



Smithsonian Institution

Office of the Inspector General

Memo

Date: January 8, 2019

To: David M. Rubenstein, Chair, Board of Regents
John W. McCarter, Jr., Chair, Audit and Review Committee, Board of Regents
Dr. David J. Skorton, Secretary

Cc: Albert G. Horvath, Chief Operating Officer and Under Secretary for Finance and Administration and Chief Financial Officer
Mike McCarthy, Deputy Under Secretary for Finance and Administration
Jean Garvin, Director, Office of Finance and Accounting
Porter Wilkinson, Chief of Staff to the Board of Regents
Greg Bettwy, Chief of Staff, Office of the Secretary

From: Cathy L. Helm, Inspector General *Cathy L. Helm*

Subject: *Independent Auditor's Report on the Smithsonian Institution's Fiscal Year 2018 Financial Statements (OIG-A-19-03)*

This memorandum transmits the second of three component reports of the fiscal year 2018 financial statement audits of the Smithsonian Institution (Smithsonian) performed by the independent public accounting firm of KPMG LLP (KPMG). On January 8, 2019, KPMG issued its independent auditor's report on the statement of the Smithsonian Institution's financial position as of September 30, 2018, and the related statements of financial activity and cash flows. KPMG expressed an unmodified opinion that concluded the financial statements were presented fairly, in all material respects, in accordance with the applicable financial reporting standards.

As part of our oversight activities, we reviewed KPMG's audit documentation and interviewed its representatives. Our review of KPMG's fiscal year 2018 audit procedures disclosed no instances where KPMG did not comply, in all material respects, with the applicable auditing standards.

Our oversight of KPMG's audit was not intended to enable us to express, and we do not express, an opinion about the Smithsonian's financial statements, internal controls over financial reporting, or compliance with laws and regulations. KPMG is responsible for its audit report and the conclusions therein.

If you have any questions, please do not hesitate to contact me or Joan T. Mockeridge, Assistant Inspector General for Audits, at (202) 633-7050.

Attachment



SMITHSONIAN INSTITUTION

Financial Statements

September 30, 2018

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

The Office of the Inspector General, Audit and Review Committee
of the Board of Regents, and Secretary Skorton
Smithsonian Institution:

We have audited the accompanying financial statements of Smithsonian Institution (Smithsonian), which comprise the statement of financial position as of September 30, 2018, and the related statements of activities and cash flows for the year 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 U.S. generally accepted accounting principles; 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 audit. We conducted our audit 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 Smithsonian'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 Smithsonian Institution as of September 30, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

Fund Detail

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The fund detail is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the fund detail is fairly stated in all material respects in relation to the financial statements as a whole.

Report on Summarized Comparative Information

We have previously audited the Smithsonian's 2017 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated January 22, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2017 is consistent, in all material respects, with the audited financial statements from which it has been derived.

KPMG LLP

Washington, District of Columbia
January 8, 2019

SMITHSONIAN INSTITUTION

Statement of Financial Position

September 30, 2018

(with summarized financial information as of September 30, 2017)

(Dollars in millions)

	Fund detail		Total funds	
	Trust	Federal	2018	2017
Assets:				
Cash, cash equivalents and U.S. Treasury balances	\$ 109.4	524.6	634.0	440.2
Receivables and advances	250.9	3.1	254.0	282.1
Inventories	12.8	0.3	13.1	13.5
Deferred expenses and other assets	47.7	—	47.7	58.8
Investments	1,880.6	—	1,880.6	1,752.9
Property and equipment, net	746.2	1,600.9	2,347.1	2,342.3
Total assets	\$ 3,047.6	2,128.9	5,176.5	4,889.8
Liabilities:				
Accounts payable and accrued expenses	\$ 124.2	165.0	289.2	296.1
Deferred revenue	59.2	—	59.2	59.1
Unexpended federal appropriations	—	461.1	461.1	289.0
Deferred gain on sale of real estate	8.2	—	8.2	12.1
Environmental remediation obligation	—	49.8	49.8	49.9
Long-term debt	148.0	—	148.0	199.6
Total liabilities	339.6	675.9	1,015.5	905.8
Net assets:				
Unrestricted	1,389.2	1,453.0	2,842.2	2,766.5
Temporarily restricted	772.6	—	772.6	692.0
Permanently restricted	546.2	—	546.2	525.5
Total net assets	2,708.0	1,453.0	4,161.0	3,984.0
Commitments and contingencies				
Total liabilities and net assets	\$ 3,047.6	2,128.9	5,176.5	4,889.8

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION
Statement of Activities
Year ended September 30, 2018
(with summarized financial information for year ended September 30, 2017)
(Dollars in millions)

