



SMITHSONIAN INSTITUTION

Financial Statements

September 30, 2012

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Regents
Smithsonian Institution:

We have audited the accompanying statement of financial position of the Smithsonian Institution (Smithsonian) as of September 30, 2012 and the related statements of financial activity and cash flows for the year then ended. These financial statements are the responsibility of the Smithsonian's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Smithsonian's 2011 financial statements, and, in our report dated February 24, 2012, we expressed an unqualified opinion on those financial statements.

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 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 Smithsonian'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 Smithsonian Institution as of September 30, 2012 and its changes in net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

January 31, 2013

SMITHSONIAN INSTITUTION

Statement of Financial Position

September 30, 2012

(with summarized financial information as of September 30, 2011)

(Dollars in millions)

	Trust funds	Federal funds	Total funds	
			2012	2011
Assets:				
Cash, cash equivalents and balances with the U.S. Treasury	\$ 179.7	350.5	530.2	505.3
Receivables and advances	268.3	0.8	269.1	219.3
Inventory	9.0	0.4	9.4	9.4
Investments	1,166.9	—	1,166.9	1,061.3
Property and equipment, net	569.3	1,219.8	1,789.1	1,690.3
Deferred expenses and other assets	30.9	—	30.9	30.8
Total assets	\$ 2,224.1	1,571.5	3,795.6	3,516.4
Liabilities:				
Accounts payable and accrued expenses	\$ 142.2	133.6	275.8	269.1
Deferred revenue	51.8	—	51.8	51.8
Deferred gain on sale of real estate	31.7	—	31.7	35.6
Unexpended federal appropriations	—	289.4	289.4	275.2
Long-term debt	107.8	—	107.8	109.3
Total liabilities	333.5	423.0	756.5	741.0
Net assets:				
Unrestricted:				
Funds functioning as endowment	531.1	—	531.1	482.7
Operational balances	416.4	1,148.5	1,564.9	1,416.3
Total unrestricted net assets	947.5	1,148.5	2,096.0	1,899.0
Temporarily restricted:				
Funds functioning as endowment	238.2	—	238.2	209.9
Donor contributions for facilities	192.7	—	192.7	205.6
Donor contributions for programs	154.4	—	154.4	141.7
Total temporarily restricted net assets	585.3	—	585.3	557.2
Permanently restricted:				
True endowments	305.0	—	305.0	278.6
Donor endowment receivables	34.9	—	34.9	24.9
Interest in perpetual and other trusts	17.9	—	17.9	15.7
Total permanently restricted net assets	357.8	—	357.8	319.2
Total net assets	1,890.6	1,148.5	3,039.1	2,775.4
Commitments and contingencies				
Total liabilities and net assets	\$ 2,224.1	1,571.5	3,795.6	3,516.4

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION
Statement of Financial Activity
Year ended September 30, 2012
(with summarized financial information as of September 30, 2011)
(Dollars in millions)

	Trust funds	Unrestricted Federal funds	Total	Temporarily restricted trust funds	Permanently restricted trust funds	Total	
						2012	2011
Operating revenues and other additions:							
Government revenue:							
Federal appropriations	\$ —	795.5	795.5	—	—	795.5	758.0
Government grants and contracts	116.0	—	116.0	—	—	116.0	113.7
Total government revenue	116.0	795.5	911.5	—	—	911.5	871.7
Contributions:							
Program support	28.8	—	28.8	100.3	35.5	164.6	107.3
Construction of facilities	—	—	—	38.5	—	38.5	44.7
Total contributions	28.8	—	28.8	138.8	35.5	203.1	152.0
Business activities and other:							
Business activities	165.2	—	165.2	—	—	165.2	165.2
Short-term investment income	4.7	—	4.7	0.2	—	4.9	1.4
Endowment payout	34.4	—	34.4	22.1	1.2	57.7	53.8
Private grants	6.4	—	6.4	—	—	6.4	6.0
Rentals, fees, commissions, and other	20.6	5.0	25.6	—	—	25.6	27.5
Gain on sale of real estate	3.9	—	3.9	—	—	3.9	3.9
Total business activities and other	235.2	5.0	240.2	22.3	1.2	263.7	257.8
Total operating revenues	380.0	800.5	1,180.5	161.1	36.7	1,378.3	1,281.5
Net assets released from restrictions	165.1	—	165.1	(165.1)	—	—	—
Total operating revenues and other additions	545.1	800.5	1,345.6	(4.0)	36.7	1,378.3	1,281.5
Expenses:							
Program activities:							
Research	126.9	122.8	249.7	—	—	249.7	242.9
Collections management	22.0	198.1	220.1	—	—	220.1	221.3
Education, public programs, and exhibitions	70.7	202.9	273.6	—	—	273.6	267.9
Business activities	134.5	—	134.5	—	—	134.5	128.0
Total program activities	354.1	523.8	877.9	—	—	877.9	860.1
Supporting activities:							
Administration	66.3	182.9	249.2	—	—	249.2	233.2
Advancement	34.7	5.7	40.4	—	—	40.4	31.2
Total supporting activities	101.0	188.6	289.6	—	—	289.6	264.4
Total expenses	455.1	712.4	1,167.5	—	—	1,167.5	1,124.5
Change in net assets from operations	90.0	88.1	178.1	(4.0)	36.7	210.8	157.0
Nonoperating activities:							
Nonoperating investment gain (loss)	27.8	—	27.8	35.9	1.9	65.6	(49.5)
Change in interest in net assets of related organizations and other	3.1	—	3.1	(3.8)	—	(0.7)	—
Change in net assets related to collection items not capitalized:							
Proceeds from sales	0.1	—	0.1	—	—	0.1	0.3
Collection items purchased	(8.8)	(3.3)	(12.1)	—	—	(12.1)	(7.8)
Change in net assets	112.2	84.8	197.0	28.1	38.6	263.7	100.0
Net assets, beginning of year	835.3	1,063.7	1,899.0	557.2	319.2	2,775.4	2,675.4
Net assets, end of year	\$ 947.5	1,148.5	2,096.0	585.3	357.8	3,039.1	2,775.4

