



Smithsonian Institution

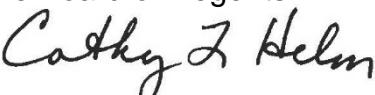
Memo

Office of the Inspector General

Date January 27, 2017

To John W. McCarter, Jr., Chair, Board of Regents
The Honorable Barbara M. Barrett, Chair, Audit and Review Committee,
Board of Regents
Dr. David J. Skorton, Secretary

cc Albert G. Horvath, Under Secretary for Finance and Administration and
Chief Financial Officer
John Benton, Acting Deputy Under Secretary for Finance and Administration and
Chief Financial Officer
Jean Garvin, Director, Office of Finance and Accounting
Greg Bettwy, Chief of Staff
Porter Wilkinson, Chief of Staff to the Board of Regents

From Cathy L. Helm, Inspector General 

Subject Independent Auditors' Report on the Smithsonian Institution's Fiscal Year 2016
Financial Statements (OIG-A-17-02)

This memorandum transmits the second of three reports on the fiscal year 2016 financial statement audits of the Smithsonian Institution (Smithsonian) performed by the independent public accounting firm of KPMG LLP (KPMG).¹ On January 27, 2017, KPMG issued its independent auditors' report on the statement of the Smithsonian's financial position as of September 30, 2016, and the related statements of financial activity and cash flows. KPMG expressed an unmodified opinion that concluded the Smithsonian's 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 reports and documentation and interviewed its representatives. Our review of KPMG's fiscal year 2016 audit work disclosed no instances where KPMG did not comply, in all material respects, with the American Institute of Certified Public Accountants' generally accepted auditing standards and the U.S. Government Accountability Office's *Government 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 reports and the conclusions therein.

¹ The Office of the Inspector General is the Smithsonian's Contracting Officer's Technical Representative for the oversight of KPMG's work.

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, 2016

(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:

Report on the Financial Statements

We have audited the accompanying financial statements of Smithsonian Institution (Smithsonian), which comprise the statement of financial position as of September 30, 2016, and the related statements of financial 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 the Smithsonian Institution as of September 30, 2016, 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 2015 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated January 22, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2015 is consistent, in all material respects, with the audited financial statements from which it has been derived.

KPMG LLP

January 27, 2017

SMITHSONIAN INSTITUTION

Statement of Financial Position

September 30, 2016

(with summarized financial information as of September 30, 2015)

(Dollars in millions)

	Fund detail		Total funds	
	Trust	Federal	2016	2015
Assets:				
Cash, cash equivalents and U.S. Treasury balances	\$ 82.8	324.8	407.6	506.4
Receivables and advances	336.0	1.5	337.5	321.8
Inventories	12.7	0.4	13.1	11.2
Deferred expenses and other assets	55.0	2.2	57.2	53.3
Investments	1,565.5	—	1,565.5	1,397.0
Property and equipment, net	791.4	1,540.6	2,332.0	2,226.5
Total assets	\$ 2,843.4	1,869.5	4,712.9	4,516.2
Liabilities:				
Accounts payable and accrued expenses	\$ 157.6	128.7	286.3	305.0
Deferred revenue	59.4	—	59.4	51.2
Unexpended federal appropriations	—	267.8	267.8	248.5
Deferred gain on sale of real estate	16.0	—	16.0	19.9
Environmental remediation obligation	—	51.3	51.3	50.3
Long-term debt	201.3	—	201.3	202.8
Total liabilities	434.3	447.8	882.1	877.7
Net assets:				
Unrestricted	1,229.2	1,421.7	2,650.9	2,397.0
Temporarily restricted	670.3	—	670.3	754.1
Permanently restricted	509.6	—	509.6	487.4
Total net assets	2,409.1	1,421.7	3,830.8	3,638.5
Commitments and contingencies				
Total liabilities and net assets	\$ 2,843.4	1,869.5	4,712.9	4,516.2

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION
 Statement of Financial Activities
 Year ended September 30, 2016
 (with summarized financial information for year ended September 30, 2015)