	Unrestricted fund detail			Temporarily restricted trust funds	Permanently restricted trust funds	Total funds	
	Trust	Federal	Total			2018	2017
Operating revenues and other additions:							
Government revenue:							
Federal appropriations	\$ —	870.4	870.4	—	—	870.4	841.0
Government grants and contracts	117.5	—	117.5	—	—	117.5	113.7
Total government revenue	117.5	870.4	987.9	—	—	987.9	954.7
Contributions	41.5	—	41.5	135.9	18.8	196.2	187.1
Business activities and other:							
Business activities	183.2	—	183.2	—	—	183.2	201.9
Short-term investment income	4.0	—	4.0	—	—	4.0	2.5
Endowment payout	42.6	—	42.6	33.9	—	76.5	75.5
Private grants	8.0	—	8.0	—	—	8.0	6.7
Rentals, fees, commissions, and other	22.1	10.4	32.5	—	—	32.5	31.7
Gain on sale of real estate	3.9	—	3.9	—	—	3.9	3.9
Imputed benefit revenue	—	71.3	71.3	—	—	71.3	50.7
Total business activities and other	263.8	81.7	345.5	33.9	—	379.4	372.9
Total operating revenues	422.8	952.1	1,374.9	169.8	18.8	1,563.5	1,514.7
Net assets released from restrictions	144.4	—	144.4	(144.4)	—	—	—
Total operating revenues and other additions	567.2	952.1	1,519.3	25.4	18.8	1,563.5	1,514.7
Expenses:							
Program activities:							
Research	142.5	160.2	302.7	—	—	302.7	298.7
Collections management	28.1	243.8	271.9	—	—	271.9	239.6
Education, public programs, and exhibitions	104.6	274.4	379.0	—	—	379.0	381.6
Business activities	156.4	—	156.4	—	—	156.4	150.4
Total program activities	431.6	678.4	1,110.0	—	—	1,110.0	1,070.3
Supporting activities:							
Administration:							
Centrally managed	20.6	104.1	124.7	—	—	124.7	122.3
Unit managed	63.5	133.6	197.1	—	—	197.1	196.8
Advancement	49.6	1.4	51.0	—	—	51.0	64.0
Total supporting activities	133.7	239.1	372.8	—	—	372.8	383.1
Total expenses	565.3	917.5	1,482.8	—	—	1,482.8	1,453.4
Change in net assets before nonoperating activities	1.9	34.6	36.5	25.4	18.8	80.7	61.3
Nonoperating activities:							
Environmental remediation costs	—	—	—	—	—	—	1.4
Gain on partial sale of Smithsonian Network	12.4	—	12.4	—	—	12.4	—
Gain on note repayment	0.7	—	0.7	—	—	0.7	—
Nonoperating investment gains - Endowment	39.4	—	39.4	55.2	1.9	96.5	99.2
Change in net assets of related organizations and other	3.6	—	3.6	—	—	3.6	2.2
Losses on disposition of assets	—	(0.5)	(0.5)	—	—	(0.5)	(0.5)
Collection items not capitalized:							
Proceeds from sales	—	—	—	—	—	—	—
Collection items purchased	(14.1)	(2.3)	(16.4)	—	—	(16.4)	(10.4)
Change in net assets	43.9	31.8	75.7	80.6	20.7	177.0	153.2
Net assets, beginning of year	1,345.3	1,421.2	2,766.5	692.0	525.5	3,984.0	3,830.8
Net assets, end of year	\$ 1,389.2	1,453.0	2,842.2	772.6	546.2	4,161.0	3,984.0

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Statement of Cash Flows

Year ended September 30, 2018

(with summarized financial information for year ended September 30, 2017)

(Dollars in millions)

	Fund detail		Total funds	
	Trust	Federal	2018	2017
Cash flows from operating activities:				
Change in net assets	\$ 145.2	31.8	177.0	153.2
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:				
Loss on disposition of assets	—	0.5	0.5	—
Collection items purchased	14.1	2.3	16.4	10.4
Depreciation and amortization	53.3	109.8	163.1	153.6
Present value discount and accretion	(0.1)	0.9	0.8	0.6
Contributions for permanent restricted purposes	(18.8)	—	(18.8)	(14.1)
Contributions for construction of facilities	(7.1)	—	(7.1)	(13.3)
Appropriations for repair, restoration, and construction	—	(136.6)	(136.6)	(121.5)
Net investment gains	(155.2)	—	(155.2)	(161.0)
Gain on partial sale of Smithsonian Network	(12.4)	—	(12.4)	—
Gain on note repayment	(0.7)	—	(0.7)	—
Decrease (increase) in assets:				
Receivables and advances	(15.3)	(0.8)	(16.1)	33.4
Inventories	0.4	—	0.4	(0.4)
Deferred expenses and other assets	(0.7)	—	(0.7)	(1.6)
Increase (decrease) in liabilities:				
Accounts payable and accrued expenses	(11.2)	0.5	(10.7)	29.3
Deferred revenue	0.1	—	0.1	(0.3)
Unexpended federal appropriations	—	(3.8)	(3.8)	9.4
Deferred gain on sale of real estate	(3.9)	—	(3.9)	(3.9)
Environmental remediation obligation	—	(1.0)	(1.0)	(2.2)
Net cash (used in) provided by operating activities	<u>(12.3)</u>	<u>3.6</u>	<u>(8.7)</u>	<u>71.6</u>
Cash flows from investing activities:				
Collection items purchased	(14.1)	(2.3)	(16.4)	(10.4)
Purchases of property and equipment	(24.9)	(139.3)	(164.2)	(183.4)
Disposition of assets	—	(0.5)	(0.5)	—
Purchases of investment securities	(586.3)	—	(586.3)	(472.3)
Proceeds from sales/maturities of investment securities	613.9	—	613.9	445.9
Proceeds from partial sale of Smithsonian Network	24.2	—	24.2	—
Proceeds from loan receivable	2.7	—	2.7	—
Net cash provided by (used in) investing activities	<u>15.5</u>	<u>(142.1)</u>	<u>(126.6)</u>	<u>(220.2)</u>
Cash flows from financing activities:				
Contributions for permanent restricted purposes	24.2	—	24.2	27.3
Contributions for construction of facilities	43.9	—	43.9	22.1
Appropriations for repair, restoration, and construction	—	312.5	312.5	133.3
Principal payments on long-term debt	(51.5)	—	(51.5)	(1.5)
Net cash provided by financing activities	<u>16.6</u>	<u>312.5</u>	<u>329.1</u>	<u>181.2</u>
Net change in cash, cash equivalents and U.S. Treasury balances	19.8	174.0	193.8	32.6
Cash, cash equivalents and U.S. Treasury balances:				
Beginning of year	89.6	350.6	440.2	407.6
End of year	<u>\$ 109.4</u>	<u>524.6</u>	<u>634.0</u>	<u>440.2</u>
Noncash investing activities:				
Construction cost accruals	\$ 2.2	14.0	16.2	12.5
Cash paid for interest	\$ 4.2	—	4.2	3.8

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2018

(Dollars in millions)

(1) Organization

The Smithsonian Institution (Smithsonian) was created by act of Congress in 1846 in accordance with the terms of the will of James Smithson of England, who, in 1826, bequeathed property to the United States of America “to found at Washington, under the name of the Smithsonian Institution, an establishment for the increase and diffusion of knowledge among men.” Congress established the Smithsonian as a trust of the United States of America and vested responsibility for its administration in the Smithsonian Board of Regents (Board).

The Smithsonian is a museum and an education and research complex consisting of 17 museums and the National Zoological Park in Washington, DC, and two museums in New York City. Additional facilities and programs are operated in five states and Panama. Research is carried out in the museums and other facilities throughout the world. During fiscal year 2018, 28.8 million individuals visited Smithsonian museums and other facilities.

