

Financial Statements

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

June 30, 2014 and 2013



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 financial statements of The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner (the "Museum"), which comprise the statements of financial position as of June 30, 2014 and 2013, and the related statements of activities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Isabella Stewart Gardner Museum, Incorporated, Trustee under the Will of Isabella Stewart Gardner as of June 30, 2014 and 2013, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Mayer Hoffmann McCann P.C.

December 9, 2014
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>2014</i>	<i>2013</i>
Assets		
Cash and cash equivalents	\$ 5,353,004	\$ 3,237,032
Receivables:		
Pledges receivable, net	4,109,285	6,285,189
Contributions receivable from remainder trusts	2,892,134	2,548,537
Other receivables	1,091,877	1,180,835
Total receivables, net	8,093,296	10,014,561
Prepays, inventory and other assets	1,082,989	1,055,678
Short-term investments	12,148,807	10,233,707
Museum property:		
Building improvements and other museum property	133,044,212	132,095,863
Construction in progress	199,323	577,035
	133,243,535	132,672,898
Less - accumulated depreciation	(27,154,289)	(21,549,668)
	106,089,246	111,123,230
Historic building, contents and land	4,482,944	4,482,944
Total museum property	110,572,190	115,606,174
Investments of endowed funds	166,278,245	140,189,017
Total assets	\$ 303,528,531	\$ 280,336,169
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses:		
Accrued pension expense	\$ -	\$ 1,187,605
Accounts payable and other accrued expenses	1,525,485	1,805,276
Total accounts payable and accrued expenses	1,525,485	2,992,881
Deferred income	105,687	127,821
Bonds payable	32,075,000	33,560,000
Unamortized premium on bonds payable	749,214	887,505
Total liabilities	34,455,386	37,568,207
Net assets:		
Unrestricted	83,987,534	86,955,972
Temporarily restricted	96,099,040	77,079,070
Permanently restricted	88,986,571	78,732,920
Total net assets	269,073,145	242,767,962
Total liabilities and net assets	\$ 303,528,531	\$ 280,336,169

See accompanying notes to the financial statements.

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

Statement of Activities

Years Ended June 30

	<i>Operating</i>	<i>Property and Other</i>	<i>Total Unrestricted</i>	<i>Temporarily Restricted</i>	<i>Permanently Restricted</i>	<i>2014 Total</i>	<i>2013 Total</i>
Revenue and other support:							
Admissions	\$ 1,636,752	\$ -	\$ 1,636,752	\$ -	\$ -	\$ 1,636,752	\$ 1,852,762
Store	942,618	-	942,618	-	-	942,618	1,004,662
Membership	705,752	-	705,752	-	-	705,752	801,880
Rental events	537,780	-	537,780	-	-	537,780	553,463
Other earned income	313,304	-	313,304	-	-	313,304	340,316
Grants and gifts	929,142	26,263	955,405	8,598,123	10,253,651	19,807,179	19,244,937
Satisfaction of restricted grants and gifts	1,077,412	2,607,942	3,685,354	(3,685,354)	-	-	-
Annual appeal	1,919,168	-	1,919,168	-	-	1,919,168	1,832,423
Special events	541,025	-	541,025	587,621	-	1,128,646	1,050,498
Investment income and net appreciation	11,981	1,669,937	1,681,918	18,809,548	-	20,491,466	16,348,186
Allocation of endowment income	5,784,902	(494,934)	5,289,968	(5,289,968)	-	-	-
	<u>14,399,836</u>	<u>3,809,208</u>	<u>18,209,044</u>	<u>19,019,970</u>	<u>10,253,651</u>	<u>47,482,665</u>	<u>43,029,127</u>
Total revenue and other support							
Expenses:							
Security and museum services	2,828,702	-	2,828,702	-	-	2,828,702	2,956,618
Collection, conservation and public programs	4,305,529	-	4,305,529	-	-	4,305,529	4,396,270
Development and external relations	2,288,255	297,623	2,585,878	-	-	2,585,878	2,694,863
Administration	2,846,176	(487,605)	2,358,571	-	-	2,358,571	2,955,924
Special projects	-	287,715	287,715	-	-	287,715	276,156
Facilities and maintenance	1,767,870	-	1,767,870	-	-	1,767,870	1,636,203
Depreciation	200,000	5,404,621	5,604,621	-	-	5,604,621	5,651,839
Interest expense	-	1,438,596	1,438,596	-	-	1,438,596	1,470,059
	<u>14,236,532</u>	<u>6,940,950</u>	<u>21,177,482</u>	<u>-</u>	<u>-</u>	<u>21,177,482</u>	<u>22,037,932</u>
Total expenses							
Change in net assets before adjustments	163,304	(3,131,742)	(2,968,438)	19,019,970	10,253,651	26,305,183	20,991,195
Reclassification of net assets	(100,000)	100,000	-	-	-	-	-
Total change in net assets	63,304	(3,031,742)	(2,968,438)	19,019,970	10,253,651	26,305,183	20,991,195
Net assets, beginning of year	1,489,029	85,466,943	86,955,972	77,079,070	78,732,920	242,767,962	221,776,767
Net assets, end of year	\$ 1,552,333	\$ 82,435,201	\$ 83,987,534	\$ 96,099,040	\$ 88,986,571	\$ 269,073,145	\$ 242,767,962