(Dollars in millions)

	Unrestricted fund detail			Temporarily restricted trust funds	Permanently restricted trust funds	Total funds	
	Trust	Federal	Total			2016	2015
Operating revenues and other additions:							
Government revenue:							
Federal appropriations	\$ —	819.9	819.9	—	—	819.9	767.9
Government grants and contracts	119.6	—	119.6	—	—	119.6	125.9
Total government revenue	119.6	819.9	939.5	—	—	939.5	893.8
Contributions	38.8	—	38.8	206.7	20.9	266.4	198.3
Business activities and other:							
Business activities	180.7	—	180.7	—	—	180.7	178.6
Short-term investment income	1.2	—	1.2	—	—	1.2	2.0
Endowment payout	42.4	—	42.4	29.6	—	72.0	66.4
Private grants	6.9	—	6.9	—	—	6.9	7.0
Rentals, fees, commissions, and other	19.3	6.6	25.9	—	—	25.9	29.2
Gain on sale of real estate	3.9	—	3.9	—	—	3.9	3.9
Imputed benefit revenue	—	44.8	44.8	—	—	44.8	33.5
Total business activities and other	254.4	51.4	305.8	29.6	—	335.4	320.6
Total operating revenues	412.8	871.3	1,284.1	236.3	20.9	1,541.3	1,412.7
Net assets released from restrictions	344.6	—	344.6	(344.6)	—	—	—
Total operating revenues and other additions	757.4	871.3	1,628.7	(108.3)	20.9	1,541.3	1,412.7
Expenses:							
Program activities:							
Research	137.7	137.3	275.0	—	—	275.0	262.6
Collections management	24.8	235.6	260.4	—	—	260.4	241.4
Education, public programs, and exhibitions	91.5	233.3	324.8	—	—	324.8	307.8
Business activities	136.9	—	136.9	—	—	136.9	139.1
Total program activities	390.9	606.2	997.1	—	—	997.1	950.9
Supporting activities:							
Administration:							
Centrally managed	20.2	96.6	116.8	—	—	116.8	112.8
Unit managed	66.6	119.9	186.5	—	—	186.5	157.6
Advancement	56.6	8.9	65.5	—	—	65.5	54.5
Total supporting activities	143.4	225.4	368.8	—	—	368.8	324.9
Total expenses	534.3	831.6	1,365.9	—	—	1,365.9	1,275.8
Change in net assets before nonoperating activities	223.1	39.7	262.8	(108.3)	20.9	175.4	136.9
Nonoperating activities:							
Environmental remediation costs	—	(1.0)	(1.0)	—	—	(1.0)	(6.7)
Nonoperating investment gains (losses)	6.6	—	6.6	24.9	1.3	32.8	(65.4)
Loss on contributions receivable	—	—	—	—	—	—	(5.1)
Change in net assets of related organizations and other	2.9	—	2.9	(0.4)	—	2.5	1.0
Collection items not capitalized:							
Proceeds from sales	0.3	—	0.3	—	—	0.3	1.2
Collection items purchased	(14.8)	(2.9)	(17.7)	—	—	(17.7)	(11.3)
Change in net assets	218.1	35.8	253.9	(83.8)	22.2	192.3	50.6
Net assets, beginning of year	1,011.1	1,385.9	2,397.0	754.1	487.4	3,638.5	3,587.9
Net assets, end of year	\$ 1,229.2	1,421.7	2,650.9	670.3	509.6	3,830.8	3,638.5

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Statement of Cash Flows

Year ended September 30, 2016

(with summarized financial information for year ended September 30, 2015)

(Dollars in millions)

