

Institute for Defense Analyses

**Report of Independent Auditors on Financial
Statements and Schedule of Expenditures of
Federal Awards in Accordance with the OMB
Uniform Guidance**

For the Year Ended September 25, 2020

EIN#: 53-0233247

Institute for Defense Analyses

Index

September 25, 2020

	Page(s)
Part I - Financial Statements and Schedule of Expenditures of Federal Awards	
Report of Independent Auditors.....	1–2
Financial Statements	3–5
Notes to Financial Statements.....	6–26
Schedule of Expenditures of Federal Awards	27
Notes to Schedule of Expenditures of Federal Awards.....	28
Part II - Reports on Compliance and Internal Control	
Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	29–30
Report of Independent Auditors on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with the Uniform Guidance.....	31–32
Part III - Findings	
Schedule of Findings and Questioned Costs	33–34
Summary Schedule of Prior Audit Findings.....	35
Management Corrective Action Plan.....	36

Part I
Financial Statements and Schedule of
Expenditures of Federal Awards
For the year ended September 25, 2020



Report of Independent Auditors

To the Board of Trustees of the
Institute for Defense Analyses

Report on the Financial Statements

We have audited the accompanying financial statements of the Institute for Defense Analyses (the "Institute"), which comprise the balance sheets as of September 25, 2020 and September 27, 2019, and the related statements of activities and of cash flows for the years 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 the financial statements in accordance with accounting principles generally accepted in the United States of America; 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 the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 our 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, we consider internal control relevant to the Institute'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 Institute'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 Institute as of September 25, 2020 and September 27, 2019, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards for the year ended September 25, 2020 is presented for purposes of additional analysis as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) and is not a required part of the financial statements. The 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 schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2020 on our consideration of the Institute's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters for the year ended September 25, 2020. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Institute's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "PricewaterhouseCoopers up". The signature is written in a cursive, flowing style.

Arlington, VA
December 18, 2020

Institute for Defense Analyses
Balance Sheets
As of September 25, 2020 and September 27, 2019

	2020	2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 28,999,037	\$ 6,992,833
Restricted cash	22,782,864	13,521,539
Contract receivables billed, less allowance of \$50,000 for 2020 and 2019	11,381,719	5,697,725
Contract receivables unbilled, less allowance of \$250,000 for 2020 and 2019	8,045,827	27,567,188
Prepaid expenses and other current assets	15,096,529	10,783,289
Total current assets	<u>86,305,976</u>	<u>64,562,574</u>
Prepaid ground rent	910,000	946,400
Property, plant and equipment - net	165,419,860	110,975,040
Investments	221,457,634	211,704,974
Total assets	<u><u>\$ 474,093,470</u></u>	<u><u>\$ 388,188,988</u></u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 16,554,343	\$ 11,535,656
Accrued salaries	6,934,683	6,891,732
Accrued interest payable	850,845	962,240
Accrued paid time off	14,549,774	11,522,918
Accrued pension and postretirement costs	5,607,557	5,663,723
Debt payable	3,650,000	3,515,000
Total current liabilities	<u>48,147,202</u>	<u>40,091,269</u>
Long-term liabilities:		
Accrued postretirement benefits costs	5,379,961	3,999,478
Interest rate swap agreements	10,365,131	8,891,029
Notes payable	43,945,000	-
Long-term debt:		
Bonds payable	123,191,623	100,254,336
Less unamortized debt issuance cost	3,056,572	3,162,711
Total long-term debt	<u>120,135,051</u>	<u>97,091,625</u>
Total liabilities	<u>227,972,345</u>	<u>150,073,401</u>
Net assets without restrictions	246,121,125	238,115,587
Total liabilities and net assets	<u><u>\$ 474,093,470</u></u>	<u><u>\$ 388,188,988</u></u>

The accompanying notes are an integral part of these financial statements.

Institute for Defense Analyses

Statements of Activities

For the fiscal years ended September 25, 2020 and September 27, 2019

	2020	2019
Operating revenue, including fixed fees of \$5,033,415 and \$6,429,134, respectively	<u>\$ 248,188,734</u>	<u>\$ 256,263,463</u>
	<u>248,188,734</u>	<u>256,263,463</u>
Contract expenses:		
Direct salaries and benefits	137,487,185	133,965,572
Other direct costs	41,228,457	50,426,301
Indirect costs	<u>63,202,859</u>	<u>63,309,483</u>
Total contract expenses	<u>241,918,501</u>	<u>247,701,356</u>
Non-contract expenses:		
Salaries and benefits	1,196,620	774,009
Other costs	1,755,546	2,417,596
Indirect costs	1,017,589	667,799
Interest	<u>2,723,867</u>	<u>2,657,199</u>
Total non-contract expenses	<u>6,693,622</u>	<u>6,516,603</u>
Total operating expenses	<u>248,612,123</u>	<u>254,217,959</u>
Operating income	<u>(423,389)</u>	<u>2,045,504</u>
Investment and other income:		
Investment income	9,752,393	7,434,548
Unrealized (loss)/gain on swap agreements	(1,474,102)	(3,437,326)
Miscellaneous income	<u>150,636</u>	<u>53,890</u>
Total investment and other income	<u>8,428,927</u>	<u>4,051,112</u>
Change in net assets	8,005,538	6,096,616
Net assets, beginning of year	<u>238,115,587</u>	<u>232,018,971</u>
Net assets, end of year	<u>\$ 246,121,125</u>	<u>\$ 238,115,587</u>

The accompanying notes are an integral part of these financial statements.

Institute for Defense Analyses

Statements of Cash Flows

For the fiscal years ended September 25, 2020 and September 27, 2019

	2020	2019
Cash flows from operating activities:		
Change in net assets	\$ 8,005,538	\$ 6,096,616
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Loss on disposal of equipment	9,012	8,589
Depreciation and amortization of property, plant, and equipment	6,619,920	6,903,778
Unrealized (gain) loss on investments	(4,724,957)	802,767
Realized gain on investments	(223,961)	(2,661,076)
Unrealized loss on swap agreements	1,474,102	3,437,326
Amortization of prepaid ground rent	36,400	36,400
Amortization of bond issuance costs	52,781	50,543
Loss on extinguishment of debt	-	131,351
Increase/(decrease) resulting from changes in assets and liabilities:		
Contract receivables	13,837,367	(6,566,645)
Prepaid expenses and other current assets	(4,313,240)	313,402
Accounts payable and accrued expenses	1,250,956	(666,500)
Accrued salaries	42,951	267,815
Accrued interest payable	(111,395)	(18,543)
Accrued paid time off	3,026,856	470,664
Accrued pension cost	(56,166)	(5,253)
Accrued postretirement benefits costs	1,380,483	591,183
Net cash and cash equivalents provided by operating activities	<u>26,306,647</u>	<u>9,192,417</u>
Cash flows from investing activities:		
Purchases of investments	(43,353,293)	(8,066,081)
Proceeds from sales of investments	38,549,551	7,063,367
Capital expenditures	(57,306,021)	(10,763,408)
Proceeds from sale of equipment	-	351
Net cash and cash equivalents used in investing activities	<u>(62,109,763)</u>	<u>(11,765,771)</u>
Cash flows from financing activities:		
Payment of debt	(3,515,000)	(3,510,000)
Proceeds from issuance of notes payable	47,030,000	-
Proceeds from issuance of bonds	64,662,287	27,639,336
Extinguishment of debt	(41,160,000)	(17,175,000)
Payment of bond issuance cost	53,358	(2,453,942)
Net cash and cash equivalents provided by financing activities	<u>67,070,645</u>	<u>4,500,394</u>
Net increase (decrease) in cash, cash equivalents and restricted cash	31,267,529	1,927,040
Cash, cash equivalents and restricted cash at beginning of year	<u>20,514,372</u>	<u>18,587,332</u>
Cash, cash equivalents and restricted cash at end of year	<u>\$ 51,781,901</u>	<u>\$ 20,514,372</u>
Supplemental disclosure of cash flow information:		
Interest paid	\$ 2,723,867	\$ 3,443,121
Capital expenditures in accounts payable	\$ 3,767,731	\$ 3,394,120
Cash, cash equivalents, and restricted cash reported on the balance sheet:		
Cash and cash equivalents	\$ 28,999,037	\$ 6,992,833
Restricted cash	<u>22,782,864</u>	<u>13,521,539</u>
Total cash, cash equivalents, and restricted cash	<u>\$ 51,781,901</u>	<u>\$ 20,514,372</u>

The accompanying notes are an integral part of these financial statements.

