

Consolidated Financial Statements and Report of  
Independent Certified Public Accountants  
**American Legacy Foundation**  
June 30, 2005 and 2004

# American Legacy Foundation

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## Report of Independent Certified Public Accountants

Board of Directors  
American Legacy Foundation

We have audited the accompanying consolidated statements of financial position of the American Legacy Foundation (the Foundation) as of June 30, 2005 and 2004, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. The consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits 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 of designing audit procedures that are appropriate in the circumstances, but not for purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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 audits provide a reasonable basis for our opinion on the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Foundation as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary information on pages 18-23, which is the responsibility of the Foundation's management, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*Grant Thornton LLP*

Vienna, Virginia  
August 26, 2005

# American Legacy Foundation

## Consolidated Statements of Financial Position

<i>June 30,</i> <i>(in thousands)</i>	2005	2004
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 152,701	\$ 177,987
Investments, at market (Note C)	909,195	871,444
Accrued interest receivable	639	597
Loan receivable (Note J)	59	57
Prepaid expenses	805	593
Inventory	80	26
Trades to be settled	769	—
<b>Total Current Assets</b>	<b>1,064,248</b>	<b>1,050,704</b>
<b>Fixed Assets, net (Note D)</b>	<b>37,279</b>	<b>37,403</b>
<b>Other Assets</b>	<b>489</b>	<b>958</b>
<b>Long-term Loan Receivable, net of current portion (Note J)</b>	<b>761</b>	<b>821</b>
<b>Total Assets</b>	<b>\$ 1,102,777</b>	<b>\$ 1,089,886</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accrued expenses	\$ 8,642	\$ 17,757
Grants payable	431	1,735
Other payable	132	113
Loans payable (Notes J and K)	61,288	61,286
Liability on interest rate SWAP agreement (Note K)	1,166	—
Trades to be settled	—	2,230
<b>Total Current Liabilities</b>	<b>71,659</b>	<b>83,121</b>
<b>Long-term Liabilities</b>		
Loans payable (Notes J and K)	18,192	19,592
Sublease liability	658	849
Other long-term liability	76	—
<b>Total Long-term Liabilities</b>	<b>18,926</b>	<b>20,441</b>
<b>Net Assets—Unrestricted</b>	<b>1,012,192</b>	<b>986,324</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 1,102,777</b>	<b>\$ 1,089,886</b>

The accompanying notes are an integral part of these statements.

# American Legacy Foundation

## Consolidated Statements of Activities and Changes in Net Assets

<i>Year ended June 30,</i> <i>(in thousands)</i>	2005	2004
<b>Revenue and Support</b>		
Settlement proceeds:		
Base	\$ 25,000	\$ 25,000
Public education	3,687	3,407
Smokeless tobacco	13,187	11,607
	<hr/>	<hr/>
	41,874	40,014
Investment income (Note C)	103,122	140,885
Other income	6,415	7,469
	<hr/>	<hr/>
<b>Total Revenue and Support</b>	151,411	188,368
<b>Program Expenses</b>		
Counter marketing, communication and policy	71,967	91,713
Grants	14,744	19,073
Other programs	18,334	20,898
	<hr/>	<hr/>
<b>Total Program Expenses</b>	105,045	131,684
<b>Supporting Expenses</b>		
General and administrative (Note C)	13,813	15,123
<b>Building Operating Expenses</b>	2,660	2,489
<b>Interest Expense</b>	2,706	694
<b>Income Tax Expense</b>	153	177
<b>Unrealized Loss on Interest Rate SWAP Agreement</b>	1,166	—
	<hr/>	<hr/>
<b>Total Expenses</b>	125,543	150,167
<b>Change in Net Assets</b>	25,868	38,201
<b>Net Assets, beginning of year</b>	986,324	948,123
	<hr/>	<hr/>
<b>Net Assets, end of year</b>	\$ 1,012,192	\$ 986,324