	Fund detail		Total funds	
	Trust	Federal	2016	2015
Cash flows from operating activities:				
Change in net assets	\$ 156.5	35.8	192.3	50.6
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:				
Proceeds from sales of collection items	(0.3)	—	(0.3)	(1.2)
Collection items purchased	14.8	2.9	17.7	11.3
Depreciation and amortization	41.1	95.0	136.1	132.8
Present value discount and accretion	—	0.7	0.7	(1.2)
Loss on contributions receivable	—	—	—	5.0
Contributions for permanent restricted purposes	(20.9)	—	(20.9)	(45.4)
Contributions for construction of facilities	(105.7)	—	(105.7)	(29.2)
Appropriations for repair, restoration, and construction	—	(119.9)	(119.9)	(117.1)
Investment income restricted for long-term purposes	—	—	—	(1.1)
Net investment (gains) losses	(94.5)	—	(94.5)	5.9
Decrease (increase) in assets:				
Receivables and advances	(0.8)	1.3	0.5	(3.9)
Deferred expenses and other assets	(3.0)	(0.9)	(3.9)	(6.6)
Inventories	(1.9)	—	(1.9)	1.7
Increase (decrease) in liabilities:				
Accounts payable and accrued expenses	(14.8)	3.4	(11.4)	39.9
Environmental remediation obligation	—	0.3	0.3	3.4
Deferred revenue and deferred gain on sale of real estate	4.2	—	4.2	0.3
Unexpended federal appropriations	—	(5.0)	(5.0)	24.4
Net cash (used in) provided by operating activities	<u>(25.3)</u>	<u>13.6</u>	<u>(11.7)</u>	<u>69.6</u>
Cash flows from investing activities:				
Proceeds from sales of collection items	0.3	—	0.3	1.2
Collection items purchased	(14.8)	(2.9)	(17.7)	(11.3)
Purchases of property and equipment	(121.0)	(127.9)	(248.9)	(337.7)
Purchases of investment securities	(249.6)	—	(249.6)	(173.5)
Proceeds from sales/maturities of investment securities	175.6	—	175.6	218.8
Net cash used in investing activities	<u>(209.5)</u>	<u>(130.8)</u>	<u>(340.3)</u>	<u>(302.5)</u>
Cash flows from financing activities:				
Contributions for permanent restricted purposes	41.6	—	41.6	45.4
Contributions for construction of facilities	68.8	—	68.8	29.2
Appropriations for repair, restoration, and construction	—	144.2	144.2	144.2
Investment income restricted for long-term purposes	—	—	—	1.1
Principal payments on long-term debt	(1.4)	—	(1.4)	(1.3)
Net cash provided by financing activities	<u>109.0</u>	<u>144.2</u>	<u>253.2</u>	<u>218.6</u>
Net change in cash, cash equivalents and U.S. Treasury balances	(125.8)	27.0	(98.8)	(14.3)
Cash, cash equivalents and U.S. Treasury balances:				
Beginning of year	<u>208.6</u>	<u>297.8</u>	<u>506.4</u>	<u>520.7</u>
End of year	<u>\$ 82.8</u>	<u>324.8</u>	<u>407.6</u>	<u>506.4</u>
Noncash investing activities:				
Construction cost accruals	\$ 21.1	10.9	32.0	39.3
Cash paid for interest	\$ 3.5	—	3.5	2.5

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(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 18 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 2016, 29.3 million individuals visited Smithsonian museums and other facilities.

At September 30, 2016, the Smithsonian’s extensive collection contained approximately 154.5 million objects: 0.3 million works of art, 8.8 million historical artifacts, and 145.4 million natural and physical science specimens (living and nonliving). The Smithsonian also maintains 145,000 cubic feet and 0.5 million items of archival holdings and 2.1 million library volumes. During fiscal year 2016, approximately 5,500 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.

The statement of financial activities 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, 2015, 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,

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(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 financial 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 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 contingencies, 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 FECA liabilities for workers compensation claims.

For fiscal 2016, the Smithsonian was appropriated \$696.0 for operations and \$144.2 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. Advancement costs related to the National Museum of African American History and Culture are included in the appropriation for operations.

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 2016, the unexpended balance of the fiscal 2010 appropriation, amounting to \$1.0, was returned.

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(Dollars in millions)

(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:

Unrestricted

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

Temporarily Restricted

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 and accumulated earnings from true endowments that have been designated for long-term investment. 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.