Institute for Defense Analyses

Notes to Financial Statements

1. Description of business and summary of significant accounting policies

Description of business

The Institute for Defense Analyses (the "Institute") is a private not-for-profit 501(c)(3) corporation which administered three federally-funded research and development centers (FFRDC) during the fiscal years ended September 25, 2020 and September 27, 2019. The Institute's largest FFRDC is for the Office of the Secretary of Defense, the second for the National Security Agency and the third for the White House Office of Science and Technology Policy.

Reporting year

The Institute's fiscal year is the 52- or 53-week annual accounting period ending the last Friday in September. The Institute's current fiscal year ended on September 25, 2020; the prior fiscal year ended on September 27, 2019.

Cash equivalents

The Institute classifies readily-convertible liquid investments with maturities of three months or less when purchased as cash equivalents, except that such investments purchased with funds held by external investment managers are classified with investments. Cash equivalents are maintained in an interest-bearing checking account.

Restricted Cash

The Institute has a contractual requirement as part of the Industrial Development Authority of the City of Alexandria Variable Rate Revenue Bonds Series 2019 to maintain funds in an interest-bearing account. These funds are used in the construction of the Institute's new headquarters facility in Alexandria, Virginia. The restricted cash balance was \$22,782,864 and \$13,521,539 as of September 25, 2020 and September 27, 2019, respectively.

Prepaid ground rent

In September 1991, the Institute paid the City of San Diego \$1,200,000 for a 55-year ground lease for the Center for Communications Research (CCR) in La Jolla. The Institute is amortizing the ground rent on a straight-line basis over its term of 55 years.

In October 2005, the Institute exercised an option with the City of San Diego under the 1991 lease to allow expansion to 50,000 square feet of building area for the Center for Communications Research building. The \$598,640 cost for the expansion rights is being amortized on a straight-line basis over the remaining years of the original 1991 agreement.

Investments

Investments are stated at fair value. The fair value of investments is based on quoted market prices with realized and unrealized gains and losses included in the Statement of Activities.

Debt

The Institute used the proceeds from the sale of tax-exempt bonds to finance construction of two office buildings, to refinance, renovate and expand the La Jolla, California building and to purchase land adjacent to the Institute's headquarters. One building serves as the Institute's current headquarters in Alexandria, Virginia; the other as an office in Princeton, New Jersey. In August 2019, the Institute issued additional tax-exempt bonds through the Industrial Development Authority of the City of Alexandria to construct a new headquarters building located in Alexandria, Virginia. Additional information about the debt is disclosed in note 6.

The Institute uses interest rate swap agreements to effectively fix the interest rates on two of its variable rate bonds. The fair value of the swaps is based on a calculation specified in the agreements and any gain or loss is included in statement of activities.

Institute for Defense Analyses

Notes to Financial Statements

Property, plant and equipment

The Institute carries property, plant and equipment at cost and depreciates them on a straight-line basis over the following estimated useful lives:

Buildings and improvements	5 to 40 years
Office furniture and equipment	5 to 10 years
Computer equipment and software	3 to 5 years

The Institute amortizes leasehold improvements on a straight-line basis over the lesser of the improvement's useful life or the remaining life of the lease. The Institute expenses repairs and maintenance as incurred; it capitalizes betterments which materially extend the lives of related assets. When it sells or retires assets, the Institute removes the related costs and accumulated depreciation from its accounts and includes any gain or loss in operations. The Institute reviews its property and equipment assets for impairment in value whenever events or circumstances indicate that the carrying value may not be recoverable.

Capitalization of interest

Interest costs related to qualifying assets are capitalized during the period which the related assets are constructed and prepared for their intended use. The Institute had \$800,711 and \$923,167 of capitalized interest for the fiscal years ended September 25, 2020 and September 27, 2019, respectively.

Bond issue costs

Bond issue costs represent expenses incurred in connection with issuing bonds and are being amortized on a straight-line basis over the terms of the related bond issues.

Paid time off

The Institute accrues paid time off leave as earned. The Institute permits employees to accumulate unused leave subject to certain limitations. The Institute pays employees for unused leave at termination or retirement.

Net assets without restrictions

Net assets represents the accumulated excess of contract revenue and other income over total costs and expenses. Net assets also represents the unrestricted net assets of the Institute in accordance with provisions for "Financial Statements of Not-for-Profit Organizations." The Institute's net assets are not subject to donor restrictions. However, there may be rare instances where a donor restriction may exist, and as such the Institute defines donor restrictions as:

Net assets without donor restrictions represents the accumulated excess of contract revenue and other income over total costs and expenses that are not subject to donor-imposed stipulations. As well, any donor-restricted contributions are reported in this category if the restrictions are met in the same time period as the contribution is received.

Net assets with donor restrictions for time or purpose, also known as temporary restrictions, are net assets subject to donor-imposed stipulations that will be met either by the actions of the Institute in accordance with those stipulations and/or by the passage of time.

The Institute does not have any assets with restrictions.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition". ASC 606 outlines a five-step model whereby revenue is recognized as performance obligations within the contract are satisfied. ASC 606 also

Institute for Defense Analyses

Notes to Financial Statements

requires new, expanded disclosures regarding revenue recognition. The Institute adopted the new standard effective September 28, 2019, the first day of the Institute's fiscal year using a modified retrospective approach. The adoption did not result in an adjustment to retained earnings as of September 28, 2019 and did not result in any changes to the Institute's revenue for the year ended September 25, 2020.

The Institute recognizes a contract when: both parties have approved; the rights of both parties are identified; payment terms are identified; the contract has commercial substance and collection of the amount the Institute expects to be entitled is probable. At the beginning of a contract, the performance obligation is identified based on the services that will be transferred to the customer. The transaction price, the amount the Institute expects to receive in exchange for transferring services to the customer, is based on funding stated in the contract or contract modification. The transaction price is allocated to the performance obligation using an estimate of the stand-alone price. The method used to estimate a stand-alone price is the expected cost to meet the performance obligation plus a profit. The Institute typically receives payments from its customers within 30 days. At the end of a contract, a portion of the negotiated fixed fee is generally withheld by the customer until audits are completed for the years associated with the contract's period of performance. The Institute has determined any potential fee withholdings do not represent a significant portion of the contract receivables balance.

The Institute recognizes revenue over time when there is a continuous transfer of control to its customer. The Institute performs research primarily for U.S. government agencies. These contracts are service based contracts and, as such, the Institute typically satisfies performance obligation as services are rendered. The Institute uses a cost-based input method to measure progress against the performance obligation. Contract costs include labor, other direct cost such as travel and materials and allocable indirect expenses. Revenue is recognized proportionally as contract costs are incurred plus fixed fee as a percentage of cost.

Income taxes

Under section 501(c)(3) of the Internal Revenue Code and the laws and regulations of the states of Virginia, Maryland, New Jersey, California, and District of Columbia, the Institute is exempt from taxes on income. The Institute is subject to unrelated business income as a result of parking benefits provided to its employees. The Institute had no unrelated business income during the year ended September 25, 2020 and \$222,121 of unrelated business income during the year ended September 27, 2019.

