

Financial Statements

The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner

June 30, 2012 and 2011



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

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Financial Statements

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Independent Auditors' Report

To the Trustees of The Isabella Stewart Gardner Museum, Incorporated
Trustee under the Will of Isabella Stewart Gardner
Boston, Massachusetts

We have audited the accompanying statements of financial position of The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner (the "Museum") as of June 30, 2012 and 2011 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, assessing the accounting principles used and significant estimates made by management, and 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 Museum as of June 30, 2012 and 2011, 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.

December 10, 2012
Boston, Massachusetts

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statements of Financial Position

	<i>June 30,</i>	
	<i>2012</i>	<i>2011</i>
Assets		
Cash and cash equivalents	\$ 3,588,304	\$ 2,478,501
Receivables:		
Pledges receivable, net	9,548,188	11,422,165
Contributions receivable from remainder trusts	2,036,260	2,058,807
Other receivables	1,913,850	812,002
Total receivables, net	13,498,298	14,292,974
Inventory	228,193	101,579
Prepaid and other assets	640,799	664,946
Unexpended bond proceeds	-	811,351
Short-term investments	10,771,003	27,804,140
Museum property:		
Building improvements and other museum property	131,944,264	15,847,434
Construction in progress	106,804	90,839,699
	132,051,068	106,687,133
Less - accumulated depreciation	(15,897,829)	(12,420,298)
	116,153,239	94,266,835
Historic building, contents and land	4,482,944	4,482,944
Total museum property	120,636,183	98,749,779
Investments of endowed funds, at fair value	115,423,861	114,590,285
Total assets	\$ 264,786,641	\$ 259,493,555
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses:		
Accrued pension expense	\$ 834,749	\$ 710,198
Accounts payable and other accrued expenses	5,964,886	6,973,847
Total accounts payable and accrued expenses	6,799,635	7,684,045
Deferred income	172,480	2,926
Bonds payable	35,000,000	35,000,000
Unamortized premium on bonds payable	1,037,759	1,190,175
Total liabilities	43,009,874	43,877,146
Net assets:		
Unrestricted	91,898,197	72,759,304
Temporarily restricted	65,107,057	87,098,547
Permanently restricted	64,771,513	55,758,558
Total net assets	221,776,767	215,616,409
Total liabilities and net assets	\$ 264,786,641	\$ 259,493,555

See accompanying notes to the financial statements.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statements of Activities

Years Ended June 30,

	2012				2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and other support:								
Sales and services:								
Admissions	\$ 1,487,183	\$ -	\$ -	\$ 1,487,183	\$ 1,041,901	\$ -	\$ -	\$ 1,041,901
Museum shop	449,452	-	-	449,452	292,502	-	-	292,502
Café	61,128	-	-	61,128	24,482	-	-	24,482
Corporate events	292,902	-	-	292,902	21,435	-	-	21,435
Concert ticket sales	130,062	-	-	130,062	84,966	-	-	84,966
Other	40,376	-	-	40,376	50,411	-	-	50,411
	<u>2,461,103</u>	<u>-</u>	<u>-</u>	<u>2,461,103</u>	<u>1,515,697</u>	<u>-</u>	<u>-</u>	<u>1,515,697</u>
Contributed, membership and pledged support:								
Grants and gifts	987,650	11,650,778	9,012,955	21,651,383	456,000	13,413,486	477,955	14,347,441
Satisfaction and changes of restricted grants and gifts	26,971,103	(26,971,103)	-	-	41,611,553	(41,611,553)	-	-
Annual appeal	1,821,097	-	-	1,821,097	1,793,058	-	-	1,793,058
Membership	799,864	-	-	799,864	302,828	-	-	302,828
Member and special events	853,179	-	-	853,179	554,525	-	-	554,525
	<u>31,432,893</u>	<u>(15,320,325)</u>	<u>9,012,955</u>	<u>25,125,523</u>	<u>44,717,964</u>	<u>(28,198,067)</u>	<u>477,955</u>	<u>16,997,852</u>
Investments:								
Investment income and net appreciation	(191,630)	(2,356,608)	-	(2,548,238)	1,913,755	16,894,134	-	18,807,889
Allocation of endowment income	4,314,557	(4,314,557)	-	-	4,141,033	(4,141,033)	-	-
	<u>4,122,927</u>	<u>(6,671,165)</u>	<u>-</u>	<u>(2,548,238)</u>	<u>6,054,788</u>	<u>12,753,101</u>	<u>-</u>	<u>18,807,889</u>
Total revenue and other support	<u>38,016,923</u>	<u>(21,991,490)</u>	<u>9,012,955</u>	<u>25,038,388</u>	<u>52,288,449</u>	<u>(15,444,966)</u>	<u>477,955</u>	<u>37,321,438</u>
Expenses:								
Security and visitor services	1,815,758	-	-	1,815,758	1,516,701	-	-	1,516,701
Museum shop	381,916	-	-	381,916	289,943	-	-	289,943
Café	14,237	-	-	14,237	8,955	-	-	8,955
Public programs	2,597,661	-	-	2,597,661	2,129,306	-	-	2,129,306
Collection, interpretation and conservation	1,135,484	-	-	1,135,484	752,360	-	-	752,360
Development and external relations	2,869,759	-	-	2,869,759	2,618,609	-	-	2,618,609
Administration	2,528,897	-	-	2,528,897	2,381,133	-	-	2,381,133
Special projects	1,513,483	-	-	1,513,483	706,113	-	-	706,113
Facilities and maintenance	1,371,538	-	-	1,371,538	946,389	-	-	946,389
Depreciation	3,541,352	-	-	3,541,352	776,378	-	-	776,378
Interest expense	983,394	-	-	983,394	-	-	-	-
	<u>18,753,479</u>	<u>-</u>	<u>-</u>	<u>18,753,479</u>	<u>12,125,887</u>	<u>-</u>	<u>-</u>	<u>12,125,887</u>
Change in net assets before adjustments	19,263,444	(21,991,490)	9,012,955	6,284,909	40,162,562	(15,444,966)	477,955	25,195,551
Net asset transfers	-	-	-	-	-	-	-	-
Pension expense (credit) excluding current year contributions and administrative costs	(124,551)	-	-	(124,551)	358,672	-	-	358,672
Total change in net assets	19,138,893	(21,991,490)	9,012,955	6,160,358	40,521,234	(15,444,966)	477,955	25,554,223
Net assets, beginning of year	72,759,304	87,098,547	55,758,558	215,616,409	32,238,070	102,543,513	55,280,603	190,062,186
Net assets, end of year	\$ 91,898,197	\$ 65,107,057	\$ 64,771,513	\$ 221,776,767	\$ 72,759,304	\$ 87,098,547	\$ 55,758,558	\$ 215,616,409

