during the years ended July 31, 2012 and 2011, consisting primarily of legal and program administration services for membership, communications, visitor services and education.

The fair value of these goods and services was estimated to be $401,200 and $491,883 for the years ended July 31, 2012 and 2011, respectively.

11. LEASE COMMITMENTS

The Collection is committed under a noncancellable operating lease for storage space. The lease was extended in August 2011 and expires September 30, 2016.

The following is a schedule of the future minimum lease payments:

Year Ending July 31,	
2013	$ 43,455
2014	45,196
2015	47,007
2016	48,885
2017	8,280
	$ 192,823

Rent expense for the years ended July 31, 2012 and 2011 was $45,888 and $35,309, respectively.

12. RETIREMENT PLAN

The Collection sponsors a defined contribution 403(b) retirement plan available to any employee who meets certain age and length of service requirements. The plan allows for employer contributions of up to 7.4% of participant annual compensation. The Collection's contributions under the plan amounted to $229,244 and $218,681 for the years ended July 31, 2012 and 2011, respectively.

13. COMMITMENTS AND CONTINGENCIES

The Collection receives grants from various agencies of the United States Government. Such grants are subject to audit under the provisions of OMB Circular A-133. The ultimate determination of amounts received under the United States Government grants is based upon the allowance of costs reported to and accepted by the United States Government as a result of the audits. Audits in accordance with the provisions of OMB Circular A-133 have been completed for all required fiscal years through 2009. Until such audits have been accepted by the United States Government, there exists a contingency to refund any amount received in excess of allowable costs. Management is of the opinion that no material liability will result from such audits. For the years ended July 31, 2012 and 2011, the Collection did not meet the requirements to be subject to an audit under the provisions of OMB Circular A-133.

The Collection has entered into a ten-year consulting contract with the former Director of the Museum who retired during 2008. The contract requires quarterly payments of $7,500 for services to be performed by the former Director. The contract ends June 30, 2018.

14. SPLIT-INTEREST AGREEMENTS

The Collection has been named as a beneficiary in two different charitable remainder trusts. Each trust pays its donor an annual amount equal to 5% of the net fair market value of the trust assets. Upon the donor's death, the remaining assets in the trust are distributed to the named charitable organizations in the manner specified in the trust document.

14. SPLIT-INTEREST AGREEMENTS (Continued)

The assets of each trust are held by outside trustees and consist of a mixture of fixed income and equity securities. The Collection records its interest in each of these charitable remainder trusts as a contribution receivable, equal to the estimated future cash receipts, discounted at 6% over the expected life of each donor.

At July 31, 2012 and 2011, the present value of the Collection's combined interest in these two trusts totaled $1,093,193 and $1,291,243, respectively, and was included in pledges receivable. The change in value of split-interest agreements was ($198,050) and $201,753 for each of the years ended July 31, 2012 and 2011, respectively, and was included in gifts, grants and corporate support on the Statements of Activities and Changes in Net Assets.

The Collection administers various gift annuity agreements. A gift annuity agreement provides for the payment of distributions to the grantor or other designated beneficiaries over the annuity's term (usually the designated beneficiary's lifetime). At the end of the annuity's term, the remaining assets are available for the Collection's use.

The portion of the annuity attributable to the present value of the future benefits to be received by the Collection is recorded in the Statements of Activities and Changes in Net Assets as a permanently restricted contribution in the period the annuity is established. There were no such contributions during the years ended July 31, 2012 and 2011. On an annual basis, the Collection revalues the liability to make distributions to the designated beneficiaries based on actuarial assumptions.

The total present value of the liability for future payments of principal at July 31, 2012 and 2011, was $196,107 and $212,447, respectively, using discount rates ranging from 3.4% to 7.4% and the applicable mortality tables.

15. FAIR VALUE MEASUREMENTS

In accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*, the Collection has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Investments recorded in the Statements of Financial Position are categorized based on the inputs to valuation techniques as follows:

Level 1. These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Collection has the ability to access.

Level 2. These are investments where values are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, or model-based valuation techniques that utilize inputs that are observable either directly or indirectly for substantially the full-term of the investments.

