

Financial Statements
Peabody Essex Museum, Inc.
December 31, 2009 and 2008



Mayer Hoffman McCann P.C.
An Independent CPA Firm
Tofias New England Division

PEABODY ESSEX MUSEUM, INC.

Financial Statements

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Mayer Hoffman McCann P.C.

An Independent CPA Firm

Tofias New England Division

350 Massachusetts Avenue

Cambridge, MA 02139

Tel: 617.761.0703 Fax: 617.761.0601

www.mhm-pc.com

Independent Auditors' Report

The Board of Trustees
Peabody Essex Museum, Inc.
Salem, Massachusetts

We have audited the accompanying statements of financial position of Peabody Essex Museum, Inc. (the "Museum") as of December 31, 2009 and 2008, and the related statements of activities, and cash flows for the years then ended. 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 audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards 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. An audit also includes 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 Peabody Essex Museum, Inc. at December 31, 2009 and 2008, and the changes in its net assets, and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Mayer Hoffman McCann P.C.

May 11, 2010
Cambridge, Massachusetts

Peabody Essex Museum, Inc.
Statements of Financial Position
December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,577,234	\$ 1,677,928
Accounts receivable	20,512	51,368
Grants receivable	416,824	138,396
Pledges receivable	3,652,096	3,352,308
Inventories, at cost	688,446	646,927
Prepaid expenses	852,356	415,303
Total current assets	<u>7,207,468</u>	<u>6,282,230</u>
Noncurrent assets:		
Pledges receivable - noncurrent	6,044,202	5,794,271
Investments, at market	187,423,764	158,242,480
Funds held by others	3,817,905	3,333,442
Assets of split-interest agreements, net	350,788	290,679
Mortgages receivable - related party	197,316	197,316
Bond issuance costs, net	260,312	280,310
Bond principal escrow	385,539	375,000
Land, buildings and equipment, net	82,213,423	86,157,588
Total assets	<u>\$ 287,900,717</u>	<u>\$ 260,953,316</u>
Liabilities and Net Assets		
Liabilities:		
Current liabilities:		
Accounts payable	\$ 905,683	\$ 773,307
Accrued expenses	603,724	626,472
Deferred revenue	331,829	169,758
Current portion of bonds payable	925,000	900,000
Current portion of environmental remediation liability	328,713	1,134,000
Current portion of lease liability	80,859	94,657
Total current liabilities	<u>3,175,808</u>	<u>3,698,194</u>
Noncurrent liabilities:		
Bonds payable	31,285,000	32,210,000
Interest rate swap, mark to market	2,607,287	3,326,802
Environmental remediation liability	-	114,918
Long-term lease liability	91,808	146,637
Total liabilities	<u>37,159,903</u>	<u>39,496,551</u>
Net assets:		
Unrestricted	88,922,295	85,302,370
Temporarily restricted	65,373,014	54,870,722
Permanently restricted	96,445,505	81,283,673
Total net assets	<u>250,740,814</u>	<u>221,456,765</u>
Total liabilities and net assets	<u>\$ 287,900,717</u>	<u>\$ 260,953,316</u>

Peabody Essex Museum, Inc.
Statements of Activities
Year Ended December 31, 2009
(with summarized financial information
for the year ended December 31, 2008)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2009	2008
Operating support and revenue:					
Contributions	\$ 1,695,059	\$ 5,998,061	\$ 14,598,988	\$ 22,292,108	\$ 15,313,542
Grants	1,588,115	-	-	1,588,115	1,633,614
Spending rate transfer appropriated for operations	4,809,118	-	-	4,809,118	4,623,061
Enterprise and other revenues	2,490,438	1,961	-	2,492,399	2,404,547
Admissions	951,583	-	-	951,583	921,681
Memberships	645,298	-	-	645,298	671,428
Satisfaction of program restrictions	7,843,792	(7,843,792)	-	-	-
Total operating support and revenue	20,023,403	(1,843,770)	14,598,988	32,778,621	25,567,873
Expenses:					
Program services:					
Exhibitions and publications	2,355,939	-	-	2,355,939	2,106,110
Curatorial and collections	2,214,481	-	-	2,214,481	2,270,554
Educational programs	1,982,177	-	-	1,982,177	1,960,834
Enterprises	1,307,945	-	-	1,307,945	1,389,314
Public information	1,816,727	-	-	1,816,727	1,927,059
Membership and guest services	612,799	-	-	612,799	660,687
Media services	605,625	-	-	605,625	546,730
Facilities and security	3,004,587	-	-	3,004,587	3,291,540
Total program services	13,900,280	-	-	13,900,280	14,152,828
Supporting services:					
Development	1,918,033	-	-	1,918,033	2,367,430
Administrative	3,249,512	-	-	3,249,512	3,271,213
Facilities and security	913,507	-	-	913,507	1,000,751
Total supporting services	6,081,052	-	-	6,081,052	6,639,394
Total program and supporting services	19,981,332	-	-	19,981,332	20,792,222
Changes in net assets from operations before other operating activities	42,071	(1,843,770)	14,598,988	12,797,289	4,775,651
Other operating activities:					
Contributions and revenues (expenses)	(462,212)	-	-	(462,212)	(102,663)
Bequests	-	-	-	-	117,101
Satisfaction of restrictions	-	-	-	-	-
Changes in net assets from operations	(420,141)	(1,843,770)	14,598,988	12,335,077	4,790,089
Nonoperating activities:					
Investment income and gains (losses) net of amounts appropriated for operations	8,950,882	13,936,209	210,892	23,097,983	(41,058,301)
Change in value of split-interest agreements and funds held by others	-	181,883	351,952	533,835	(1,542,680)
Debt service costs	(1,483,894)	-	-	(1,483,894)	(1,459,100)
Unrealized gain (loss) under interest rate swap	719,515	-	-	719,515	(1,877,101)
Environmental remediation cost	-	-	-	-	-
Depreciation and amortization	(4,263,580)	-	-	(4,263,580)	(4,346,666)
Gain (loss) on disposal of fixed assets	(6,713)	-	-	(6,713)	9,375
Plant related satisfaction of program restrictions	172,623	(172,623)	-	-	-
Sale of collection items	-	-	-	-	6,500
Collection items purchased	(1,648,174)	-	-	(1,648,174)	(5,911,480)
Satisfaction of program restrictions - collection items	1,599,407	(1,599,407)	-	-	-
Change in net assets from nonoperating activities	4,040,066	12,346,062	562,844	16,948,972	(56,179,453)
Change in net assets	3,619,925	10,502,292	15,161,832	29,284,049	(51,389,364)
Net assets at beginning of year	85,302,370	54,870,722	81,283,673	221,456,765	272,846,129
Net assets at end of year	\$ 88,922,295	\$ 65,373,014	\$ 96,445,505	\$ 250,740,814	\$ 221,456,765

