SMITHSONIAN INSTITUTION

Financial Statements

September 30, 2008

(With Independent Auditors' Report Thereon)

KPMG LLP
2001 M Street, NW
Washington, DC 20036

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, 2008 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 2007 financial statements, and, in our report dated February 15, 2008, 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, 2008 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 30, 2009

SMITHSONIAN INSTITUTION

Statement of Financial Position

September 30, 2008
(With summarized financial information as of September 30, 2007)

(Dollars in millions)

	Trust funds	Federal funds	Total funds 2008	Total funds 2007
Assets:				
Cash, cash equivalents and balances with the U.S. Treasury	$ 61.2	285.8	347.0	430.6
Receivables and advances	232.6	0.1	232.7	258.8
Prepaid and deferred expenses	30.4	1.0	31.4	32.0
Inventory	13.2	—	13.2	14.5
Investments	1,060.8	—	1,060.8	1,063.8
Property and equipment, net	475.2	911.5	1,386.7	1,305.6
Total assets	$ 1,873.4	1,198.4	3,071.8	3,105.3
Liabilities:				
Accounts payable and accrued expenses	$ 106.4	113.8	220.2	201.4
Deferred revenue	56.6	—	56.6	44.7
Deferred gain on sale of real estate	47.3	—	47.3	51.2
Unexpended federal appropriations	—	241.6	241.6	200.5
Long-term debt	111.9	—	111.9	112.9
Total liabilities	322.2	355.4	677.6	610.7
Net assets:				
Unrestricted:				
Funds functioning as endowment	569.9	—	569.9	639.1
Operational balances	307.9	843.0	1,150.9	1,164.2
Total unrestricted net assets	877.8	843.0	1,720.8	1,803.3
Temporarily restricted:				
Funds functioning as endowment	150.1	—	150.1	199.9
Donor contributions for facilities	139.3	—	139.3	104.4
Donor contributions for programs	149.8	—	149.8	177.2
Total temporarily restricted net assets	439.2	0.0	439.2	481.5
Permanently restricted:				
True endowments	218.4	—	218.4	188.4
Interest in perpetual and other trusts	15.8	—	15.8	21.4
Total permanently restricted net assets	234.2	0.0	234.2	209.8
Total net assets	1,551.2	843.0	2,394.2	2,494.6
Commitments and contingencies				
Total liabilities and net assets	$ 1,873.4	1,198.4	3,071.8	3,105.3

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Statement of Financial Activity

Year ended September 30, 2008
(With summarized financial information for the year ended September 30, 2007)

(Dollars in millions)

	Unrestricted			Temporarily	Permanently	Total	
	Trust funds	Federal funds	Total	restricted trust funds	restricted trust funds	2008	2007
Operating revenues and other additions:							
Government revenue:							
Federal appropriations	$ —	640.2	640.2	—	—	640.2	620.0
Government grants and contracts	119.2	—	119.2	—	—	119.2	104.1
Total government revenue	119.2	640.2	759.4	—	—	759.4	724.1
Contributions:							
Program support	41.4	—	41.4	33.3	27.3	102.0	155.3
Construction of facilities	—	—	—	28.4	—	28.4	5.4
Total contributions	41.4	—	41.4	61.7	27.3	130.4	160.7
Business activities and other:							
Business activities	187.1	—	187.1	—	—	187.1	197.9
Short-term investment income	3.9	—	3.9	(0.2)	—	3.7	13.1
Endowment payout	29.7	—	29.7	14.5	0.9	45.1	39.2
Private grants	5.9	—	5.9	—	—	5.9	7.4
Rentals, fees, commissions, and other	23.4	2.0	25.4	—	—	25.4	18.9
Gain on sales of real estate	3.9	—	3.9	—	—	3.9	4.2
Total business activities and other	253.9	2.0	255.9	14.3	0.9	271.1	280.7
Total operating revenues	414.5	642.2	1,056.7	76.0	28.2	1,160.9	1,165.5
Net assets released from restrictions	52.0	—	52.0	(52.0)	—	—	—
Total operating revenues and other additions	466.5	642.2	1,108.7	24.0	28.2	1,160.9	1,165.5
Expenses:							
Program activities:							
Research	127.7	133.1	260.8	—	—	260.8	239.5
Collections management	12.0	113.3	125.3	—	—	125.3	124.5
Education, public programs, and exhibitions	64.1	172.9	237.0	—	—	237.0	245.2
Business activities	154.3	—	154.3	—	—	154.3	172.1
Total program activities	358.1	419.3	777.4	—	—	777.4	781.3
Supporting activities:							
Administration	50.7	198.0	248.7	—	—	248.7	249.5
Advancement	25.1	1.0	26.1	—	—	26.1	22.2
Total supporting activities	75.8	199.0	274.8	—	—	274.8	271.7
Total expenses	433.9	618.3	1,052.2	—	—	1,052.2	1,053.0
Change in net assets from operations	32.6	23.9	56.5	24.0	28.2	108.7	112.5
Nonoperating activities:							
Nonoperating investment income (loss)	(130.4)	—	(130.4)	(65.2)	(3.8)	(199.4)	120.0
Accumulated net loss on defined benefit retirement plan	—	—	—	—	—	—	(0.6)
Change in interest in net assets of related organizations	(1.5)	—	(1.5)	(1.1)	—	(2.6)	(0.4)
Change in net assets related to collection items not capitalized:							
Proceeds from sales	0.9	—	0.9	—	—	0.9	0.6
Collection items purchased	(5.4)	(2.6)	(8.0)	—	—	(8.0)	(11.9)
Change in net assets	(103.8)	21.3	(82.5)	(42.3)	24.4	(100.4)	220.2
Net assets, beginning of the year	981.6	821.7	1,803.3	481.5	209.8	2,494.6	2,274.4
Net assets, end of the year	$ 877.8	843.0	1,720.8	439.2	234.2	2,394.2	2,494.6