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Statement of Cash Flows

Year ended September 30, 2012

(with summarized financial information as of September 30, 2011)

(Dollars in millions)

	Trust funds	Federal funds	Total	
			2012	2011
Cash flows from operating activities:				
Change in net assets	\$ 178.9	84.8	263.7	100.0
Adjustments to reconcile change in net assets to net cash provided by operating activities:				
Proceeds from sales of collection items	(0.1)	—	(0.1)	(0.3)
Collection items purchased	8.8	3.3	12.1	7.8
Depreciation	34.1	80.2	114.3	106.8
Loss on disposition of assets	—	—	—	0.2
Contributions for permanent endowment	(25.1)	—	(25.1)	(23.5)
Contributions for construction of facilities	(20.3)	—	(20.3)	(24.7)
Appropriations for repair, restoration, and construction	—	(174.7)	(174.7)	(124.7)
Investment income restricted for long-term purposes	(1.3)	—	(1.3)	(1.2)
Net investment (gain)/loss	(119.7)	—	(119.7)	0.8
Decrease (increase) in assets:				
Receivables and advances	(50.3)	0.5	(49.8)	(5.3)
Deferred expenses and other assets	(0.2)	0.1	(0.1)	(7.3)
Inventory	(0.1)	0.1	—	0.6
Increase (decrease) in liabilities:				
Accounts payable and accrued expenses	(0.9)	1.2	0.3	5.9
Deferred revenue and deferred gain on sale of real estate	(3.9)	—	(3.9)	(3.7)
Unexpended federal appropriations	—	14.2	14.2	0.8
Net cash provided by (used in) operating activities	<u>(0.1)</u>	<u>9.7</u>	<u>9.6</u>	<u>32.2</u>
Cash flows from investing activities:				
Proceeds from sales of collection items	0.1	—	0.1	0.3
Collection items purchased	(8.8)	(3.3)	(12.1)	(7.8)
Purchases of property and equipment	(42.7)	(164.0)	(206.7)	(170.0)
Purchases of investment securities	(770.9)	—	(770.9)	(674.6)
Proceeds from sales/maturities of investment securities	785.0	—	785.0	714.1
Net cash used in investing activities	<u>(37.3)</u>	<u>(167.3)</u>	<u>(204.6)</u>	<u>(138.0)</u>
Cash flows from financing activities:				
Contributions for permanent endowment	25.1	—	25.1	23.5
Contributions for construction of facilities	20.3	—	20.3	24.7
Appropriations for repair, restoration, and construction	—	174.7	174.7	124.7
Investment income restricted for long-term purposes	1.3	—	1.3	1.2
Principal payments on long-term debt	(1.5)	—	(1.5)	(1.9)
Net cash provided by financing activities	<u>45.2</u>	<u>174.7</u>	<u>219.9</u>	<u>172.2</u>
Net change in cash, cash equivalents and balances with U.S. Treasury	7.8	17.1	24.9	66.4
Cash, cash equivalents and balances with U.S. Treasury:				
Beginning of year	<u>171.9</u>	<u>333.4</u>	<u>505.3</u>	<u>438.9</u>
End of year	\$ <u>179.7</u>	<u>350.5</u>	<u>530.2</u>	<u>505.3</u>
Noncash investing activities:				
Construction cost accruals	\$ 6.8	19.6	26.4	20.0

Cash paid for interest during fiscal years 2012 and 2011 was approximately \$1.5 in each year.

See accompanying notes to financial statements.

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Notes to Financial Statements

September 30, 2012

(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 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, D.C., and two museums in New York City. Additional facilities and programs operate in five states and Panama. Research is carried out in the Smithsonian’s museums and in other facilities throughout the world. During fiscal year 2012, over 30 million individuals visited Smithsonian museums and other facilities.

The Smithsonian describes its collections by the following categories: works of art, historical artifacts, natural and physical science specimens (living and nonliving), archival holdings, and library holdings.

At September 30, 2012, the Smithsonian’s extensive collection contained approximately 136.9 million objects as follows: works of art (0.3 million), historical artifacts (8.8 million), and natural and physical science specimens (127.8 million). In addition, 127,500 cubic feet of archives and 1.9 million library volumes are maintained by the Smithsonian. Acquisitions and disposals of collection items during fiscal year 2012 were nominal in each category of collection items, except for the acquisition of approximately 0.4 million natural and physical science specimens.