Peabody Essex Museum, Inc.
Statement of Activities
Year Ended December 31, 2008

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total 2008</u>
Operating support and revenue:				
Contributions	\$ 1,982,496	\$ 12,627,934	\$ 703,112	\$ 15,313,542
Grants	1,633,614	-	-	1,633,614
Spending rate transfer appropriated for operations	4,623,061	-	-	4,623,061
Enterprise and other revenues	2,404,547	-	-	2,404,547
Admissions	921,681	-	-	921,681
Memberships	671,428	-	-	671,428
Satisfaction of program restrictions	8,581,286	(8,581,286)	-	-
Total operating support and revenue	<u>20,818,113</u>	<u>4,046,648</u>	<u>703,112</u>	<u>25,567,873</u>
Expenses:				
Program services:				
Exhibitions and publications	2,106,110	-	-	2,106,110
Curatorial and collections	2,270,554	-	-	2,270,554
Educational programs	1,960,834	-	-	1,960,834
Enterprises	1,389,314	-	-	1,389,314
Public information	1,927,059	-	-	1,927,059
Membership and guest services	660,687	-	-	660,687
Media services	546,730	-	-	546,730
Facilities and security	3,291,540	-	-	3,291,540
Total program services	<u>14,152,828</u>	<u>-</u>	<u>-</u>	<u>14,152,828</u>
Supporting services:				
Development	2,367,430	-	-	2,367,430
Administrative	3,271,213	-	-	3,271,213
Facilities and security	1,000,751	-	-	1,000,751
Total supporting services	<u>6,639,394</u>	<u>-</u>	<u>-</u>	<u>6,639,394</u>
Total program and supporting services	<u>20,792,222</u>	<u>-</u>	<u>-</u>	<u>20,792,222</u>
Changes in net assets from operations before other operating activities	25,891	4,046,648	703,112	4,775,651
Other operating activities:				
Other contributions and revenues (expenses)	(102,663)	-	-	(102,663)
Bequests	117,101	-	-	117,101
Satisfaction of restrictions	-	-	-	-
Changes in net assets from operations	<u>40,329</u>	<u>4,046,648</u>	<u>703,112</u>	<u>4,790,089</u>
No operating activities:				
Investment income and losses net of amounts appropriated for operations	(12,060,798)	(27,003,461)	(1,994,042)	(41,058,301)
Change in value of split-interest agreements and funds held by others	-	(531,200)	(1,011,480)	(1,542,680)
Debt service costs	(1,459,100)	-	-	(1,459,100)
Unrealized loss under interest rate swap	(1,877,101)	-	-	(1,877,101)
Environmental remediation costs	-	-	-	-
Depreciation and amortization	(4,346,666)	-	-	(4,346,666)
Loss on disposal of fixed assets	9,375	-	-	9,375
Plant related satisfaction of program restrictions	132,118	(132,118)	-	-
Sale of collection items	-	6,500	-	6,500
Collection items purchased	(5,911,480)	-	-	(5,911,480)
Satisfaction of program restrictions - collection items	5,791,655	(5,791,655)	-	-
Change in net assets from no operating activities	<u>(19,721,997)</u>	<u>(33,451,934)</u>	<u>(3,005,522)</u>	<u>(56,179,453)</u>
Change in net assets	(19,681,668)	(29,405,286)	(2,302,410)	(51,389,364)
Net assets at beginning of year	97,566,483	96,696,843	78,582,803	272,846,129
Reclassification of net assets	7,417,555	(12,420,835)	5,003,280	-
Net assets at end of year	<u>\$ 85,302,370</u>	<u>\$ 54,870,722</u>	<u>\$ 81,283,673</u>	<u>\$ 221,456,765</u>

See accompanying notes to the financial statements.