Management estimates and uncertainties

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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.

Concentration of credit risk

The Institute's financial instruments that are exposed to concentrations of credit risk consist primarily of its cash and cash equivalents, investments and accounts receivable. The Institute's excess cash and cash equivalents are deposited in high quality financial institutions. Deposits may be redeemed upon demand and are considered to be a minimal credit risk. Investments are held mainly in the form of high quality publicly traded mutual funds and exchange traded funds. The Institute performs periodic evaluations of these institutions for relative credit standing. The composition and maturities of investments are regularly monitored by management. The Institute limits the amount of credit exposure to any one financial institution or commercial issuer. The accounts receivable are primarily due from U.S. government agencies.

Institute for Defense Analyses

Notes to Financial Statements

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation. The reclassification had no impact on the total net assets, total change in net assets, the balance sheet, or the statement of cash flows.

2. Revenue from Contracts with Customers

The Institute's revenue from contracts with customers is primarily from contracts with the U.S. government in areas of defense, intelligence and policy. These are service based cost-plus fixed fee contracts. With a cost-plus fixed fee contract, the Institute is reimbursed for cost that are determined to be reasonable, allowable and allocable to the contract plus a contract negotiated fee.

Revenue by customer for the fiscal years ended September 25, 2020 and September 27, 2019:

	2020	2019
Department of Defense	\$ 238,434,226	\$ 246,813,921
National Science Foundation	8,572,499	8,449,696
Office of the Director of National Intelligence	1,015,647	685,916
Other government agencies	166,362	313,930
	<u>\$ 248,188,734</u>	<u>\$ 256,263,463</u>

3. Contract receivables

Contract receivables at September 25, 2020 and September 27, 2019 consisted of the following:

	2020	2019
Billed receivables	\$ 11,431,719	\$ 5,747,725
Unbilled receivables	8,295,827	27,817,188
	<u>\$ 19,727,546</u>	<u>\$ 33,564,913</u>

Most of the Institute's business is with U.S. Government departments and agencies and is subject to government audit. These costs and fees are included in unbilled receivables, as well as any costs recorded after the billing cycle. Cost recorded after the billing cycle is billed in the subsequent period. The government has completed audits for all years through September 28, 2018. Management of the Institute believes that disallowed costs, if any, for the period not yet audited will not have a material adverse impact on the financial statements. A management reserve is maintained for potential losses from certain areas of risk associated with performing contract work with the federal government. The management reserve balance as of September 25, 2020 and September 27, 2019 amounted to \$350,000. The Institute has reserved \$50,000 of the management reserve for government audits, which is included in accounts payable in the Balance Sheets.

Institute for Defense Analyses

Notes to Financial Statements

4. Investments

Investments as of September 25, 2020 and September 27, 2019 are set forth below at cost and fair value by investment type:

	2020		2019	
	Cost	Fair Value	Cost	Fair Value
Long-term investments				
Equity				
Small Cap Growth	\$ 16,282,809	\$ 16,458,513	\$ 14,324,063	\$ 16,319,452
International Fund	26,807,423	29,807,938	28,081,193	31,606,575
Large Cap Growth	46,483,505	85,776,973	41,493,914	75,396,864
Diversifying Strategies	9,755,693	6,109,291	11,719,647	8,557,547
Subtotal - equity	<u>99,329,430</u>	<u>138,152,715</u>	<u>95,618,817</u>	<u>131,880,438</u>
Fixed income				
Money market funds	34,494	34,222	2,667,771	2,667,488
Fixed income - Total Return	79,690,060	83,270,697	75,739,428	77,157,048
Subtotal - fixed income	<u>79,724,554</u>	<u>83,304,919</u>	<u>78,407,199</u>	<u>79,824,536</u>
Total investments	<u>\$ 179,053,984</u>	<u>\$ 221,457,634</u>	<u>\$ 174,026,016</u>	<u>\$ 211,704,974</u>

On August 29, 1997, the Board of Trustees of the Institute resolved to use available funds and future earnings thereon to establish a capital reserve pool. Based upon the intent of the Institute, assets of the capital reserve pool of \$221,457,634 and \$211,704,974 are classified as long-term as of September 25, 2020, and September 27, 2019, respectively. Market values of investments may change for a number of reasons, including changes in prevailing market and interest rates, increases in defaults and credit rating downgrades. See note 4 for further discussion of fair value measurements. Interest and dividends are reinvested into the capital reserve pool.

Total net investment gain for the years ended September 25, 2020 and September 27, 2019, respectively, consists of the following:

	2020	2019
Interest and dividends	\$ 4,803,742	\$ 5,405,213
Realized gains and (losses), net	223,961	2,661,076
Unrealized gains and (losses), net	4,724,957	(802,767)
Less - investment management expenses	<u>(82,387)</u>	<u>(82,088)</u>
Total net investment gain	<u>\$ 9,670,273</u>	<u>\$ 7,181,434</u>

Total net investment gain is included in investment income on the Statement of Activities.

Institute for Defense Analyses

Notes to Financial Statements

5. Fair value measurements

The Institute previously adopted FASB Accounting Standards Codification 820-10 “Fair Value Measurement” (ASC 820-10) which establishes a framework for measuring fair value, establishes a fair value hierarchy based upon the observability of inputs used to measure fair value, and expands disclosures about fair value measurements. Under ASC 820-10, fair value of an investment is the price that would be received to sell an asset or to transfer a liability in an orderly transaction between market participants at the measurement date.

ASC 825-10 gives entities the option, at specific elections dates, to measure certain financial assets and liabilities at fair value. The election may be applied to financial assets and liabilities on an instrument basis, is irrevocable, and may only be applied to entire instruments. Unrealized gains and losses on instruments for which the fair value option has been elected are reported in earnings at each subsequent reporting date. The Institute did not elect fair value accounting for any assets or liabilities that are not currently required to be measured at fair value.

The hierarchy gives the highest priority to investments with readily available quoted prices in an active market and the lowest priority to unobservable inputs which require a higher degree of judgment when measuring fair value. The three categories of the fair value hierarchy are as follows:

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

Level 2 - Quoted prices in markets that are not active or other pricing inputs that are either directly or indirectly observable as of the measurement date.

Level 3 – Prices or valuation techniques in which one or more significant value drivers are unobservable as of the measurement date. The determination of fair value for these financial instruments requires one or more inputs subject to significant management judgment or estimation.

In cases where inputs used to measure fair value fall into different categories within the fair value hierarchy, an investment’s level is based on the lowest level of input that is significant to the fair value measurement.

In general, for Level 2 and Level 3 investments, the Institute utilized the investment manager of the asset to provide a valuation estimate based on previously disclosed techniques and processes which have been reviewed by management for propriety and consistency given the asset type and investment strategy. In addition, the Institute may also use established processes for determining the fair value of such securities which reflects the Institute’s own assumptions to value the assets as well. Management makes best estimates based on information available. The following estimates and assumptions were used to determine the fair value of each class of financial instrument held by the Institute at September 25, 2020 and September 27, 2019. There have not been any changes to the method used to determine the fair value of the assets and no changes to the level of the assets. The levels associated with the securities are not an indication of the risk associated with investing in those securities.

Investments – The assets included are funds purchased to provide returns to the Institute’s Capital Reserve Pool as well as money market accounts for the debt service reserve fund associated with the Institute’s tax-exempt bonds.

Institute for Defense Analyses

Notes to Financial Statements

Equities – Small Cap, International, Large Cap and Natural Resources equity investments include but are not limited to commingled funds that track US and non-US index funds. These funds generally seek results similar to indexes such as the S&P or Russell. These securities are traded in an active market and are priced using available quotes as of the reporting date. They are classified as Level 1.