See accompanying notes to the financial statements.

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

Statement of Activities

Year Ended June 30, 2013

	<i>Operating</i>	<i>Property and Other</i>	<i>Total Unrestricted</i>	<i>Temporarily Restricted</i>	<i>Permanently Restricted</i>	<i>Total</i>
Revenue and other support:						
Admissions	\$ 1,852,762	\$ -	\$ 1,852,762	\$ -	\$ -	\$ 1,852,762
Store	1,004,662	-	1,004,662	-	-	1,004,662
Membership	801,880	-	801,880	-	-	801,880
Rental events	553,463	-	553,463	-	-	553,463
Other earned income	340,316	-	340,316	-	-	340,316
Grants and gifts	813,750	-	813,750	8,412,537	10,018,650	19,244,937
Satisfaction of restricted grants and gifts	1,126,272	2,722,404	3,848,676	(3,848,676)	-	-
Annual appeal	1,832,423	-	1,832,423	-	-	1,832,423
Special events	642,998	-	642,998	407,500	-	1,050,498
Investment income and net appreciation	19,510	1,309,202	1,328,712	15,019,474	-	16,348,186
Allocation of endowment income	5,225,000	(477,341)	4,747,659	(4,747,659)	-	-
	<u>14,213,036</u>	<u>3,554,265</u>	<u>17,767,301</u>	<u>15,243,176</u>	<u>10,018,650</u>	<u>43,029,127</u>
Total revenue and other support						
Expenses:						
Security and museum services	2,956,618	-	2,956,618	-	-	2,956,618
Collection, conservation and public programs	4,396,270	-	4,396,270	-	-	4,396,270
Development and external relations	2,255,447	439,416	2,694,863	-	-	2,694,863
Administration	2,603,068	352,856	2,955,924	-	-	2,955,924
Special projects	-	276,156	276,156	-	-	276,156
Facilities and maintenance	1,636,203	-	1,636,203	-	-	1,636,203
Depreciation	200,000	5,451,839	5,651,839	-	-	5,651,839
Interest expense	-	1,470,059	1,470,059	-	-	1,470,059
	<u>14,047,606</u>	<u>7,990,326</u>	<u>22,037,932</u>	<u>-</u>	<u>-</u>	<u>22,037,932</u>
Total expenses						
Change in net assets before adjustments	165,430	(4,436,061)	(4,270,631)	15,243,176	10,018,650	20,991,195
Reclassification of net assets	(455,114)	(216,480)	(671,594)	(3,271,163)	3,942,757	-
Total change in net assets	(289,684)	(4,652,541)	(4,942,225)	11,972,013	13,961,407	20,991,195
Net assets, beginning of year	1,778,713	90,119,484	91,898,197	65,107,057	64,771,513	221,776,767
Net assets, end of year	\$ 1,489,029	\$ 85,466,943	\$ 86,955,972	\$ 77,079,070	\$ 78,732,920	\$ 242,767,962

