Portland Art Museum

Financial Statements and Other Information
as of and for the Years Ended June 30, 2008 and 2007
and Report of Independent Accountants

PORTLAND ART MUSEUM

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Report of the Treasurer

The financial statements and other information contained in this report have been prepared by management, which is responsible for the information's integrity and objectivity. The financial statements have been prepared in accordance with generally accepted accounting principles applied on a consistent basis and are deemed to present fairly the financial position of the PORTLAND ART MUSEUM and the changes in its net assets and cash flows. Where necessary, management has made informed judgments and estimates of the outcome of events and transactions, with due consideration given to materiality.

As a means of fulfilling its responsibility for the integrity of financial information included in this report, management relies on a system of internal controls established to ensure, within reasonable limits, that assets are safeguarded against loss or unauthorized use, that transactions are properly recorded and executed in accordance with management's authorization, and that the accounting records can be relied upon to prepare financial statements in accordance with generally accepted accounting principles. This system is augmented by careful selection and training of qualified personnel and the dissemination of written policies and procedures.

The financial statements have been examined by the Museum's independent accountants, GARY MCGEE & CO., whose report follows. Their examinations were made in accordance with generally accepted auditing standards. The Board of Trustees meets periodically with management and the independent accountants to review accounting, auditing, internal accounting controls, and financial reporting matters, and to ensure that all responsibilities are fulfilled with regard to the objectivity and integrity of the Museum's financial statements. The Board of Trustees also reviews the scope and results of the Museum's audit, and current and emerging accounting and financial requirements and practices affecting the Museum.

Patricia M. Gianelli
Treasurer
Board of Trustees
Portland Art Museum

GaryMcGee & Co.
CERTIFIED PUBLIC ACCOUNTANTS

REPORT OF INDEPENDENT ACCOUNTANTS

The Board of Trustees
Portland Art Museum:

We have audited the accompanying statements of financial position of the Portland Art Museum as of June 30, 2008 and 2007, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Portland Art 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 auditing standards generally accepted in the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Portland Art Museum's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Portland Art Museum as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Gary McGee & Co.

October 16, 2008

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PORTLAND ART MUSEUM

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2008 AND 2007

	2008	2007
Assets:		
Cash and cash equivalents *(note 5)*	$ 7,118,517	7,402,710
Accounts receivable *(note 3)*	602,586	655,203
Pledges receivable *(note 4)*	12,559,596	14,284,359
Inventories and prepayments	417,881	418,991
Other assets	636,360	567,235
Investments, at market value *(notes 5 and 15)*	43,348,171	44,364,418
Real estate investments, at cost *(notes 10 and 16)*	4,837,854	4,837,854
Property and equipment *(notes 6 and 10)*	61,807,145	63,360,884
Beneficial interest in the net assets of the Oregon Arts Heritage Endowment Fund *(note 7)*	–	4,448,372
Museum collections *(note 8)*		
Total assets	$ 131,328,110	140,340,026
Liabilities:		
Accounts payable and accrued liabilities	1,281,351	1,121,105
Deferred revenues *(note 9)*	512,205	322,892
Notes payable *(note 10)*	15,807,157	20,814,127
Deferred compensation *(note 15)*	–	2,841,334
Total liabilities	17,600,713	25,099,458
Net assets:		
Unrestricted:		
Available for programs and general operations	10,379,234	16,095,399
Designated by the Board of Trustees for operating reserves *(note 11)*	17,537,848	19,626,735
Net investment in capital assets	50,837,842	47,384,611
Total unrestricted	78,754,924	83,106,745
Temporarily restricted *(note 11)*	5,655,748	7,541,434
Permanently restricted for endowment *(note 11)*	29,316,725	24,592,389
Total net assets	113,727,397	115,240,568
Commitments and contingencies *(notes 10, 14, 15, 16, 17 and 18)*		
Total liabilities and net assets	$ 131,328,110	140,340,026

See accompanying notes to financial statements.

STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2008 AND 2007

	2008			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains and other support:				
Contributions, memberships and grants	$ 6,478,563	1,277,490	5,225,933	12,981,986
In-kind contributions *(note 12)*	421,160	–	–	421,160
Financial support received from volunteer groups	234,051	–	–	234,051
Admissions	1,625,413	–	–	1,625,413
Museum shop sales	1,216,601	–	–	1,216,601
Total investment return *(note 5)*	(939,374)	(1,267,144)	–	(2,206,518)
Net appreciation (decline) in beneficial interest in the net assets of the Oregon Arts Heritage Endowment Fund *(note 7)*	–	–	(276,963)	(276,963)
Other	2,440,509	–	–	2,440,509
Total revenues and gains	11,476,923	10,346	4,948,970	16,436,239
Net assets released from restrictions *(note 11)*	1,896,032	(1,896,032)	–	–
Net distributions from the Oregon Arts Heritage Endowment Fund *(note 7)*	224,634	–	(224,634)	–
Total revenues, gains and other support	13,597,589	(1,885,686)	4,724,336	16,436,239
Expenses *(note 13):*				
Program activities:				
Acquisition of art	612,121	–	–	612,121
Museum programs	9,736,061	–	–	9,736,061
Film center programs	1,548,918	–	–	1,548,918
Total program services	11,897,100	–	–	11,897,100
Supporting activities:				
Management and general	4,327,516	–	–	4,327,516
Fundraising, membership and development	1,724,794	–	–	1,724,794
Total supporting services	6,052,310	–	–	6,052,310
Total expenses	17,949,410	–	–	17,949,410
Increase (decrease) in net assets	(4,351,821)	(1,885,686)	4,724,336	(1,513,171)
Net assets at beginning of year	83,106,745	7,541,434	24,592,389	115,240,568
Net assets at end of year	$ 78,754,924	5,655,748	29,316,725	113,727,397

See accompanying notes to financial statements.