Fixed Income – Total Return include but are not limited to US government and corporate debt securities and commingled funds investing in US government and non-government debt securities. The Institute primarily invests in funds consisting of intermediate term bonds with a moderate risk rating. These assets are traded in an active market and are priced using available quotes as of the reporting date. They are classified as Level 1.

Money Market – Cash equivalent consist of investments in money market accounts, which are actively traded. These are priced by independent market prices in the primary trading market and are classified as Level 2.

Deferred Compensation Plan Assets – Retirement funds purchased to provide returns to those employees who are participating in the Institute's deferred compensation plan. The plan is administered and investments are restricted to TIAA (Teachers Insurance and Annuity Association), CREF (College Retirement Equities Fund) and TIAA-CREF. The individual investment is selected by the participant and the value of the investment is available to the employee upon termination.

TIAA Guaranteed Fixed Annuity – Valued at contract value which is the amount that would be received at the reporting date if amounts were withdrawn or funds transferred prior to maturity. A participant can only withdraw according to predetermined installment plan. Contract value represents fair value. These assets are classified as Level 3 due to lack of observable transactions of similar investment instruments at or around the balance sheet date.

Pooled Separate Account – Valued at quoted price of accumulation units held at year end. Transfers out of this account are limited to once per quarter. These assets have a publicly quoted price but are not publically traded and carry some restrictions with regard to movement in or out of the account and are therefore classified as Level 2.

CREF Variable Annuities – These assets include funds that invest in governmental, non-governmental debt securities, stocks and other investments categories that at the quoted price for accumulation units held at the year end. These assets have a publicly quoted price but are not publically traded and carry some restrictions with regard to movement in or out of the account and therefore classified as Level 2,

TIAA-CREF Retirement Mutual Funds – These assets include funds that invest in international equity and other investment categories valued at the NAV of shares held at year end. Because these funds are traded on an active exchange and are valued primarily on the basis of market quotations, official closing prices or other basis of information furnished by a pricing service, they are classified as Level 1.

Interest Rate Swap Agreements – The fair value of the interest rate swaps are based on quotes received from the counterparties to the agreements. The Institute does not have access to specific valuation models used by the counterparties; however, the Institute does receive an independent third-party valuation of these agreements. Based on the lack of observable inputs, these agreements are classified as a Level 3.

Institute for Defense Analyses

Notes to Financial Statements

The following table presents the Institute's assets and liabilities that are measured at fair value by level within the hierarchy as of September 25, 2020:

	Level 1	Level 2	Level 3	Total
Assets:				
Investments				
Equities:				
Small Cap	\$ 16,458,513	\$ -	\$ -	\$ 16,458,513
International	29,807,938	-	-	29,807,938
Large Cap	85,776,973	-	-	85,776,973
Natural Resources	6,109,291	-	-	6,109,291
Fixed Income:				
Total Return	83,270,697	-	-	83,270,697
Certificate of Deposit	-	-	-	-
Money Market	-	34,222	-	34,222
Subtotal - investments	<u>221,423,412</u>	<u>34,222</u>	<u>-</u>	<u>221,457,634</u>
Deferred Compensation Plan Assets				
TIAA Guaranteed Fixed Annuities	-	-	1,004,759	1,004,759
Pooled Separate Account:				
Real Estate	-	275,315	-	275,315
CREF Variable Annuities:				
Fixed Income	-	345,489	-	345,489
Equities	-	407,395	-	407,395
Other	-	155,031	-	155,031
TIAA-CREF Retirement Class Mutual Funds:				
Target Date Retirement Funds	1,911,194	-	-	1,911,194
Other	732,580	-	-	732,580
Subtotal - deferred compensation	<u>2,643,774</u>	<u>1,183,230</u>	<u>1,004,759</u>	<u>4,831,763</u>
Total assets at fair value	<u>\$ 224,067,186</u>	<u>\$ 1,217,452</u>	<u>\$ 1,004,759</u>	<u>\$ 226,289,397</u>
Liabilities:				
Interest Rate Swap Agreements	\$ -	\$ -	10,365,131	\$ 10,365,131
Total liabilities at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,365,131</u>	<u>\$ 10,365,131</u>

Institute for Defense Analyses

Notes to Financial Statements

The following table presents the Institute's assets and liabilities that are measured at fair value by level within the hierarchy as of September 27, 2019:

	Level 1	Level 2	Level 3	Total
Assets:				
Investments				
Equities:				
Small Cap	\$ 16,319,452	\$ -	\$ -	\$ 16,319,452
International	31,606,575	-	-	31,606,575
Large Cap	75,396,864	-	-	75,396,864
Natural Resources	8,557,547	-	-	8,557,547
Fixed Income:				
Total Return	77,157,048	-	-	77,157,048
Certificate of Deposit	-	-	-	-
Money Market	-	2,667,488	-	2,667,488
Subtotal - investments	<u>209,037,486</u>	<u>2,667,488</u>	<u>-</u>	<u>211,704,974</u>
Deferred Compensation Plan Assets				
TIAA Guaranteed Fixed Annuities	-	-	816,506	816,506
Pooled Separate Account:				
Real Estate	-	278,300	-	278,300
CREF Variable Annuities:				
Fixed Income	-	204,122	-	204,122
Equities	-	301,841	-	301,841
Other	-	121,916	-	121,916
TIAA-CREF Retirement Class Mutual Funds:				
Target Date Retirement Funds	1,895,654	-	-	1,895,654
Other	1,278,979	-	-	1,278,979
Subtotal - deferred compensation	<u>3,174,633</u>	<u>906,179</u>	<u>816,506</u>	<u>4,897,318</u>
Total assets at fair value	<u>\$ 212,212,119</u>	<u>\$ 3,573,667</u>	<u>\$ 816,506</u>	<u>\$ 216,602,292</u>
Liabilities:				
Interest Rate Swap Agreements	\$ -	\$ -	\$ 8,891,029	\$ 8,891,029
Total liabilities at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,891,029</u>	<u>\$ 8,891,029</u>

Institute for Defense Analyses

Notes to Financial Statements

The following table is a reconciliation of the Institute's Level 3 assets and liabilities measured at fair value for the fiscal year ended September 25, 2020:

	<u>Guaranteed Fixed Annuities</u>
Beginning Balance	\$ 816,506
Interest credited	27,569
Total purchases	164,803
Total sales	(4,119)
Ending Balance	<u>\$ 1,004,759</u>

	<u>Interest Rate Swaps</u>
Beginning Balance	\$ (8,891,029)
Total unrealized loss	(1,474,102)
Ending Balance	<u>\$ (10,365,131)</u>

Amount of loss recognized on the Statement of Activities

Total unrealized loss	\$ (1,474,102)
Net interest expense	(1,180,136)

Net interest expense is a result of interest paid of \$1,508,487 and interest received of \$328,351 which is included on the Statement of Activities.

The following table is a reconciliation of the Institute's Level 3 assets and liabilities measured at fair value for the fiscal year ended September 27, 2019:

	<u>Guaranteed Fixed Annuities</u>
Beginning Balance	\$ 1,126,780
Interest credited	26,912
Total purchases	26,694
Total sales	(363,880)
Ending Balance	<u>\$ 816,506</u>

	<u>Interest Rate Swaps</u>
Beginning Balance	\$ (5,453,703)
Total unrealized loss	(3,437,326)
Ending Balance	<u>\$ (8,891,029)</u>

Amount of loss recognized on the Statement of Activities

Total unrealized loss	\$ (3,437,326)
Net interest expense	(834,609)

Net interest expense is a result of interest paid of \$1,579,565 and interest received of \$744,956 which is included on the Statement of Activities.