Peabody Essex Museum, Inc.
Statements of Cash Flows
Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Change in net assets	\$ 29,284,049	\$ (51,389,364)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,263,580	4,346,666
(Gain) loss on disposal of fixed assets	6,713	(9,375)
Contributions restricted for long-term investments and capital additions	(12,234,047)	(9,312,760)
Net unrealized and realized (gains) losses on long-term investments	(24,460,398)	39,278,784
Interest rate swap, mark to market	(719,515)	1,877,101
Environmental remediation cost	(920,205)	(186,971)
Outlays for collections	1,648,174	5,911,480
(Increase) decrease in assets:		
Pledges receivable	(549,719)	11,795,467
Accounts receivable	30,856	134,639
Grants receivable	(278,428)	576,031
Inventories	(41,519)	28,035
Prepaid expenses	(437,053)	(132,751)
Increase (decrease) in liabilities:		
Accounts payable	132,376	(168,801)
Accrued expenses	(22,748)	(415,362)
Deferred revenue	162,071	836
	<u>(4,135,813)</u>	<u>2,333,655</u>
Net cash provided by (used in) operating activities		
Cash flows from investing activities:		
Additions to land, building, equipment and construction in progress	(288,262)	(505,286)
Purchases of investments	(58,258,633)	(46,067,928)
Proceeds from sales of investments	53,537,747	37,796,254
Proceeds from sales of fixed assets	1,000	50,000
Outlays for collections	(1,648,174)	(5,911,480)
(Additions to) distributions from split-interest agreements	(17,495)	2,251,559
Change in value of split-interest agreements and perpetual trusts	(527,077)	1,348,065
	<u>(7,200,894)</u>	<u>(11,038,816)</u>
Net cash used in investing activities		
Cash flows from financing activities:		
Payments on bonds payable	(900,000)	(875,000)
Payments to bond principal escrow	(10,539)	(10,417)
Contributions restricted for long-term investments and capital additions	12,234,047	9,312,760
Payments of capital lease obligations	(87,495)	(91,308)
	<u>11,236,013</u>	<u>8,336,035</u>
Net cash provided by financing activities		
Net decrease in cash and cash equivalents	(100,694)	(369,126)
Cash and cash equivalents at beginning of year	<u>1,677,928</u>	<u>2,047,054</u>
Cash and cash equivalents at end of year	<u>\$ 1,577,234</u>	<u>\$ 1,677,928</u>
Supplemental disclosure of noncash activities:		
Capital leases used to finance equipment	\$ 25,972	\$ 147,844

See accompanying notes to the financial statements.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 1 - Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The Peabody Essex Museum, Inc. (the “Museum”) was formed on July 1, 1992 through a merger of the former Peabody Museum of Salem and the Essex Institute. The Museum presents outstanding works of artistic and cultural creativity from New England and around the world. The Museum’s collections are among the finest of their kind, showcasing an unrivaled spectrum of American art and architecture (including four national historic landmark buildings), American decorative art, maritime art and culture, and Native American art, as well as Asian, Asian export, African, oceanic, photography and contemporary art collections. In addition to its vast collections, the Museum develops and offers a variety of special exhibitions and educational programs, and works with the world’s finest museums to bring traveling exhibitions to audiences in the greater Boston area and beyond. The Museum campus features numerous parks and gardens, and 22 historic properties, including Yin Yu Tang, a 200-year-old house that is the only example of Chinese domestic architecture on display outside of China. The Museum’s Phillips Library is one of the oldest and largest research libraries in New England.

The Museum is recognized by the Internal Revenue Service as an organization described in Section 501(c)(3) of the Internal Revenue Code and is generally exempt from federal and state income taxes on related income. Accordingly, no provision for income taxes is made in the financial statements.

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis and in accordance with the reporting principles of not-for-profit accounting.

Unrestricted Net Assets

Unrestricted net assets are not subject to donor-imposed stipulations. Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions or law. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or law.

Temporarily Restricted Net Assets

Temporarily restricted net assets carry specific, donor-imposed restrictions on the expenditure or other use of contributed funds or limitations imposed by law. Temporary restrictions may expire either because of the passage of time or because certain actions are taken by the Museum which fulfill the restriction. Expirations of temporary restrictions on net assets, that is, the donor-imposed stipulated purpose has been accomplished or the stipulated time period has elapsed, are reported as satisfaction of program restrictions in the statement of activities.

Permanently Restricted Net Assets

Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained in perpetuity by the Museum. Generally, the donors of these assets permit the Museum to use all or part of the income earned and capital appreciation on related investments for general or specific purposes.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 1 - Nature of Operations and Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents

All highly liquid debt instruments with a maturity of three months or less when purchased are classified as cash equivalents. Cash and cash equivalents include repurchase agreements which are typically issued on an overnight basis. Cash and cash equivalents held by investment managers are considered part of investments.

Investments

The Museum reports investments at fair market value. Fair value is determined per as more fully described under fair value of financial instruments below. The Museum's management is responsible for the fair measurement of investments reported in the financial statements and believes that the reported values are reasonable.

Fair Value of Financial Instruments

The Museum measures its financial instruments at fair market value. Fair market value standards require an entity to maximize the use of observable inputs and minimize the use of unobservable inputs to determine value. Fair value standards also require the Museum to classify its financial instruments into a three-level hierarchy, based on the priority of inputs to the valuation techniques, as follows:

Level 1 - Quoted prices are available in active markets for identical instruments as of the reporting date. The type of instruments included in Level 1 includes listed equity and debt securities publicly traded on a stock exchange.

Level 2 - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Instruments which are generally included in this category include interest rate swaps and investments that allow for short-term redemption of invested amounts at a net asset value as determined by the investee.

Level 3 - Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument. The inputs into the determination of fair value require significant management judgment or estimation. Instruments that are included in this category generally include investments in privately held portfolio companies, promissory notes to privately held companies and interests in other investment partnerships.

In some instances, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such instances, an instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 1 - Nature of Operations and Summary of Significant Accounting Policies (Continued)

Pledges and Accounts Receivable

Pledges and accounts receivable are reported at the amount management expects to collect on balances outstanding at year-end. Management estimates the allowance for doubtful accounts based on history of collections and knowledge acquired about specific facts relating to outstanding items. Adjustments to the allowance are charged to bad debt expense. Uncollectible accounts are written off against the allowance. An account is considered uncollectible when all efforts to collect the account have been exhausted.

Inventories

Inventories, principally retail merchandise, are stated at the lower of cost or market, with cost calculated using the first-in, first-out (FIFO) method, and market based upon net realizable value.