See accompanying notes to the financial statements.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Statements of Cash Flows

	<i>Years Ended June 30,</i>	
	<i>2012</i>	<i>2011</i>
Cash flows from operating activities:		
Change in net assets	\$ 6,160,358	\$ 25,554,223
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	3,477,531	779,039
Contributions and change in value of remainder trusts	22,547	(334,251)
Net realized and unrealized gains on investments	2,371,534	(18,866,561)
Changes in:		
Pledges and other receivables	772,129	2,782,861
Inventory	(126,614)	132,613
Prepaid and other assets	24,148	72,169
Accounts payable and accrued expenses	466,259	(387,369)
Deferred income	169,554	(12,358)
Restricted contributions	(22,560,256)	(16,448,554)
	<u>(9,222,810)</u>	<u>(6,728,188)</u>
Net cash used in operating activities	(9,222,810)	(6,728,188)
Cash flows from investing activities:		
Expenditures for museum property	(26,867,019)	(42,588,058)
(Purchase) sale of short-term investments	17,844,487	28,017,653
Purchase of long-term investments	(20,853,829)	(13,000,004)
Proceeds from sale of investments	17,648,720	17,204,191
	<u>(12,227,641)</u>	<u>(10,366,218)</u>
Net cash used in investing activities	(12,227,641)	(10,366,218)
Cash flows from financing activities:		
Proceeds from contributions restricted for:		
Endowment	8,403,316	612,550
Plant and other	14,156,940	15,836,004
Other financing activities:		
Proceeds from bond issuance	-	-
	<u>22,560,256</u>	<u>16,448,554</u>
Net cash provided by financing activities	22,560,256	16,448,554
Net change in cash and cash equivalents	1,109,805	(645,852)
Cash and cash equivalents, beginning of year	<u>2,478,501</u>	<u>3,124,353</u>
Cash and cash equivalents, end of year	\$ <u>3,588,306</u>	\$ <u>2,478,501</u>
Supplemental disclosures:		
Cash paid for interest	\$ <u>1,627,513</u>	\$ <u>1,627,513</u>

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies

The Isabella Stewart Gardner Museum, Incorporated (the “Museum”) is the sole trustee under the will of Isabella Stewart Gardner. The Museum owns the property that is located at 280 The Fenway, Boston, Massachusetts, as well as Mrs. Gardner’s art collection contained therein. The Museum Corporation operates the Museum, which is open to the public and includes three floors of artwork, a garden, a cafe and a gift shop. The following is a summary of the significant accounting policies of the Museum.