Institute for Defense Analyses

Notes to Financial Statements

6. Property, plant and equipment

Property and equipment balances as of September 25, 2020 and September 27, 2019 are summarized as follows:

	2020	2019
Land	\$ 41,341,225	\$ 41,341,225
Buildings and improvements	105,915,031	107,031,670
Construction in progress	69,181,234	9,115,959
Computer software, equipment, and furniture	36,258,178	34,943,191
	<u>252,695,668</u>	<u>192,432,045</u>
Accumulated depreciation and amortization	<u>(87,275,808)</u>	<u>(81,457,005)</u>
Property, plant and equipment - net	<u>\$ 165,419,860</u>	<u>\$ 110,975,040</u>

In April 2016, the Institute purchased land in Alexandria, Virginia for future development of the Institute's headquarters facility. The purchase price of the land was \$12,863,512 of which the Institute initially paid \$8,515,072. The balance was to be paid upon the construction of the Potomac Yard Metro Station. With the commencement of the Potomac Yard Metro Station construction, the Institute paid the remaining purchase price of \$4,348,440 in 2020. The land purchase was originally financed with a seven-year variable rate note maturing December 2022 for \$15,000,000. The land purchase has been refinanced with proceeds from the Series 2019 bonds and the variable rate note has been extinguished.

Institute for Defense Analyses

Notes to Financial Statements

7. Debt

Debt as of September 25, 2020 and September 27, 2019, is as follows:

	2020	2019
New Jersey Education Facilities Authority (NJEFA) Variable Rate Revenue Bonds, Series 2000D issued in the original principal amount of \$16,695,000 and a new principal amount of \$11,070,000 in fiscal year 2016 in connection with the construction of an office building in Princeton, New Jersey, November 16, 2000; interest payments are monthly resulting in a weighted average interest rate of .01579; annual principal payments ranging from \$500,500 to \$705,000 beginning October 1, 2016 and ending October 1, 2030.	\$ 7,216,613	\$ 7,750,621
California Association of Bay Area Government (ABAG) Authority Variable Rate Revenue Bonds Series 2005 issued in the original principal amount of \$11,945,000 and the new principal amount of \$11,945,000 in fiscal year 2016 to finance the expansion and renovation of the Center for Communication Research (CCR) La Jolla facility on September 1, 2005; interest payments are monthly resulting in a weighted average interest rate of .015774; annual principal payments ranging from \$2,000,000 to \$2,310,000 beginning October 1, 2031 to October 1, 2035.	10,619,713	10,610,728
The Industrial Development Authority of the City of Alexandria Variable Rate Revenue Bonds Series 2015A issued in the original principal amount of \$69,935,000 for purposes of (i) refunding Series 2000B issued in the principal amount of \$26,445,000 in connection with the construction of the Institute's headquarter facility in Alexandria on June 1, 2000 (ii) refunding Series 2005 issued in the original principal amount \$53,925,000 for the purpose of advance refunding of Series 2000A (iii) refunding Series 2006 issued in the original principal amount \$14,875,000 in connection with the acquisition of land at the Institute's headquarters facility in Alexandria on March 1, 2006; interest payments are monthly resulting in a weighted interest rate of .016191; annual principal payments ranging from \$2,663,000 to \$2,840,000 beginning October 1, 2016 and ending October 1, 2035.	\$ 12,821,229	\$ 56,918,425
The Industrial Development Authority of the City of Alexandria Variable Rate Revenue Bonds Series 2019 issued in the principal amount of \$249,400,000 in connection with the construction of the Institute's new headquarters facility in Alexandria issued on August 8, 2019 ; interest payments are monthly resulting in a weighted interest rate of .02455; annual principal payments ranging from \$2,870,000 to \$10,000 beginning October 1, 2023 and ending October 1, 2054.	\$ 90,042,496	\$ 25,326,851
	<u>\$ 120,700,051</u>	<u>\$ 100,606,625</u>

Institute for Defense Analyses

Notes to Financial Statements

Total debt and unamortized debt issuance cost as of September 25, 2020 and September 27, 2019:

	2020			2019		
	Debt	Unamortized Debt Issuance Cost	Debt less Unamortized Issuance Cost	Debt	Unamortized Debt Issuance Cost	Debt less Unamortized Issuance Cost
New Jersey Education Facilities Authority Variable Rate Revenue Bond Series 2000D	\$ 7,320,000	\$ 103,387	\$ 7,216,613	\$ 7,865,000	\$ 114,379	\$ 7,750,621
California Statewide Communities Development Authority Variable Rate Revenue Refunding Bond Series 2000	-	-	-	-	-	-
California Association of Bay Area Government Authority Variable Rate Revenue Bond Series 2005	10,750,000	130,287	10,619,713	10,750,000	139,272	10,610,728
The Industrial Development Authority of the City of Alexandria Variable Rate Revenue Bond Series 2015A	13,385,000	563,771	12,821,229	57,515,000	596,575	56,918,425
The Industrial Development Authority of the City of Alexandria Variable Rate Revenue Bond Series 2019	92,301,623	2,259,127	90,042,496	27,639,336	2,312,485	25,326,851
	<u>\$ 123,756,623</u>	<u>\$ 3,056,572</u>	<u>\$ 120,700,051</u>	<u>\$ 103,769,336</u>	<u>\$ 3,162,711</u>	<u>\$ 100,606,625</u>

The Institute's debt is primarily financed with tax-exempt variable rate bonds which are privately held by BB&T Bank. Interest is paid monthly.

In 2019, the Institute issued \$249,400,000 of tax-exempt variable rate bonds to finance the construction of a new headquarters facility. These bonds are structured as a bank drawdown facility. The bond proceeds are made available to the Institute through periodic draws during construction period up to \$249,400,000. The Institute recognized debt associated with the Series 2019 bonds of \$92,301,623 and \$27,639,336 for September 25, 2020 and September 27, 2019, respectively. These amounts are reflected on the balance sheet as long-term debt. These bonds are also privately held by BB&T Bank and carry an interest rate of 79% of 1-month Libor plus not more than 1.10%. Interest is calculated and paid monthly on the recognized debt balance.

In October 2019, the Institute entered into an agreement for the City of Alexandria to lease the building located at 4850 Mark Center Drive. As a result of this lease agreement, the Institute refinanced a portion of the tax-exempt Industrial Development Authority of the City of Alexandria Variable Rate Bond Series 2015A with a variable rate term loan held by BB&T in the amount of \$47,030,000. Proceeds from the loan were used to extinguish a portion of the bond in the amount of \$41,160,000. The remainder of the proceeds were for commissions and other cost associated with the lease. The note is a seven-year variable rate note, maturing October 1, 2026 with an interest rate of One-Month LIBOR plus 1.05%.

The bonds require that the Institute meet certain financial covenants, including maintaining a debt service coverage ratio of 1.1 to 1.0 and certain other liquidity ratios at the end of each fiscal year. These bonds are uncollateralized as long as the Institute meets the financial covenants. Interest expense related to long-term debt was \$2,723,867 and \$2,807,495 for the years ended September 25, 2020 and September 27, 2019, respectively. In the opinion of management, the Institute was in compliance with all covenants of the bonds as of September 25, 2020 and September 27, 2019.

Institute for Defense Analyses

Notes to Financial Statements

The annual debt payments required are as follows:

Fiscal Year	Total
2021	\$ 3,650,000
2022	3,780,000
2023	3,925,000
2024	6,945,000
2025	7,095,000
Thereafter	302,490,000
	<u>\$ 327,885,000</u>

8. Interest rate swap

During the year ending September 30, 2005, the Institute entered into three interest rate swap agreements to effectively fix interest rates on outstanding variable debt. Two of the Swap agreements collectively hedge the cash flow associated with the series 2005A bond. Both agreements are in the amount of \$15,280,000 and carry a fixed rate of 3.475% which the Institute pays. In return, the Institute receives interest based on a variable rate equal to the USD-BMA municipal Swap Index. The agreements are set to expire October 1, 2030.