2007			
Unrestricted	Temporarily restricted	Permanently restricted	Total
7,196,290	1,701,144	247,489	9,144,923
518,034	–	–	518,034
344,337	–	–	344,337
2,958,272	–	–	2,958,272
1,458,113	–	–	1,458,113
4,509,207	2,521,002	–	7,030,209
–	–	1,011,326	1,011,326
3,824,765	–	–	3,824,765
20,809,018	4,222,146	1,258,815	26,289,979
3,502,682	(3,502,682)	–	–
209,077	–	(209,077)	–
24,520,777	719,464	1,049,738	26,289,979
1,490,412	–	–	1,490,412
11,576,379	–	–	11,576,379
1,501,380	–	–	1,501,380
14,568,171	–	–	14,568,171
5,487,809	–	–	5,487,809
1,820,532	–	–	1,820,532
7,308,341	–	–	7,308,341
21,876,512	–	–	21,876,512
2,644,265	719,464	1,049,738	4,413,467
80,462,480	6,821,970	23,542,651	110,827,101
83,106,745	7,541,434	24,592,389	115,240,568

PORTLAND ART MUSEUM

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Cash flows from operating activities:		
Cash received from contributors, grantors and members	$ 13,032,242	13,609,330
Cash received from admissions and service recipients	3,083,944	4,426,142
Interest and dividends received	1,256,318	1,126,791
Other receipts	2,467,509	3,824,765
Cash paid to employees and suppliers	(16,984,619)	(15,723,200)
Interest paid	(964,685)	(1,331,461)
Net cash provided by operating activities	1,890,709	5,932,367
Cash flows from investing activities:		
Purchases of investments	(1,627,334)	(231,021)
Reinvestment of investment income	(701,033)	(752,233)
Proceeds from the sale of investments	4,053,187	3,973,339
Acquisition of works of art	(612,121)	(1,490,412)
Acquisition of property and equipment	(93,064)	(1,907,246)
Acquisition of real estate *(note 16)*	–	(2,237,854)
Net cash provided by (used in) investing activities	1,019,635	(2,645,427)
Cash flows from financing activities:		
Proceeds from contributions restricted to long-term investment	1,812,433	1,500,829
Proceeds received upon the issuance of a long-term note	–	1,500,000
Repayment of note principal	(5,006,970)	(2,685,873)
Net cash provided by (used in) financing activities	(3,194,537)	314,956
Net increase (decrease) in cash and cash equivalents	(284,193)	3,601,896
Cash and cash equivalents at beginning of year	7,402,710	3,800,814
Cash and cash equivalents at end of year	$ 7,118,517	7,402,710

Supplemental schedule of noncash investing and financing activities		
A real estate acquisition financed through the issuance of a note	$ –	2,600,000
Termination of the Oregon Arts Heritage Endowment Fund and the related transfer of the funds to the Museum to establish the Portland Art Museum Endowment Fund *(see notes 5 and 7)*	3,931,756	–

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008 AND 2007

1. Organization

The Portland Art Museum was incorporated as an educational, nonprofit organization in 1892. The mission of the Museum is to serve the public by providing access to art of enduring quality, by educating a diverse audience about art, and by collecting and preserving a wide range of art for the enrichment of present and future generations.

The Museum operates the Portland Art Museum and the Northwest Film Center (the "Film Center"). Through each, the Museum conducts a coordinated program of visual and media art education, exhibition, collection and outreach programs. The Film Center also provides a coordinated film and video program, and instruction in filmmaking, production and editing.

2. Summary of Significant Accounting Policies

The significant accounting policies followed by the Museum are described below to enhance the usefulness of the financial statements to the reader.

Basis of Accounting – The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles and the principles of fund accounting. Fund accounting is the procedure by which resources for various purposes are classified for accounting purposes in accordance with activities or objectives specified by donors.

Basis of Presentation – The Museum has adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 116, *Accounting for Contributions Received and Contributions Made*, and SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*. Under these provisions, net assets and all balances and transactions are presented based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Museum and changes therein are classified and reported as follows:

- *Unrestricted net assets* – Net assets not subject to donor-imposed stipulations.
- *Temporarily restricted net assets* – Net assets subject to donor-imposed stipulations that will be met either by actions of the Museum and/or the passage of time. These balances generally represent the unexpended portion of externally restricted contributions and investment return to be used for specific programs and activities as directed by donors.
- *Permanently restricted net assets* – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Museum. Generally, the donors of these assets permit the Museum to use all or part of the income earned on related investments for general or specific purposes.

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 stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as net assets released from restrictions.

Use of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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. Actual results could differ from those estimates.

Cash and Cash Equivalents – For purposes of the financial statements, the Museum considers all liquid investments having initial maturities of one year or less to be cash equivalents.

Investments – Investments are carried at market value. Net appreciation in the fair value of investments, which consists of the realized gains or losses and the unrealized appreciation (decline) of those investments, is shown in the statements of activities. Interest income is accrued as earned and is reported net of investment advisory fees. Security transactions are recorded on a trade date basis.