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 nonoperating losses in the statement of financial 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 nonoperating gains in the statement of financial 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 \$18.5 and \$52.1 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 \$324.8 restricted for federal appropriation capital and operating expenses.

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(Dollars in millions)

(f) 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 funds 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, 2016, the fund, totaling \$237.8, is comprised of \$52.1 in cash equivalents with maturity dates of three months or less and short-term investments of \$185.7, all of which are included in investments (see note 5).

(g) Trade Accounts Receivable

Trade accounts receivable generally consists of accounts receivables related to magazine advertising and certain concession agreements. As of September 30, 2016, trade accounts receivable totaled \$18.0 (see note 3).

(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 \$15.0 were received in fiscal year 2016 and recognized as program support revenues and expenses in the statement of financial 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 6,220 volunteers contributed about 538,000 hours of service to the Smithsonian during fiscal year 2016. 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. At

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(Dollars in millions)

September 30, 2016, deferred expenses and other assets include \$5.5 of deferred promotion costs, related primarily to the magazines. Advertising expense, including direct response advertising of \$3.3, totaled \$12.9 in fiscal year 2016 and is included in business activities expenses in the statement of financial 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, and the gift annuity program investments are reported at fair value, which are 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, 2016, 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 financial 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. 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.

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(Dollars in millions)

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 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 lands 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 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 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

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fiscal year 2016, noncash deaccessions included works of art, animals, historical objects, and natural specimens. Contributed items held for sale, amounting to \$0.9, are included in other assets.

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.

(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 accrued expenses in the statement of financial position.

(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. 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 financial activities.

(r) Nonoperating Activities

Nonoperating activities include environmental remediation costs, nonoperating investment income, loss on contributions receivable, changes in the net assets of related organizations, and changes in net assets related to collection items.

Nonoperating 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.

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.

(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 2016. The

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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.

(3) Receivables and Advances

Receivables and advances consisted of the following:

	Trust	Federal	Total
Contributions	\$ 269.4	—	269.4
Grants and contracts	19.9	—	19.9
Trade accounts, net of \$0.8 allowances	16.5	1.5	18.0
Accrued interest and dividends	1.5	—	1.5
Charitable trusts	18.0	—	18.0
Advances and other	10.7	—	10.7
 Total receivables and advances	 \$ 336.0	 1.5	 337.5

Contributions receivable consist of the following:

Due within:

Less than 1 year	\$ 129.9
1 to 5 years	157.8
5 years or beyond	11.4
	<hr/> 299.1

Less:

Allowance for uncollectible contributions	(15.5)
Unamortized discount (at rates ranging from 0.62% to 5.78%)	(14.2)
Contributions receivable, net	<hr/> \$ 269.4

Included in contributions receivable due in 1 to 5 years is \$45.7 due from a single donor for construction of facilities.

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(4) Federal Appropriations

Federal appropriation revenue is reconciled to the fiscal 2016 federal appropriation as follows:

	<u>Salaries and expenses</u>	<u>Repair and restoration and construction</u>	<u>Total</u>
Federal appropriation revenue	\$ 700.0	119.9	819.9
Unexpended 2016 appropriation	93.2	110.6	203.8
Amounts expended from prior years' appropriations	<u>(97.2)</u>	<u>(86.3)</u>	<u>(183.5)</u>
 Fiscal year 2016 federal appropriation	 <u>\$ 696.0</u>	 <u>144.2</u>	 <u>840.2</u>

Federal expenses are reconciled to the fiscal year 2016 federal appropriation as follows:

	<u>Salaries and expenses</u>	<u>Repair and Restoration and construction</u>	<u>Total</u>
Federal appropriation expense	\$ 739.9	91.7	831.6
Unexpended 2016 appropriation	93.2	110.6	203.8
Depreciation	(14.4)	(80.6)	(95.0)
Imputed benefit costs	(44.8)	—	(44.8)
Collection items purchased	2.9	—	2.9
Amounts expended from prior years' appropriations	<u>(97.2)</u>	<u>(86.3)</u>	<u>(183.5)</u>
Capital expenditures	21.8	108.8	130.6
Unfunded expenses - FECA, annual leave	1.2	—	1.2
Other funding	<u>(6.6)</u>	<u>—</u>	<u>(6.6)</u>
 Fiscal year 2016 federal appropriation	 <u>\$ 696.0</u>	 <u>144.2</u>	 <u>840.2</u>

Unexpended appropriations for all fiscal years total \$267.8 at September 30, 2016 and consist of \$126.4 in unexpended operating funds and \$141.4 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) 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.
- 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.

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The following summarizes Smithsonian's investments at fair value which are determined primarily based on quoted market prices as of September 30, 2016:

	<u>Total</u>	<u>Level 1</u>	<u>Level 3</u>	<u>NAV⁽¹⁾</u>
Fixed income	\$ 185.7	185.7	—	—
Endowment investments:				
Global equities:				
Developed markets	57.9	57.9	—	—
Emerging markets	32.1	32.1	—	—
Real assets:				
Energy and natural resources	26.6	26.6	—	—
Fixed income	94.5	94.5	—	—
Cash and equivalents	20.6	20.6	—	—
Pooled investments	231.7	231.7	—	—
Investments at NAV	<u>1,124.6</u>	<u>—</u>	<u>—</u>	<u>1,124.6</u>
Total pooled investments	1,356.3	231.7	—	1,124.6
Nonpooled investments:				
U.S. Treasury deposits	0.9	0.9	—	—
Total endowment	1,357.2	232.6	—	1,124.6
Gift annuities, primarily equities	22.6	22.6	—	—
Total investments	<u>1,565.5</u>	<u>440.9</u>	<u>—</u>	<u>1,124.6</u>
Charitable trusts	18.0	—	18.0	—
	<u>\$ 1,583.5</u>	<u>440.9</u>	<u>18.0</u>	<u>1,124.6</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:

	NAV	Redemption terms	Days of notices	Unfunded commitments
Global equity:				
Developed markets	\$ 284.4	Weekly to annually	6-91	\$ —
Emerging markets	84.3	Daily to quarterly	30-91	—
Marketable alternatives:				
Long/short equity	55.2	Monthly to annually	30-91	—
Credit and distressed	84.1	Annually to at maturity	90-n/a	9.6
Multistrategy	66.3	Quarterly to annually	60-90	—
Global marco	73.8	Monthly to semi-annually	2-90	—
Private equity:				
Private equity	86.3	Not applicable	N/A	41.9
Venture capital	191.7	Not applicable	N/A	78.5
Real assets:				
Energy and natural resources	73.0	Daily to at maturity	45-n/a	45.0
Real estate funds	103.5	Quarterly to at maturity	60-n/a	78.8
Fixed income	<u>22.0</u>	Quarterly	90	—
	<u><u>\$ 1,124.6</u></u>			<u><u>\$ 253.8</u></u>

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

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.

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, multistrategy, 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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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.

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.

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, 2016, the Smithsonian had uncalled commitments totaling approximately \$253.8. 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 2016: beginning balance \$17.9; distribution \$0.3; and net gains \$0.4; and ending balance \$18.0. There are no transfers and reclassifications of assets between levels during fiscal year 2016.

Investment return consisted of the following for fiscal year 2016:

Dividend and interest income	\$	14.0
Net investment gains		94.5
Investment management fees		(2.5)
	\$	<u>106.0</u>

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Investment return is classified in the statement of financial activities as follows for fiscal year 2016:

Short-term investment income	\$	1.2
Endowment payout		72.0
Nonoperating investment gain		32.8
Investment return	\$	106.0

(6) Endowment Funds

The Smithsonian endowment consists of approximately 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. 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. At September 30, 2016, the per unit market value of the pool was \$844.71 (in whole dollars).