See accompanying notes to financial statements.

SMITHSONIAN INSTITUTION

Statement of Cash Flows

Year ended September 30, 2008
(With summarized financial information for the year ended September 30, 2007)

(Dollars in millions)

		Trust funds	Federal funds	Total 2008	Total 2007
Cash flows from operating activities:					
Change in net assets	$	(121.7)	21.3	(100.4)	220.2
Adjustments to reconcile change in net assets to net cash provided by operating activities:					
Proceeds from sales of collection items		(0.9)	—	(0.9)	(0.6)
Collection items purchased		5.4	2.6	8.0	11.9
Depreciation		27.4	70.0	97.4	97.8
(Gain) loss on disposition of assets		—	0.2	0.2	(4.1)
Contributions for permanent endowment		(6.6)	—	(6.6)	(15.4)
Contributions for construction of facilities		(44.4)	—	(44.4)	(23.9)
Appropriations for repair, restoration, and construction		—	(105.4)	(105.4)	(98.6)
Investment income restricted for long-term purposes		(2.8)	—	(2.8)	(4.6)
Net investment loss (gain)		161.4	—	161.4	(144.6)
Decrease (increase) in assets:					
Receivables and advances		26.1	—	26.1	1.5
Prepaid and deferred expenses		1.1	(0.5)	0.6	(0.7)
Inventory		1.3	—	1.3	—
Increase (decrease) in liabilities:					
Accounts payable and accrued expenses		17.3	(0.9)	16.4	20.6
Deferred revenue		8.0	—	8.0	(1.9)
Unexpended federal appropriations		—	41.1	41.1	13.5
Net cash provided by operating activities		71.6	28.4	100.0	71.1
Cash flows from investing activities:					
Proceeds from sales of collection items		0.9	—	0.9	0.6
Collection items purchased		(5.4)	(2.6)	(8.0)	(11.9)
Purchases of property and equipment		(81.7)	(94.6)	(176.3)	(165.3)
Purchases of investment securities		(769.5)	—	(769.5)	(886.6)
Proceeds from sales/maturities of investment securities		611.1	—	611.1	905.9
Net cash used in investing activities		(244.6)	(97.2)	(341.8)	(157.3)
Cash flows from financing activities:					
Contributions for permanent endowment		6.6	—	6.6	15.4
Contributions for construction of facilities		44.4	—	44.4	23.9
Appropriations for repair, restoration, and construction		—	105.4	105.4	98.6
Investment income restricted for long-term purposes		2.8	—	2.8	4.6
Payments on long-term debt		(1.0)	—	(1.0)	(1.5)
Net cash provided by financing activities		52.8	105.4	158.2	141.0
Net change in cash, cash equivalents and balances with U.S. Treasury		(120.2)	36.6	(83.6)	54.8
Cash, cash equivalents and balances with U.S. Treasury:					
Beginning of the year		181.4	249.2	430.6	375.8
End of the year	$	61.2	285.8	347.0	430.6
Noncash investing activities:					
Construction cost accruals	$	8.5	8.5	17.0	14.6

Cash paid for interest during fiscal years 2008 and 2007 was approximately $3.6 and $4.3, respectively.