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis and in accordance with the reporting principles of not-for-profit accounting. Resources are classified into separate net asset classes in accordance with donor-imposed restrictions and legal restrictions under Massachusetts law. The categories unrestricted, temporarily restricted, and permanently restricted net assets are defined as follows:

Unrestricted

Unrestricted net assets are resources over which the Trustees have discretionary control. The Museum records its property and equipment, other than its historical treasures, in this category because there are no time or use restrictions on the use of these assets.

Temporarily Restricted

Temporarily restricted net assets are those resources subject to donor-imposed restrictions which will be satisfied by the actions of the Museum or the passage of time. Appreciation on permanently restricted net assets is recorded in temporarily restricted net assets and may be expended under the terms of the gift instrument or, in the absence of specific terms, in accordance with Massachusetts law.

Permanently Restricted

Permanently restricted net assets are those resources subject to the donor-imposed restriction that they be maintained permanently by the Museum. The donors of these resources require that the principal be invested in perpetuity and permit the income earned, including appreciation, to be used, all or in part, for unrestricted or temporarily restricted purposes. The Museum has shown its historical treasures in this category because of their restricted use imposed by the will of Isabella Stewart Gardner.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market accounts. These assets are stated at cost, which approximates fair value. Cash and cash equivalents held by investment managers are considered part of investment balances. The Museum may hold amounts at a single financial institution in excess of federally insured limits. The Museum monitors its exposure associated with cash and cash equivalents and has not experienced any losses in such accounts.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies (Continued)

Pledges, Grants and Gifts and Annual Funds

Unconditional promises to give are recorded at fair value when initially pledged. Pledges that are expected to be collected in more than one year are recorded at present value using a risk-adjusted rate to account for the inherent risk associated with the expected future cash flows. Amortization of the discount is included in gift and grant revenue. Unconditional promises to give are periodically reviewed to estimate an allowance for doubtful collections. Conditional promises to give are not included as revenue until the conditions are substantially met.

Contributions Receivable from Remainder Trusts

The Museum records the fair value of contributions from remainder trusts upon notification that it has an irrevocable interest in trust assets. The receivable is measured at the present value of estimated future cash flows and recorded presuming a time restriction plus the effects of any further donor restriction. Present values are updated annually for remaining life expectancies using the discount rates set when the contributions were initially recorded.

Inventories

Inventories for the Museum shop are recorded at the lower of average cost or market.

Museum Property

Museum property which existed in 1936 is stated at appraised values established as of December 24, 1936. Subsequent additions are stated at cost. The Museum capitalizes renovations and other additions that materially add to the value of the related assets and extend their useful lives. Equipment and furnishings of relatively small dollar amounts are expensed.

Depreciation of property, plant and equipment is computed using the straight-line method based on estimates of useful lives. The estimated useful lives are principally 10 to 40 years for buildings and improvements and 3 to 10 years for other property. Depreciation for construction in progress begins upon completion of the related project. For more information regarding the Museum's fixed assets, see Note 3 - Fixed Assets.

Investments

Investments are carried at fair value. Interest, dividends and net gains or losses on investments are reported as increases or decreases in permanently restricted net assets if the terms of the original gift require that they be applied to the principal of a permanent endowment fund; as increases or decreases in temporarily restricted net assets if the terms of the gift and/or relevant state law impose restrictions on the current use of the income or net gains and losses; and as increases or decreases in unrestricted net assets in all other cases. For more information on the fair value of the Museum's investments, see Note 5.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies (Continued)

Fair Value Measurements

The Museum reports certain assets and liabilities at fair value on a recurring and non-recurring basis depending on the underlying accounting policy for the particular item. Recurring fair value measures include contributions receivable from remainder trusts, unexpended bond proceeds, and both short-term investments and investments of endowed funds. Non-recurring measures include pledges receivable.

Fair value standards require an entity to maximize the use of observable inputs (such as quoted market prices in active markets) and minimize the use of unobservable inputs (such as appraisals or other valuation techniques) to determine fair value. The Museum reports certain investments under the so-called “practical expedient” rule, which allows net asset value per share to represent fair value for reporting purposes when the criteria for using this method are met. Fair value standards require the Museum to categorize its financial instruments into a three-level hierarchy based on the priority of inputs to the valuation technique and based on liquidity provisions, as discussed below.

Level 1 – Quoted prices are available in active markets for identical instruments as of the reporting date. Instruments which are generally included in this category include 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. Level 2 assets include investments reported at net asset value per share with withdrawal restrictions of six months or less.

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. Level 3 assets include investments reported at net asset value per share with withdrawal restrictions of more than six months.

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.

Market price is affected by a number of factors, including the type of instrument and the characteristics specific to the instrument. Instruments with readily available actively quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. It is reasonably possible that changes in values of these instruments will occur in the near term and that such changes could materially affect amounts reported in these financial statements. For more information on the fair value of the Museum’s financial instruments, see Note 5 - Fair Values of Financial Instruments.