The Museum has some exposure to investment risks, including interest rate, market, and credit risks, for both marketable and non-marketable securities. Due to the level of risk exposure, it is possible that near-term valuation changes for investment securities may occur to an extent that could materially affect the amounts reported in the accompanying financial statements.

Real Estate Investments – The Museum's real estate investments consist of unimproved land, improved properties, and long-term ground leases. Because of the inherent uncertainties of real estate valuation, the Museum's real estate investments are carried at cost, or at market value when acquired through a charitable contribution. No depreciation is calculated on real estate investments. See note 16 for further discussion of the Museum's real estate investments.

Derivative Instruments – The Museum makes limited use of interest rate swap agreements to manage interest rate risk associated with variable rate debt. Under interest rate swap agreements, the Museum and the counterparties agree to exchange the difference between fixed rate and variable rate interest amounts calculated by reference to specified notional principal amounts during the agreement period. Notional principal amounts are used to express the volume of these transactions, but the cash requirements and amounts subject to credit risk are substantially less. Amounts receivable or payable under swap agreements are accounted for as adjustments to interest expense on the related debt.

Inventories – Inventories, which consist primarily of educational materials and other items held for sale in the Museum's gift shop, are carried at the lower of cost or market value. Cost is determined using the average cost method.

Capital Assets and Depreciation – Property and equipment are carried at cost, and at market value when acquired by gift. Interest is capitalized in connection with the construction of major facilities until such time as the facilities become operational. The capitalized interest is recorded as a part of the assets to which it relates and is amortized over the asset's estimated useful life. Depreciation is generally provided on a straight-line basis over the estimated useful lives of the respective assets, which is 50 years for buildings and 5 years for furniture, equipment and leasehold improvements, or the term of the lease, if less.

Museum Collections – The Museum's collections comprise more than 45,000 objects and works of art, including works of European painting and sculpture, American painting and sculpture, silver, Asian art, Native American art, Pre-Columbian art, Cameroon and other African art, contemporary art, sculpture, prints and drawings, and photography. The collections are maintained for public exhibition, education and research in furtherance of public service, rather than for financial gain. The Museum's collections, acquired through purchase and donation, are not recognized as assets in the accompanying financial statements. Purchases of collection items are recorded in the year in which the items were acquired as decreases in unrestricted or temporarily restricted net assets, depending on the source of the assets used to purchase the items and whether those assets were restricted by donors. Contributed collection items are not reflected in the financial statements. Pursuant to Museum policy, proceeds from the sale of art and related insurance settlements are recorded as temporarily restricted net assets for the acquisition of works of art.

Program Activities – The Museum's program activities include all Museum and Film Center programs and activities, including research, collections management, education, public programs, exhibitions, and the acquisition of art.

Contributions – Contributions, which include unconditional promises to give (i.e., pledges), are recognized as revenues in the period the promise was received by the Museum. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at an appropriate rate commensurate with the risks involved. Amortization of the discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. Management estimates an allowance for uncollectible contributions receivable based on past collection history.

Contributions of capital assets without donor stipulations concerning the use of such long-lived assets are reported as revenues of the unrestricted net asset class. Contributions of cash or other assets to be used to acquire capital assets with such donor stipulations are reported as revenues of the temporarily restricted net asset class; the restrictions are considered to be released at the time of acquisition of such long-lived assets.

In-Kind Contributions – The Museum receives contributed services from a large number of volunteers who assist in fundraising and other efforts through their participation in a range of businesses and activities. In accordance with SFAS No. 116, the value of such services, which the Museum considers generally not practicable to estimate, have not been recognized in the accompanying financial statements. Significant services received, which create or enhance a non-financial asset or require specialized skills that the Museum would have purchased if not donated are recognized in the accompanying financial statements.

In-kind contributions of equipment and other materials are recorded where there is an objective basis upon which to value these contributions and where the contributions are an essential part of the Museum's activities.

Revenue Recognition – All contributions and grants are considered available for unrestricted use unless specifically restricted by the donor. Bequests are recorded as revenue at the time the Museum has an established right to the bequest and the proceeds are measurable. Admissions and other service revenues are recognized at the time the services are provided and the revenues are earned. All revenues associated with advance ticket sales and tuition and fees received for future fiscal years are reported as deferred revenues until earned. Membership payments received from Museum members are considered equivalent to unrestricted contributions and are recognized as revenue when received.

Benefits Provided to Donors at Special Events – The Museum conducts special fundraising events in which a portion of the gross proceeds paid by the participants represents payment for the direct cost of the benefits received by participants at the event. Unless a verifiable, objective means exists to demonstrate otherwise, the fair value of meals and entertainment provided at special events is measured at the actual cost to the Museum.

Outstanding Legacies – The Museum is the beneficiary under various wills and trust agreements, the total realizable amounts of which are not presently determinable. The Museum's share of such bequests is recorded when the probate courts declare the testamentary instrument valid and the proceeds are measurable.

Advertising and Promotional Expenses – Advertising and promotional costs are charged to expense as they are incurred. Advertising and marketing expenses totaled $472,562 and $528,083 for the years ended June 30, 2008 and 2007, respectively.