As of September 30, 2018, the Smithsonian’s extensive collection contained approximately 155.1 million objects: 0.4 million works of art, 8.8 million historical artifacts, and 145.9 million natural and physical science specimens (living and nonliving). The Smithsonian also maintains 173,900 cubic feet and 0.7 million items of archival holdings and 2.1 million library volumes. During fiscal year 2018, approximately 105,600 natural and physical science specimens were disposed of.

A substantial portion of the Smithsonian’s operations is funded by annual federal appropriations. Federal appropriations are also received for the construction or repair and restoration of its facilities. Construction of certain facilities has been funded entirely by federal appropriations, while others have been funded by a combination of federal and private funds.

In addition to federal appropriations, the Smithsonian receives private support, government grants and contracts, and earns income from investments and its various business activities. Business activities include Smithsonian magazines, other publications, online catalogs, and theaters, shops and food services located in its museums and centers.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The financial statements present the financial position, financial activities, and cash flows of the Smithsonian on the accrual basis of accounting. Funds received from direct federal appropriations and related transactions are reported as federal funds. All other funds and related transactions are reported as trust funds.

These financial statements include certain fiscal year 2017 summarized, comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Smithsonian’s financial statements as of and for the year ended September 30, 2017, from which the summarized information was derived.

These financial statements do not include the accounts of the National Gallery of Art, the John F. Kennedy Center for the Performing Arts, or the Woodrow Wilson International Center for Scholars,

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(Dollars in millions)

which were established by Congress within the Smithsonian, but are governed by independent boards of trustees and therefore not controlled by the Smithsonian.

Expenses are presented on a functional basis in the statement of activities. Programs include research, collections management, education, public programs and exhibitions, and business activities. Supporting services include administration and advancement. Administration is reported as centrally managed, through the Office of Under Secretary for Finance and Administration, or unit managed, as part of an individual museum or center. Depreciation, security, and other general operating costs that benefit more than one program are allocated across programs and services based on relative square feet.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Actual results could differ from those estimates. The most significant estimates affecting the Smithsonian's financial statements relate to the net asset value of nonmarketable investments, environmental remediation obligations and other liabilities, and the allowance for contributions receivable.

(c) Federal Funds

Federal appropriations revenues are classified as unrestricted and recognized as exchange transactions as expenses are incurred. The net assets of federal funds consist primarily of the Smithsonian's net investment in property and equipment purchased with or constructed using federal funds less unfunded liabilities for environmental remediation obligations and annual leave and estimated Federal Employee Compensation Act (FECA) liabilities for workers compensation claims.

For fiscal 2018, the Smithsonian was appropriated \$731.4 for operations and \$311.9 for construction or repair and restoration of facilities. Federal appropriations for operations are generally available for two years. Federal appropriations for construction or repair and restoration of facilities are generally available for obligation until expended. Unexpended appropriation is shown in the liability section of the statement of financial position.

In accordance with Public Law 110-161, appropriations for operations are maintained for five years following the year of appropriation, at which time the appropriation account is closed and any unexpended balance is returned to the U.S. Treasury. During fiscal year 2018, the unexpended balance of the fiscal 2012 appropriation, amounting to \$0.8, was returned.

(d) Trust Funds

Trust net assets, revenues, expenses and gains and losses are classified and reported based on the existence or absence of donor-imposed restrictions as follows:

(i) Unrestricted

Unrestricted net assets are not subject to donor-imposed or other legal stipulations on the use of the funds. Funds functioning as endowment (board designated) in this category represent unrestricted net assets that have been designated by the Board for long-term investment.

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(Dollars in millions)

(ii) Temporarily Restricted

Temporarily restricted net assets are subject to donor-imposed stipulations that may be met by actions of the Smithsonian and/or the passage of time. Donor restricted and board designated endowment funds in this category represent donor-restricted contributions and accumulated earnings from true endowments that have been designated for long-term investment, respectively. Once the temporary restriction has been met (i.e., the donor stipulation has been fulfilled, assets placed in service, and/or the stipulated time period has elapsed), net assets are reported as reclassifications from temporarily restricted net assets to unrestricted net assets.

(iii) Permanently Restricted

Permanently restricted net assets are subject to donor-imposed stipulations requiring the principal be maintained permanently by the Smithsonian. Generally, the donors of these assets permit the use of all or part of the income earned on investment of the assets for either general or donor-specified purposes.

Trust fund revenues are reported as increases in unrestricted net assets unless the use of the related assets is limited by the donor. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Losses on investments that reduce the assets of donor-restricted endowment funds below the level required by donor stipulations or by law are generally classified as reductions of unrestricted net assets and reported as non-operating losses in the statement of activities. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level are classified as increases in unrestricted net assets and reported as non-operating gains in the statement of activities.

(e) Cash Equivalents

The Smithsonian considers all highly liquid investments purchased with an average maturity of three months or less, including U.S. Treasury balances, to be cash equivalents. Cash equivalents for trust funds include funds held by the U.S. Treasury of \$19.4 and \$62.8 of institutional money market funds with maturity dates of three months or less. Cash and cash equivalents for federal funds consist entirely of U.S. Treasury balances of \$524.6 for federal appropriation capital and operating expenses.

(f) Working Capital

The Smithsonian has adopted a working capital policy to meet immediate and long-term cash needs using high-quality investments. The working capital investment policy requires funds be invested in short-term instruments that will allow for required liquidity and provide a maximum interest return within defined risk constraints. As of September 30, 2018, the fund, totaling \$275.0, is comprised of \$62.8 in cash equivalents with maturity dates of three months or less and short-term investments of \$212.2, all of which are included in investments (see note 5).

(g) Trade Accounts Receivable

Trade accounts receivable generally consists of accounts receivable related to magazine advertising and certain concession agreements and are stated at invoice amount. Allowances are recognized for uncollectible amounts based on past collection experience.

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(h) Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the appropriate category of net assets in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at estimated fair value at the date of gift, except items that are contributed and held as part of the Smithsonian's collections are not capitalized. Contributions restricted to the acquisition of long-lived assets are recorded as temporarily restricted revenue in the period received. Generally, the donor's restrictions are considered met and the net assets are released from restriction when the related long-lived asset is placed in service.

Contributions receivable are reported net of management's estimate of uncollectible amounts which is based on judgment and analyses of donors' creditworthiness, past collection experience, and other relevant factors. Estimated collectible contributions scheduled to be received after one year are discounted using a risk-adjusted rate for the expected period of collection. Amortization of the discount is recorded as contribution revenue.