Land, Building and Equipment

Buildings, capital improvements, period house renovations and equipment are stated at cost less accumulated depreciation computed on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings	30 to 50 years
Capital improvements	5 to 20 years
Equipment	3 to 10 years
Period house renovations	5 to 30 years

Betterments which materially add to the value of the related assets or materially extend the useful life of the assets are capitalized. Equipment and furnishings of relatively small dollar value are expensed as incurred. When equipment is retired, its cost and the related accumulated depreciation are eliminated from the respective accounts. Gains or losses arising from dispositions are charged to unrestricted net assets.

Deferred Revenues

Deposits for function rentals, education programs and publication subscriptions are deferred and are recorded as unrestricted revenues in the year in which the services are provided.

Operating Activities

Operating activities represent revenues by source and expenses by major function. Its purpose is to present revenues and expenses related solely to the budgeted operating activities of the Museum. Other operating activities reflect transactions that are typically nonrecurring and are not customarily planned for in the annual budgeting process. Nonoperating activities include investment results net of the spending policy, debt service costs, changes in the valuation of the swap, changes in the value of split-interest agreements and funds held by others, depreciation, collection items purchased as well as certain other items of income and expense.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 1 - Nature of Operations and Summary of Significant Accounting Policies (Continued)

Collections and Works of Art

The collections, which were acquired through purchases and contributions since the Museum's inception, are not recognized as assets on the statement of financial position. Purchases of collection items are recorded as decreases in unrestricted net assets in the year in which the items are acquired. Contributed collection items are not reflected on the financial statements. Proceeds from deaccessions or insurance recoveries are reflected as increases in the appropriate net asset classes.

Recognition of Contributions and Grants

Contributions and grants, including unconditional promises to give, are recorded as revenue at fair value when verifiably committed. Conditional contributions and grants and intentions to give are recorded as revenue when the conditions have been met. Contributions and grants are reflected as unrestricted, temporarily restricted or permanently restricted based on the existence or absence of donor-imposed restrictions. Amounts received with donor-imposed restrictions that are recorded as temporarily restricted revenues are reclassified to unrestricted net assets when the time or purpose restriction has been satisfied.

Contributed Services and Gifts In-Kind

Contributions of services are recognized when provided by individuals or organizations whose skills would be purchased if not provided by donation. In addition, a substantial number of unpaid volunteers have made significant contributions of their time to develop and maintain the Museum's programs. The value of this contributed time is not reflected in these statements.

Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 revenues and expenses during the period. Actual results could differ from those estimates.

Concentrations

The Museum maintains its cash and cash equivalents at various financial institutions. The Museum has not experienced any losses on such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents, which, at times, exceeds federally insured limits.

Bond Issuance Costs

Bond issuance costs represent expenses incurred in connection with the issuance of the Museum's bond. Such costs are amortized using the straight-line method over the life of the associated bond issue.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 1 - Nature of Operations and Summary of Significant Accounting Policies (Continued)

Advertising Costs

Advertising costs are charged to operations when incurred. Advertising costs for the years ended December 31, 2009 and 2008 were \$523,974 and \$600,159, respectively.

Reclassifications

Certain reclassifications were made to the 2008 financial statements to conform to the 2009 presentation.

Uncertain Tax Positions

The Museum accounts for the effect of any uncertain tax positions based on a “more likely than not” threshold to the recognition of the tax positions being sustained based on the technical merits of the position under scrutiny by the applicable taxing authority. If a tax position or positions are deemed to result in uncertainties of those positions, the unrecognized tax benefit is estimated based on a “cumulative probability assessment” that aggregates the estimated tax liability for all uncertain tax positions. Interest and penalties assessed, if any, are accrued as income tax expense.

The Museum has identified its tax status as a tax exempt entity as a tax position and has determined that such tax position does not result in an uncertainty requiring recognition. The Museum is not currently under examination by any taxing jurisdiction. Its federal and state income tax returns are generally open for examination for the past three years.

Subsequent Events

The Museum has evaluated subsequent events through May 11, 2010, the date the financial statements were authorized to be released.

Note 2 - Pledges Receivable

Pledges expected to be collected within one year are recorded at their net realizable value. Pledges that are expected to be collected in future years are recorded at the present value of estimated future cash flows utilizing a discount rate.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 2 - Pledges Receivable (Continued)

Pledges receivable as of December 31, 2009 and 2008 are expected to be realized in the following time frame:

	2009	2008
Within one year	\$ 3,692,096	\$ 3,440,266
One to five years	6,097,637	6,379,448
More than five years	<u>747,315</u>	<u>747,757</u>
Pledges receivable	10,537,048	10,567,471
Less: Present value discount	(800,750)	(1,255,982)
Less: Allowance for uncollectible pledges	<u>(40,000)</u>	<u>(164,910)</u>
	 \$ <u>9,696,298</u>	 \$ <u>9,146,579</u>

During 2006, the Museum was awarded a \$65,000,000 conditional endowment challenge grant. Due to the uncertainties of achieving the conditions of the grant, the award is reflected in the financial statements as the conditions are met. During 2008, no contribution was recognized under the grant. During 2009, the Museum met certain conditions of the grant resulting in a \$10,000,000 contribution to the endowment. To date, the Museum has received \$30,000,000 from the conditional endowment challenge grant.

Note 3 - Investments

The Museum's investments are summarized as follows at December 31:

	2009	2008
Money market mutual funds	\$ 14,078,822	\$ 14,678,555
Domestic equity funds	44,938,856	35,967,669
International equity funds	50,595,433	42,604,780
Bond mutual funds	50,839,478	41,527,987
Real assets	4,301,054	5,138,127
Alternative investments	<u>22,670,121</u>	<u>18,325,362</u>
Investments, at market	 \$ <u>187,423,764</u>	 \$ <u>158,242,480</u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 3 - Investments (Continued)

Investment returns are reported as follows:

- as increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment fund;
- as increases in temporarily restricted net assets if the terms of the gift or state law impose restrictions on the current use of the income or net gains; and
- as increases in unrestricted net assets in all other cases.