The third Swap agreement is to hedge \$11,945,000 of the ABAG Series 2005 Bond. The Swap agreement carries a fixed rate of 3.416% which the Institute pays. In return the Institute receives interest based on a variable rate equal to 70% of LIBOR. The agreement is set to expire October 1, 2035.

The Swaps are recognized as Interest Rate Swap Agreements at fair value in the Balance Sheet. The changes in fair value are recorded as unrealized gains or losses in the Statement of Activities. The fair value of the swap agreements was \$(10,365,131) as of September 25, 2020 and \$(8,891,029) as of September 27, 2019. The Swaps resulted in unrealized loss of \$(1,474,102) and \$(3,437,326) for September 25, 2020 and September 27, 2019, respectively.

9. Commitments and contingencies

The Institute has several operating leases for the rental of office space with noncancellable remaining terms of more than one year. All operating leases expire by the year 2029.

Minimum annual rental commitments are as follows:

Fiscal years	
2021	\$ 1,245,492
2022	1,273,581
2023	1,302,225
2024	1,331,471
2025	1,361,457
Thereafter	5,380,903
	<u>\$ 11,895,129</u>

Institute for Defense Analyses

Notes to Financial Statements

Operating lease rent expense was \$1,219,641 for the years ended September 25, 2020 and September 27, 2019.

The Institute maintains a revolving credit agreement maturing on March 10, 2022, that allows borrowings up to \$29,500,000. The agreement is not collateralized; however, so long as the agreement is in effect, the Institute may not encumber its accounts receivables which must remain free and clear of all liens, encumbrances and pledges. Interest accrues on outstanding balances at the Institute's choice of the London Inter-Bank Offered Rate plus the applicable Interest Margin, as defined, or prime rate minus one-half of one percent. The Agreement requires the Institute to maintain a net worth of not less than \$75,000,000 and certain financial ratios. As of September 25, 2020 and September 27, 2019, the Institute had no outstanding borrowings under this agreement. The Institute also has a compensating balance agreement of \$5,000,000.

10. Postretirement benefits

Defined contribution retirement plan

The Institute maintains a defined contribution retirement plan in which eligible employees participate. Under the Plan, the Institute contributes a fixed percentage of participating employees' eligible compensation to an insurance company or a mutual fund to purchase annuities or mutual fund units of participation. The Plan requires a six-month waiting period for all new employees. Contributions vest fully after two years' service. The Institute funds retirement costs as they accrue. Institute contributions to the Plan were \$15,001,719 and \$14,471,374 for the years ended September 25, 2020 and September 27, 2019, respectively.

Other postretirement benefits

The Institute provides limited medical insurance benefits for eligible retirees. Employees with 15 years' service who retire after age sixty-two may continue their medical insurance at group rates until age sixty-five. The Institute accrues the cost of postretirement benefits during each employee's service. It funds postretirement benefits on a pay-as-you-go basis. The measurement date is October 1, 2019.

In accordance with provisions of FASB Accounting Standards Codification (ASC) 715-60 and 958-715-25, the Institute recognizes the funded status of a defined benefit postretirement plan on the Balance Sheet. An overfunded plan is recognized as an asset and an underfunded plan is recognized as a liability. The Institute uses the Citigroup Pension Index to determine the discount rate.

The accumulated postretirement benefit obligation for the years ended September 25, 2020 and September 27, 2019 are as follows (in thousands):

	2020	2019
Accumulated postretirement benefit obligation at the beginning of year	\$ 4,203	\$ 3,609
Service cost	403	253
Interest cost	138	139
Plan participants' contribution	18	16
Actuarial gain	966	254
Benefits paid	(165)	(68)
Accumulated postretirement benefit obligation at the end of year	<u>\$ 5,563</u>	<u>\$ 4,203</u>

Institute for Defense Analyses

Notes to Financial Statements

The plan assets for the years ended September 25, 2020 and September 27, 2019 were (in thousands):

	2020	2019
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contribution	147	52
Plan participants' contribution	18	16
Benefits paid	(165)	(68)
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>

The Institute's policy is to fund postretirement benefits as payments are made.

Funded status of benefit plan as of September 25, 2020 and September 27, 2019 were (in thousands):

	2020	2019
Fair value of plan assets	\$ -	\$ -
Funded status	(5,563)	(4,203)
Unrecognized net actuarial loss	-	-
Unrecognized prior service cost	-	-
Accrued postretirement liability reflected in the accrued postretirement benefits costs	<u>\$ (5,563)</u>	<u>\$ (4,203)</u>

The components of the net periodic benefit cost and amounts recognized in net assets without restrictions for the years ended September 25, 2020 and September 27, 2019 were (in thousands):

	2020	2019
Service cost	\$ 403	\$ 253
Interest cost	138	139
Amortization of (gain)	(3)	(63)
Amortization of prior service cost	(12)	(12)
Recognized net actuarial loss	-	-
Net periodic benefit cost	<u>\$ 526</u>	<u>\$ 317</u>

	2020	2019
Prior year unrecognized amounts in unrestricted net assets	\$ (1,096)	\$ (1,425)
Current year unrecognized (gain)	(11)	(980)
Current year unrecognized prior service cost/(credit)	(104)	(116)
Current year unrecognized transition obligation	-	-
Total unrecognized current year in unrestricted net assets	<u>\$ (115)</u>	<u>\$ (1,096)</u>
Change in unrestricted net assets	\$ 981	\$ 329

Institute for Defense Analyses

Notes to Financial Statements

The assumptions used to determine the benefit obligation for 2020 and 2019 are as follows:

	2020	2019
Discount rate - weighted average	2.25%	3.00%
Assumed health care cost trend rate	6.50%	7.00%
Ultimate trend rate	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2027	2027
Assumed dental cost trend rate	4.00%	4.00%
Ultimate trend rate	4.00%	4.00%
Year that the rate reaches the ultimate trend rate	2021	2020

The assumptions used to determine the net periodic benefit cost for 2020 and 2019 are as follows:

	2020	2019
Discount rate - weighted average	3.00%	4.00%
Assumed health care cost trend rate	7.00%	7.00%
Ultimate trend rate	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2027	2027
Assumed dental cost trend rate	4.00%	4.00%
Ultimate trend rate	4.00%	4.00%
Year that the rate reaches the ultimate trend rate	2020	2019

The assumed medical cost trend rate for next year is 6.5% and the assumed dental trend rate for next year is 4.0%. The pattern of change for each rate is -0.5% per year to 5%, then 5% thereafter.

The ultimate trend rate is expected to be achieved for medical cost in 2027 and for dental cost in 2020. The assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percent-point increase in the rates would increase the postretirement service plus interest cost by \$98,931 and increase the year-end accumulated postretirement benefit obligation by \$714,649. A one-percent-point decrease in the rates would decrease the postretirement service plus interest cost by \$80,117 and decrease the year-end accumulated postretirement benefit obligation by \$600,555.

Amounts recognized in net assets without restrictions (in thousands):

	2020	2019
Net actuarial (gain)	\$ (11)	\$ (980)
Prior service credit	(104)	(116)
Net periodic benefit cost	<u>\$ (115)</u>	<u>\$ (1,096)</u>

Institute for Defense Analyses

Notes to Financial Statements

Estimated amount that will be amortized from net assets without restrictions into net periodic benefit cost in 2021 (in thousands):

	2021
Actuarial loss/(gain)	\$ -
Prior service cost/(credit)	(12)
Total	<u>\$ (12)</u>

Cash Flows

Contributions

The Institute expects to contribute approximately \$15,451,770 to its defined contribution retirement plan and to spend approximately \$185,220 on its other postretirement medical benefit plan in 2020.