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 2016, in dollars, was \$39.27 or 5% of the average per unit market value of the endowment over the prior five years. An additional payout per eligible unit of \$7.85 (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. At September 30, 2016, the fair value of permanent endowment gifts was \$1.3 below the original value of the gifts. Such deficiencies are generally the result of unfavorable market fluctuations and continuing the appropriations for various programs is generally deemed prudent by the Board.

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Endowment net assets, excluding contributions receivable, consist of the following:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor restricted	\$ (1.3)	291.2	457.3	747.2
Board designated	<u>610.9</u>	<u>10.6</u>	<u>—</u>	<u>621.5</u>
Total endowment net assets	<u><u>\$ 609.6</u></u>	<u><u>301.8</u></u>	<u><u>457.3</u></u>	<u><u>1,368.7</u></u>
Uninvested cash and receivables				\$ (11.4)
Total endowment assets under management				<u><u>\$ 1,357.3</u></u>

Activity in endowment net assets is as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Balance, beginning of year	\$ 592.1	281.8	414.3	1,288.2
Investment return:				
Investment income	2.9	3.4	—	6.3
Realized and unrealized gains, net	<u>42.7</u>	<u>50.4</u>	<u>—</u>	<u>93.1</u>
Total investment return	<u>45.6</u>	<u>53.8</u>	<u>—</u>	<u>99.4</u>
Contributions, including board designated transfers	7.7	2.4	43.0	53.1
Appropriated for expenditure	(37.1)	(34.9)	—	(72.0)
Deficiency recovery	<u>1.3</u>	<u>(1.3)</u>	<u>—</u>	<u>—</u>
Balance, end of year	<u><u>\$ 609.6</u></u>	<u><u>301.8</u></u>	<u><u>457.3</u></u>	<u><u>1,368.7</u></u>

(7) Property and Equipment

Property and equipment consists of the following:

	Trust	Federal	Total
Land	\$ 12.6	—	12.6
Buildings and capital improvements	1,073.9	2,838.5	3,912.4
Equipment and software	70.5	233.2	303.7
Leasehold improvements	<u>97.9</u>	<u>31.5</u>	<u>129.4</u>
	<u>1,254.9</u>	<u>3,103.2</u>	<u>4,358.1</u>
Accumulated depreciation	<u>(463.5)</u>	<u>(1,562.6)</u>	<u>(2,026.1)</u>
Total property and equipment	<u><u>\$ 791.4</u></u>	<u><u>1,540.6</u></u>	<u><u>2,332.0</u></u>

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Buildings and capital improvements include \$79.0 and \$249.5 of construction in progress within trust and federal funds, respectively. Depreciation expense totaled \$40.9 in trust funds and \$95.0 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 0.81% and a discount rate of 1.56%. 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 2016 activity in the unfunded environmental remediation obligation follows:

Beginning balance, September 30, 2015	\$ 50.3
Accretion	0.7
Liabilities incurred	0.2
Liabilities settled	(0.2)
Change in estimate	<u>0.3</u>
 Ending balance, September 30, 2016	 <u>\$ 51.3</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 2016, \$3.9 of the deferred gain was recognized.

(8) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consists of the following:

	Trust	Federal	Total
Accounts payable	\$ 52.8	44.8	97.6
Accrued salaries and benefits	41.4	83.9	125.3
Deferred rent liability	22.5	—	22.5
Gift annuity liabilities	14.3	—	14.3
Other accrued liabilities	<u>26.6</u>	<u>—</u>	<u>26.6</u>
 Total accounts payable and accrued expenses	 <u>\$ 157.6</u>	 <u>128.7</u>	 <u>286.3</u>

Accrued salaries and benefits include estimated FECA liabilities of \$2.4 for trust employees and \$39.8 for federal employees.