Earnings on the Investment of Endowment and Similar Funds – Income, realized net gains, and unrealized net gains on the investment of endowment and similar funds 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 impose restrictions on the use of the income;

- As increases in unrestricted net assets in all other cases.

Conflict of Interest Policies – Included among the Museum's Board members and committee members are volunteers from the community who provide valuable assistance to the Museum in the development of policies and programs, and in the evaluation and oversight of services. The Museum has established a conflict-of-interest policy whereby Board and committee members must advise the Board of Trustees of any direct or indirect interest in any transaction or relationship with the Museum, and not participate in discussions and decisions regarding any action affecting their individual, professional, or business interests.

Concentrations of Credit Risk – The Museum's investments consist primarily of financial instruments including cash equivalents, equity securities, fixed income securities, investments in limited partnerships, mutual funds, money market funds, and investments held at the Oregon Community Foundation. These financial instruments may subject the Museum to concentrations of credit risk as, from time to time, cash balances may exceed amounts insured by the Federal Deposit Insurance Corporation, the market value of securities are dependent on the ability of the issuer to honor its contractual commitments, and the investments are subject to changes in market values. Certain pledges receivable also subject the Museum to concentrations of credit risk. Management believes that risk with respect to these balances is minimal, due to the high credit quality of the institutions used and because most donors to the Museum are locally based and known to the Museum.

At June 30, 2008 and 2007, the Museum held $4,391,153 and $2,501,499, respectively, in cash balances in excess of the Federal Deposit Insurance Corporation insured level. On October 3, 2008, President George W. Bush signed the Emergency Economic Stabilization Act of 2008, which temporarily raises the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. The temporary increase in deposit insurance coverage became effective immediately upon the President's signature. The legislation provides that the basic deposit insurance limit will return to $100,000 after December 31, 2009.

Income Taxes – The Museum is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and comparable state law.

Other Significant Accounting Policies – Other significant accounting policies are set forth in the financial statements and the following notes.

3. Accounts Receivable

At June 30, 2008 and 2007, the following accounts receivable were outstanding:

		2008	2007
Oregon Arts Heritage Endowment Fund [1]	$	239,653	320,906
Rentals of artwork		115,721	99,777
Events and other		247,212	234,520
	$	602,586	655,203

[1] 30% of the 2007 figure is receivable for the benefit of the Pacific Northwest College of Art. See note 7.

4. Pledges Receivable

Pledges receivable at June 30, 2008 and 2007 are summarized as follows:

		2008	2007
Endowment	$	6,578,293	3,271,733
Museum operations and programs		6,766,445	13,043,384
		13,344,738	16,315,117
Less discount [1]		(785,142)	(2,030,758)
Less allowance for doubtful collection		–	–
	$	12,559,596	14,284,359

[1] Unconditional promises to give due in more than one year are reflected at the present value of estimated future cash flows using a discount rate of between 4.25% and 8.25%.

Amounts are due at June 30, 2008 and 2007, as follows:

		2008	2007
Unconditional promises expected to be collected in:			
Less than one year	$	3,765,746	4,842,168
One year to five years		9,053,191	7,386,829
Over five years		525,801	4,086,120
	$	13,344,738	16,315,117

5. Investable Assets and Investment Return

Investments, including cash equivalents, as of June 30, 2008 and 2007 comprised the following:

	2008	2007
Equity mutual funds	$ 27,118,474	33,568,450
Fixed income mutual funds	9,245,033	9,074,859
Government bonds	658,651	–
Interests in private equity partnerships	2,045,305	1,255,619
Money market funds and other cash equivalents	7,467,469	7,868,200
Investments held at the Oregon Community Foundation [1]	3,931,756	–
	$ 50,466,688	51,767,128

[1] Investments held at the Oregon Community Foundation ("the Community Foundation") represent endowment funds transferred to the Museum from its share of the Oregon Arts Heritage Endowment Fund (see note 7). Under the terms of its agreement with the Community Foundation, the Community Foundation established the Portland Art Museum Endowment Fund and has undertaken the management of the fund on behalf of the Museum, with the Museum receiving an annual distribution of total investment return equal to 6.0% of the fair market value of the fund, calculated in accordance with the Community Foundation's percentage payout policies for endowment funds (currently based on a 13-quarter market value average). Additional distributions can be made at any time by the affirmative vote of the majority of the Museum's Board of Trustees and the approval of the Community Foundation. At June 30, 2008, the Museum also reported $239,653 in related outstanding receivables from the Community Foundation, representing the distribution declared by the Community Foundation as of June 30, 2008.

The above total is reported on the accompanying statements of financial position in the cash and investment categories, as follows:

	2008	2007
Cash and cash equivalents	$ 7,118,517	7,402,710
Investments	43,348,171	44,364,418
	$ 50,466,688	51,767,128

Investments consist of the Museum's ownership interest in externally managed investment funds, which invest in market-traded fixed-income securities, equity securities, and other investment securities. Investments in private equity partnerships consist of the Museum's ownership interest in externally managed funds which invest in less liquid securities. For all investment funds, fair value represents the Museum's original investment plus the Museum's allocated share of income, realized gains and losses, and unrealized appreciation and decline, net of fees and distributions. The market value of mutual funds and equity securities is based on quoted market prices and published unit values. The market value of the funds held at the Oregon Community Foundation is based on information reported to the Museum by the Community Foundation.