Revenue Recognition

The Museum’s revenues from sales and services are recognized when earned which in most cases is when paid for.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 1 - Description of Organization and Summary of Significant Accounting Policies (Continued)

Income Taxes

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.

The Museum has determined that its status as a tax exempt entity is not an uncertain tax position within the meaning of generally accepted accounting principles for its open tax years. The Museum's Federal and state income tax returns are generally open for examination for 3 years following the date filed.

Use of Estimates in the Preparation of Financial Statements

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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant management estimates include reserves for doubtful pledges, discounts on pledges receivable, fair value of certain investments, useful lives of depreciable assets, and pension plan assumptions. Actual results could differ from those estimates.

Subsequent Events

The Museum has evaluated subsequent events through December 10, 2012, the date the financial statements were issued.

Reclassifications

Certain reclassifications have been made to amounts in prior year's financial statements to conform to current year presentation. There is no effect on previously reported net assets.

Note 2 - Pledges Receivable

Unconditional promises to give (pledges receivable) which are expected to be collected within one year are recorded at their net realizable value. Pledges receivable that are expected to be collected in future years are recorded at the present value of estimated future cash flows, measured at a discount rate of 5%.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 2 - Pledges Receivable (Continued)

The Museum had the following pledges receivable outstanding at June 30:

	<i>2012</i>	<i>2011</i>
Temporarily restricted non-operating support	\$ 9,455,209	\$ 12,212,511
Permanently restricted endowment	1,044,044	500,000
	10,499,253	12,712,511
Less: unamortized discount	(426,102)	(654,720)
Less: allowance for uncollectibles	(524,963)	(635,626)
	\$ 9,548,188	\$ 11,422,165
Amounts due in:		
Less than one year	\$ 4,503,371	\$ 3,589,025
One to five years	5,995,882	9,123,486
	\$ 10,499,253	\$ 12,712,511

In addition to the unconditional pledges receivable referenced above, the Museum had gross conditional pledges receivable of approximately \$33 million and \$38 million as of June 30, 2012 and 2011, respectively.

Note 3 - Fixed Assets

In January 2012, the Museum opened to the public a new 70,000 square foot addition to its original building, designed to preserve the historic 1902 structure and alleviate pressures caused by years of use. The new wing includes purpose-built spaces for concerts, exhibitions, and classes, along with enhanced visitor amenities. The structure and contents will be depreciated over periods ranging from 10 to 40 years. For the year ended June 30, 2012, depreciation expense for the new wing was \$2,590,523. Total depreciation expenses in the years ended June 30, 2012 and 2011 were \$3,541,352 and \$776,378, respectively.

Note 4 - Investments of Endowed Funds

The Museum's endowed funds are managed by an Investment Committee made up of Trustees with investment experience and with assistance from professional investment consultants. The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain or enhance the purchasing power of the endowment assets.

The Museum employs external investment managers, with discretion to manage a designated portion of the portfolio to best achieve the investment objectives and requirements of the Museum under guidelines set forth in the Museum's written investment policy statement. The investment portfolio is designed to provide a consistent or enhanced level of support for the Museum's operations, with an average annual real total return (net of investment management fees) of at least 5% over the long term (rolling five-year periods). The Museum believes the investment management fees are comparable to the industry average, however, the fees have not been broken out as some fees are netted by the investment managers against the total investment returns.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 4 - Investments of Endowed Funds (Continued)

To satisfy its long-term rate-of-return objectives, the Museum diversifies its investment portfolio both by asset class (e.g., equities, bonds, cash equivalents, and other alternative investments) and within each asset class (e.g., within equities by economic sector/style, industry, quality, size, etc.). The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the total portfolio.

The Museum categorizes its investments into the following groups:

Equities:

Global Developed Equity – includes investments in funds that seek to achieve income and/or 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.

Emerging Markets Equity – includes investments in funds that seek to achieve income and/or capital appreciation through investments in equity-related securities and bonds of companies engaged in business in countries undergoing rapid growth and industrialization.

Fixed Income Funds

Cash and Cash Equivalents

Inflation Hedging:

Natural Resources – includes investments in funds that invest primarily in securities of global energy and natural resources companies, associated businesses and utilities.

Fixed Income Arbitrage – includes investments in funds that use a series of complex fixed income strategies combined with significant leverage to exploit inefficiencies in the global fixed income markets to produce absolute returns.

Marketable Alternatives:

Long/Short, Global Sector – includes investments in funds that seek to provide a long-term return in excess of that generated by the overall public equity markets while reducing the market risk of the portfolios through selective short positions.