Investment return consisted of the following for the years ended December 31, 2009 and 2008:

	2009	2008
Interest and dividend income	\$ 3,895,977	\$ 6,661,184
Net realized gains on investments	(5,546,603)	(1,699,278)
Net unrealized appreciation (depreciation) of investments	30,007,003	(41,081,770)
Less investment fees	<u>(449,276)</u>	<u>(315,376)</u>
Net return	27,907,101	(36,435,240)
Total return appropriated to support operations	<u>(4,809,118)</u>	<u>(4,623,061)</u>
Investment return, net of amounts appropriated to support operations	\$ <u>23,097,983</u>	\$ <u>(41,058,301)</u>

Funds Held by Others

The Museum is the beneficiary of four trusts held by others. The Museum records contribution revenue and the value of the assets at the time of the gift. The fair value of these trusts is \$3,797,059 and \$3,317,559 at December 31, 2009 and 2008, respectively. Annual distributions from the trusts of \$108,416 and \$161,585 for the years ended December 31, 2009 and 2008, respectively, are reported as investment income in the appropriate net assets category depending on the nature of the donor's restrictions on distributions. Adjustments to the amounts reported as assets are recognized as a change in value of the funds held by others in the statement of activities.

Split-Interest Agreements

Assets of split-interest agreements are recorded at fair value, net of the present value of the liability for income payable to the donor or the donor's designee, and in the appropriate net asset category based on donor stipulation. Related contributions are recognized as contribution revenue equal to the present value of future benefits less the liability for income payable to the donor or the donor's designee. The liability for income payable under split-interest agreements for which the Museum is trustee was \$146,042 and \$139,456 for the years ended December 31, 2009 and 2008, respectively.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 3 - Investments (Continued)

Split-Interest Agreements (Continued)

During the term of these agreements, changes in the value of split-interest agreements are recognized in the statement of activities based on accretion of the discounted amount of the contribution, the expected future benefits to be received by the Museum, changes in the fair value of underlying investments and the expected future payment to other beneficiaries, based on changes in life expectancy and other actuarial assumptions. Discount rates ranging from 4.88% and 8.50% were used in these calculations. The discount rates were equivalent to treasury yields of similar maturity at the time the Museum entered into the arrangement.

Note 4 - Fair Value Measurements

The valuation of the Museum's investments by the above fair value hierarchy consisted of the following at December 31, 2009:

	<i>Portion Carried at Fair Value</i>	<i>Quoted Prices in Active Markets Level 1</i>	<i>Significant Observable Inputs Level 2</i>	<i>Significant Unobservable Inputs Level 3</i>
Investments	\$ 187,423,764	\$ 98,374,886	\$ 62,170,455	\$ 26,878,423
Funds held by others	\$ 3,817,905	\$ 3,817,905	\$ -	\$ -
Assets of split-interest agreements	\$ 350,788	\$ 350,788	\$ -	\$ -
Interest rate swap	\$ (2,607,287)	\$ -	\$ (2,607,287)	\$ -

The valuation of the Museum's investments by the above fair value hierarchy consisted of the following at December 31, 2008:

	<i>Portion Carried at Fair Value</i>	<i>Quoted Prices in Active Markets Level 1</i>	<i>Significant Observable Inputs Level 2</i>	<i>Significant Unobservable Inputs Level 3</i>
Investments	\$ 158,242,480	\$ 110,537,464	\$ 29,047,897	\$ 18,657,119
Funds held by others	\$ 3,333,442	\$ 3,333,442	\$ -	\$ -
Assets of split-interest agreements	\$ 290,679	\$ 290,679	\$ -	\$ -
Interest rate swap	\$ (3,326,802)	\$ -	\$ (3,326,802)	\$ -

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 4 - Fair Value Measurements (Continued)

The changes in instruments measured at fair value for which the Museum has used Level 3 inputs to determine fair value are as follows:

	<i>Level 3</i>
Balance, January 1, 2008	\$ 9,672,431
Purchases (sales), net	12,132,583
Realized and unrealized losses	<u>(3,147,895)</u>
Balance, December 31, 2008	18,657,119
Purchases (sales), net	6,112,363
Realized and unrealized losses	<u>2,108,941</u>
Balance, December 31, 2009	<u>\$ 26,878,423</u>
Changes in unrealized gains included in earnings related to Level 3 investments still held at reporting date December 31, 2009	<u>\$ 1,874,062</u>
Changes in unrealized losses included in earnings related to Level 3 investments still held at reporting date December 31, 2008	<u>\$ (3,277,041)</u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 4 - Fair Value Measurements (Continued)

The Museum invests in certain entities that calculate net asset value per share in accordance with guidance relative to investment companies, and these investments are reported at fair value based on the net asset value per share as reported by the investee. These investments are measured at fair value using Level 2 or Level 3 inputs. Investments are categorized as Level 2 instruments when the Museum has the ability to redeem its investment in the entity at net asset value per share at year-end or within 90 days of year-end. Investments are categorized as Level 3 instruments when the Museum cannot redeem its investment within 90 days of year-end. A summary of the significant categories of such investments and their attributes is as follows:

	<i>Fair Value</i>	<i>Commitments</i>	<i>Eligible</i>	<i>Redemption Notice Period</i>
		<i>(in thousands)</i>		
Global equity funds	\$ 30,478	\$ -	monthly	30 days
Global fixed income funds	3,164	-	monthly	30 - 60 days
Absolute return funds	12,080	-	quarterly, annually	45 - 90 days
Real asset commingled trusts	3,662	-	monthly	7 days
Private company equity	24,275	-	quarterly	90 days
Diversified fund-of-funds	9,685	-		65 days
Real estate limited partnerships	4,208	-		liquidation of fund
Private equity	<u>1,497</u>	<u>480</u>		liquidation of fund
	<u>\$ 89,049</u>	<u>\$ 480</u>		

Global equity funds – includes investments in funds that seek to achieve capital appreciation through investments in equity-related securities and bonds of companies, many of which conduct significant activities in countries other than the United States. All of these funds are redeemable on a monthly basis with less than 30 days notice.