Estimated Future Postretirement Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next fiscal years ending as of September:

2021	\$ 185,220
2022	295,758
2023	310,980
2024	331,711
2025	414,597
Years 2026-2029	1,885,316

Deferred compensation

The Institute provides a deferred compensation plan for trustees and certain key employees regulated by Section 457(b) of the Internal Revenue Code. The plan is funded through participant deferrals with no additional contributions from the Institute. Plan assets consist of money market funds and equity securities and are held for the benefit of the participant. Assets are recorded at fair value based upon quoted market prices, and are included in prepaid expenses and other current assets. The related liability is included in accrued pension costs. At September 25, 2020 and September 27, 2019, deferred compensation was \$4,831,763 and \$4,897,318 respectively.

11. Functional classification of expenses

Total operating expenses for the years ended September 25, 2020 and September 27, 2019 consist of:

	2020	2019
Research and development		
Program and non-program cost	\$ 184,391,531	\$ 190,240,678
Support costs, principally general and administrative	64,220,592	63,977,281
	<u>\$ 248,612,123</u>	<u>\$ 254,217,959</u>

Institute for Defense Analyses

Notes to Financial Statements

12. Natural classification of expenses

Total operating expenses for the year end September 25, 2020 consist of:

	Program Expenses	Non-Program Expenses	Management and General	Total
Salaries	\$ 112,315,844	\$ 2,860	\$ 30,896,896	\$ 143,215,600
Benefits	42,749,816	1,193,835	13,372,235	57,315,886
Travel	4,391,303	745,384	789,123	5,925,809
Materials	4,350,367	17,944	3,670,503	8,038,813
Consultants/Subcontractors	3,452,117	15,300	145,940	3,613,357
Facilities	8,642,942	200,688	8,821,140	17,664,770
Services	2,167,602	232,786	4,923,142	7,323,530
Other	645,652	534,315	1,224,587	2,404,554
Insurance	-	8,911	377,027	385,938
Interest	-	2,723,867	-	2,723,867
	<u>\$ 178,715,642</u>	<u>\$ 5,675,889</u>	<u>\$ 64,220,592</u>	<u>\$ 248,612,123</u>

Total operating expenses for the year end September 27, 2019 consist of:

	Program Expenses	Non-Program Expenses	Management and General	Total
Salaries	\$ 110,748,894	\$ 8,889	\$ 27,304,108	\$ 138,061,891
Benefits	42,644,994	765,101	12,072,751	55,482,846
Travel	10,453,563	974,480	1,616,849	13,044,892
Materials	6,042,003	30,769	3,681,868	9,754,640
Consultants/Subcontractors	4,106,425	-	144,432	4,250,857
Facilities	6,284,783	331,100	9,147,370	15,763,253
Services	3,415,159	620,506	7,660,798	11,696,463
Other	696,052	642,655	2,000,200	3,338,907
Insurance	-	-	348,905	348,905
Interest	-	2,475,305	-	2,475,305
	<u>\$ 184,391,873</u>	<u>\$ 5,848,805</u>	<u>\$ 63,977,281</u>	<u>\$ 254,217,959</u>

Program expenses are directly related to the Institute's current contracts. Non-program expenses are ordinary and necessary business expenses which are not allowed to be charged directly or indirectly to a government contract. Management and general administrative expenses are related to both contract and non-contract functions. Benefit costs are allocated as a percentage of salary expense.

Institute for Defense Analyses

Notes to Financial Statements

13. Liquidity and availability of financial assets

Financial assets and liquidity resources available within one year to meet cash needs for general operating expenditures consist of cash of \$28,999,037 and accounts receivable of \$19,427,546. The Institute also has an available line of credit of \$29,500,000.

The COVID-19 pandemic did not have a significant financial impact for the Institute during fiscal year 2020. The Institute was able to continue to fulfill all of its contractual obligations with the U.S. Government. The Institute did experience a decrease in revenue primarily due to reduction in travel costs caused by widespread travel restrictions and stay at home orders. However, the revenue decrease was partially offset by an increase in contract labor as a result of lower employee use of the paid time off benefit. The Institute's liquidity has remained strong throughout the pandemic and there has not been a need to use the available line of credit.

14. Regulation

On March 27, 2020, Congress passed into law the Coronavirus Aid, Relief and Economic Securities ("CARES") Act. Section 3610 of the CARES act provided assistance for contractors whose employees could not perform work at a facility approved by the Federal Government due to facility closures or restrictions and who could not perform their work remotely but otherwise remained in a ready state. Following strict guidelines established by government agencies with regards to charging and invoicing, the Institute did receive reimbursement under the CARES act from March 27, 2020 through September 25, 2020.

15. New Accounting Pronouncements

In February 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition" and most industry-specific guidance. The core principle of ASU 2014-09 is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The Institute adopted ASU 2014-09 effective September 28, 2019 using the modified retrospective method. Additional information is presented in Note 1 "Revenue Recognition" and Note 2 "Revenue from Contracts with Customers".

In 2019, the Institute adopted ASU 2016-14, Presentation of Financial Statements of Not-For-Profit Entities. Under the new guidance, changes were made to accounting rules that would enable not-for-profit organizations to better report and explain their financial position and results of operations. The most significant changes for the Institute are to report expenses both by the function and nature and to provide quantitative and qualitative information about the management of liquid resources and availability of financial assets. This information is presented in notes 12 and 13.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows in Topic 230: Restricted Cash. The standard requires the statement of cash flows to present the changes in all cash and cash equivalents, including restricted cash and provides additional disclosure regarding the nature of restrictions on cash. The standard is effective for fiscal years beginning after December 15, 2018. The Institute adopted ASU 2016-18 effective September 28, 2019.

Institute for Defense Analyses

Notes to Financial Statements

In February 2016, the FASB issued ASU 2016-02, Leases ("ASC 2016-02"). Lessees will need to recognize on their balance sheet a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The liability will be equal to the present value of lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense (similar to current operating leases) while finance leases will result in a front-loaded expense pattern (similar to current capital leases). The standard is effective for periods beginning after December 15, 2018 for not-for-profit entities. Management is currently evaluating the impact of ASU 2016-02 on the Institute's financial statements.

16. Subsequent events

The Institute has evaluated its September 25, 2020 financial statements for subsequent events through December 18, 2020 which is the date the financial statements were available to be issued, noting no subsequent events which require recognition or disclosure in the financial statements.

Institute for Defense Analyses
Schedule of Expenditures of Federal Awards
For the year ended September 25, 2020

Federal Grantor/ Program Title	CFDA Number	Contract Number	Pass-through Entity	Pass-through Entity Award number	Federal Expenditures	Pass-through to Subrecipients
RESEARCH AND DEVELOPMENT CLUSTER						
<u>Department of Defense</u>						
Washington Headquarters Service Acquisition Directorate	12.RD	HQ0034-14-D-0001			\$ 26,364,312	\$ -
Washington Headquarters Service Acquisition Directorate	12.RD	HQ0034-19-D-0001			144,068,600	-
(Studies & Analyses FFRDC)						
Maryland Procurement Office	12.RD	H98230-16-D-0030			50,178,482	-
(Communications & Computing FFRDC)						
COVID-19 Maryland Procurement Office	12.RD	H98230-16-D-0030			16,902,041	-
(Communications & Computing FFRDC)						
Johns Hopkins University/Applied Physics Lab	12.RD	152711	Naval Sea Systems Command	N00024-13-D-6400	205,970	-
Johns Hopkins University/Applied Physics Lab	12.RD	164528	Naval Sea Systems Command	N00024-13-D-6400	24,762	-
			Washington Headquarters			
Dartmouth College	12.RD	R1362	Service Acquisition	HQ0034-20-1-0001	4,977	-
			Washington Headquarters			
Pennsylvania State University	12.RD	S0000479-DHP	Service Acquisition	HQ0034-20-1-0002	138	-
IPA-Intergovernmental Personnel Act	12.RD	Various			873,859	-
TOTAL DEPARTMENT OF DEFENSE					238,623,141	-
<u>Central Intelligence Agency</u>						
ODNI (E12)	13.RD	2020-20060500401			305,352	-
TOTAL CENTRAL INTELLIGENCE AGENCY					305,352	-
<u>National Science Foundation</u>						
Office of Science and Technology Policy Institute	47.RD	OIA-0408601			8,573,917	-
(Science and Technology Policy Institute FFRDC)						
TOTAL NATIONAL SCIENCE FOUNDATION					8,573,917	-
TOTAL RESEARCH AND DEVELOPMENT CLUSTER					247,502,410	-
TOTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS					\$ 247,502,410	\$ -

The accompanying notes are an integral part of the Schedule of Expenditures of Federal Awards.