Investments in private equity partnerships totaling $2,045,305 and $1,255,619 at June 30, 2008 and 2007, respectively, have been valued by the general partners of the partnerships. A portion of these investments are in non-marketable securities for which there are no readily obtainable market values. Values for these investments, which are generally subject to certain withdrawal restrictions, are provided by the general partner and may be based on historical cost, appraisals, obtainable prices for similar assets, or other estimates. The Museum believes that the stated value of its alternative investments was a reasonable estimate of fair value at June 30, 2008 and 2007. However, because of the inherent uncertainty of valuation for these investments, values may differ significantly from values that would have been used had a readily available market for the investments existed.

In addition to the investments summarized above, the Museum is obligated under the terms of certain agreements with private equity partnerships to remit additional funding periodically. At June 30, 2008 and 2007, such commitments totaled $1,066,823 and $455,641, respectively.

Investment performance for all accounts managed under investment agreements is reviewed periodically by the Museum's Investment Committee and Board of Trustees.

Total investment return for the years ended June 30, 2008 and 2007 are summarized as follows:

	2008	2007
Interest and dividend income	$ 1,016,665	997,412
Net appreciation, (decline) in the fair market value of investments	(3,223,183)	6,032,797
Total investment return	$ (2,206,518)	7,030,209

The Museum's Board of Trustees has adopted a policy for the spending of income and appreciation generated by long-term investments, including investments of true endowment funds and Board-designated reserve funds. The Board's intention is that the purchasing power of such funds be maintained unless explicit donor stipulations specify how the appreciation of such funds must be used. To meet that objective, the Museum's policies limit the spending of investment income and appreciation to 6.0% of the market value of such investments computed on a thirteen-quarter trailing average for 2008 and an eight-quarter trailing average for 2007.

In accordance with this policy, $2,262,363 and $2,231,632 were allocated to current operations during the years ended June 30, 2008, and 2007, respectively.

In addition, during the year ended June 30, 2007, the Board authorized the drawdown of an additional $2,493,482 for the purchase and improvement of property. No similar additional funds were allocated during the year ended June 30, 2008.

Changes in Investment Valuation Subsequent to June 30, 2008

Subsequent to June 30, 2008, a number of external factors combined to create unprecedented volatility in the world's credit and financial markets. In turn, these events have raised the risks and uncertainties associated with management and valuation of the Museum's investment portfolio. Although there were significant changes in the quoted market prices of the investment securities held by the Museum during the period subsequent to June 30, 2008, management believes that these changes do not represent a permanent impairment of the true value of its investments.

6. Property and Equipment

A summary of property and equipment at June 30, 2008 and 2007 is as follows

	2008	2007
Land and land improvements	$ 3,545,955	3,545,955
Belluschi Building	8,498,151	8,498,151
Mark Building	41,839,166	41,839,166
Hoffman Wing	18,892,260	18,892,260
Furniture and equipment	4,325,687	4,234,653
Leasehold improvements	288,790	286,760
	77,390,009	77,296,945
Less accumulated depreciation	(15,582,864)	(13,936,061)
	$ 61,807,145	63,360,884

The Museum accounts for the impairment of long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Museum evaluates all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Upon such an occurrence, recoverability of assets to be held and used is measured by comparing the carrying amount of the asset to forecasted, undiscounted future net cash flows expected to be generated by the asset. If the carrying amount exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount exceeds the fair value of the asset.

7. Beneficial Interest in the Net Assets of the Oregon Arts Heritage Endowment Fund

Through May 31, 2008, the Museum held a one-third beneficial interest in the net assets of the Oregon Arts Heritage Endowment Fund (the "Heritage Fund"), a fund established by the Portland Opera Association, the Oregon Symphony Association, and the Museum in 1983 to coordinate an endowment campaign on behalf of the three organizations.

Thirty percent of the Museum's share of the Heritage Fund was held by the Museum on behalf of the Pacific Northwest College of Art ("PNCA"), a former component of the Museum whose separation from the Museum was approved by the Museum's Board of Trustees on July 1, 1994. In connection with the separation, the Museum agreed to pay PNCA 30% of any amounts received by the Museum from the Oregon Arts Heritage Endowment Fund. PNCA has no beneficial or other ownership interest in the Heritage Fund, and this separation agreement represents an obligation exclusive to the Museum.

The Heritage Fund was invested and managed by the Oregon Community Foundation (the "Community Foundation"), a separate and unaffiliated nonprofit organization. Under the terms of its agreement with the Community Foundation, the Museum received annual distributions of income earned on its share of the investment of the Fund's assets, based on a percentage of the aggregate value of the assets held by the Fund.

As originally planned, effective June 1, 2008, the Community Foundation distributed the assets of the Heritage Fund to its respective beneficiaries, including PNCA. Accordingly, the Museum's obligation to PNCA was fully satisfied in June of 2008. Subsequently, the Museum transferred the funds to the Community Foundation and established the Portland Art Museum Endowment Fund (see note 5).

Changes in the Museum's beneficial interest in the Heritage Fund for the year ended June 30, 2008 are summarized as follows:

Balance at beginning of year (70%, net), less $2,002,716 (30%) held on behalf of PNCA	$	4,673,006
Less decline in the fair market value of the fund's investments [1]		(276,963)
Net distributions to the Museum's general operating funds		(224,634)
Transfer to the Museum of 70% of the fund for the establishment of the Portland Art Museum Endowment, less $1,787,747 (30%) transferred to PNCA		(4,171,409)
Balance at end of year	$	–

[1] Includes a $271,883 correction of the balance at July 1, 2008.