In-kind contributions of goods and services totaling \$13.3 were received in fiscal year 2018 and recognized as program support revenues and expenses in the statement of activities. In-kind contributions include donated space, equipment, and various other items. A substantial number of volunteers also make significant contributions of time to the Smithsonian, enhancing its activities and programs. Approximately 7,100 volunteers contributed about 532,400 hours of service to the Smithsonian during fiscal year 2018. In accordance with applicable guidance, the value of these contributions is not recognized in the financial statements.

(i) Deferred Revenues and Expenses

Revenues from magazine subscriptions and long-term contracts are deferred and recognized ratably over the period of the underlying agreement.

Promotion production expenses are recognized when related advertising materials are released. Direct-response advertising relating to the magazines is deferred and amortized over one year. As of September 30, 2018, deferred expenses and other assets include \$6.8 of deferred promotion costs, related primarily to the magazines. Advertising expense, including direct response advertising of \$7.3, totaled \$12.0 in fiscal year 2018 and is included in business activities expenses in the statement of activities.

(j) Inventories

Inventories are reported at the lower of cost or market, and consist primarily of merchandise and books. Cost is determined using the first-in, first-out method.

(k) Investments

Smithsonian employs an investment strategy that utilizes equities, marketable alternatives, fixed income, private equity and venture capital, natural resources and real estate, and cash and cash equivalents to fulfill its fiduciary responsibility to its donors and constituents.

Investments in fixed income, certain global equities, publicly traded natural resources and cash and cash equivalents, including gift annuity program investments are reported at fair value, which are

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(Dollars in millions)

determined primarily based on quoted market prices. Investments in private equity and venture capital, certain real estate, natural resources, marketable alternatives, and public equities held through commingled funds (collectively, nonmarketable investments) are stated at estimated fair value based on the funds' net asset values, or their equivalents (collectively, NAV) as a practical expedient, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of September 30, 2018, the Smithsonian had no plans or intentions to sell investments at amounts different from NAV. These estimated fair values may differ from the values that would have been used had a ready market existed for these investments, and the differences could be significant.

Investments are exposed to various risks including business, interest rate, market, exchange rate, liquidity, and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that significant changes in the values of investments could occur in the near term.

Changes in fair value are recognized in the statement of activities. Purchases and sales of investments are recorded on the trade date using average cost. Investment income is recorded when earned.

(l) Split Interest Agreements and Perpetual Trusts

Split interest agreements with donors consist primarily of irrevocable charitable remainder trusts, charitable gift annuities, and perpetual trusts. The assets for the charitable trusts are included in receivables and advances. Contribution revenues from charitable remainder trusts are recognized at the dates the trusts are established based on the net present value of the estimated future payments to be made to the donors and/or other beneficiaries. For the charitable gift annuities, assets are recognized at fair value at the dates of the annuity agreements and included in investments. An annuity liability is recognized for the present value of future cash flows expected to be paid to the donor and contribution revenues are recognized equal to the difference between the assets and the annuity liability. Liabilities are adjusted during the terms of the annuities for payments to donors, accretion of discounts, and changes in the life expectancies of the donors.

The Smithsonian is also the beneficiary of certain perpetual trusts held and administered by others. The fair values of the trusts are recognized as assets and contribution revenues at the dates the trusts are established. Distributions from the trusts are recorded as investment income and the assets are adjusted for changes in the fair value of the trust assets.

(m) Property and Equipment

Property and equipment purchased with federal or trust funds are recorded at cost. Property and equipment acquired through transfers from government agencies are recorded at net book value or fair

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September 30, 2018

(Dollars in millions)

value at the date of transfer, whichever is more readily determinable. Property and equipment acquired through donation are recorded at estimated fair value at the date of the gift.

Property and equipment assets are depreciated on a straight-line basis over their estimated useful lives as follows:

Buildings	30 years
Major renovations	15 years
Equipment and software	3–7 years
Exhibit costs	10 years

Leasehold improvements are amortized over the shorter of the lease term or their useful lives.

Rent expense under operating leases that provide for scheduled rent increases over their terms is recognized on a straight-line basis.

Certain land occupied by Smithsonian buildings, located primarily in the District of Columbia, Maryland, and Virginia, were appropriated and reserved by Congress for the Smithsonian's use. The Smithsonian serves as trustee of the land for as long as they are used to carry out its mission. The land are titled in the name of the U.S. government and are not included in the accompanying financial statements.

(n) Collections – Stewardship Assets

The Smithsonian acquires its collections by purchase (using federal or trust funds) or by donation. Collections are held for public exhibition, education, or research. The Smithsonian's collections management policy includes guidance on the preservation, care, and maintenance of the collections and procedures relating to the accession/deaccession of collection items.

In conformity with the practice generally followed by museums, no value is assigned to the collections in the statement of financial position. Purchases of collection items are recognized as reductions in unrestricted net assets in the period of acquisition. Proceeds from deaccessions or insurance recoveries for lost or destroyed collection items are recognized as increases in the appropriate net asset class and are designated for future collection acquisitions.

Noncash deaccessions result from the exchange, donation, or destruction of collection items, and occur because objects deteriorate, are outside the scope of a museum's mission, or are duplicative. During the fiscal year, noncash deaccessions included works of art, animals, historical objects, and natural specimens.

Items that are acquired with the intent to sell, exchange, or otherwise be used for financial gain are not considered collection items and are recorded as other assets at their fair value at the date of acquisition. Contributed items held for sale, amounting to \$0.9, are included in other assets.

(o) Annual Leave

The Smithsonian's federal and trust employees earn annual leave in accordance with federal laws and regulations and internal policies, respectively. Annual leave for all employees is recognized as an expense when earned. The liability for unused annual leave is included in accounts payable and

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accrued expenses in the statement of financial position aggregated to \$15.0 for trust and \$28.9 for federal as of September 30, 2018.

(p) Sponsored Projects

The Smithsonian receives grants and enters into contracts with U.S. federal, state and local governments, which generally provide for reimbursement of costs. Revenues under these agreements are recognized as reimbursable expenditures are incurred as government grants and contracts. These revenues include recoveries of facilities and administrative costs that are generally based on a negotiated or agreed-upon percentage of direct costs, with certain exclusions.