A substantial portion of the Smithsonian’s operations is funded from annual federal appropriations. The Smithsonian also receives federal appropriations 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 and other publications, a mail-order catalog, and museum shops and food services.

(2) Summary of Significant Accounting Policies

(a) *Basis of Presentation*

The financial statements present the financial position, financial activity, 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.

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September 30, 2012

(Dollars in millions)

The statement of financial activity includes certain prior-year 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 for the year ended September 30, 2011, from which the summarized information was derived. Certain prior year amounts have been reclassified to conform to the current year presentation.

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, which were established by Congress within the Smithsonian, but are governed by independent boards of trustees.

Expenses are presented on a functional basis in the statement of financial activity. Programs include research, collections management, education, public programs and exhibitions, and business activities. Supporting services include administration and advancement. Depreciation, security, and other operating costs that generally benefit more than one program are general allocated based on a square footage methodology.

(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 determination of the fair value of nonmarketable investments, allocation of functional expenses, FECA liability, and the allowance and discount for contributions. The financial market volatility in the U.S. has impacted and will continue to impact the Smithsonian's investment portfolio. Such conditions could have a material impact on management's significant accounting estimates.

(c) Federal Funds

Federal appropriations revenues are classified as unrestricted and recognized as exchange transactions as expenditures 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 annual leave and estimated liabilities under the Federal Employees' Compensation Act (FECA) for workers compensation claims.

The Smithsonian was appropriated \$635.4 for operations and \$174.7 for construction or repair and restoration of facilities net of rescissions of \$1.3 in fiscal year 2012. Federal appropriations for operations are generally available for obligation only in the year received. In accordance with Public Law 110-161, these appropriations are maintained by the Smithsonian for five years following the year of appropriation, after which the appropriation account is closed and any unexpended balances are returned to the U.S. Treasury. During fiscal year 2012, the Smithsonian returned \$2.3 to the U.S. Treasury, which represented the unexpended balance of appropriations for operations for fiscal

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2012

(Dollars in millions)

year 2007. Federal appropriations for construction or repair and restoration of facilities are generally available for obligation until expended.

(d) Trust Funds

Net assets, revenues, and gains and losses of trust funds are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of trust funds are classified and reported as follows:

Unrestricted

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

Temporarily Restricted

Net assets subject to donor-imposed stipulations that may be met by actions of the Smithsonian and/or the passage of time. Funds functioning as endowment in this category represent donor-restricted contributions that have been designated for long-term investment. Expiration of temporary restrictions on net assets (i.e., the donor stipulation has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from temporarily restricted net assets to unrestricted net assets.

Permanently Restricted

Net assets subject to donor-imposed stipulations that the principal be maintained permanently by the Smithsonian. Generally, the donors of these assets permit the Smithsonian to use 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 donor-imposed restrictions. 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 nonoperating losses in the statement of financial activity. 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 nonoperating gains in the statement of financial activity.

(e) Cash Equivalents

The Smithsonian considers all highly liquid investments purchased with an average maturity of three months or less to be cash equivalents. At September 30, 2012, cash equivalents consisted of funds held by the U.S. Treasury of \$350.5 and investments with maturity dates of three months or less, \$140.9 of which are invested in AAA institutional money market funds.

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Notes to Financial Statements

September 30, 2012

(Dollars in millions)

(f) Trade Account Receivables

The Smithsonian's trade account receivables balance generally consists of accounts receivables related to magazine advertising and certain concession agreements. As of September 30, 2012, trade accounts receivable totaled \$12.6.

(g) Working Capital

The Smithsonian has adopted a working capital policy to meet immediate and long-term cash needs of the organization using high quality investments. The working capital investment policy requires that Smithsonian funds should be invested in short-term instruments that will allow for required liquidity and provide a maximum interest return within defined risk constraints. At September 30, 2012, the fund is comprised of cash equivalents with maturity dates of three months or less of \$140.9 and short-term investments which include U.S. government agency bonds of \$91.9. The total working capital fund as of September 30, 2012 is \$232.8.

(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 their estimated fair value at the date of gift, except that items 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. The donor's restrictions are considered met and the net assets are released from restriction when the related asset is placed in service.

Contributions receivable are reported net of estimated uncollectible amounts determined based on management's judgment and analysis of the creditworthiness of donors, past collection experience, and other relevant factors. Estimated collectible contributions 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 additional contribution revenue.

In-kind contributions of goods and services totaling \$11.0 were received in fiscal year 2012 and recognized as program support revenues and expenses in the statement of financial activity. 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. In fiscal year 2012, approximately 6,000 volunteers contributed approximately 453,000 hours of service to the Smithsonian. In accordance with applicable guidance, the value of these contributions is not recognized in the financial statements.

(i) Deferred Revenues and Expenses

Revenues from subscriptions to Smithsonian and Air and Space/Smithsonian magazines are deferred and recognized ratably over the period of the subscription, generally one year.