8. Museum Collections

During the years ended June 30, 2008 and 2007, the Museum acquired works of art for a total cost of $612,121 and $1,490,412, respectively. During these same periods, the Museum accepted donations of art with an estimated value of $2,587,996 and $1,619,942, respectively. Pursuant to Museum policy, purchases of art are recorded as decreases in net assets in the statement of activities; contributions of art are excluded from the accompanying financial statements.

9. Deferred Revenues

Deferred revenues were the result of the following activities as of June 30, 2008 and 2007:

		2008	2007
Film Center tuition	$	168,908	166,756
Events and projects		268,870	129,556
Other		74,427	26,580
	$	512,205	322,892

10. Notes Payable

At June 30, 2008 and 2007, the Museum reported the following outstanding financing arrangements:

	2008	2007
Revolving line of credit facility [1]	$ 13,807,157	18,814,127
Note issued for the acquisition of certain real estate [2]	2,000,000	2,000,000
	$ 15,807,157	20,814,127

[1] The Museum maintains an unsecured revolving line of credit facility with a financial institution in the amount of $25,000,000 for renovations made to the Mark building during the 2004-06 years. The facility carries a variable-interest rate equal to LIBOR plus 1.25%. Accordingly, at the inception of the borrowing in 2004, the Museum also entered into an interest rate swap agreement with the bank to fix the interest rate risk on a portion of the debt.

At June 30, 2008, $13,807,157 was outstanding under the agreement. The agreement provides that the Museum will pay a fixed rate of interest equal to 5.75% on $3,958,412 of the outstanding balance, and 7.05% on $1,500,000 of the outstanding balance. In return, under the interest rate swap agreement, the Museum receives the actual variable rate paid on the note based on the notional principal amount outstanding. Amounts receivable or payable under the swap agreement are accounted for as adjustments to interest expense. Interest on the remaining balance outstanding ($8,348,745 at June 30, 2008) is currently variable (3.71% at June 30, 2008).

At June 30, 2007, $18,814,127 was outstanding under this agreement, $4,494,453 at a fixed interest rate of 5.75%, $1,500,000 at a fixed interest rate of 7.05%, and the remaining balance ($12,819,674 at June 30, 2007) at a variable rate of interest (6.57% at June 30, 2007).

Repayment terms require monthly payment of principal and interest through June 2014. Principal and interest can also be repaid at any time prior to June 1, 2014 without penalty. At June 30, 2008, the market value of the interest rate swap agreement was a negative $166,544. At June 30, 2007, the market value was a positive $100,742.

The agreement contains restrictive provisions that require the maintenance of a debt service coverage ratio of 1.25, a liquidity ratio of 1.5, and limit the ability to incur additional significant direct or contingent liabilities or lease obligations. The Museum was in compliance with the debt covenants as of and for the years ended June 30, 2008 and 2007.

[2] During the year ended June 30, 2006, the Museum issued an interest-free promissory note in the amount of $2,000,000 for the acquisition of certain real estate (see note 16). This note is secured by the underlying property and is due in full on November 2, 2008.

The following table summarizes the maturities of note principal for the five years subsequent to June 30, 2008 and thereafter:

Years ending June 30,	
2009	$ 4,462,556
2010	2,621,144
2011	2,793,392
2012	2,975,536
2013	1,900,086
Thereafter	1,054,443
	$ 15,807,157

The Museum paid a total of $964,685 and $1,331,461 in interest expense for the years ended June 30, 2008 and 2007, respectively, including payments associated with the interest rate swap agreement described above.

11. Restrictions and Limitations on Net Asset Balances

Board-Designated Net Assets

At June 30, 2008, and 2007, $17,537,848 and $19,626,735 of the Museum's unrestricted net assets, respectively, had been designated by the Board of Trustees for operating reserves.

Temporarily Restricted Net Assets

At June 30, 2008, and 2007, temporarily restricted net assets totaled $5,655,748 and $7,541,434, respectively, and comprised contributions, grants, and other unexpended revenues and gains restricted by donors and available only for specific program services and future periods, as follows:

		2008	2007
Acquisition of works of art	$	956,161	2,124,143
General operations [1]		4,422,213	5,070,476
Future periods		277,374	346,815
	$	5,655,748	7,541,434

[1] Temporarily restricted net assets held for general operations includes restricted donations for maintaining the art collections, support of exhibitions, and other Museum programs.

For the years ended June 30, 2008 and 2007, $1,896,032 and $3,502,682, respectively, were released from restrictions in satisfaction of the purposes specified by donors, or by the occurrence of other events, as follows:

		2008	2007
Acquisition of works of art	$	506,580	1,419,770
Capital acquisitions		29,574	13,465
Other operational support		1,359,878	2,069,447
	$	1,896,032	3,502,682

Accordingly, a corresponding amount is reported as a reclassification from temporarily restricted net assets to unrestricted net assets in the accompanying financial statements.