(q) Advancement

The Smithsonian raises private financial support from individual donors, corporations, and foundations to fund programs and other initiatives. Financial support is also generated through numerous membership programs. Fund-raising costs are expensed as incurred and reported as advancement expenses in the statement of activities.

(r) Non-operating Activities

Non-operating activities include environmental remediation costs, non-operating investment income, changes in the net assets of related organizations, and changes in net assets related to collection items.

Non-operating investment income is calculated as the difference between the total return on the endowment (i.e., dividends, interest and net gain or loss) and the annual payout of the endowment funds, used to support operations.

The Smithsonian recognizes its interest in the net assets of organizations that are financially interrelated and the changes in its interest using a method similar to the equity method of accounting. The principal financially interrelated organizations are the Smithsonian Network and Friends of the National Zoo. During fiscal year 2018, the Smithsonian sold half of its interest in the Smithsonian Network recognizing a gain of \$12.4.

(s) Income Taxes

The Smithsonian is recognized as exempt from income taxation under the provisions of Section 501(c)(3) of the Internal Revenue Code. Organizations described in that Section are taxable only on their unrelated business income. Advertising sales are the principal source of unrelated business income for the Smithsonian. The provision for income taxes was not material for fiscal year 2018. The Smithsonian recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. The Smithsonian does not believe its financial statements include any uncertain tax positions.

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(3) Receivables and Advances

Receivables and advances consisted of the following as of September 30, 2018:

	<u>Trust</u>	<u>Federal</u>	<u>Total</u>
Contributions receivable, net	\$ 192.9	—	192.9
Grants and contracts	21.5	—	21.5
Charitable trusts	19.3	—	19.3
Trade accounts, net of \$0.5 allowances	15.1	3.1	18.2
Accrued interest and dividends	1.8	—	1.8
Advances and other	0.3	—	0.3
	<hr/>	<hr/>	<hr/>
Total receivables and advances	\$ 250.9	3.1	254.0
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Contributions receivable consist of the following:

Due within:		
Less than 1 year		\$ 102.6
1 to 5 years		100.3
5 years or beyond		0.1
		<hr/>
		203.0
Less:		
Allowance for uncollectible contributions		(4.6)
Unamortized discount (at rates ranging from 1.1% to 2.9%)		(5.5)
		<hr/>
Contributions receivable, net		\$ 192.9
		<hr/> <hr/>

(4) Federal Appropriations

Fiscal year 2018 federal appropriation is reconciled to federal appropriation revenue as follows:

	<u>Salaries and expenses</u>	<u>Repair and restoration and construction</u>	<u>Total</u>
Fiscal year 2018 federal appropriation	\$ 731.4	311.9	1,043.3
Unexpended 2018 appropriation	(93.1)	(283.2)	(376.3)
Amounts expended from prior years' appropriations	95.5	107.9	203.4
	<hr/>	<hr/>	<hr/>
Federal appropriation revenue	\$ 733.8	136.6	870.4
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

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Fiscal year 2018 federal appropriation is reconciled to federal appropriation expenses as follows:

	<u>Salaries and expenses</u>	<u>Repair and restoration and construction</u>	<u>Total</u>
Fiscal year 2018 federal appropriation	\$ 731.4	311.9	1,043.3
Unexpended 2018 appropriation	(93.1)	(283.2)	(376.3)
Depreciation	12.1	97.7	109.8
Imputed benefit costs	71.3	—	71.3
Collection items purchased	(2.3)	—	(2.3)
Amounts expended from prior years' appropriations	95.5	107.9	203.4
Capital expenditures	(2.6)	(136.7)	(139.3)
Loss on disposition of assets	0.5	—	0.5
Unfunded expenses – FECA, annual leave, and actuarial adjustment	(0.8)	9.2	8.4
Other funding	<u>(1.3)</u>	<u>—</u>	<u>(1.3)</u>
 Federal appropriation expense	 <u>\$ 810.7</u>	 <u>106.8</u>	 <u>917.5</u>

Unexpended appropriations for all fiscal years total \$461.1 as of September 30, 2018 and consist of \$132.0 in unexpended operating funds and \$329.1 in unexpended construction funds. Unexpended operating and construction funds represent amounts appropriated for Smithsonian's operations and new facilities or renovations, respectively.

(5) Investments and Fair Value Measurements

The Smithsonian has adopted investment policies for its endowment, including board designated funds, which attempt to provide a predictable stream of funding in support of the operating budget, while seeking to preserve the real value of the endowment assets over time. The Smithsonian relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends), targeting a diversified asset allocation. The Board's Investment Committee reviews the long-term asset allocation for the endowment.

The three levels of the fair value hierarchy for recurring fair value measurements are prioritized based on the inputs to valuation techniques used to measure fair value and are as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities, as of the reporting date.

Level 2 – Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following summarizes Smithsonian's investments at fair value which are determined primarily based on quoted market prices as of September 30, 2018:

	<u>Total</u>	<u>Level 1</u>	<u>Level 3</u>	<u>NAV ⁽¹⁾</u>
Fixed income	\$ 212.2	212.2	—	—
Endowment investments:				
Global equities:				
Global markets	57.0	57.0	—	—
Emerging markets	5.6	5.6	—	—
Real assets:				
Energy and natural resources	31.1	31.1	—	—
Fixed income	69.9	69.9	—	—
Cash and equivalents	16.3	16.3	—	—
Pooled investments	179.9	179.9	—	—
Investments at NAV	1,462.5	—	—	1,462.5
Total pooled investments	1,642.4	179.9	—	1,462.5
Nonpooled investments:				
U.S. Treasury deposits	1.0	1.0	—	—
Total endowment	1,643.4	180.9	—	1,462.5
Gift annuities, primarily equities	25.0	25.0	—	—
Total investments	1,880.6	418.1	—	1,462.5
Charitable trusts	19.3	—	19.3	—
	<u>\$ 1,899.9</u>	<u>418.1</u>	<u>19.3</u>	<u>1,462.5</u>

⁽¹⁾ Investments held through limited partnerships and comingled funds for which fair value is estimated using the NAV's reported by the investment managers as a practical expedient have not been categorized within the fair value hierarchy; however, these investments are included in the table above to permit reconciliation with the statement of financial position.