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>2014</i>	<i>2013</i>
Cash flows from operating activities:		
Change in net assets	\$ 26,305,183	\$ 20,991,195
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	5,604,621	5,651,839
Contributions and change in value of remainder trusts	(343,597)	(512,277)
Net realized and unrealized gains on investments	(20,600,481)	(16,589,559)
Changes in:		
Pledges and other receivables	2,264,862	3,996,014
Prepays, inventory and other assets	(27,311)	(186,686)
Accounts payable and accrued expenses	(1,467,396)	(1,862,563)
Deferred income	(22,134)	(44,659)
Restricted contributions	(20,354,343)	(20,218,809)
	<u>(8,640,596)</u>	<u>(8,775,505)</u>
Net cash used in operating activities	(8,640,596)	(8,775,505)
Cash flows from investing activities:		
Expenditures for museum property	(708,927)	(2,716,275)
Sale of short-term investments	(1,915,100)	537,296
Purchase of long-term investments	(26,407,832)	(16,883,801)
Redemption of long-term investments	20,919,084	8,708,204
	<u>(8,112,775)</u>	<u>(10,354,576)</u>
Net cash used in investing activities	(8,112,775)	(10,354,576)
Cash flows from financing activities:		
Proceeds from contributions restricted for:		
Endowment	9,181,140	13,990,932
Plant and other	11,173,203	6,227,877
Principal payments on bonds payable	(1,485,000)	(1,440,000)
	<u>18,869,343</u>	<u>18,778,809</u>
Net cash provided by financing activities	18,869,343	18,778,809
Net change in cash and cash equivalents	2,115,972	(351,272)
Cash and cash equivalents, beginning of year	3,237,032	3,588,304
Cash and cash equivalents, end of year	\$ 5,353,004	\$ 3,237,032
Supplemental disclosures:		
Cash paid for interest	<u>\$ 1,584,313</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 campus which includes a historic building with three floors of artwork, outdoor gardens, and a new wing that opened in January 2012 with purpose-built spaces for visitor accommodation, public programs and administration. 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 those resources that have no time or use restrictions. The Museum separates this category of net assets into two sub-categories: Operating and Property and Other. Operating activities are those related to the ongoing operation, programming and maintenance of the Museum. The Property and Other sub-category include activities that are one-time or episodic in nature; also included are resources over which the Trustees have discretionary control, including the unrestricted endowment and reserve funds.

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 reports its historical treasures in this category because of their restricted use imposed by the will of Isabella Stewart Gardner.

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 the assets under contributions receivable from remainder trust, and both short-term investments and investments of endowed funds. Non-recurring measures include pledges receivable, and the liability netted against the assets under contributions receivable from remainder trusts.

**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 (Continued)

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, as well as the effects of market, interest and credit risk. 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 different assumptions or changes in values of these instruments could occur which 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.

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 using a Level 2 fair value approach. 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 using a Level 3 fair value approach. 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.

Short-term Investments

Short-term investments are comprised of unspent and undesignated capital campaign funds. These funds consist of cash and money market accounts and are stated at cost, which approximates fair value.

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. Fair value of donated fixed assets is effectively recorded using a Level 3 market approach. For more information regarding the Museum's fixed assets, see Note 3 - Fixed Assets.

**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)

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.

Revenue Recognition

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

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 and its determinations as to its income being related and unrelated are not uncertain tax positions 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 generally accepted accounting principles in the United States of America 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, value of charitable remainder trusts, releases from restriction, and expense allocation by function. Actual results could differ from those estimates.

Subsequent Events

The Museum has evaluated subsequent events through December 9, 2014, 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.

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

Notes to Financial Statements

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 Museum had the following pledges receivable outstanding at June 30:

	<i>2014</i>	<i>2013</i>
Temporarily restricted non-operating support	\$ 3,228,619	\$ 6,313,233
Permanently restricted endowment	1,269,840	430,000
	4,498,459	6,743,233
Less: unamortized discount	(164,251)	(120,882)
Less: allowance for uncollectibles	(224,923)	(337,162)
	\$ 4,109,285	\$ 6,285,189
 Amounts due in:		
Less than one year	\$ 2,480,367	\$ 5,123,081
One to five years	2,018,092	1,620,152
	\$ 4,498,459	\$ 6,743,233

In addition to the unconditional pledges receivable referenced above, the Museum had gross conditional pledges of approximately \$18.1 million and \$24.5 million as of June 30, 2014 and 2013, 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. Total Museum depreciation expenses in the years ended June 30, 2014 and 2013 were \$5,604,621 and \$5,651,839, 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 ISABELLA STEWART GARDNER MUSEUM, INCORPORATED,
TRUSTEE UNDER THE WILL OF ISABELLA STEWART GARDNER**

Notes to Financial Statements

Note 4 - Investments of Endowed Funds (Continued)

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.

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's endowment consists of about 130 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 \$5,785,000 and \$5,225,000 in fiscal years ended June 30, 2014 and 2013, 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 \$6,469,000 for the fiscal year ending June 30, 2015.

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 are reported in unrestricted net assets. There were no such funds as of June 30, 2014 or 2013.