Institute for Defense Analyses

Notes to the Schedule of Expenditures of Federal Awards For the year ended September 25, 2020

1. Presentation and Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) for the Institute for Defense Analyses (IDA) has been prepared on the accrual basis of accounting which conforms to accounting principles generally accepted in the United States of America and is consistent with the IDA's basic financial statements. The information in this Schedule is presented in accordance with the requirements of applicable guidance, therefore some amounts presented in the Schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

For purposes of the Schedule, federal awards include all grants, contracts and similar agreements entered directly between IDA and agencies and departments of the federal government and all sub-awards to IDA by non-federal organizations pursuant to federal grants, contracts and similar agreements. For the purpose of the Schedule, expenditures for federal award programs are recognized on the accrual basis of accounting.

Negative numbers in the schedule represent adjustments to amounts previously reported in the normal course of business.

2. Indirect Cost Rate

The Institute has negotiated an indirect cost rate with the Defense Contract Management Agency as our cognizant agency for indirect costs. As such, the Institute did not elect to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

Part II
Reports on Compliance and Internal Control



**Report of Independent Auditors on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Board of Trustees of the
Institute for Defense Analyses

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Institute for Defense Analyses, which comprise the balance sheet as of September 25, 2020, and the related statements of activities and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 18, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Institute for Defense Analyses' internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Institute for Defense Analyses' internal control. Accordingly, we do not express an opinion on the effectiveness of the Institute for Defense Analyses' internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified a deficiency in internal control that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2020-001 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Institute for Defense Analyses' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Institute for Defense Analyses' Response to Findings

The Institute for Defense Analyses' response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Institute for Defense Analyses' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "PricewaterhouseCoopers up". The signature is written in a cursive, flowing style.

Arlington, VA
December 18, 2020



**Report of Independent Auditors on Compliance with Requirements
That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over
Compliance in Accordance with the Uniform Guidance**

To the Board of Trustees of the
Institute for Defense Analyses

Report on Compliance for Each Major Federal Program

We have audited the Institute of Defense Analyses' compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Institute of Defense Analyses' major federal programs for the year ended September 25, 2020. The Institute for Defense Analyses' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Institute for Defense Analyses' major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Institute for Defense Analyses' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Institute for Defense Analyses' compliance.

Opinion on Each Major Federal Program

In our opinion, the Institute for Defense Analyses complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 25, 2020.



Report on Internal Control Over Compliance

Management of the Institute for Defense Analyses is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Institute for Defense Analyses' internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Institute for Defense Analyses' internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

A handwritten signature in black ink that reads "PricewaterhouseCoopers up". The signature is written in a cursive, flowing style.

Arlington, VA
June 22, 2021

Part III

Findings

Institute for Defense Analyses
Schedule of Findings and Questioned Costs
For the year ended September 25, 2020

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:

Unmodified

Internal control over financial reporting:

- Material weakness (es) identified? x yes no
- Significant deficiency (ies) identified that are not considered to be material weaknesses? yes x none reported
- Noncompliance material to financial statements noted? yes x no

Federal Awards

Internal control over major programs:

- Material weakness (es) identified? yes x no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? yes x none reported

Type of auditor’s report issued
on compliance for major programs:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? yes x no

Identification of major programs: CFDA Number(s)	Name of Federal Program or Cluster
Various	Research and Development Cluster
Dollar threshold used to distinguish between type A and type B programs:	\$3,000,000
Auditee qualified as low-risk auditee?	<u> x </u> yes <u> </u> no

Institute for Defense Analyses
Schedule of Findings and Questioned Costs, Continued
For the year ended September 25, 2020

Section II – Financial Statement Findings

Finding 2020-001: Journal entries are not adequately reviewed prior to approval and posting

Criteria:

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Condition, Cause and Effect:

Monthly interest rate swap agreement journal entries are prepared by a staff accountant and sent for review and approval. PwC identified a variance between the mark-to-market reports and the general ledger of \$1.9M. This variance was due to an error in the preparation of the monthly journal entry, in which the preparer input the incorrect beginning balances used in their calculation of the adjustment. The inaccurate entry was then sent to the reviewer for approval and posting, but the review was inadequate as the error was not identified.

PwC notes that the likelihood of misstatement is both at least reasonably possible and material due to the following:

PwC notes that the deficiency identified, as it relates the appropriate review of journal entries, (1) is pervasive and impacts all financial statement assertions, (2) is susceptible to loss or fraud of the related asset or liability involved in the instance, (3) is subjective and judgmental in determining the amounts involved, and (4) results in possible future consequences due to inappropriate journal entries or balances reported.

It is noted that regardless of the potential dollar value, the magnitude of misstatement would be deemed material as the lack of adequate review of journal entries contributes directly to the risk of management override for which dollar value does not play a role in determining magnitude.

Recommendation:

The Institute should provide training to preparers and reviewers of journal entries to ensure adequate preparation and review take place prior to approval and posting to the general ledger.

View of Responsible Officials:

Refer to management's corrective action plan on page 36.

Section III – Federal Award Findings and Questioned Costs

No findings to be reported.

Institute for Defense Analyses
Summary Schedule of Prior Audit Findings
For the year ended September 25, 2020

Section III – Federal Award Findings and Questioned Costs

There were no prior audit findings which require an update in this report.

**Institute for Defense Analyses response to Financial Statement Finding
Uniform Guidance Audit September 25, 2020**

Management Corrective Action Plan to Finding 2020-001: Journal entries are not adequately reviewed prior to approval and posting

IDA has taken several measures to address the finding identified by PwC with regard to inadequate review of journal entries prior to approval and posting of the entry. First, management reviewed the journal entry process to fully understand the cause of the error. As a result of the review, several areas of improvement were identified and the following corrective action have occurred.

- A master list was developed of all repetitive journal entries occurring each accounting period. This list is used as a new control to ensure all entries are processed each accounting period.
- Desk procedures were developed for all repetitive journal entries which focused on the purpose of the entry and ensures adequate controls are in place for the entry.
- Entries relying on a spreadsheet calculation were identified and steps were taken to enhance the spreadsheets and strengthen controls around the calculation.

Second, to ensure a similar vulnerability did not exist in other areas, the effort was expanded beyond journal entries to include the review and documentation of additional processes occurring throughout the accounting area. Third, management has engaged with an external accounting firm to conduct an internal audit of the period closing process. This audit is currently in progress but will be completed no later than September 24, 2021. Lastly, the accounting staff recently received AICPA training on internal controls. Additional training will be conducted throughout the year and annual training objectives will be included in the staff performance plans each year.



Jean C. Conley

Director of Finance and Administration, Treasurer and CFO