Long/Short, Value Hedge – includes investments in funds that focus on securities which, due to market inefficiencies, trade at prices significantly below their intrinsic economic value.

Multi-Strategy, Event Driven – includes investments in funds that seek to achieve capital appreciation, with a focus on event-driven investments which seek to exploit situations in which announced or anticipated events create inefficiencies in the pricing of securities.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 4 - Investments of Endowed Funds (Continued)

Marketable Alternatives (Continued):

Multi-Strategy, Open Mandate – includes investments in funds that invest in various asset types and employ various investment objectives and methodologies.

Non-Marketable Assets:

Credit Opportunities – includes investments in funds that invest in distressed debt, mezzanine, structured products and special situations.

Hedge Fund of Funds – includes investments in funds that invest in private equity partnerships in the venture capital, buyout and capital restructuring sectors.

The Museum's endowment consists of about 100 individual funds established for a variety of purposes. These funds include both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments.

The Board of Trustees authorized the withdrawal of a portion of the cumulative investment return to support operating activities in the amounts of \$4,772,616 and \$4,615,578 in fiscal years ended June 30, 2012 and 2011, respectively. These amounts represent 5% of the 36-month rolling average market values of endowment funds for which market value exceeded historic cost at the time the withdrawal amount was authorized. The Board has authorized the withdrawal of \$5,225,000 for the fiscal year ending June 30, 2013.

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 net assets were \$7,105 and \$0 as of June 30, 2012 and 2011, respectively. The deficiency in 2012 resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted funds.

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 4 - Investments of Endowed Funds (Continued)

The change in the Museum's endowment assets was as follows for the years ended June 30:

	<i>2012</i>			
	<i>Unrestricted</i>	<i>Temporarily</i>	<i>Permanently</i>	<i>Total</i>
	<i>Net Assets</i>	<i>Restricted</i>	<i>Restricted</i>	
Endowments at beginning of year	\$ 10,278,910	\$ 55,241,588	\$ 49,014,125	\$ 114,534,623
Gifts and additions	-	-	8,403,316	8,403,316
Net investment gains	(257,333)	(2,372,588)	-	(2,629,921)
Amounts appropriated under endowment spending policy for operations	(457,389)	(4,315,228)	-	(4,772,617)
Reclassification for endowment losses exceeding corpus	(7,105)	7,105	-	-
Endowments at end of year	\$ 9,557,083	\$ 48,560,877	\$ 57,417,441	\$ 115,535,401
Balance due to (from) working capital				(111,540)
Total investments				\$ 115,423,861
	<i>2011</i>			
	<i>Unrestricted</i>	<i>Temporarily</i>	<i>Permanently</i>	
	<i>Net Assets</i>	<i>Restricted</i>	<i>Restricted</i>	<i>Total</i>
Endowments at beginning of year	\$ 9,038,166	\$ 42,429,612	\$ 48,401,575	\$ 99,869,353
Gifts and additions	-	50,000	612,550	662,550
Net investment gains	1,682,339	16,935,959	-	18,618,298
Amounts appropriated under endowment spending policy for operations	(474,545)	(4,141,033)	-	(4,615,578)
Reclassification for endowment losses exceeding corpus	32,950	(32,950)	-	-
Endowments at end of year	\$ 10,278,910	\$ 55,241,588	\$ 49,014,125	\$ 114,534,623
Balance due to (from) working capital				55,662
Total investments				\$ 114,590,285

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 5 - Fair Values of Financial Instruments

The following tables present financial assets at June 30, 2012 and 2011 that the Museum measures at fair value on a recurring basis, by level within the fair value hierarchy:

	2012			
	Level 1	Level 2	Level 3	
	Market	Observable	Management	
	Prices	Inputs	Judgment	Total
Global Developed Equity	\$ -	\$ 26,921,347	\$ -	\$ 26,921,347
Emerging Markets Equity	3,621,869	4,421,265	-	8,043,134
Total Equities	3,621,869	31,342,612	-	34,964,481
Fixed Income Funds	3,080,629	-	-	3,080,629
Cash & Cash Equivalents	9,430,753	-	-	9,430,753
Natural Resources	4,976,767	-	-	4,976,767
Fixed Income Arbitrage	-	1,929,478	3,858,956	5,788,434
Total Inflation Hedging	4,976,767	1,929,478	3,858,956	10,765,201
Long/Short, Global Sector	-	71,030	7,625,280	7,696,310
Long/Short, Value Hedge	-	4,982,912	11,138,916	16,121,828
Multi-Strategy, Event Driven	-	3,844,745	-	3,844,745
Multi-Strategy, Open Mandate	-	19,661,894	6,534,655	26,196,549
Total Marketable Alternatives	-	28,560,581	25,298,852	53,859,433
Credit Opportunities	-	-	2,703,479	2,703,479
Hedge Fund of Funds	-	-	619,885	619,885
Total Non-Marketable Assets	-	-	3,323,364	3,323,364
Total Investments of Endowment Funds	\$ 21,110,018	\$ 61,832,671	\$ 32,481,172	\$ 115,423,861
Short-Term Investments				
Money Market Accounts	\$ 10,771,003	-	-	\$ 10,771,003