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September 30, 2012

(Dollars in millions)

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. At September 30, 2012, deferred expenses and other assets included \$5.4 of deferred promotion costs, related primarily to Smithsonian magazine. Advertising expense, including direct response advertising of \$0.9, totaled \$11.8 in fiscal year 2012 and is included in business activities expenses in the statement of financial activity.

(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's investments consist primarily of publicly traded fixed income and equity securities, hedge funds, private equity, real assets, and cash and equivalents.

For detailed descriptions of investment assets and the valuation methods and assumptions applied to determine fair value, please refer to footnote 6, *Investments and Fair Value Measurements*. Investments are exposed to various risks including interest rate, market, 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 financial activity. Purchases and sales of investments are recorded on the trade date using average costs. 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. For the charitable remainder trusts, the assets are included in receivables. The related contribution revenues 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. 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.

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September 30, 2012

(Dollars in millions)

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

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

Certain lands occupied by the Smithsonian's buildings, primarily located 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 these lands for as long as they are used to carry out its mission. These lands 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. All 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 generally designated for future collection acquisitions.

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.

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September 30, 2012

(Dollars in millions)

(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 expense when earned. The liability for unused annual leave is included in accounts payable and accrued expenses in the statement of financial position.

(p) Sponsored Projects

The Smithsonian receives grants and enters into contracts with the U.S. government and state and local governments which generally provide for cost reimbursement to the Smithsonian. Revenues under these agreements are recognized as reimbursable expenditures are incurred. These revenues include recoveries of facilities and administrative costs that are generally determined as 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. Fundraising costs are expensed as incurred and reported as advancement expenses in the statement of financial activity. Fundraising expenses for fiscal year 2012 were \$40.4.

(r) Related Organizations

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 Friends of the National Zoo (FONZ), which raises funds for the benefit of the Smithsonian's National Zoological Park, and the Smithsonian Network.

(s) Measure of Operations

The Smithsonian considers operations to include all changes in net assets exclusive of investment income not used for operations, change in the interest in net assets of related organizations, and changes in net assets related to collection items. Investment income not used for operations 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 for the endowment funds.

(t) Reclassification

Certain prior year balances have been reclassified to conform to current year presentation.

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September 30, 2012

(Dollars in millions)

(3) Receivables and Advances

Receivables and advances consisted of the following at September 30, 2012:

	<u>Trust</u>	<u>Federal</u>	<u>Total</u>
Trade receivables, net of \$0.9 in allowances	\$ 11.8	0.8	12.6
Contributions receivable, net	197.6	—	197.6
Grants and contracts	18.4	—	18.4
Investment receivables	21.0	—	21.0
Charitable trusts	18.9	—	18.9
Advances	0.6	—	0.6
	<hr/>	<hr/>	<hr/>
Total receivables and advances	\$ 268.3	0.8	269.1
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Contributions receivable, net, are summarized as follows at September 30, 2012:

Due within:		
Less than 1 year		\$ 57.6
1 to 5 years		123.9
More than 5 years		34.3
		<hr/>
		215.8
Less:		
Allowance for uncollectible contributions		(7.4)
Unamortized discount (at rates ranging from 0.62% to 4.23%)		(10.8)
		<hr/>
Contributions receivable, net		\$ 197.6
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At September 30, 2012, gross contributions receivable included approximately \$45.7 due from one donor for construction of facilities.

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September 30, 2012

(Dollars in millions)

(4) Federal Appropriations

Federal appropriation revenues recognized in fiscal year 2012 are reconciled to the federal appropriations for fiscal year 2012 as follows:

	<u>Salaries and expenses</u>	<u>Repair and restoration and construction</u>	<u>Total</u>
Federal appropriation revenue	\$ 633.2	162.3	795.5
Unexpended 2012 appropriation	83.9	131.7	215.6
Amounts expended from prior years	<u>(81.7)</u>	<u>(119.3)</u>	<u>(201.0)</u>
Fiscal year 2012 federal appropriation	<u>\$ 635.4</u>	<u>174.7</u>	<u>810.1</u>

Federal expenses recognized in fiscal year 2012 are reconciled to the federal appropriations for fiscal year 2012 as follows:

	<u>Salaries and expenses</u>	<u>Repair and Restoration and construction</u>	<u>Total</u>
Federal appropriation expense	\$ 632.2	80.2	712.4
Unexpended 2012 appropriation	83.9	131.7	215.6
Depreciation	(15.3)	(64.9)	(80.2)
Loss on disposition of assets	—	—	—
Unfunded annual leave and FECA costs	(1.6)	—	(1.6)
Amounts expended from prior years	(81.7)	(119.3)	(201.0)
Capital expenditures	19.5	147.0	166.5
Foreign currency and related costs	(0.5)	—	(0.5)
Collection items purchased	3.3	—	3.3
Other funding	<u>(4.4)</u>	<u>—</u>	<u>(4.4)</u>
Fiscal year 2012 federal appropriations	<u>\$ 635.4</u>	<u>174.7</u>	<u>810.1</u>

Unexpended appropriations for all fiscal years total \$289.4 at September 30, 2012 and consist of \$113.0 in unexpended operating funds and \$176.4 in unexpended construction funds. Unexpended operating and construction funds represent amounts appropriated for Smithsonian's operations and new facilities or renovations, respectively.