See accompanying notes to financial statements.

(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 are operated in five states and Panama. Research is carried out in the Smithsonian’s museums and in other facilities throughout the world. During fiscal year 2008, over 24.0 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, 2008, the Smithsonian’s extensive collection contained approximately 136.7 million objects as follows: works of art (0.3 million), historical artifacts (10.2 million), and natural and physical science specimens (126.2 million). In addition, 90,300 cubic feet of archives and 1.7 million library volumes are maintained by the Smithsonian. Acquisitions and disposals of collection items during fiscal year 2008 were nominal in each category of collection items, except for the disposal of approximately 0.7 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.

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, 2007, 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, which were established by Congress within the Smithsonian, but are governed by independent boards of trustees.

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, and the allowance for uncollectible contributions.

(b) 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 $562.4 for operations and $120.1 for construction or repair and restoration of facilities in fiscal year 2008. 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 2008, the Smithsonian returned $4.2 to the U.S. Treasury, which represented the unexpended balance of appropriations for operations for fiscal year 2003. Federal appropriations for construction or repair and restoration of facilities are generally available for obligation until expended.

(c) 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.

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 the required level are classified as increases in unrestricted net assets and reported as nonoperating gains in the statement of financial activity. 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.

(d) Cash Equivalents

Short-term investments with maturities at date of purchase of three months or less (except those purchased with funds held by external investment managers) and funds held by U.S. Treasury are considered cash equivalents. At September 30, 2008, cash equivalents consisted of short-term investments of $41.1 and funds held by U.S. Treasury of $285.8.

(e) 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

(Continued)

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. Contributions expected to be collected beyond one year are discounted to present value using a risk-free 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 $10.8 were received in fiscal year 2008 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 2008, approximately 6,200 volunteers contributed approximately 583,000 hours of service to the Smithsonian. In accordance with applicable guidance, the value of these contributions is not recognized in the financial statements.

(f) 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.

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, 2008, prepaid and deferred expenses included $8.4 of deferred promotion costs, related primarily to Smithsonian magazine. Promotion expense totaled $17.1 in fiscal year 2008 and is included in business activities expenses in the statement of financial activity.

(g) Inventories

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

(h) Investments

At September 30, 2008, approximately 18% of the endowment and similar investments and all of the short-term investments and gift annuity program investments are reported at fair value based on quoted market prices. The remaining investments are reported at estimated fair value as determined by management based upon various valuation techniques developed by the general partners or investment managers. Because these investments are not readily marketable, their reported values are subject to additional uncertainty, and therefore values realized upon disposition may vary, even significantly, from the currently reported amounts.

Changes in fair value are recognized in the statement of financial activity. Purchases and sales of investments are recorded on the trade date. Investment income is recorded when earned.

As mandated by Congress, the Smithsonian maintains two U.S. Treasury investments totaling $1.0 relating in part to the original gift from James Smithson.

(i) Split Interest Agreements and Perpetual Trusts

Split interest agreements with donors consist primarily of irrevocable charitable remainder trusts and charitable gift annuities. For the charitable remainder trusts, the assets are included in receivables. Contribution revenues are recognized at the dates the trusts are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted during the terms of the trusts for changes in the value of the assets, accretion of discounts, and other changes in the estimated future benefits. 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 present values of the estimated future cash receipts from 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 carrying value of the assets is adjusted for changes in the estimates of future receipts.

(j) Property and Equipment

Property and equipment purchased with federal or trust funds are recorded at cost. Property and equipment acquired through transfer 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

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.

(k) 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.

(l) Financial Instruments

The carrying value of long-term debt obligations in the financial statements is less than their fair value by approximately $1.7 at September 30, 2008. 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 values of all other financial instruments in the financial statements approximate their fair values.

(m) 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.

(n) 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.

(o) 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 2008 were $23.3.

(p) 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 organization is The Friends of the National Zoo (FONZ), which raises funds for the benefit of the Smithsonian's National Zoological Park.