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 5 - Fair Values of Financial Instruments (Continued)

	<i>2011</i>			<i>Total</i>
	<i>Level 1 Market Prices</i>	<i>Level 2 Observable Inputs</i>	<i>Level 3 Management Judgment</i>	
Global Developed Equity	\$ -	\$ 30,742,551	\$ 33,643	\$ 30,776,194
Emerging Markets Equity	-	7,059,818	-	7,059,818
Total Equities	-	37,802,369	33,643	37,836,012
Fixed Income Funds	3,036,492	-	-	3,036,492
Cash & Cash Equivalents	5,739,575	-	-	5,739,575
Natural Resources	7,155,892	-	-	7,155,892
Fixed Income Arbitrage	-	1,786,402	3,572,805	5,359,207
Total Inflation Hedging	7,155,892	1,786,402	3,572,805	12,515,099
Long/Short, Global Sector	-	5,156,819	4,423,955	9,580,774
Long/Short, Value Hedge	-	4,921,936	5,910,779	10,832,715
Multi-Strategy, Event Driven	-	3,805,255	-	3,805,255
Multi-Strategy, Open Mandate	-	22,852,951	4,885,588	27,738,539
Total Marketable Alternatives	-	36,736,961	15,220,322	51,957,283
Credit Opportunities	-	-	2,715,269	2,715,269
Hedge Fund of Funds	-	-	790,555	790,555
Total Non-Marketable Assets	-	-	3,505,824	3,505,824
Total Investments of Endowment Funds	\$ 15,931,959	\$ 76,325,732	\$ 22,332,594	\$ 114,590,285
Short-Term Investments				
Money Market Accounts	\$ 27,804,140	\$ -	\$ -	\$ 27,804,140
Unexpended Bond Proceeds	\$ 811,351	\$ -	\$ -	\$ 811,351

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Notes to Financial Statements

Note 5 - Fair Values of Financial Instruments (Continued)

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

	<i>Equities</i>	<i>Inflation Hedging</i>	<i>Marketable Alternatives</i>	<i>Non- Marketable Assets</i>	<i>Total Level 3</i>
Balance as of July 1, 2010	\$ 32,357	\$ -	\$ 4,162,671	\$ 3,322,554	\$ 7,517,582
Net investment gain (loss)	1,286	239,472	197,980	573,234	1,011,972
Transfers from Level 2	-	-	2,955,115	-	2,955,115
Purchases	-	3,333,333	8,000,000	-	11,333,333
Redemptions and distributions	-	-	(95,444)	(389,964)	(485,408)
Balance as of June 30, 2011	<u>33,643</u>	<u>3,572,805</u>	<u>15,220,322</u>	<u>3,505,824</u>	<u>22,332,594</u>
Net investment gain (loss)	-	286,151	(102,045)	95,407	279,513
Transfers from Level 2	-	-	2,219,716	-	2,219,716
Purchases	-	-	8,000,000	-	8,000,000
Redemptions and distributions	(33,643)	-	(39,141)	(277,867)	(350,651)
Balance as of June 30, 2012	<u>\$ -</u>	<u>\$ 3,858,956</u>	<u>\$ 25,298,852</u>	<u>\$ 3,323,364</u>	<u>\$ 32,481,172</u>

The Museum holds certain investment instruments which are subject to withdrawal restrictions, including initial lock-in periods and specified exit dates with advance notification requirements. Any such investments that cannot be redeemed before January 1, 2013 are reported as Level 3 assets. Some investment managers maintain “side pockets” or designated illiquid investments, and such funds are reported as Level 3 assets. The net change in value of the “side pockets” is reported as “Transfers from Level 2” in the schedule above. The Museum has no commitments to invest additional funds as of the reporting date. The following investment balances were subject to withdrawal restrictions as of June 30, 2012:

<i>Next Available Exit Date</i>	<i>Equities</i>	<i>Inflation Hedging</i>	<i>Marketable Alternatives</i>	<i>Non- Marketable Assets</i>	<i>Total</i>
Awaiting Redemption	\$ -	\$ -	\$ 1,972,850	\$ -	\$ 1,972,850
On or before 12/31/2012	31,342,612	1,929,478	35,466,040	-	68,738,130
After 12/31/2012	-	3,858,956	16,420,543	-	20,279,499
Indeterminate	-	-	-	3,323,364	3,323,364
	<u>\$ 31,342,612</u>	<u>\$ 5,788,434</u>	<u>\$ 53,859,433</u>	<u>\$ 3,323,364</u>	<u>\$ 94,313,843</u>

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Notes to Financial Statements

Note 5 - Fair Values of Financial Instruments (Continued)

Management has determined that fair value approximates carrying value for cash and cash equivalents, prepaid assets, other receivables, accounts payable and accrued expenses. Management has no practical or cost effective way of determining fair value for pledges receivable. Fair value of bonds payable is discussed in Note 6 - Bonds Payable.