Level 3. Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

15. FAIR VALUE MEASUREMENTS (Continued)

Following is a description of the valuation methodology used for investments measured at fair value. There have been no changes in the methodologies used at July 31, 2012 and 2011.

- *Money market funds* - Fair value is equal to the reported net asset value of the fund.
- *Mutual funds* - The fair value is equal to the reported net asset value of the fund, which is the price at which additional shares can be obtained.
- *Certificates of deposit* - Generally valued at original cost plus accrued interest, which approximates fair value.
- *Interest rate swap agreements* - Fair value is derived from quotes from a dealer or broker, where available. Models used in valuing such agreements consider the contractual terms of and specific risks inherent in the instrument, and inputs used typically include yield curve, instrument volatility, prepayment rates and assumptions concerning nonperformance risk.
- *Interests in hedge funds, limited partnerships, private equity funds* - These instruments do not have a readily determinable fair value. The fair values used are generally determined by the general partner or management of the entity and are based on appraisals or other estimates that require varying degrees of judgment. Inputs used in determining fair value may include the cost and recent activity concerning the underlying investments in the funds or partnerships.

The table below summarizes, by level within the fair value hierarchy, the Collection's investments as of July 31, 2012:

	Level 1	Level 2	Level 3	Total July 31, 2012
Financial Assets:				
Money market funds	$ 468,726	$ -	$ -	$ 468,726
Fixed income and blended mutual funds	6,695,021	1,449,216	-	8,144,237
Domestic equity mutual funds	1,172,748	-	-	1,172,748
International equity mutual funds	4,613,536	-	-	4,613,536
Global equity mutual funds	1,193,039	-	-	1,193,039
TIFF multi-asset fund	3,122,664	-	-	3,122,664
Alternative funds	-	-	30,089,848	30,089,848
	$ 17,265,734	**$ 1,449,216**	**$ 30,089,848**	**$ 48,804,798**
Financial Liabilities:				
Interest Rate Swap Obligation	**$ -**	**$ 1,442,644**	**$ -**	**$ 1,442,644**

15. FAIR VALUE MEASUREMENTS (Continued)

The table below summarizes, by level within the fair value hierarchy, the Collection's investments as of July 31, 2011:

	Level 1	Level 2	Level 3	Total July 31, 2011
Financial Assets:				
Money market funds	$ 415,884	$ -	$ -	$ 415,884
Fixed income and blended mutual funds	9,721,823	1,369,195	-	11,091,018
Domestic equity mutual funds	1,254,677	-	-	1,254,677
International equity mutual funds	5,177,344	-	-	5,177,344
Global equity mutual funds	1,250,304	-	-	1,250,304
TIFF multi-asset funds	3,109,851	-	-	3,109,851
Alternative funds	-	-	28,532,268	28,532,268
	$ 20,929,883	**$ 1,369,195**	**$ 28,532,268**	**$ 50,831,346**
Financial Liabilities:				
Interest Rate Swap Obligation	**$ -**	**$ 1,344,559**	**$ -**	**$ 1,344,559**

Level 3 Financial Assets

The following table provides a summary of changes in fair value of the Collection's Level 3 financial assets for the year ended July 31, 2012:

	Investments
Beginning balance as of August 1, 2011	$ 28,532,268
Purchases and capital calls	4,231,133
Sales and distributions	(3,460,058)
Gain on sales	476,867
Unrealized gains	309,638
BALANCE AS OF JULY 31, 2012	**$ 30,089,848**

The following table provides a summary of changes in fair value of the Collection's Level 3 financial assets for the year ended July 31, 2011:

	Investments
Beginning balance as of August 1, 2010	$ 23,757,056
Purchases and capital calls	2,452,470
Sales and distributions	(224,678)
Loss on sales	(96,443)
Unrealized gains	2,643,863
BALANCE AS OF JULY 31, 2011	**$ 28,532,268**

16. ENDOWMENT

The Collection's endowment (the Fund) consists of donor-restricted endowment funds. As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Collection classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Collection in a manner consistent with the standard of prudence prescribed by UPMIFA.