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(5) Accessions and Deaccessions

For fiscal year 2012, \$8.8 of trust funds and \$3.3 of federal funds were spent to acquire collection items. For fiscal year 2012, sales of collection items were \$0.1 of trust funds. At September 30, 2012, accumulated proceeds and related earnings from deaccessions amounted to \$6.3.

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 fiscal year 2012 the Smithsonian's noncash deaccessions included works of art, animals, historical objects, and natural specimens. Contributed items held for sale, which are included in other assets, were \$1.4 at September 30, 2012.

(6) 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 is responsible for determining the long-term asset allocation for the endowment.

As of September 30, 2012, the carrying values of the Smithsonian's cash, cash equivalents and balances with the U.S. Treasury, U.S. government agency bonds and other fixed income holdings, receivables and advances, deferred expenses, accounts payable and accrued expenses, deferred revenues and certain other liabilities approximate their fair values because of the terms and relatively short maturity of these assets and liabilities.

The fair value of debt is determined based on quoted market prices for publicly traded issues and on the discounted future payments to be made for other issues. The discount rates used approximate current market rates for loans of similar maturities and credit quality. The carrying value of long-term debt obligations in the financial statements is less than their fair value by approximately \$4.4 at September 30, 2012.

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 that have weekly liquidity and/or are redeemable in up to 90 days.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset 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.

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The following table presents information relating to the fair value measurements for assets that are measured at fair value on a recurring basis at September 30, 2012:

	Fair value at September 30,				Redemption terms	Days of notice
	2012	Level 1	Level 2	Level 3		
U.S. government agency bonds	\$ 91.9	91.9	—	—		
Total short-term investments	<u>91.9</u>	<u>91.9</u>	<u>—</u>	<u>—</u>		
Endowment :						
Pooled investments:						
Global equity:						
Global developed equity	257.6	79.1	97.6	80.9	Daily to annually	0-120
Emerging markets equity	106.5	19.6	12.2	74.7	Daily to at maturity	3-n/a
Hedge funds:						
Long/short equity	52.9	—	—	52.9	Quarterly to at maturity	45-n/a
Credit and distressed	80.6	—	—	80.6	Quarterly to at maturity	90-n/a
Multi-strategy	160.2	—	—	160.2	Quarterly to at maturity	60-n/a
Global macro	60.6	—	14.5	46.1	Monthly to quarterly	2-90
Private equity:						
Private equity	56.6	—	—	56.6	n/a	n/a
Venture capital	46.4	—	—	46.4	n/a	n/a
Real assets:						
Energy and natural resources	62.3	20.1	—	42.2	Daily to at maturity	0-n/a
Real estate	43.5	—	—	43.5	Quarterly to at maturity	60-n/a
Fixed income	105.9	105.9	—	—	Daily	0
Cash and equivalents	<u>18.9</u>	<u>18.9</u>	<u>—</u>	<u>—</u>		
Total pooled investments	1,052.0	243.6	124.3	684.1		
Nonpooled investments:						
Deposits with U. S. Treasury	<u>1.0</u>	<u>1.0</u>	<u>—</u>	<u>—</u>		
Total endowment	1,053.0	244.6	124.3	684.1		
Gift annuity program assets	<u>22.0</u>	<u>22.0</u>	<u>—</u>	<u>—</u>		
Total investments	1,166.9	358.5	124.3	684.1		
Charitable trusts	<u>18.9</u>	<u>—</u>	<u>—</u>	<u>18.9</u>	n/a	n/a
Grand total	<u><u>1,185.8</u></u>	<u><u>358.5</u></u>	<u><u>124.3</u></u>	<u><u>703.0</u></u>		

Investments in U.S. government agency bonds, certain global equities, natural resources and real estate funds, cash and equivalents, deposits with U.S. Treasury, and gift annuity program investments are reported at fair value, which are determined primarily based on quoted market prices. Investments in certain global equity, hedge funds, private equity and venture capital, natural resources and real estate, and charitable trusts, are reported at estimated fair values as determined by management and are generally recorded based on the manager reported net asset value (NAV). No adjustments to NAV were considered necessary by management. There are no transfers and reclassifications of assets between Level 1 and Level 2. The following presents the nature and risk of the major categories reported as of September 30, 2012.

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(a) U. S. Government Agency Bonds

U.S. government agency bonds are comprised of AA+ U.S. government agency (Fannie Mae, Freddie Mac, etc.) bonds.

(b) Global Equity

Investments in U.S. publicly listed equity securities and funds invested in global developed and emerging markets strategies. Certain level 3 funds are subject to lock-ups of up to 2 years.

(c) Hedge Funds

Investments in a broad array of securities and strategies aimed to reduce volatility and enhance returns. Smithsonian's hedge funds are broadly defined as long/short equity, credit and distressed, multi-strategy, and global macro funds. Long/short equity funds invest both long and short in primarily U.S. common stocks. Credit and distressed funds invest in assets that are in default and/or restructuring. Multi-strategy funds invest in multiple strategies to diversify risks and reduce volatility. Global macro funds invest in strategies to profit from economic and political views and projections. Certain level 3 funds are subject to soft and hard lock-ups of up to 2 years and other funds are not eligible for redemption.