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(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:	\$ 50.0
Interest rate 3.434%, due September 1, 2023	
Series 2013 Taxable Bonds, Series B:	50.0
Variable interest rate, due September 1, 2018	
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	7.8
Series 2010 Revenue Bonds, term, principal amounts ranging from \$1.8 to \$2.4, interest rate 5.25%, due February 1, 2022 through 2028	14.7
Series 2003 Revenue Bonds, Series A:	52.5
Variable interest rate, due December 1, 2033	
Series 2003 Revenue Bonds, Series B:	25.0
Variable interest rate, due December 1, 2033	
Sub total	<hr/> 200.0
Less unamortized bond issue cost	(0.2)
Plus unamortized bond premium	<hr/> 1.5
Total long-term debt	<hr/> <hr/> \$ 201.3

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 is payable monthly at a variable interest rate determined in accordance with the Indenture (0.75% at September 30, 2016).

In connection with the Series B offering, the Smithsonian entered into a second Standby Bond Purchase agreement with Wells Fargo (Trustee) and Northern Trust Company (Liquidity Facility Provider), for the creation of the 2013 Liquidity Facility. The 2013 Liquidity Facility secures only the payment of the purchase price of the Series B bonds tendered for purchase and does not otherwise secure payment of the principal or interest on the Bonds. The Liquidity Facility expires September 4, 2018.

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 \$1.3 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.

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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 0.84% and 0.86%, respectively, at September 30, 2016.

The bonds are supported by a standby bond purchase agreement for Series A and a standby purchase agreement for Series B (collectively, the Liquidity Facility). The Northern Trust 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 Liquidity Facility expires September 12, 2017.

Interest expense totaled \$3.0.

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

2017	\$	1.5
2018		51.5
2019		1.6
2020		1.6
2021		1.7
Thereafter		142.1
	\$	<u>200.0</u>

(10) Net Assets

Unrestricted net assets include \$609.6 of funds functioning as endowments.

Temporarily restricted net assets are available for the following purposes:

Museums and general support	\$	179.4
Education, public programs and exhibitions		145.4
Research		92.6
Acquisitions and collections		64.4
Facilities		188.5
	\$	<u>670.3</u>

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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:

Museums and general support	\$ 55.5
Education, public programs and exhibitions	78.4
Research	27.0
Acquisitions and collections	15.2
Facilities	<u>168.5</u>
	<u>\$ 344.6</u>

Permanently restricted net assets are restricted for the following purposes:

Museums and general support	\$ 132.1
Education, public programs and exhibitions	241.2
Research	84.7
Acquisitions and collections	50.1
Facilities	<u>1.5</u>
	<u>\$ 509.6</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 2016 expense for these plans was \$37.5. Additional imputed costs associated with these plans are borne by the US government. The Smithsonian recognizes its share of such costs (\$44.5 for fiscal 2016) 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.

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.

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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 2016 was \$18.0.

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. At September 30, 2016, the accrued benefit obligation under this plan was \$16.1 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.

(12) Business Activities

A summary of business activities is as follows:

	Revenues	Expenses	Net
Smithsonian business enterprises	\$ 158.3	(121.9)	36.4
Unit auxiliary activities	22.4	(15.0)	7.4
Total business activities	<u><u>180.7</u></u>	<u><u>(136.9)</u></u>	<u><u>43.8</u></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 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 at September 30, 2016 are as follows:

2017	\$ 42.5
2018	42.8
2019	42.4
2020	42.4
2021	26.5
Thereafter	36.8
	<u><u> </u></u>
	<u><u>233.4</u></u>

SMITHSONIAN INSTITUTION

Notes to Financial Statements

September 30, 2016

(Dollars in millions)

Rent expense under operating leases, including executory costs such as maintenance, insurance, and taxes, totaled \$55.6 for fiscal year 2016, which includes \$7.1 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*

The Smithsonian has various commitments related to construction projects currently in process at a number of its locations. The most significant construction contracts are \$476.0 for the National Museum of African American History & Culture, \$37.0 for the National Air and Space Museum, and \$23.6 for the National Museum of Natural History. Remaining commitments under these contracts total approximately \$26.8 as of September 30, 2016.

(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

Subsequent to September 30, 2016, the Smithsonian committed capital of \$63.3 to 8 funds. Management has evaluated subsequent events from September 30, 2016 through January 27, 2016, 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.