Global fixed income funds – includes one investment in a limited partnership that invests in high yield bonds, short-term and intermediate-term corporate bonds and other corporate fixed income obligations. This investment may be redeemed on a monthly basis with 30 days notice for partial withdrawals, and 60 days notice for full withdrawals.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 4 - Fair Value Measurements (Continued)

Absolute return funds – includes investments in actively managed portfolios that aim to achieve positive annual returns relative to broad equity market indices. These funds invest primarily in equity and equity-related securities in both U.S. and non-U.S. markets, and to a lesser extent in fixed income securities in both U.S. and non-U.S. markets. These investments utilize many different investment strategies, including long and short positions, derivatives and leverage. Approximately 51% of these assets are locked up until August of 2010, after which the investment is redeemable on a quarterly basis with 45 days notice. Approximately 45% is redeemable annually on July 1 with 90 days notice. The remaining 5% of this category relates to a manager holdback of proceeds from liquidation of an investment; this amount is scheduled to be received 15 days after the completion of audited financial statements.

Real asset commingled trusts – includes one investment in a commingled pool of investments in multiple specific investment strategies with a target allocation of 40% to energy equities, 15% to metals and mining equities, 25% in commodities and 20% in fixed income assets. Within each segment, positions may be concentrated in specific sectors or regions. The investment is redeemable on a monthly basis with 7 days notice.

Private company equity – includes participating senior common stock in a private company that provides investment advisory, management and investor services for a range of collective investment vehicles and separately managed accounts for individual and institutional customers. Ownership of these shares is limited to certain groups of permitted holders, including persons employed by the company, its subsidiaries or other organizations with a continuing business relationship with the company, their personal representatives and charities.

Diversified fund-of-funds – includes one limited partnership investment that operates as an offshore feeder fund in a master-feeder type structure. The master fund is a multi-manager, multi-strategy fund-of-funds formed to invest predominantly in partnerships and similar pooled investment vehicles.

Real estate limited partnerships – includes investments in private equity funds that invest primarily in a diversified portfolio of income producing properties. The partnership has invested in a geographically diversified portfolio of real estate investments, principally industrial, office, residential and retail properties. These investments are not redeemable; instead, distributions will be received as the underlying investments of the fund are liquidated. It is estimated that the underlying assets of the fund will be liquidated over the next eight to nine years.

Private equity – includes one private equity fund that invests in a pooled investment vehicle that makes venture investments in mezzanine situations. The investment is not redeemable; instead, the fund will terminate at the end of the term of the underlying investments. The Museum has an outstanding capital commitment to the fund of \$480,000.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 4 - Fair Value Measurements (Continued)

Fair values of financial instruments for which the Museum did not elect the fair value option includes cash and cash equivalents, receivables, mortgages, accounts payable and bonds payable. Mortgages were considered insignificant so management did not estimate the fair value. Fair value of the bonds payable was determined to approximate their carrying value. Different assumptions could significantly affect these estimated fair values. Accordingly, the net realizable values could be materially different from the estimates at December 31, 2009. In addition, the estimates are only indicative of the value of individual financial instruments and should not be considered an indication of the fair value of the Museum.

Note 5 - Land, Buildings and Equipment

Land, buildings and equipment are carried at cost and consist of the following at December 31:

	<i>2009</i>	<i>2008</i>
Land and buildings	\$ 84,552,263	\$ 84,552,263
Capital improvements	19,594,078	19,530,983
Furniture, fixtures and equipment	12,584,026	13,303,799
Period houses	999,528	999,528
	<hr/>	<hr/>
Total	117,729,895	118,386,573
Accumulated depreciation	(35,538,972)	(32,384,985)
	<hr/>	<hr/>
Total	82,190,923	86,001,588
Construction in progress	22,500	156,000
	<hr/>	<hr/>
Land, buildings and equipment, net	\$ 82,213,423	\$ 86,157,588

Depreciation expense was \$4,243,582 and \$4,326,125 for the years ended December 31, 2009 and 2008, respectively.

Note 6 - Collections and Works of Art

The Museum's collections are made up of works of art and artifacts of historical, cultural and scientific significance that are held for curatorial, educational and research purposes. Each of the items is cataloged, preserved and cared for, and activities verifying their existence and assessing their condition are performed continuously. The collections are subject to a policy that requires proceeds from their sales to be used to acquire other items for collections.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 7 - Defined Contribution Plan

The Museum has a defined contribution plan covering all eligible employees. Employees become eligible to participate after completing one year of service and attaining the age of 21. The Museum contributes 6% (and in some cases higher amounts) of each eligible employee's annual salary. Contributions made by the Museum for the years ended December 31, 2009 and 2008 were \$634,805 and \$637,857, respectively.