In accordance with UPMIFA, and at such time as the museum has accumulated earnings in the Fund which are in excess of the total of the original gifts, the Board of Trustees will consider the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund;
- The purpose of the organization and the donor-restricted endowment fund;
- General economic conditions and the possible effect of inflation and deflation;
- The expected total return from income and the appreciation of investments; and
- Investment policies of the organization.

Changes in endowment net assets by type of fund for the year ended July 31, 2012 as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ (2,470,100)	$ -	$ 33,995,554	$ 31,525,454
Net investment loss	(15,366)	-	-	(15,366)
Contributions at present value	-	-	254,611	254,611
Appropriations of endowment assets for expenditures	(2,003,621)	-	-	(2,003,621)
Art acquisitions	-	-	(76,204)	(76,204)
ENDOWMENT NET ASSETS, END OF YEAR	**$ (4,489,087)**	**$ -**	**$ 34,173,961**	**$ 29,684,874**

16. ENDOWMENT (Continued)

Changes in endowment net assets by fund type for the year ended July 31, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ (4,714,620)	$ -	$ 33,143,516	$ 28,428,896
Net investment income	4,567,574	-	-	4,567,574
Contributions at present value	-	-	902,826	902,826
Appropriation of endowment assets for expenditure	(2,323,054)	-	-	(2,323,054)
Art acquisitions	-	-	(50,788)	(50,788)
ENDOWMENT NET ASSETS, END OF YEAR	**$ (2,470,100)**	**$ -**	**$ 33,995,554**	**$ 31,525,454**

Funds with Deficiencies -

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Collection to retain. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were $4,489,087 and $2,470,100 as of July 31, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations occurring after the investment of permanently restricted contributions. As a result of these net deficiencies, there are no assets available to be held in temporarily restricted net assets.

Return Objectives and Risk Parameters -

The Collection has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to activities supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period(s). Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner to generate a total return that will exceed not only the museum's operating requirements, but also all expenses associated with managing the Fund and the eroding effects of inflation. It is the intention that all total return (interest income, dividends, realized gains, and unrealized gains), above and beyond the amount approved for expenditure or distribution, will be reinvested. The assets will be managed on a total return basis, consistent with the applicable standard of conduct set forth in the Uniform Prudent Management of Institutional Funds Act.

Strategies Employed for Achieving Objectives -

To achieve its investment objective, the endowment assets will be allocated among several asset classes with a bias toward equity and equity-like investments due to their higher long-term return expectations. Other asset classes have and may be added to the portfolio to enhance returns, reduce volatility through diversification, and/or offer a broader investment opportunity set.

16. ENDOWMENT (Continued)

Strategies Employed for Achieving Objectives (continued) -

The portfolio will be diversified both by and within asset classes. The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the performance of the total portfolio. As a result, the risk level associated with the portfolio investment is reduced.

Spending Policy and How the Investment Objectives Relate to Spending Policy -

The Collection has a policy of appropriating for distribution each year 5% of its endowment fund's average fair value calculated by averaging the quarter end values of the two full prior fiscal years and the current fiscal year through the third quarter. In establishing this policy, the Collection considered the long-term expected return on its endowment.

Spending Policy and How the Investment Objectives Relate to Spending Policy (continued) -

The Board may authorize special exceptions to this policy. Actual cash withdrawals are based on this budgeted amount and may be made at staff's discretion subject to a) the operating requirements of the museum, b) the market conditions affecting investment holdings, and c) anticipated cash flow from other sources.

17. SUBSEQUENT EVENTS

In preparing these financial statements, the Collection has evaluated events and transactions for potential recognition or disclosure through October 25, 2012, the date the financial statements were issued.

Subsequent to July 31, 2012, the Collection accepted a proposal to refinance its outstanding tax-exempt bonds under a non-bank qualified agreement eliminating the need for a letter of credit and the associated bank credit risk. The new refinancing will be structured as a fixed rate 10-year agreement and is expected to be consummated effective November 1, 2012.