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The following summarizes information relating to the investments, which are stated at NAV as practical expedient for fair value and includes information about the nature, strategies, and risks of these major classes of nonmarketable investments:

	<u>NAV</u>	<u>Redemption terms</u>	<u>Days of notices</u>	<u>Unfunded commitments</u>
Global equity:				
Developed markets	\$ 292.6	Weekly to annually	6-91	\$ —
Emerging markets	106.7	Monthly to quarterly	10-90	—
Marketable alternatives:				
Long/short equity	111.8	Monthly to annually	60	—
Credit and distressed	110.7	Annually to at maturity	90-n/a	41.6
Multistrategy	29.4	Quarterly	60	—
Global marco	58.3	Monthly to semi-annually	2-60	—
Private equity:				
Private equity	149.5	Not applicable	N/A	84.8
Venture capital	326.6	Not applicable	N/A	87.1
Real assets:				
Energy and natural resources	110.7	Quarterly to at maturity	45-n/a	27.9
Real estate funds	140.9	Quarterly to at maturity	60-n/a	90.2
Fixed income	<u>25.3</u>	Quarterly to at maturity	90-n/a	<u>—</u>
	<u>\$ 1,462.5</u>			<u>\$ 331.6</u>

The following describes the nature, strategies, and risks of the major classes of the investments that are stated at NAV for fair value.

(a) Global Equity

Global equity is comprised of investments in funds and strategies invested in publicly listed equity securities in the global developed and emerging markets. Some of the funds are subject to lock-ups.

(b) Marketable Alternatives

Marketable alternatives consist of investments in a broad array of securities and strategies aimed to reduce volatility and enhance returns. Smithsonian's marketable alternatives are broadly defined as long/short equity, credit and distressed, multi-strategy, and global macro funds. Long/short equity funds invest in long equity positions that are expected to increase in value and short equity positions in stocks that are expected to decrease in value. Credit and distressed funds generally invest in corporate fixed income and debt securities of companies that are experiencing financial or operational difficulties. Multi-strategy funds invest across different strategies to diversify risks and reduce volatility. Global macro funds invest in strategies to profit from macroeconomic events that may include changes in interest rates, currency movements and stock market performance. Some of the funds are subject to soft and hard lock-ups and other funds are not eligible for redemption.

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(c) Private Equity and Venture Capital

Private equity consists of limited partnerships that are organized to invest primarily in shares of operating companies that are not listed on a publicly traded stock exchange. Private equity strategies include investments in leveraged buyouts, growth capital and distressed investments. Venture capital strategies invest in start-ups and small businesses with perceived long-term growth potential. Distributions to limited partners are made as soon as feasible and, in accordance with the limited partnership agreement, when realizations (sales of portfolio companies) are made, or when interest payments, dividends, or recapitalizations are received.

(d) Real Assets

Real assets include real estate and energy and natural resources investments that are made mostly in private limited partnerships as well as publicly traded securities funds. Distributions to limited partners are made as soon as feasible and, in accordance with the limited partnership agreement, when realizations (sales of portfolio companies) are made, or when interest payments, dividends, or recapitalizations are received.

(e) Fixed Income

Fixed income includes funds that invest in U.S. government, agency and municipal bonds, and other interest bearing products.

The Smithsonian is obligated under the terms of certain limited partnership agreements to remit additional funding periodically as capital calls are exercised. As of September 30, 2018, the Smithsonian had uncalled commitments totaling approximately \$331.6. Such commitments are callable over the fund investment period, generally the first five years of the funds. The standard life of Smithsonian's investments in these private partnerships are between 8 to 10 years with possible one to two one-year extension periods and/or other termination clauses.

Activity for charitable trusts measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for fiscal year 2018: beginning balance \$19.1; distribution \$0.4; net gains \$0.6; and ending balance \$19.3. There are no transfers and reclassifications of assets between levels during fiscal year 2018.

Investment return consisted of the following for fiscal year 2018:

Dividend and interest income	\$	23.7
Net investment gains		155.2
Investment management fees		<u>(1.9)</u>
	\$	<u><u>177.0</u></u>

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Investment return is classified in the statement of activities as follows for fiscal year 2018:

Short-term investment income	\$	4.0
Endowment payout		76.5
Nonoperating investment gain		96.5
		<hr/>
Investment return	\$	<u>177.0</u>

(6) Endowment Funds

The Smithsonian endowment consists of over 600 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board to function as endowments (board designated). Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Smithsonian's management and investment of donor-restricted endowment funds follows the provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Based on the Smithsonian's interpretation of the provisions of UPMIFA, the organization is required to act prudently when making decisions to spend or accumulate donor-restricted endowment assets and in doing so to consider a number of factors including the duration and preservation of its donor restricted endowment funds. As a result of this interpretation, the Smithsonian classifies as permanently restricted net assets, the original value of gifts donated to the permanent endowment. The remaining portion of the endowment fund is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

The Smithsonian manages and invests the individual endowment funds considering UPMIFA standards. Substantially all of the investments of the endowment are pooled, with individual funds buying or disposing of units on the basis of the per unit market value at the beginning of the month in which the transaction takes place. As of September 30, 2018, the per unit market value of the pool, in whole dollars, was \$950.58.

Each fund participating in the investment pool receives an annual appropriation based on the number of units owned. The annual appropriation is determined in light of UPMIFA standards and the investment policy of the institution, which targets a long-term investment return assumption, an estimated inflation factor, and the investment policy of the institution that targets an appropriation to be 5% of the prior five years' average value of the endowment. The per unit payout for fiscal year 2018, in whole dollars, was \$41.12 or 5% of the average per unit market value of the endowment over the prior five years. An additional payout per eligible unit of \$6.31 (in whole dollars) was authorized and made to support the fund-raising campaign.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the original value of gifts donated to the permanent endowment. Deficiencies of this nature are reported in unrestricted net assets. Such deficiencies are generally the result of unfavorable market fluctuations and continuing the appropriations for various programs is generally deemed prudent by the Board. There were no such deficiencies at September 30, 2018.