Note 8 - Bonds Payable

Bonds payable consisted of the following for the years ended December 31:

	2009	2008
Massachusetts Health and Education Facilities Authority Peabody Essex Museum Issue, Series 2002 Revenue Bonds, interest payable monthly at a variable rate of 1.01% and 3.31 %, respectively, principal due in annual installments through 2033	\$ <u>32,210,000</u>	\$ <u>33,110,000</u>

Principal payments are due as follows:

2010	\$ 925,000
2011	975,000
2012	1,000,000
2013	1,025,000
2014	1,075,000
Thereafter	<u>27,210,000</u>
	<u>\$ 32,210,000</u>

Payments on the bonds are guaranteed under a direct pay letter of credit issued by Bank of America. The letter of credit expires on July 1, 2010 at which time it must be renewed. The Museum is obligated, under a reimbursement agreement with the bank, to repay any drawings under the letter of credit. Under the terms of the reimbursement agreement, the Museum is subject to certain restrictive covenants involving financial results, additional indebtedness and the maintenance of certain financial ratios. The covenants were revised in fiscal year 2009. The more restrictive covenants require that the Museum maintain a cash flow available for debt service of \$1 or greater and that the Museum's unrestricted cash combined with unrestricted and temporarily restricted investments be 1.75 times the funded debt. As of December 31, 2009 and 2008, the Museum was in compliance with its debt covenants.

Total bond interest expense including the effects of the swap was \$1,273,588 and \$1,260,718 in 2009 and 2008, respectively.

Letter of credit fees and bond administration and remarketing fees were \$210,306 and \$198,382 for the years ended December 31, 2009 and 2008, respectively.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 9 - Derivative Instruments

In March 2005, the Museum entered into an interest rate swap to manage its exposure to interest rate risk associated with the Museum's variable rate debt. The Museum accounts for its derivative instruments in accordance with the standards for derivative instruments and hedging activities. The guidance provides that derivative instruments be classified as either assets or liabilities at fair value in the statement of financial position. The Museum has reflected the change in the fair value of the swap agreement as a nonoperating item in the statement of activities. The swap agreement, with a notional amount of \$33,225,000, matures on April 2, 2015. The Museum pays a fixed rate of 3.865% and receives a monthly average of the Securities Industry and Financial Markets Association index rate which was 0.250% at December 31, 2009. As of December 31, 2009, the Museum had recorded in the statement of activities as a nonoperating item a gain of \$719,515 related to the fair value of the interest rate swap. As of December 31, 2008, the Museum had recorded in the statement of activities as a nonoperating item a loss of \$1,877,101 related to the fair value of the interest rate swap.

Note 10 - Net Assets and Endowment Matters

Unrestricted Net Assets

Unrestricted net assets are comprised of the following:

Fixed assets - The value of buildings and equipment, net of depreciation, used in the Museum's operations. This amount is offset by outstanding liabilities related to the assets, such as bond debt.

Board-designated - Funds set aside by the Board of Trustees for strategic purposes and to provide investment income to support operations. These amounts may only be used with the approval of the Board of Trustees.

Operating - Discretionary funds available for carrying on the operating activities of the Museum.

	<i>2009</i>	<i>2008</i>
Fixed assets	\$ 46,541,079	\$ 47,886,356
Board-designated:		
Functioning as endowment	9,849,700	8,733,945
Not functioning as endowment	31,272,216	27,307,360
Operating	<u>1,259,300</u>	<u>1,374,709</u>
	<u>\$ 88,922,295</u>	<u>\$ 85,302,370</u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 10 - Net Assets and Endowment Matters (Continued)

Temporarily Restricted Net Assets

Temporarily restricted net assets are comprised of the following:

Unrealized/realized gains on permanently restricted investments - In accordance with standards for accounting for investments and endowment funds held by not-for-profit organizations and with Massachusetts state law, these amounts represent unappropriated gains on permanently restricted endowment investments.

Purpose restricted - Amounts received with donor restrictions which have not yet been expended for their designated purposes.

Time restricted - Amounts designated by donors for use in future periods.

Split-interest agreements - Assets under split-interest agreements for which the use of the remainder interest is stipulated by the donor.

Funds held by others - Funds held in trust where the annual distribution of income is restricted in use by the donor.

	<i>2009</i>	<i>2008</i>
Unrealized and realized gains on permanently restricted investments:		
General support	\$ 35,129,198	\$ 24,428,139
Restricted	9,593,219	7,493,894
Purpose restricted	16,745,565	17,400,743
Time restricted	3,411,954	5,244,396
Split-interest agreements	265,119	231,102
Funds held by others	<u>227,959</u>	<u>72,448</u>
	<u><u>\$ 65,373,014</u></u>	<u><u>\$ 54,870,722</u></u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 10 - Net Assets and Endowment Matters (Continued)

Permanently Restricted Net Assets

Permanently restricted net assets are comprised of the following:

Endowment principal - Amounts restricted by donors against any expenditure of principal. Substantially all the income earned on principal may be used for general or donor-restricted purposes and is recorded in unrestricted net assets or temporarily restricted net assets, as appropriate.

Funds held by others - Assets held in trust in perpetuity for which the Museum is the beneficiary of annual distributions of income.

Split-interest agreements - Assets under split-interest agreements for which the remainder interest is permanently restricted by the donor.