(d) Private Equity

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. All partnerships are not eligible for redemption.

(e) Real Assets

Comprised of publicly traded and privately held real estate, energy and natural resource assets. Real estate investments are held in private limited partnerships. Energy and natural resources investments are publicly traded securities in the natural resources sector, private oil and gas partnerships and commodity futures funds. All partnerships are not eligible for redemption.

(f) Cash and Equivalents

High quality, highly liquid, short duration commercial paper, and money market funds.

(g) Fixed Income

Funds that invest in U.S. government and agency bonds, and other interest bearing products.

(h) Deposits with U.S. Treasury

The Smithsonian maintains U.S. Treasury investments totaling \$1.0 relating in part to the original gift from James Smithsonian.

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(i) Gift Annuity Program Assets

Publicly traded mutual funds in equities, bonds, and money market funds.

(j) Charitable Trusts

Receivables related to interests in irrevocable charitable remainder trusts and certain perpetual trusts held and administered by others. Charitable trusts are not eligible for redemption.

The following table summarizes activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for fiscal year 2012:

Asset Subclass	September 30, 2011	Dividends and income	Realized gain/loss	Unrealized gain/loss investment	Purchases	Redemptions	Transfer in/out	September 30, 2012
Global developed equity	79.1	-	7.5	17.7	-	(23.4)	-	80.9
Emerging markets equity	61.1	-	(4.4)	10.9	18.0	(10.9)	-	74.7
Long/short equity	55.6	-	5.6	4.2	15.0	(27.5)	-	52.9
Credit and distressed	95.5	-	4.9	9.7	-	(29.5)	-	80.6
Multi-strategy	169.1	-	6.8	7.5	-	(23.2)	-	160.2
Global Macro	-	-	-	1.1	45.0	-	-	46.1
Private equity	61.4	0.7	2.0	(0.2)	7.3	(13.8)	(0.8)	56.6
Venture capital	32.8	-	1.1	2.6	11.4	(1.4)	(0.1)	46.4
Energy and natural resources	24.3	-	(2.7)	2.7	26.8	(8.9)	-	42.2
Real estate funds	35.4	0.4	0.9	1.8	9.7	(4.7)	-	43.5
Charitable Trusts	16.1	-	-	2.1	0.7	-	-	18.9
Total	<u>630.4</u>	<u>1.1</u>	<u>21.7</u>	<u>60.1</u>	<u>133.9</u>	<u>(143.3)</u>	<u>(0.9)</u>	<u>703.0</u>

The Smithsonian is obligated under the terms of certain limited partnership agreements to remit additional funding periodically as capital calls are exercised. At September 30, 2012, the Smithsonian had uncalled commitments of approximately \$19.6 for private equity, \$37.3 for venture capital, \$18.3 for private real estate investments, and \$22.1 for energy and natural resources. Such commitments are generally callable over the next 5 years and the related agreements contain fixed expiration dates or other termination clauses. The average remaining life of Smithsonian's investments in these private partnerships are between 7 to 8 years to maturity.

Investment return consisted of the following for fiscal year 2012:

Dividend and interest income	\$	7.4
Net investment gain		122.7
Investment management fees		<u>(1.9)</u>
Investment return	\$	<u>128.2</u>

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Investment return is classified in the statement of financial activity as follows for fiscal year 2012:

Short-term investment income	\$	4.9
Endowment payout		57.7
Nonoperating investment gain		65.6
Investment return	\$	<u>128.2</u>

(7) Endowment Funds

The Smithsonian endowment consists of approximately 500 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. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The District of Columbia adopted the Uniform Prudent Management of Funds Act (UPMIFA) in January 2008. The Smithsonian determined that it was not required to follow the District of Columbia's version of UPMIFA as a matter of law. Absent a federal statutory prudence standard, however, the Smithsonian chose to implement the standards of UPMIFA because they represent best practices for investing and spending charitable endowments in most states and the District of Columbia. In practice, many of the Smithsonian's endowment investment and management standards already aligned with UPMIFA.

The Smithsonian's adoption of UPMIFA standards became effective October 1, 2010. Prior to that date, the Smithsonian's management and investment of donor-restricted endowment funds conformed with the provisions of the Uniform Management of Institutional Funds Act of 1972 (UMIFA).

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 that is not classified in permanently restricted net assets 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. At September 30, 2012, the market value of the pool equated to seven hundred sixty-one dollars and fifty-one cents per unit.

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

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factor, and the investment policy of the institution which targets an appropriation to be 5% of the prior five years' average value of the endowment. The payout for programs and operating costs for fiscal year 2012 was thirty-nine dollars and seventeen cents per unit or 5% of the average per unit market value of the endowment over the prior five years. An additional payout of two dollars and twenty-five cents per eligible unit was made to support the national 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. The Smithsonian reports deficiencies of this nature in unrestricted net assets. As of September 30, 2012, the fair value of permanent endowment gifts fell \$3.6 below the original value of the gifts. These deficiencies resulted from unfavorable market fluctuations and continued appropriation for certain programs that were deemed prudent by the Board.