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

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>2014</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	\$ 10,418,622	\$ 58,785,772	\$ 71,408,373	\$ 140,612,767
Gifts and additions	26,263	-	9,181,140	9,207,403
Net investment return	1,451,780	18,809,550	-	20,261,330
Amounts appropriated under endowment spending policy for operations	(494,934)	(5,289,968)	-	(5,784,902)
Endowments at end of year	\$ <u>11,401,731</u>	\$ <u>72,305,354</u>	\$ <u>80,589,513</u>	\$ <u>164,296,598</u>
Temporarily restricted funds invested alongside endowment				3,182,211
Balance due from working capital				(1,200,564)
Total investments				\$ <u>166,278,245</u>
	<i>2013</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	\$ 9,557,083	\$ 48,560,877	\$ 57,417,441	\$ 115,535,401
Gifts and additions	57,911	(55,412)	13,990,932	13,993,431
Net investment return	1,273,864	15,035,071	-	16,308,935
Amounts appropriated under endowment spending policy for operations	(477,341)	(4,747,659)	-	(5,225,000)
Reclassification for endowment losses exceeding corpus	7,105	(7,105)	-	-
Endowments at end of year	\$ <u>10,418,622</u>	\$ <u>58,785,772</u>	\$ <u>71,408,373</u>	\$ <u>140,612,767</u>
Balance due from working capital				(423,750)
Total investments				\$ <u>140,189,017</u>

**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, 2014 and 2013 that the Museum measures at fair value on a recurring basis, by level within the fair value hierarchy:

	<i>2014</i>			
	<u><i>Level 1</i></u>	<u><i>Level 2</i></u>	<u><i>Level 3</i></u>	<u><i>Total</i></u>
Cash and Cash Equivalents	\$ 15,224,831	\$ -	\$ -	\$ 15,224,831
Fixed Income Funds	3,115,194	-	-	3,115,194
Equities	11,192,966	42,524,294	-	53,717,260
Inflation Hedging	7,224,205	-	-	7,224,205
Marketable Alternatives	-	33,493,769	52,026,979	85,520,748
Non-Marketable Assets	-	-	1,476,007	1,476,007
Total Investments of Endowment Funds	\$ <u>36,757,196</u>	\$ <u>76,018,063</u>	\$ <u>53,502,986</u>	\$ <u>166,278,245</u>

	<i>2013</i>			
	<u><i>Level 1</i></u>	<u><i>Level 2</i></u>	<u><i>Level 3</i></u>	<u><i>Total</i></u>
Cash and Cash Equivalents	\$ 14,816,108	\$ -	\$ -	\$ 14,816,108
Fixed Income Funds	3,086,254	-	-	3,086,254
Equities	6,438,518	38,662,199	-	45,100,717
Inflation Hedging	5,527,203	-	-	5,527,203
Marketable Alternatives	-	30,086,570	39,341,779	69,428,349
Non-Marketable Assets	-	-	2,230,386	2,230,386
Total Investments of Endowment Funds	\$ <u>29,868,083</u>	\$ <u>68,748,769</u>	\$ <u>41,572,165</u>	\$ <u>140,189,017</u>

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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>Marketable Alternatives</i>	<i>Non- Marketable Assets</i>	<i>Total Level 3</i>
Balance as of July 1, 2012	\$ 29,157,808	\$ 3,323,364	\$ 32,481,172
Net investment gain	4,476,220	361,461	4,837,681
Transfers from Level 2	7,961,494	-	7,961,494
Purchases	5,000,000	-	5,000,000
Redemptions and distributions	<u>(7,253,743)</u>	<u>(1,454,439)</u>	<u>(8,708,182)</u>
Balance as of June 30, 2013	39,341,779	2,230,386	41,572,165
Net investment gain	5,256,498	247,551	5,504,049
Transfers to Level 2	(1,218,859)	-	(1,218,859)
Purchases	12,000,000	-	12,000,000
Redemptions and distributions	<u>(3,352,439)</u>	<u>(1,001,930)</u>	<u>(4,354,369)</u>
Balance as of June 30, 2014	\$ <u>52,026,979</u>	\$ <u>1,476,007</u>	\$ <u>53,502,986</u>

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 to/from Level 2” in the schedule above. The Museum has no commitments to invest additional funds as of the reporting date.

Management has no intentions or plans to liquidate any NAV practical expedient investments at other than NAV per share.

Under unusual circumstances, fund managers can reserve the right to limit distributions to shareholders; however, the Museum has not experienced any changes or limits over fund distributions.

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.

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Notes to Financial Statements

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 at various dates through 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 were 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.