Note 6 - Bonds Payable

The Museum issued Massachusetts Health and Educational Facilities Authority Revenue Bonds, Series A (2009) in the amount of \$35,000,000. The bonds bear fixed interest rates ranging from 3% to 5%, and mature between May 1, 2013 and May 1, 2029. The bonds were issued at a premium of \$1,444,201, which is being amortized over the life of the bonds. Proceeds from the bond issuance are to be expended on (i) construction, furnishing, and equipping of a new museum building, and (ii) interior renovations to the existing museum building. The bonds are secured by all revenues of the Museum.

Costs of issuance of \$506,515 have been capitalized and are being amortized over the life of the bonds. Unamortized bond issuance costs are included in Prepaid and Other Assets.

Bond interest of \$1,627,513 was accrued and paid in each of the years ended June 30, 2012 and 2011. Bond premium of \$152,416 was amortized in each year. During the construction period of the new museum building, the net of these amounts was capitalized as construction period interest and added to the construction in progress cost of the building and renovations.

Scheduled maturities of the bonds are as follows:

2013	\$	1,440,000
2014		1,485,000
2015		1,525,000
2016		1,590,000
Thereafter		<u>28,960,000</u>
Total bonds payable	\$	<u>35,000,000</u>

As of June 30, 2012 and 2011, the fair value of the Museum's bonds payable approximated \$40 and \$38 million, respectively, based on quoted market prices for the same or similar issues. The fair value reflects what the Museum would have to pay a creditworthy third party to assume its obligation and does not reflect an additional liability to the Museum.

Unexpended bond proceeds at June 30, 2011 consisted of a capitalized interest fund set aside to pay debt service through May 31, 2012.

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Notes to Financial Statements

Note 7 - Defined Benefit Plan

The Museum has a defined benefit pension plan which it froze as of June 30, 2006. Management intends to terminate this plan in the future when it is administratively convenient to do so. A summary of the funded status of the plan is as follows as of June 30:

	<i>2012</i>	<i>2011</i>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 3,798,072	\$ 3,772,770
Interest cost	199,195	200,263
Benefits paid	(146,652)	(153,710)
Actuarial (gain)/loss	556,588	(21,251)
Benefit obligation at end of year	<u>4,407,203</u>	<u>3,798,072</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	3,087,874	2,703,900
Actual return on plan assets	231,232	137,684
Employer contributions	400,000	400,000
Benefits paid	(146,652)	(153,710)
Fair value of plan assets at end of year	<u>3,572,454</u>	<u>3,087,874</u>
Funded status at end of year	<u>(834,749)</u>	<u>(710,198)</u>
Total pension liability at end of year	\$ <u>(834,749)</u>	\$ <u>(710,198)</u>

The following assumptions were used to determine the benefit obligation at June 30:

	<i>2012</i>	<i>2011</i>
Discount rate	4.25%	5.50%
Expected return on plan assets	6.00%	6.00%

The Museum contributed approximately \$300,000 to the plan during the year ended June 30, 2012.

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Notes to Financial Statements

Note 7 - Defined Benefit Plan (Continued)

The following benefit payments are expected to be paid during the fiscal years ending June 30:

2013	\$	178,000
2014		178,000
2015		209,000
2016		220,000
2017		221,000
2018-2022		1,226,000

The Museum's plan assets were comprised of the following at June 30:

	<u>2012</u>		<u>2011</u>			
Cash and cash equivalents	\$	817,182	23%	\$	641,126	21%
Fixed income		2,510,605	70%		2,446,748	79%
Equities		244,667	7%		-	0%
Fair value of plan assets	\$	<u>3,572,454</u>	100%	\$	<u>3,087,874</u>	100%

All investments held by the plan at June 30, 2012 and 2011 were Level 1 assets.

Note 8 - Defined Contribution Plan

The Museum has a 403(b) retirement plan in which eligible employees may invest a portion of their compensation. Eligibility is based on the length of service. Employer contributions into the plan on behalf of eligible employees are discretionary and vest over a two year period. Employer contributions made under this plan totaled \$201,420 and \$214,091 during fiscal years ended June 30, 2012 and 2011, respectively.