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Endowment net assets, excluding contributions receivable, consist of the following as of September 30, 2018:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor restricted	\$ —	409.4	511.0	920.4
Board designated	<u>707.7</u>	<u>17.2</u>	<u>—</u>	<u>724.9</u>
Total endowment net assets	\$ <u>707.7</u>	<u>426.6</u>	<u>511.0</u>	<u>1,645.3</u>
Uninvested cash and receivables				<u>(2.9)</u>
Total endowment assets under management				\$ <u>1,642.4</u>

Activity in endowment net assets is as follows for the year ended September 30, 2018:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Balance, September 30, 2017	\$ 657.9	359.1	485.2	1,502.2
Investment return:				
Investment income	6.2	7.9	—	14.1
Realized and unrealized gains, net	<u>67.8</u>	<u>85.4</u>	<u>—</u>	<u>153.2</u>
Total investment return	74.0	93.3	—	167.3
Contributions, including board designated transfers	18.4	8.1	25.8	52.3
Appropriated for expenditure	<u>(42.6)</u>	<u>(33.9)</u>	<u>—</u>	<u>(76.5)</u>
Balance, September 30, 2018	\$ <u>707.7</u>	<u>426.6</u>	<u>511.0</u>	<u>1,645.3</u>

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(7) Property and Equipment

Property and equipment consists of the following as of September 30, 2018:

	<u>Trust</u>	<u>Federal</u>	<u>Total</u>
Land	\$ 12.6	—	12.6
Buildings and capital improvements	1,017.0	3,071.7	4,088.7
Equipment and software	178.0	242.5	420.5
Leasehold improvements	<u>105.6</u>	<u>35.0</u>	<u>140.6</u>
	1,313.2	3,349.2	4,662.4
Accumulated depreciation	<u>(567.0)</u>	<u>(1,748.3)</u>	<u>(2,315.3)</u>
Total property and equipment	\$ <u>746.2</u>	\$ <u>1,600.9</u>	\$ <u>2,347.1</u>

Buildings and capital improvements include \$65.6 and \$368.8 of construction in progress within trust and federal funds, respectively. Depreciation expense totaled \$53.3 in trust funds and \$109.8 in federal funds.

The Smithsonian has an unfunded environmental remediation obligation that is estimated based on third-party studies, contractor bids and internal estimates derived from recently completed remediation projects for similar Smithsonian facilities and other information for similar projects. The present value of the obligation is calculated using an inflation rate of 2.4% and a discount rate of 2.0%. Each period the obligation is accreted to its present value. Because the related properties are fully depreciated, changes in the estimated obligation are expensed. Any difference between the estimated obligation and the actual cost of remediation is also expensed. Fiscal year 2018 activity in the unfunded environmental remediation obligation follows:

Beginning balance, September 30, 2017	\$ 49.9
Accretion	0.9
Liabilities incurred	0.2
Liabilities settled	(0.2)
Change in estimate	<u>(1.0)</u>
Ending balance, September 30, 2018	\$ <u>49.8</u>

In fiscal year 2006, the Smithsonian sold an office building in Washington, DC, and entered into short-term and long-term leases for approximately 32% of the building. As a result of the leaseback, the full gain of \$62.9 was deferred at the date of sale and is being recognized over the term of the leases. In fiscal year 2018, \$3.9 of the deferred gain was recognized.

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(8) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consists of the following:

	<u>Trust</u>	<u>Federal</u>	<u>Total</u>
Accounts payable and other liabilities	\$ 28.8	68.7	97.5
Accrued salaries and benefits	39.7	96.3	136.0
Deferred rent liability	18.4	—	18.4
Gift annuity liabilities	14.1	—	14.1
Other liabilities	<u>23.2</u>	<u>—</u>	<u>23.2</u>
Total accounts payable and accrued expenses	\$ <u>124.2</u>	<u>165.0</u>	<u>289.2</u>

Accrued salaries and benefits include estimated FECA liabilities of \$2.4 for trust employees and \$43.5 for federal employees.

(9) Long-term Debt

The Smithsonian's long-term debt are unsecured obligations and funded solely through unrestricted trust funds. Long-term debt is comprised of the following:

Series 2013 Taxable Bonds, Series A: Interest rate 3.434%, due September 1, 2023	\$ 50.0
Series 2010 Revenue Bonds, serial, principal amounts ranging from \$1.3 to \$1.7, interest rates 3.00% to 5.25%, due February 1, 2016 through 2021	4.9
Series 2010 Revenue Bonds, term, principal amounts ranging from \$1.8 to \$2.4, interest rate 5.25%, due February 1, 2022 through 2028	14.6
Series 2003 Revenue Bonds, Series A: Variable interest rate, due December 1, 2033	52.5
Series 2003 Revenue Bonds, Series B: Variable interest rate, due December 1, 2033	<u>25.0</u>
	147.0
Less unamortized bond issue cost	(0.1)
Plus unamortized bond premium	<u>1.1</u>
Total long-term debt	\$ <u>148.0</u>

(a) Series 2013 A and B Taxable Bonds

The Series 2013 A and B taxable bonds were issued in November 2013 to finance capital and other projects. Interest on the Series A bonds is payable semiannually every March 1 and September 1 while interest on the Series B bonds was payable monthly at a variable interest rate determined in accordance with the Indenture. Series B bonds matured on September 1, 2018. Series A bonds have the final maturity date of September 1, 2023 (see note 14).

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(b) Series 2010 Revenue Bonds

The tax-exempt Series 2010 Revenue Bonds were issued by the District of Columbia on behalf of the Smithsonian to finance capital and other projects. Interest is payable semiannually every August 1 and February 1.

The serial bonds mature annually through February 1, 2021, with principal repayments ranging from \$1.6 to \$1.7 per year. The term bonds maturing on February 1, 2028 are subject to mandatory redemption by sinking fund installments, which begin on February 1, 2022 and range from \$1.8 to \$2.4 per year through the maturity date.

(c) Series 2003 Revenue Bonds

The tax-exempt Series 2003 Revenue Bonds were issued by the Fairfax County Economic Development Authority (Virginia) on behalf of the Smithsonian to finance a portion of the Steven F. Udvar-Hazy Center, an extension of the National Air and Space Museum. The bonds are subject to early redemption at the option of the Smithsonian. Interest is payable monthly at a variable interest rate determined in accordance with the Indenture. Interest rates for Series A and Series B were 1.6%, as of September 30, 2018.

The bonds are supported by a standby bond purchase agreement for both the Series A and Series B (collectively, the 2003 Liquidity Facility) with Wells Fargo (Trustee) and Northern Trust Company (Liquidity Facility provider). The 2003 Liquidity Facility provides liquidity support when the bonds are bearing interest at a daily or weekly rate and expires September 10, 2019.

Interest expense was \$4.2 in fiscal year 2018.