Permanently Restricted Net Assets

At June 30, 2008, and 2007, the Museum held $29,316,725 and $24,592,389, respectively, in endowment funds. The investment income earned on these permanently restricted net assets is restricted or unrestricted as follows:

		2008	2007
Income restricted for:			
Museum operations	$	19,678,658	19,397,156
Acquisition of works of art		823,729	457,904
Income unrestricted		8,814,338	4,737,329
	$	29,316,725	24,592,389

Effective January 1, 2008, the State of Oregon adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") which replaces the Uniform Management of Institutional Funds Act ("UMIFA"), which has governed Oregon charitable institutions with respect to the management, investment and expenditure of endowment funds since 1975. UPMIFA eliminates the concept of "historic dollar value" from the management of endowment funds required under UMIFA, and instead stresses the prudent management of the endowment fund as a whole, rather than the prudent spending of amounts above historical dollar value as did UMIFA. The Museum's management is currently evaluating the new law and the anticipated financial reporting changes.

12. In-Kind Contributions

The Museum is the recipient of various in-kind contributions of goods and services for which objective measurement or valuation is available. These in-kind contributions are reported in the accompanying financial statements as follows for the years ended June 30, 2008 and 2007:

		2008	2007
Museum programs	$	212,027	223,365
Film Center programs		209,133	294,669
	$	421,160	518,034

13. Expenses

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

Costs by their natural classification are summarized as follows:

	2008	2007
Salaries and related costs	$ 7,091,361	7,072,826
Contract labor	1,042,189	1,573,328
Professional services	175,092	331,861
Exhibition participation fees	601,477	1,540,172
Exhibition installation	70,231	265,520
Exhibition audio guides	88,669	119,564
Events	175,462	241,555
Acquisition of works of art *(note 8)*	612,121	1,490,412
Occupancy	948,416	932,947
Merchandise	622,909	740,313
Insurance	163,510	627,327
Advertising	472,562	528,083
Postage and shipping	797,149	500,137
Travel	206,025	362,488
Printing and publications	285,496	290,849
Equipment maintenance	198,964	205,525
Merchant fees	129,905	193,575
Supplies	137,295	168,810
Moving and search fees	61,323	146,956
Interest	964,685	1,331,461
Depreciation	1,646,803	1,667,912
In-kind expenses	421,160	518,034
Other	1,036,606	1,026,857
	$ 17,949,410	21,876,512

Included in the above table are legal and other nonrecurring expenses associated with the renovation of the Mark Building totaling $707,835 for the year ended June 30, 2007, including costs of the capital campaign and non-capitalized costs related to construction and the opening of the building. There were no similar expenses incurred during the year ended June 30, 2008.

Finally, exhibition-related costs in the above table totaled $2,851,091 and $4,063,851 for the years ended June 30, 2008 and 2007, respectively. Exhibition-related costs vary significantly from year to year depending on the number and size of exhibitions installed.

14. Retirement Plan

The Museum has enrolled substantially all eligible employees in a defined contribution money purchase pension plan. The Museum contributes an amount to the plan based on a percentage of the employee's annual salary. The percentage contributed ranges from 3.0% to 7.0%, depending upon the years of employment. Participants become fully vested in the funds after three years of employment. The Museum's policy is to fund pension costs as they are accrued. Pension expense totaled $140,744 and $185,946 for the years ended June 30, 2008 and 2007, respectively.

15. Deferred Compensation

To provide supplemental retirement income for two former key senior executives, the Museum established a nonqualified deferred compensation arrangement in 1997. The arrangement was "unfunded" so that the deferred amounts were not includible in the executives' gross income until the amounts were actually or constructively received. However, to provide the executives with a measure of security without the arrangement being considered funded for tax purposes, the Museum established a "rabbi" trust (the "trust") to serve as a fund to hold the assets from which the nonqualified deferred compensation payments would be made in the future.

The trust was irrevocable and did not permit the Museum to use the assets for purposes other than to provide the nonqualified deferred compensation. However, the terms of the trust also provided that the assets were subject to the claims of the Museum's creditors in the event of the insolvency of the employer. Accordingly, the assets in trust were included in the investment category of the accompanying statements of financial position as of June 30, 2007.

The two executives ended their employment with the Museum during the year ended June 30, 2006 and were fully vested in the trust assets, including cumulative investment return at that time. The combined deferred compensation liability at June 30, 2007 totaled $2,841,334.

During the year ended June 30, 2008, the terms of the deferred compensation plan were amended to permit an election by the executives to receive payment in full. This election was exercised by the two executives and, accordingly, the trust assets were liquidated and the payments made in February of 2008. At June 30, 2008, the Museum had no further liability for deferred compensation.

16. Real Estate Investments

To provide for possible future expansion of its facilities, in November of 2006 the Museum acquired additional parcels of land in the City of Portland located next to the Museum's current facilities. The acquisition included two parcels of property, one representing the outright purchase of fee title interest in real property and the second representing the acquisition of all interest in property subject to a 99-year ground lease, together with various exchange option and extension agreements. The purchase price for both parcels totaled $3.1 million, plus $37,854 in closing costs. Concurrent with this acquisition, the Museum paid an additional $1.7 million to purchase all rights previously sold to an unrelated party to acquire and develop both properties, including all existing plans, drawings, specifications, blueprints, surveys and other work product relating to the ownership, operation, maintenance and development of both properties.

The purchase was partially financed through a $2,600,000 interest-free note, with $600,000 of note principal forgiven by the seller shortly after the transaction was completed (see note 10). The balance of the purchase was underwritten using Board-designated unrestricted funds.