Note 9 - Net Assets

Unrestricted net assets include the following categories as of June 30:

	<u>2012</u>		<u>2011</u>	
Operating	\$	1,778,713	\$	1,683,931
Board-designated		10,096,725		10,693,773
Property		80,022,759		60,381,600
Total	\$	<u>91,898,197</u>	\$	<u>72,759,304</u>

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Notes to Financial Statements

Note 9 - Net Assets (Continued)

Operating fund activity was as follows for the years ended June 30:

	<i>2012</i>	<i>2011</i>
Sales and services	\$ 2,461,103	\$ 1,515,697
Contributed income	5,119,500	3,970,254
Allocation of endowment	4,772,616	4,615,578
Expenses	(12,008,437)	(9,879,358)
Transfers to operating reserve	<u>(250,000)</u>	<u>(150,000)</u>
Operating net surplus	\$ <u>94,782</u>	\$ <u>72,171</u>

Temporarily restricted net assets include the following categories as of June 30:

	<i>2012</i>	<i>2011</i>
Accumulated unspent gains on endowments:		
Not designated for specific purpose	\$ 39,470,702	\$ 43,619,143
Designated for operating activities	<u>8,505,187</u>	<u>11,085,067</u>
Total unspent gains on endowments (subject to Trustee appropriation)	47,975,889	54,704,210
Gifts and grants designated for operating activities	1,566,544	1,375,904
Gifts and grants designated for non-operating activities	6,851,304	19,798,950
Pledges receivable designated for non-operating activities	8,607,286	10,993,650
Contributions receivable from remainder trusts	<u>106,034</u>	<u>225,833</u>
Temporarily restricted net assets	\$ <u>65,107,057</u>	\$ <u>87,098,547</u>

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Notes to Financial Statements

Note 9 - Net Assets (Continued)

Permanently restricted net assets are restricted as follows as of June 30:

	<i>2012</i>	<i>2011</i>
Endowed assets designated for the following purposes:		
Undesignated purposes	\$ 17,058,770	\$ 15,268,477
Curatorial programs and curator	8,619,814	8,619,814
Education programs and educator	3,815,211	3,815,211
Music, contemporary, and horticulture programs	2,563,366	2,553,366
Collection conservation and building preservation	20,102,880	13,499,857
Other purposes, pledges, and charitable remainder trusts	8,128,528	7,518,889
Investment in perpetuity, the income from which is expendable (with appreciation recorded as temporarily restricted)	60,288,569	51,275,614
Historical treasures	4,482,944	4,482,944
Permanently restricted net assets	\$ 64,771,513	\$ 55,758,558

Note 10 - Restrictions on Operating Surplus

The Trustees are directed, under the will of Isabella Stewart Gardner, to pay to certain designated hospitals any surplus of income that, in the opinion of the Director and Trustees, will not be needed for the proper and reasonable maintenance of the Museum. These amounts, if any, are payable at the end of successive five-year periods, the most recent of which ended on December 31, 2009. The Trustees have determined that excesses, if any, are needed for the proper and reasonable maintenance of the Museum.

Note 11 - Functional Expenses

The following summarizes the functional expenses for the year ended June 30:

	<i>2012</i>	<i>2011</i>
Museum programs	\$ 8,733,810	\$ 3,855,247
Collection - exhibition, conservation, protection and management	5,065,190	3,447,550
Gardens and horticulture	1,309,423	977,717
Management and general	1,297,792	1,150,492
Fundraising	2,347,264	2,694,881
	\$ 18,753,479	\$ 12,125,887

**THE ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
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Notes to Financial Statements

Note 11 - Functional Expenses (Continued)

The above functional expense classifications reflect the ongoing programs of the Museum. Certain expenses such as employee benefits, depreciation, security, and building operations have been allocated to the functions identified above. Methods used in allocating these expenses include actual expenses incurred and proportional percentage allocation. Expenses for the year ended June 30, 2011 have been restated to reflect changes in the methodology of allocating expenses adopted in the year ended June 30, 2012.

Note 12 - Commitments and Contingencies

As of June 30, 2012, the Museum was unable to estimate the range of settlement dates and the related probabilities for certain asbestos remediation Asset Retirement Obligations (AROs). These conditional AROs are primarily related to the encapsulated structural fireproofing that is not subject to abatement unless the buildings are demolished and non-encapsulated asbestos that the Museum would remediate only if it performed major renovations of certain existing buildings. Because these conditional obligations have indeterminate settlement dates, the Museum could not develop a reasonable estimate of their fair values. The Museum will continue to assess its ability to estimate fair values at each future reporting date. The related liability will be recognized once sufficient additional information becomes available.