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

# American Legacy Foundation

## Consolidated Statements of Cash Flows

<i>Year ended June 30,</i> <i>(in thousands)</i>	2005	2004
<b>Cash Flows from Operating Activities</b>		
Change in net assets	\$ 25,868	\$ 38,201
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Unrealized gain on investments	(61,834)	(76,566)
Realized gain on investments	(23,056)	(46,885)
Other investment loss (gain)	60	(264)
Loss on disposal of fixed assets	—	40
Depreciation	1,897	1,727
Accrued interest receivable	(42)	353
Loan receivable	58	56
Trades to be settled, net	(2,999)	1,757
Inventory	(54)	(26)
Other assets	469	(556)
Prepaid expenses	(212)	104
Accrued expenses	(9,115)	4,457
Grants payable	(1,304)	(3,072)
Other payable	19	6
Liability on interest rate SWAP agreement	1,166	—
Sublease liability	(191)	849
Other long-term liability	76	—
<b>Net Cash Used in Operating Activities</b>	<b>(69,194)</b>	<b>(79,819)</b>
<b>Cash Flows from Investing Activities</b>		
Purchase of fixed assets and leasehold improvements	(1,772)	(4,417)
Proceeds from sale of investments	5,003,478	8,642,399
Purchases of investments	(4,956,400)	(8,595,300)
<b>Net Cash Provided by Investing Activities</b>	<b>45,306</b>	<b>42,682</b>
<b>Cash Flows from Financing Activities</b>		
Borrowings under line-of-credit agreement	—	30,000
Proceeds from loan payable	—	20,000
Payments on loan payable	(1,398)	(56)
<b>Net Cash (Used in) Provided by Financing Activities</b>	<b>(1,398)</b>	<b>49,944</b>
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	<b>(25,286)</b>	<b>12,807</b>
<b>Cash and Cash Equivalents, beginning of year</b>	<b>177,987</b>	<b>165,180</b>
<b>Cash and Cash Equivalents, end of year</b>	<b>\$ 152,701</b>	<b>\$ 177,987</b>
<b>Cash Paid for Income Taxes</b>	<b>\$ 153</b>	<b>\$ 177</b>

The accompanying notes are an integral part of these statements.

# American Legacy Foundation

## Notes to Consolidated Financial Statements

*June 30, 2005 and 2004*

*(in thousands)*

### NOTE A—NATURE OF OPERATIONS

In November 1998, a coalition of 46 state attorney generals successfully settled their civil cases with the tobacco companies. As a result, the settling states and the participating tobacco manufacturers entered into two separate settlement agreements: the Master Settlement Agreement (MSA) and the Smokeless Tobacco Master Settlement Agreement (STMSA). The two settlement agreements provided for the establishment and initial funding of a Section 501(c)(3) organization to reduce tobacco usage in the United States. Pursuant to these agreements, an organization named Master Settlement Agreement Foundation (MSA Foundation) was created in March 1999, and later renamed American Legacy Foundation (the Foundation). The Foundation's mission is to build a world where young people will reject tobacco and anyone can quit.

The Foundation is a non-profit organization organized and operated exclusively for charitable, scientific, and educational purposes within the meaning of the Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the Code). All references to sections of the Code include the corresponding provisions of any subsequent federal tax law. More specifically, the purpose for which the Foundation was formed is to support (1) the study of and programs to reduce youth tobacco product usage and youth substance abuse in the United States, and (2) the study of and educational programs to prevent diseases associated with the use of tobacco products in the United States.

The Foundation is governed by a Board of Directors, which is comprised of state governors, legislators, attorneys general and experts in the medical, education and public health fields.

The functions of the Foundation shall be:

1. Carrying out a nationwide sustained advertising and education program to: (a) counter the use by youth of tobacco products, and (b) educate consumers about the cause and prevention of diseases associated with the use of tobacco products;
2. Developing and disseminating model advertising and education programs to counter the use by youth of substances that are unlawful for the use or purchase by youth, with an emphasis on reducing youth smoking; monitoring and testing the effectiveness of such model programs and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs, as appropriate;
3. Developing and disseminating model classroom education programs and curriculum ideas about smoking and substance abuse in the K-12 school system, including specific target programs for special at-risk populations, monitoring and testing the effectiveness of such model programs and ideas and, based on the information received from such model programs or ideas, continuing to develop and disseminate revised versions of such model programs, as appropriate;

## American Legacy Foundation

### Notes to Consolidated Financial Statements—Continued

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*June 30, 2005 and 2004*

*(in thousands)*

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#### NOTE A—NATURE OF OPERATIONS—Continued