Bond interest expense was \$1,576,887 and \$1,620,313 in the years ended June 30, 2014 and 2013, respectively. Bond premium amortization was \$138,291 and \$150,254 in the years ended June 30, 2014 and 2013, respectively, and is a credit netted against interest expense. 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.

Scheduled maturities of the bonds are as follows:

2015	\$	1,525,000
2016		1,590,000
2017		1,650,000
2018		1,730,000
2019		1,815,000
Thereafter		<u>23,765,000</u>
Total bonds payable	\$	<u>32,075,000</u>

As of June 30, 2014 and 2013, the fair value of the Museum's bonds payable approximated \$37 million and \$36 million, respectively, based on quoted market prices for the same or similar issues. The fair value reflects what the Museum would have to pay based on current interest rates and credit position and does not reflect an additional liability to the Museum.

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Notes to Financial Statements

Note 7 - Employee Retirement Plans

The Museum terminated its Defined Benefit Plan effective December 31, 2012. The Plan's assets were used to make lump-sum distributions or purchase annuities for participants. The net plan expense was a credit of approximately \$117,000 and an expense of \$893,000 in 2014 and 2013, respectively.

The operating and non-operating activity reflected in the Administration expense line item in the statement of activities as of June 30, 2014 is comprised of the following Defined Benefit Plan activity:

	<u>Operating</u>	<u>Property and Other</u>	<u>Total</u>
Contributions	\$ 318,010	\$ 700,000	\$ 1,018,010
Expenses not covered by plan	53,149	-	53,149
FAS adjustment	-	(187,605)	(187,605)
Reversal of prior year accrual	-	(1,000,000)	(1,000,000)
Total	\$ <u>371,159</u>	\$ <u>(487,605)</u>	\$ <u>(116,446)</u>

The Museum's plan assets were comprised of the following at June 30 2013:

Cash and cash equivalents	\$ 1,410,368	35%
Fixed income	2,070,900	51%
Equities	<u>576,521</u>	<u>14%</u>
Fair value of plan assets	\$ <u>4,057,789</u>	<u>100%</u>

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 \$233,599 and \$206,652 during fiscal years ended June 30, 2014 and 2013, respectively.

The Museum also offers a tax-deferred retirement plan regulated by U.S. Internal Revenue Code Section 457(b) which allows certain employees to contribute pre-tax compensation deferrals to the plan, subject to annual statutory limitations. The Museum does not contribute to this plan.

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Notes to Financial Statements

Note 8 - Net Assets

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

	<i>2014</i>	<i>2013</i>
Accumulated unspent gains on endowments:		
Collection conservation and building preservation	\$ 7,431,354	\$ 3,970,802
Curatorial programs	6,855,201	4,890,172
Music, contemporary, and horticulture programs	3,401,860	2,013,536
Education and other public programs	3,075,561	2,243,172
Undesignated	50,120,775	44,618,737
Other purposes	1,420,604	1,049,353
Total unspent gains on endowments (subject to Trustee appropriation)	72,305,355	58,785,772
Gifts and grants designated for operating activities	1,612,614	1,772,668
Gifts and grants designated for non-operating activities	19,093,766	10,528,507
Pledges receivable and charitable remainder trusts	3,087,305	5,992,123
Temporarily restricted net assets	\$ 96,099,040	\$ 77,079,070

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

	<i>2014</i>	<i>2013</i>
Endowed assets designated for the following purposes:		
Collection conservation and building preservation	\$ 28,899,819	\$ 21,899,869
Curatorial programs	16,544,091	15,099,619
Music, contemporary, and horticulture programs	9,956,341	9,619,623
Education and other public programs	6,773,611	6,373,611
Undesignated	15,415,651	15,415,651
Other purposes	3,000,000	3,000,000
Investment in perpetuity, the income from which is expendable (with appreciation recorded as temporarily restricted)	80,589,513	71,408,373
Pledges receivable and charitable remainder trusts	3,914,114	2,841,603
Historical treasures	4,482,944	4,482,944
Permanently restricted net assets	\$ 88,986,571	\$ 78,732,920

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Notes to Financial Statements

Note 9 - 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 10 - Functional Expenses

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

	<i>2014</i>	<i>2013</i>
Museum programs	\$ 17,662,616	\$ 18,316,369
Management and general	1,375,857	1,632,839
Fundraising	<u>2,139,009</u>	<u>2,088,724</u>
	<u><u>\$ 21,177,482</u></u>	<u><u>\$ 22,037,932</u></u>

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.

Note 11 - Commitments and Contingencies

As of June 30, 2014, 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.