At June 30, 2008, the approximate minimum rental commitments under the ground lease described above, for the initial 10 years of the lease, are as follows:

Years ending June 30,		
2009	$	98,400
2010		98,400
2011		98,400
2012		100,400
2013		101,400
Thereafter		338,000
	$	835,000

Rent expense associated with this arrangement totaled $98,400 and $65,800 for the years ended June 30, 2008 and 2007, respectively.

Put and Call Options

As a part of the ground lease agreement on the second parcel of land, the Museum also acquired all rights and conditions previously held by the seller, including various put and call options. For example, the lessor holds the right to exercise a put option on the fifth anniversary of the ground lease and every five years thereafter. This means that, in accordance with the specific terms of the agreement, the lessor may require the Museum to purchase the underlying land at a price to be determined based on an independent appraisal of the fair market value of the property at that time. Simultaneously, the Museum has acquired the right to exercise a call option (or the right to purchase the underlying property) at the end of the 10 year initial lease period, or on any date thereafter, again, with the price to be determined based on an independent appraisal of the fair market value of the property.

In the event the Museum decides to develop the property for charitable purposes, the Museum also has the right to purchase the property at any time prior to the 10th anniversary of the effective date of the ground lease agreement (i.e., November 2, 2016), but the purchase price will be based on an independent appraisal of the fair market value of the property, increased by an amount equal to 5.0% for each full year remaining of the first five years of the initial 10-year lease period, and 2.3% for each full year remaining of the last five years of the initial 10-year lease period.

17. Other Operating Leases

The Museum leases various other office and program equipment and vehicles under noncancelable operating leases expiring at various dates through February of 2012.

At June 30, 2008, the approximate minimum rental commitments under these leases are as follows:

Years ending June 30,		
2009	$	93,274
2010		78,276
2011		72,476
2012		35,840
	$	279,866

Rent expense associated with these lease arrangements totaled $111,021 and $195,264 for the years ended June 30, 2008 and 2007, respectively.

In addition, the Museum subleases to unrelated parties a parking lot and certain other facilities under single-year leases. Annual rental revenues for the years ended June 30, 2008 and 2007 totaled approximately $331,000 and $326,000, respectively.

18. Other Commitments and Contingencies

The Museum has entered into several contracts regarding future exhibitions. Outstanding commitments under these contracts totaled approximately $465,875 and $541,000 for the years ended June 30, 2008 and 2007, respectively.

19. Related Party Transactions

From time to time, the Museum enters into transactions with individuals or entities that have a relationship to a member of the Board of Trustees. These transactions have been subject to Board approval, which management believes approximates fair value.

There were no related party transactions during the years ended June 30, 2008 or 2007.

20. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each major class of financial instruments appearing on the statements of financial position, for which it was practicable to estimate that value (for all categories listed, carrying value approximates fair value).

- *Cash and cash equivalents* – These assets consist primarily of cash in banks and investments in short-term, interest-bearing instruments that are carried at cost plus accrued interest.
- *Pledges receivable* – Fair value, after allowances for uncollectible amounts, was determined by discounting the expected future cash flows by a risk-free short-term borrowing rate (using the ca. 3.99% yield on U.S. Treasury 10-year notes at June 30, 2008).
- *Investments* – The fair value of investments, which consist primarily of equity securities, debt securities, investment funds and limited partnerships, was based principally upon quoted market prices or, if unavailable, was determined by the general partners of limited partnerships.
- *Notes payable* – The fair value of these liabilities was based upon discounting of future cash flows (using the 3.71% rate ascribed to the Museum's variable rate notes payable at June 30, 2008).

The carrying values and fair values of these financial instruments are summarized in the following table:

	Carrying Value	Fair value
Cash and cash equivalents	$ 7,118,517	7,118,157
Pledges receivable	12,559,596	12,015,515
Investments	43,348,171	43,348,171
Notes payable	15,807,157	14,247,509

The carrying values of all other financial instruments approximate their estimated fair values.

22. Reclassification of 2007 Comparative Totals

Certain 2007 amounts presented herein have been reclassified to conform to the 2008 presentation.

21. Statements of Cash Flows Reconciliation

The following presents a reconciliation of the increase (decrease) in net assets (as reported on the statements of activities) to net cash provided by operating activities (as reported on the statements of cash flows):

	2008	2007
Increase (decrease) in total net assets	$ (1,513,171)	4,413,467
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation	1,646,803	1,667,912
Net (appreciation) decline in the fair market value of investments	3,223,183	(6,032,797)
Acquisition of works of art	612,121	1,490,412
Proceeds from contributions restricted to long-term investment	(1,812,433)	(1,500,829)
Forgiveness of debt *(note 16)*	–	(600,000)
Net (increase) decline in beneficial interest in the net assets of the Oregon Arts Heritage Endowment Fund	516,616	(786,692)
Net changes in:		
Accounts receivable	52,617	(123,591)
Pledges receivable	1,724,763	6,266,955
Inventories and prepayments	1,110	627,961
Other assets	(69,125)	(46,056)
Accounts payable and accrued liabilities	160,246	142,578
Deferred revenues	189,313	38,093
Deferred compensation *(note 15)*	(2,841,334)	374,954
Total adjustments	3,403,880	1,518,900
Net cash provided by operating activities	$ 1,890,709	5,932,367

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GOVERNING BOARD AND MANAGEMENT

[1] Executive committee
[2] Finance committee
[3] Audit committee
[4] Investment committee

INQUIRIES AND OTHER INFORMATION

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