	<i>2009</i>	<i>2008</i>
Endowment principal:		
General support	\$ 76,006,515	\$ 63,614,490
Restricted	9,524,902	9,461,223
Pledges receivable	6,238,945	3,887,861
Funds held by others	3,589,946	3,260,994
Split-interest agreements	85,669	59,577
Other	999,528	999,528
	<u>\$ 96,445,505</u>	<u>\$ 81,283,673</u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 10 - Net Assets and Endowment Matters (Continued)

The following represents required disclosure relative to the composition and activities of endowment and funds functioning as endowment for the year ended December 31, 2009:

	<i>Unrestricted Net Assets</i>	<i>Temporarily Restricted Net Assets</i>	<i>Permanently Restricted Net Assets</i>	<i>Total</i>
Endowment assets and those functioning as endowment assets, beginning of year	\$ <u>8,733,945</u>	\$ <u>31,922,033</u>	\$ <u>81,283,673</u>	\$ <u>121,939,651</u>
Gifts and additions	<u>-</u>	<u>-</u>	<u>14,576,986</u>	<u>14,576,986</u>
Investment returns:				
Interest and dividends, net of investment expenses	219,303	2,509,290	30,406	2,758,999
Net realized and unrealized gains (losses)	<u>1,514,299</u>	<u>15,157,232</u>	<u>554,440</u>	<u>17,225,971</u>
Total investment returns	<u>1,733,602</u>	<u>17,666,522</u>	<u>584,846</u>	<u>19,984,970</u>
Expenditures:				
Amounts appropriated for operations	<u>(617,847)</u>	<u>(4,866,138)</u>	<u>-</u>	<u>(5,483,985)</u>
Change in investments	<u>1,115,755</u>	<u>12,800,384</u>	<u>15,161,832</u>	<u>29,077,971</u>
Endowment assets and those functioning as endowment assets, end of year	\$ <u><u>9,849,700</u></u>	\$ <u><u>44,722,417</u></u>	\$ <u><u>96,445,505</u></u>	\$ <u><u>151,017,622</u></u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 10 - Net Assets and Endowment Matters (Continued)

The following represents required disclosure relative to the composition and activities of endowment and funds functioning as endowment for the year ended December 31, 2008:

	<i>Unrestricted Net Assets</i>	<i>Temporarily Restricted Net Assets</i>	<i>Permanently Restricted Net Assets</i>	<i>Total</i>
Endowment assets and those functioning as endowment assets, beginning of year	\$ <u>3,635,380</u>	\$ <u>72,195,493</u>	\$ <u>74,618,367</u>	\$ <u>150,449,240</u>
Gifts and additions	<u>1,347,100</u>	<u>-</u>	<u>3,683,251</u>	<u>5,030,351</u>
Investment returns:				
Interest and dividends, net of investment expenses	503,295	4,346,356	28,068	4,877,719
Net realized and unrealized gains (losses)	<u>(3,594,166)</u>	<u>(29,299,274)</u>	<u>(1,010,449)</u>	<u>(33,903,889)</u>
Total investment returns	<u>(3,090,871)</u>	<u>(24,952,918)</u>	<u>(982,381)</u>	<u>(29,026,170)</u>
Expenditures:				
Amounts appropriated for operations	<u>(575,219)</u>	<u>(3,938,551)</u>	<u>-</u>	<u>(4,513,770)</u>
Change in investments	<u>(2,318,990)</u>	<u>(28,891,469)</u>	<u>2,700,870</u>	<u>(28,509,589)</u>
Reclassifications:				
Reclassification of net assets	<u>7,417,555</u>	<u>(11,381,991)</u>	<u>3,964,436</u>	<u>-</u>
Endowment assets and those functioning as endowment assets, end of year	\$ <u>8,733,945</u>	\$ <u>31,922,033</u>	\$ <u>81,283,673</u>	\$ <u>121,939,651</u>

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 10 - Net Assets and Endowment Matters (Continued)

Interpretation of Relevant Law and Spending Policy

The Attorney General of Massachusetts has issued written guidance that all gains on permanently restricted endowment funds that have not been appropriated in accordance with the law should be classified as temporarily restricted net assets unless otherwise restricted by the donor.

State law allows the Board of Trustees to appropriate a percentage of net appreciation as is prudent considering the Museum's long- and short-term needs, present and anticipated financial requirements and expected total return on its investments, price level trends and general economic conditions. The Museum's endowment spending policy is computed based on the average market value for the previous 12 quarters, excluding Board designated funds that do not function as endowment, through September 30 of the prior year. The percentage spent was 5% for the years ended December 31, 2009 and 2008.

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 requires the Museum to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted are \$257,326 and \$2,419,707 as of December 31, 2009 and 2008, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions.

Return Objectives and Risk Parameters

The Museum's investment portfolio is managed to provide for the long-term support of the Museum. Accordingly, these funds are managed with disciplined longer-term investment objectives and strategies designed to meet cash flow and spending requirements. Management of the assets is designed to attain the maximum total return consistent with acceptable and agreed upon levels of risk. The target is to achieve an average annual real total return (net of investment management fees and inflation) of at least 5% when measured over rolling periods of not less than five years.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Museum relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Museum targets an asset allocation strategy wherein assets are diversified among several asset classes. The pursuit of maximizing total return is tempered by the need to minimize the volatility of returns and preserve capital. As such, the Museum seeks broad diversification among assets having different characteristics with the intent to endure lower relative performance in strong markets in exchange for greater downside protection in weak markets.

PEABODY ESSEX MUSEUM, INC.

Notes to Financial Statements

Note 11 - Commitments and Contingencies

The Museum continues to carry a liability associated with environmental remediation costs associated with the migration of heating oil on its property. Management expects to incur the balance of these costs during the 2010 fiscal year. The Museum believes that its adjusted reserves for these costs are adequate. The Museum is seeking to recover these costs through insurance coverage, but it is not possible to estimate the amount of recovery at this time.

The Museum is involved in legal actions in the ordinary course of business. In the opinion of management, there are no legal proceedings pending against or involving the Museum whose outcome is likely to have a material adverse effect upon the statements of financial position, statements of activities, changes in net assets and the statements of cash flows of the Museum.

Note 12 - Related Party Transactions

The Museum has a mortgage receivable bearing interest at 6% annually from an officer of the Museum for \$197,316 at December 31, 2009 and 2008.

Certain members of the Museum's Board are employed by firms that provide legal services to the Museum. Aggregate payments under these arrangements were \$8,306 and \$45,815 for the years ended December 31, 2009 and 2008, respectively.