Future annual maturities of long-term debt are as follows:

2019	\$	1.6
2020		1.6
2021		1.7
2022		1.8
2023		51.9
Thereafter		88.4
	\$	<u>147.0</u>

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(10) Net Assets

Unrestricted net assets include \$707.7 of funds functioning as endowments as of September 30, 2018.

Temporarily restricted net assets are available for the following purposes as of September 30, 2018:

Museums and general support	\$	210.9
Education, public programs and exhibitions		261.5
Research		105.8
Acquisitions and collections		84.0
Facilities		110.4
		<u>110.4</u>
	\$	<u>772.6</u>

Net assets released from donor restrictions due to the passage of time, assets placed in service, or by incurring expenses satisfying the restricted purpose specified by the donors were as follows for fiscal 2018:

Museums and general support	\$	28.8
Education, public programs and exhibitions		61.2
Research		16.3
Acquisitions and collections		9.4
Facilities		28.7
		<u>28.7</u>
	\$	<u>144.4</u>

Permanently restricted net assets are restricted for the following purposes as of September 30, 2018:

Museums and general support	\$	140.4
Education, public programs and exhibitions		264.0
Research		88.4
Acquisitions and collections		51.9
Facilities		1.5
		<u>1.5</u>
	\$	<u>546.2</u>

(11) Employee Benefit Plans

Federal employees of the Smithsonian are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The terms of these plans are defined in federal regulations. Under both systems, a specified percentage is withheld from each federal employee's salary. The Smithsonian also contributes specified percentages of employees' salaries. The fiscal year 2018 expense for these plans was \$40.2. Additional imputed costs associated with these plans are borne by the US government. The Smithsonian recognizes its share of such costs (\$71.3 for fiscal year 2018) as imputed benefit revenue and expense in the financial statements. The Smithsonian is not responsible for and does not report CSRS or FERS assets, accumulated plan benefits, or liabilities applicable to its employees. The Office of Personnel Management (OPM) administers these plans and is responsible for the reporting of these amounts.

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Employees covered by CSRS and FERS are eligible to contribute to the U.S. government's Thrift Savings Plan (TSP), which is administered by the Federal Retirement Thrift Investment Board. A TSP account is automatically established for FERS-covered employees and the Smithsonian makes mandatory and matching contributions of specified percentages of the basic pay for FERS-covered employees. The Smithsonian makes no matching contributions for CSRS-covered employees.

Most federal employees are entitled to participate in the Federal Employees Group Life Insurance (FEGLI) Program. Participating employees can obtain basic term life insurance, with the employee paying two-thirds of the cost and the Smithsonian paying one-third. Additional coverage is optional, to be paid fully by the employee. The basic life coverage may be continued into retirement if certain requirements are met. OPM administers this program and is responsible for the reporting of liabilities.

Trust fund employees are covered by a separate defined-contribution retirement plan for trust fund employees in which substantially all such employees are eligible to participate. Under the plan, the Smithsonian contributes specified percentages of employees' salaries that are used to purchase individual annuities, the rights to which are immediately vested with the employees. Employees can make voluntary contributions, subject to certain limitations. The Smithsonian's expense for this plan for fiscal year 2018 was \$20.4.

In addition to the retirement plans, certain health care and life insurance benefits are made available to active and retired trust fund employees. The plan is contributory for retirees and requires payment of premiums and deductibles. Retiree contributions for premiums are established by an insurance carrier based on the average per capita cost of benefit coverage for all participants. As of September 30, 2018, the accrued benefit obligation under this plan was \$14.1 and is included in accounts payable and accrued expenses in the statement of financial position.

Most federal employees are eligible to enroll in the Federal Employees Health Benefit (FEHB) Program, which provides post-retirement health benefits if certain conditions are met. OPM administers this plan and Smithsonian is not obligated under this plan.

(12) Business Activities

A summary of business activities is as follows for fiscal year 2018:

	<u>Revenues</u>	<u>Expenses</u>	<u>Net</u>
Smithsonian business enterprises	\$ 159.6	(127.1)	32.5
Unit auxiliary activities	23.6	(30.2)	(6.6)
Total business activities	<u>\$ 183.2</u>	<u>(157.3)</u>	<u>25.9</u>

(13) Commitments and Contingencies

(a) Leasing Activities

The Smithsonian leases office and warehouse space under long-term operating leases expiring at various dates to 2032. These leases generally provide for rent escalations based on increases in the Consumer Price Index or changes in property taxes or operating expenses attributable to the leased

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Notes to Financial Statements

September 30, 2018

(Dollars in millions)

properties. The Smithsonian has the authority to enter into leases for up to 30 years using federal funds.

Annual minimum lease payments due under operating leases in effect as of September 30, 2018 are as follows:

2019	\$	46.5
2020		46.5
2021		29.5
2022		15.8
2023		13.2
Thereafter		9.7
	\$	<u>161.2</u>

Rent expense under operating leases, including executory costs such as maintenance, insurance, and taxes, totaled \$60.1 for fiscal year 2018, which includes \$7.6 in office space received in-kind.

(b) Government Awards

The Smithsonian receives significant amounts of federal funding in the form of appropriations, grants, and contracts. These awards are subject to audit by federal agencies. Management is of the opinion that no material disallowances of costs or expenses are likely.

(c) Construction

As of September 30, 2018, the Smithsonian has commitments approximating \$115.0 related to construction in process at a number of its locations. The most significant of these relate to projects at the National Air and Space Museum (\$38.3), the National Zoological Park (\$20.1), and the National Museum of Natural History (\$38.4).

(d) Litigation

The Smithsonian is a party to various litigation arising out of the normal conduct of its operations. In the opinion of the Smithsonian's general counsel, the ultimate resolution of these matters will not have a significant effect on the Smithsonian's financial position or future results of operations.

(14) Subsequent Events

Management has evaluated subsequent events from September 30, 2018 through January 8, 2019, which is the date that the financial statements are available to be issued, and determined that there are no adjustments to or other items to disclose, except as follows:

- Subsequent to September 30, 2018, the Smithsonian committed capital of \$22.5 to 4 funds.
- On October 25, 2018, the Smithsonian redeemed the remaining of its outstanding Series 2013 Taxable Bonds, Series A for \$50.8, including accrued interest of \$0.3.
- In October 2018, the Smithsonian established a \$50.0 line of credit.