(q) Measure of Operations

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

The Smithsonian uses the "total return" approach to management of investments of pooled true endowment funds and funds functioning as endowment (referred to collectively as the endowment). Under this approach, the endowment pays out an amount for annual support of operations based upon a number of factors evaluated and approved by the Board; however, if the market value of any endowment fund is less than 110% of its historical value, the payout is limited to the actual interest and dividends allocable to that fund. The difference between the total return (i.e., dividends, interest and net gain or loss) and the payout is reported as nonoperating investment income or loss in the statement of financial activity.

(r) Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements (*SFAS 157). SFAS 157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements, but does not require any new fair value measures. SFAS 157 will be effective for the Smithsonian in fiscal year 2009. The Smithsonian is currently evaluating the impact SFAS 157 will have on its financial statements.

In August 2008, the FASB issued FASB Staff Position No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP 117-1). FSP 117-1 provides guidance on classifying the net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of Uniform Prudent Management Institutional Funds Act (UPMIFA), which serves as a model act for states to modernize their laws governing donor-restricted endowment funds. The FSP also requires additional disclosures about endowments (both donor-restricted funds and board-designated funds) for all organizations, including those that are not yet subject to an enacted version of UPMIFA. The District of Columbia has adopted UPMIFA in January 2008. The Smithsonian has determined that it is not required to follow the District of Columbia's version of UPMIFA as a matter of law, but it may choose to implement the standards of UPMIFA in a future period. A key component of FSP 117-1 is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure in UPMIFA jurisdictions. The provisions of FSP 117-1 are effective for the Smithsonian for fiscal year 2009.

(Dollars in millions)

(3) Receivables and Advances

Receivables and advances consisted of the following at September 30, 2008:

	Trust	Federal	Total
Trade receivables, net of $0.8 in allowances	$ 15.7	0.1	15.8
Contributions receivable, net	172.2	—	172.2
Grants and contracts	25.9	—	25.9
Accrued interest and dividends	1.6	—	1.6
Advance payments	0.5	—	0.5
Charitable trusts	16.7	—	16.7
Total receivables and advances	$ 232.6	0.1	232.7

Contributions receivable, net, are summarized as follows at September 30, 2008:

Due within:	
Less than 1 year	$ 140.3
1 to 5 years	36.5
More than 5 years	8.2
	185.0
Less:	
Allowance for uncollectible contributions	(1.3)
Discount to present value (at rates ranging from 2.90% to 4.84%)	(11.5)
Contributions receivable, net	$ 172.2

At September 30, 2008, gross contributions receivable included approximately $59.9 due from two donors for construction of facilities.

(Dollars in millions)

(4) Federal Appropriations

Federal appropriation revenues recognized in fiscal year 2008 are reconciled to the federal appropriations for fiscal year 2008 as follows:

		Salaries and expenses	Repair and restoration and construction	Total
Federal appropriation revenue	$	561.7	78.5	640.2
Unexpended 2008 appropriation		58.8	99.2	158.0
Amounts expended from prior years		(58.1)	(57.6)	(115.7)
Fiscal year 2008 federal appropriations	$	562.4	120.1	682.5

Federal expenses recognized in fiscal year 2008 are reconciled to the federal appropriations for fiscal year 2008 as follows:

		Salaries and expenses	Repair and restoration and construction	Total
Federal appropriation expense	$	567.0	51.3	618.3
Unexpended 2008 appropriation		58.8	99.2	158.0
Depreciation		(20.0)	(50.0)	(70.0)
Loss on disposition of assets		(0.2)	—	(0.2)
Unfunded annual leave and FECA costs		(1.2)	—	(1.2)
Amounts expended from prior years		(58.1)	(57.6)	(115.7)
Capital expenditures		15.5	77.2	92.7
Collection items purchased		2.6	—	2.6
Other funding		(2.0)	—	(2.0)
Fiscal year 2008 federal appropriations	$	562.4	120.1	682.5

Unexpended appropriations for all fiscal years total $241.6 at September 30, 2008 and consist of $85.7 in unexpended operating funds and $155.9 in unexpended construction funds. Unexpended operating funds represent amounts appropriated for Smithsonian operations. Unexpended construction funds represent amounts appropriated for new facilities or renovations.

(Dollars in millions)

(5) Accessions and Deaccessions

For fiscal year 2008, $5.4 of trust funds and $2.6 of federal funds were spent to acquire collection items. For fiscal year 2008, sales of collection items were $0.9 of trust funds. At September 30, 2008, accumulated proceeds and related earnings from deaccessions amounted to $20.9.

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 2008 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 $2.3 at September 30, 2008.