Endowment net assets (excluding contributions receivable) consist of the following at September 30, 2012:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (3.8)	229.3	305.0	530.5
Board-designated endowment funds	<u>534.9</u>	<u>8.9</u>	<u>—</u>	<u>543.8</u>
Total endowment net assets	<u>\$ 531.1</u>	<u>238.2</u>	<u>305.0</u>	<u>1,074.3</u>
 Total endowment net assets			\$ 1,074.3	
Less:				
Uninvested cash and other				(1.0)
Deposit with U.S. Treasury				<u>(1.0)</u>
Total endowment assets under management			\$	<u><u>1,072.3</u></u>

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Changes in endowment net assets for fiscal year 2012 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Balance, beginning of year	\$ 482.7	209.9	278.6	971.2
Investment return:				
Investment income	2.0	0.5	1.3	3.8
Net appreciation (realized and unrealized)	<u>60.1</u>	<u>57.8</u>	<u>—</u>	<u>117.9</u>
Total investment return	62.1	58.3	1.3	121.7
Contributions	—	0.3	25.1	25.4
Appropriation for expenditure	(28.1)	(25.0)	—	(53.1)
Deficiency reclassification (net)	7.4	(7.4)	—	—
Transfer to Board-designated endowment funds	<u>7.0</u>	<u>2.1</u>	<u>—</u>	<u>9.1</u>
Balance, end of year	\$ <u><u>531.1</u></u>	<u><u>238.2</u></u>	<u><u>305.0</u></u>	<u><u>1,074.3</u></u>

(8) Property and Equipment

Property and equipment consisted of the following at September 30, 2012:

	<u>Trust</u>	<u>Federal</u>	<u>Total</u>
Land	\$ 12.5	—	12.5
Buildings and capital improvements	732.3	2,221.3	2,953.6
Equipment and software	47.8	187.2	235.0
Leasehold improvements	<u>93.8</u>	<u>22.5</u>	<u>116.3</u>
	886.4	2,431.0	3,317.4
Accumulated depreciation	<u>(317.1)</u>	<u>(1,211.2)</u>	<u>(1,528.3)</u>
Total property and equipment	\$ <u><u>569.3</u></u>	<u><u>1,219.8</u></u>	<u><u>1,789.1</u></u>

At September 30, 2012, buildings and capital improvements included \$80.4 and \$420.7 of construction in progress within trust and federal funds, respectively. Depreciation expense for fiscal year 2012 totaled \$34.1 in trust funds and \$80.2 in federal funds.

During fiscal year 2006, the Smithsonian completed the sale of the Victor Building, located in Washington, D.C., and entered into short-term and long-term (15 years) leases for portions of the property (approximately 32% of the building). As a result of this leaseback, the Smithsonian deferred the full gain at

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the date of sale (\$62.9) and is recognizing the gain over the term of the leases. In fiscal year 2012, \$3.9 of the deferred gain was recognized.

(9) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of the following at September 30, 2012:

	<u>Trust</u>	<u>Federal</u>	<u>Total</u>
Accounts payable	\$ 24.5	38.8	63.3
Accrued salaries and benefits	39.8	94.1	133.9
Deferred rent liability	19.0	—	19.0
Gift annuity liabilities	11.9	—	11.9
Other accrued liabilities	<u>47.0</u>	<u>0.7</u>	<u>47.7</u>
Total accounts payable and accrued expenses	\$ <u>142.2</u>	<u>133.6</u>	<u>275.8</u>

Accrued salaries and benefits include estimated FECA liabilities of \$4.2 for trust employees and \$44.7 for federal employees at September 30, 2012.

(10) Long-Term Debt

The Smithsonian is obligated with respect to the following issues of long-term debt at September 30, 2012:

Series 2010 Revenue Bonds, serial, principal amounts ranging from \$1.2 to \$1.7, interest rates, 3.00% to 5.25%, due February 1, 2013 through 2021	\$	13.1
Series 2010 Revenue Bonds, term:		
Interest rate 5.25%, due February 1, 2022		1.8
Interest rate 5.25%, due February 1, 2023		1.9
Interest rate 5.25%, due February 1, 2024		2.0
Interest rate 5.25%, due February 1, 2025		2.1
Interest rate 5.25%, due February 1, 2026		2.2
Interest rate 5.25%, due February 1, 2027		2.3
Interest rate 5.25%, due February 1, 2028		2.4
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		25.0
Plus unamortized bond premium		<u>2.5</u>
Total long-term debt	\$	<u>107.8</u>

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The individual debt components at September 30, 2012 are described as follows:

Series 2010 Revenue Bonds

The tax exempt Series 2010 Revenue Bonds represent a refunding of the Series 1997 bonds issued by the District of Columbia on behalf of the Smithsonian. The Series 2010 term and serial revenue bonds were also issued by the District of Columbia on behalf of the Smithsonian and represent unsecured general obligations of the Smithsonian. Interest is payable semiannually every August 1 and February 1. Principal and interest payments are funded solely by trust funds.