(6) Investments

Investments consisted of the following at September 30, 2008:

Cash equivalents	$	0.2
U.S. Government obligations		138.7
		138.9
Endowment and similar investments:		
Pooled investments:		
Cash equivalents		54.5
Global equities		329.4
Emerging market equities		42.5
Absolute return		306.8
Real estate and commodities		20.7
Private equities and venture capital		39.0
Fixed income		111.9
Total pooled investments		904.8
Nonpooled investments:		
Deposits with U.S. Treasury		1.0
Total nonpooled investments		1.0
Total endowment and similar investments		905.8
Gift annuity program investments:		
Cash equivalents		0.3
Fixed income		5.0
Equities		10.8
Total gift annuity program investments		16.1
Total investments	$	1,060.8

(Dollars in millions)

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, 2008, the Smithsonian had uncalled commitments of approximately $85.2. Such commitments are generally callable over a period of years and the related agreements contain fixed expiration dates or other termination clauses.

Investments are professionally managed by outside investment organizations, subject to direction and oversight by a committee of the Board. The Board has established investment policies and guidelines that provide for asset allocation and performance objectives, and impose various restrictions and limitations on the managers. Policies, procedures and performance are reviewed periodically by the Investment Committee and Smithsonian's staff.

Investment income (loss) consisted of the following for fiscal year 2008:

Dividend and interest income	$	15.9
Net investment loss		(165.3)
Investment management fees		(1.2)
Investment loss	$	(150.6)

Investment income (loss) is classified in the statement of financial activity as follows for fiscal year 2008:

Short-term investment income	$	3.7
Endowment payout		45.1
Nonoperating investment loss		(199.4)
Investment loss	$	(150.6)

(7) Endowment Funds

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, 2008, the market value of the pool equated to seven hundred fifty three dollars and seven cents per unit. The market value of the pool's net assets (i.e., pooled investments minus net receivables and payables related to unsettled investment transactions) at September 30, 2008 was $904.8.

Each fund participating in the investment pool receives an annual payout equal to the number of units owned times the annual payout amount per unit. The payout for fiscal year 2008 was thirty-seven dollars and twenty three cents per unit or 5% of the average per unit market value of the endowment over the prior five years.

(Dollars in millions)

Net asset balances of the endowment consisted of the following at September 30, 2008:

Unrestricted	$	330.5
Unrestricted – designated for operating units		239.4
Total unrestricted		569.9
Temporarily restricted		150.1
Permanently restricted		218.4
Total endowment net assets	$	938.4

(8) Property and Equipment

Property and equipment consisted of the following at September 30, 2008:

		Trust	Federal	Total
Land	$	12.5	—	12.5
Buildings and capital improvements		590.2	1,685.0	2,275.2
Equipment and software		54.1	136.8	190.9
Leasehold improvements		38.9	21.3	60.2
		695.7	1,843.1	2,538.8
Accumulated depreciation		(220.5)	(931.6)	(1,152.1)
Total property and equipment	$	475.2	911.5	1,386.7

At September 30, 2008, buildings and capital improvements included $32.5 and $144.0 of construction in progress within trust and federal funds, respectively. Depreciation expense for fiscal year 2008 totaled $27.4 in trust funds and $70.0 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 the date of sale ($62.9) and is recognizing the gain over the term of the leases. In fiscal year 2008, $3.9 of the deferred gain was recognized.

(Continued)

(Dollars in millions)

(9) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of the following at September 30, 2008:

		Trust	Federal	Total
Accounts payable	$	34.4	24.7	59.1
Accrued salaries and benefits		30.3	83.7	114.0
Deferred rent liability		7.6	—	7.6
Gift annuity liabilities		9.4	—	9.4
Other accrued liabilities		24.7	5.4	30.1
Total accounts payable and accrued expenses	$	106.4	113.8	220.2

Accrued salaries and benefits include estimated FECA liabilities of $4.8 for trust employees and $43.5 for federal employees at September 30, 2008.

(10) Long-Term Debt

The Smithsonian is obligated with respect to the following issues of long-term debt at September 30, 2008:

District of Columbia issues:		
Series 1997 Revenue Bonds, Serial, principal amounts ranging from $1.1 to $1.2, interest rates, 4.50% to 4.75%, due February 1, 2009 through 2012	$	4.7
Series 1997 Revenue Bonds, Term:		
Interest rate 5.00%, due February 1, 2017		7.1
Interest rate 4.75%, due February 1, 2018		1.6
Interest rate 5.00%, due February 1, 2028		21.6
Series 2003 Revenue Bonds, Series A:		
Variable interest rate, due December 1, 2033		52.5
Series 2003 Revenue Bonds, Series B:		
Variable interest rate, due December 1, 2033		25.0
Less unamortized bond discount		(0.6)
Total long-term debt	$	111.9

The individual debt components at September 30, 2008 are described as follows:

Series 1997 Revenue Bonds

The series 1997 serial and term revenue bonds were 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.

(Dollars in millions)

The term bonds maturing on February 1, 2017 and February 1, 2028 are subject to mandatory redemption by sinking fund installments. Installment payments for the term bond maturing February 1, 2017 begin on February 1, 2013 and range from $1.3 to $1.6 per year through the maturity date. Installment payments for the term bond maturing February 1, 2028 begin on February 1, 2019 and range from $1.7 to $2.7 per year through the maturity date.

Series 2003 Revenue Bonds

The 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 (6.92% at September 30, 2008). Due to unusual conditions in the capital markets, the September 30, 2008 interest rate is significantly higher than the interest rate that has historically been applicable to the bonds. The average interest rate for fiscal year 2008 was 2.4%. Principal and interest payments are funded solely by trust funds.

Interest expense on long-term debt for fiscal year 2008 totaled $3.7.

The annual maturities of long-term debt for the five fiscal years subsequent to fiscal year 2008 and thereafter are as follows: 2009, $1.1; 2010, $1.1; 2011, $1.2; 2012, $1.2; 2013, $1.3; and thereafter, $106.6.

(11) Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2008:

Museums and general support	$	80.1
Education, public programs and exhibitions		119.1
Research		44.5
Acquisitions and collections		56.2
Facilities		139.3
	$	439.2

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, 2008:

Program support	$	28.9
Facilities		4.9
Research and other		18.2
	$	52.0

(Dollars in millions)

Permanently restricted net assets are restricted for the following purposes at September 30, 2008:

Museums and general support	$	55.3
Education, public programs and exhibitions		88.3
Research		54.8
Acquisitions and collections		27.6
Facilities		1.5
Other		6.7
	$	234.2

(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 2008 was $26.5.

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 2008 was $14.0.

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, 2008, the accrued benefit obligation under this plan was $11.6 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 2008.

On October 1, 2007, the Smithsonian adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 requires that a tax position be recognized or derecognized based on a more-likely-than-not threshold. This applies to positions taken or expected to be taken in a tax return. The implementation of FIN 48 had no impact on the Smithsonian’s financial statements. The Smithsonian does not believe its financial statements include any uncertain tax positions.

(Dollars in millions)

(14) Business Activities

A summary of business activities revenues and expenses for fiscal year 2008 is as follows:

		Revenues	Expenses	Net
Smithsonian business enterprises:				
Magazines	$	60.6	(49.4)	11.2
Museum shops and mail order		63.1	(57.2)	5.9
Concessions, licensing, and other		33.6	(24.0)	9.6
		157.3	(130.6)	26.7
Unit auxiliary activities		29.8	(23.7)	6.1
Total business activities	$	187.1	(154.3)	32.8

(15) Commitments and Contingencies

(a) Leasing Activities

The Smithsonian leases office and warehouse space under long-term operating leases expiring at various dates to 2023. 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 operating leases in effect at September 30, 2008 are summarized as follows:

2009	$	31.5
2010		31.5
2011		30.8
2012		28.6
2013		28.0
Thereafter		240.9
	$	391.3

Rental expense under operating leases, including executory costs such as maintenance, insurance and taxes, totaled $45.7 for fiscal year 2008.

(Continued)

(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 construction projects in process throughout its museums with significant projects at the National Zoological Park, the National Museum of American History, and the National Museum of Natural History. Commitments under related contracts aggregated $54.6 at September 30, 2008.

(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.

(16) Subsequent Events

The continuing turmoil in the financial markets has resulted in an unusually high degree of volatility and increased the risks associated with the Smithsonian's investment portfolio. As of December 31, 2008, total investments were approximately $892.5, a decrease of $168.3 from September 30, 2008, due to continual declines in market valuations of most investments, maturities of certain government securities which were reclassified from the investment portfolio to cash equivalent holdings, and payouts from the endowment to fund programmatic activities. The ultimate long-term impact of the investment losses on the Smithsonian's programmatic and other activities will be determined based upon future market conditions.