The serial bond matures yearly beginning February 1, 2011 through February 1, 2021. Payments for the serial bond began on February 1, 2011 and principal repayments range from \$1.2 to \$1.7 per year. The term bonds maturing on February 1, 2028 are subject to mandatory redemption by sinking fund installments. Installment payments for the term bond maturing February 1, 2028 begin on February 1, 2022 and range from \$1.8 to \$2.4 per year through the maturity date.

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. The bonds were issued to finance a portion of the costs of the Steven F. Udvar-Hazy Center, an extension of the National Air and Space Museum, and are due on December 1, 2033, subject to earlier redemption at the option of the Smithsonian. The bonds are unsecured, and bear interest, payable monthly, at a variable interest rate determined in accordance with the Indenture. Interest rates for Series A and Series B were 0.18% and 0.19%, respectively, at September 30, 2012. Principal and interest payments are funded solely by trust funds.

Pursuant to the terms of the Trust Indenture dated December 1, 2003, the Bonds were subject to mandatory tender for purchase on September 13, 2012 (the "Mandatory Tender Date"). The bonds are supported by a Standby Bond Purchase Agreement - Series A and a Standby Bond Purchase Agreement - Series B (collectively, the "2012 Liquidity Facility"). The Northern Trust Company acts as the liquidity facility provider but does not guarantee principal or interest on the Bonds and does not provide liquidity support for the Bonds except while bearing interest at a daily or weekly rate. The 2012 Liquidity Facility expires September 13, 2013.

Interest expense on long-term debt for fiscal year 2012 totaled \$1.2.

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The annual maturities of long-term debt for the five fiscal years subsequent to fiscal year 2012 and thereafter are as follows:

2013	\$	1.2
2014		1.3
2015		1.3
2016		1.4
2017		1.4
Thereafter		98.7
	\$	<u>105.3</u>

(11) Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2012:

Museums and general support	\$	151.3
Education, public programs and exhibitions		100.9
Research		79.6
Acquisitions and collections		60.8
Facilities		192.7
	\$	<u>585.3</u>

Net assets released from donor restrictions due to the passage of time or by incurring expenses satisfying the restricted purpose specified by the donors were as follows for the year ended September 30, 2012:

Program support and other	\$	68.8
Facilities		77.0
Research		19.3
	\$	<u>165.1</u>

Permanently restricted net assets are restricted for investment in perpetuity, the income from which is expendable to support the following purposes at September 30, 2012:

Museums and general support	\$	95.7
Education, public programs and exhibitions		156.4
Research		70.3
Acquisitions and collections		33.6
Facilities		1.5
Other		0.3
	\$	<u>357.8</u>

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(12) Employee Benefit Plans

The 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, the Smithsonian withholds a specified percentage from each federal employee's salary. The Smithsonian also contributes specified percentages of employees' salaries. The Smithsonian's expense for these plans for fiscal year 2012 was \$32.1.

The Smithsonian has 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 2012 was \$15.7.

In addition to the Smithsonian's retirement plans, the Smithsonian makes available certain health care and life insurance benefits 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. At September 30, 2012, the accrued benefit obligation under this plan was \$14.9 and is included in accounts payable and accrued expenses in the statement of financial position.

(13) 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. Periodical advertising sales are the principal source of unrelated business income for the Smithsonian. The provision for income taxes was not material for fiscal year 2012.

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.

(14) Business Activities

A summary of business activities revenues and expenses for fiscal year 2012 is as follows:

	<u>Revenues</u>	<u>Expenses</u>	<u>Net</u>
Smithsonian business enterprises	\$ 142.5	(114.0)	28.5
Unit auxiliary activities	22.7	(20.5)	2.2
Total business activities	<u>\$ 165.2</u>	<u>(134.5)</u>	<u>30.7</u>

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(15) 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 for increases in property taxes or operating expenses attributable to the leased properties or based on increases in the Consumer Price Index. The Smithsonian has the authority to enter into leases for up to 30 years using federal funds.

Annual minimum lease payments due under non-cancellable operating leases in effect at September 30, 2012 are summarized as follows:

2013	\$	36.2
2014		36.1
2015		37.0
2016		37.0
2017		34.4
Thereafter		172.5
	\$	<u>353.2</u>

The Smithsonian has one cancellable lease which renews annually at approximately \$2.0. Rental expense under operating leases, including executory costs such as maintenance, insurance and taxes, totaled \$50.7 for fiscal year 2012 which includes \$6.7 in office space received in-kind.

(b) Government Grants and Contracts

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

The Smithsonian has various commitments related to construction projects in process throughout its museums with significant projects at the National Museum of African American History and Culture of \$85.4, the Smithsonian Environmental Research Center of \$13.7, the Arts and Industries Building of \$14.2, and Cooper-Hewitt National Design Museum of \$17.6. Remaining commitments under related contracts aggregated approximately \$130.9 at September 30, 2012.

(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.

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2012

(Dollars in millions)

(16) Subsequent Events

Management has performed an evaluation of subsequent events through January 31, 2013, which is the date that the financial statements are available to be issued, noting no events which affect the financial statements as of September 30, 2012.