4. Developing and disseminating criteria for the effectiveness cessation program; monitoring and testing the effectiveness of such criteria; and continuing to develop and disseminate revised versions of such criteria, as appropriate;
5. Commissioning studies, funding research, and publishing reports and factors that influence youth smoking and substance abuse, and developing strategies to address the conclusions of such studies and research;
6. Developing other innovative youth smoking and substance abuse prevention programs;
7. Providing targeted training and information for parents;
8. Maintaining a library of Foundation-funded studies, reports and other publications related to the cause and prevention of youth smoking and substance abuse that will be open to the public;
9. Tracking and monitoring youth smoking and substance abuse, with a focus on the reasons for any increases in, or failures to decrease, youth smoking and substance abuse and what actions can be taken to reduce youth smoking and substance abuse; and
10. Receiving, controlling, and managing contributions and funds provided by other entities for further purposes described in the Foundation's certificate of incorporation.

In order to meet the general goals and specific focus areas set forth above, the Foundation is organized into three major sections: one for administration, fiscal, personnel, legal and board relations; another section focusing on public education by means of counter-marketing of tobacco use, public relations and policy; and a third section focusing on grant-giving for research-commissioned studies, program initiatives related to the Foundation's goals, strategic partnerships, and the rigorous evaluation of the Foundation's programs.

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#### NOTE B—SUMMARY OF ACCOUNTING POLICIES

##### *Organization*

In December 2002, the Foundation purchased the property at 2030 M Street, NW, Washington, D.C. through M Street Holdings LLC, a single-member LLC, 100 percent owned by the Foundation. Space in the building is occupied by the Foundation as well as leased to other tenants. The Foundation's control, combined with its economic interest, supports consolidation of M Street Holdings LLC.

All significant intercompany transactions have been eliminated in the consolidated financial statements.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

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June 30, 2005 and 2004

(in thousands)

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### NOTE B—SUMMARY OF ACCOUNTING POLICIES—Continued

#### *Basis of Presentation*

These consolidated financial statements present the financial position, activities and cash flows of the Foundation prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. These net assets represent expendable funds that are available for support of the Foundation's operations.

#### *Settlement Revenue*

The Foundation receives revenue that is derived from the two settlement agreements: the MSA and the STMSA. Certain payments received pursuant to the settlement agreements can be utilized at the Foundation's discretion. Other payments are intended to assist the Foundation in carrying out a nationwide sustained advertising and education program.

These agreements contain various provisions and conditions that ultimately will determine the amount and timing of payments to be received. Consequently, revenue is recognized at the time payments either are received or can be reasonably estimated and are receivable.

#### *Investments*

Investments are recorded at fair value as determined by quoted market prices. Realized and unrealized gains and losses are recorded as a component of investment income in the statements of activities.

#### *Fixed Assets*

Fixed assets are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets, which range from three to 39-½ years. Leasehold improvements are amortized using the straight-line method over the lesser of the estimated useful lives of the assets or the related lease terms.

#### *Cash and Cash Equivalents*

For purposes of the statements of cash flows, the Foundation considers all short-term, highly liquid debt instruments to be cash equivalents, including commercial paper, money market funds, and certificates of deposit purchased with an original maturity of three months or less.

#### *Allocation of Expenses*

Expenses are either directly charged to program services as incurred, or proportionately allocated to functional categories, based on various allocation methods.

#### *Inventory of Merchandise*

Inventory is stated at the lower of cost or market using the first-in, first-out method.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

June 30, 2005 and 2004

(in thousands)

### NOTE B—SUMMARY OF ACCOUNTING POLICIES—Continued

#### *Use of Estimates in Preparing Financial Statements*

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, at the date of the financial statements, revenue, and expenses during the reporting period.

#### *Reclassifications*

Certain reclassifications of 2004 information have been made to conform to the 2005 presentation.

### NOTE C—INVESTMENTS

Investments at fair value consisted of the following at June 30:

	2005	2004
U.S. government securities	\$ 360,828	\$ 404,917
Inflation Hedging	195,651	167,236
U.S. equity securities	67,833	53,176
Non-U.S. securities	132,481	140,413
Emerging Markets	60,777	78,178
Absolute/Hedge Funds	91,625	27,524
	<u>\$ 909,195</u>	<u>\$ 871,444</u>

Investment return consisted of the following at June 30:

	2005	2004
Interest, dividends, and accretion income	\$ 18,292	\$ 17,170
Realized gain on investments	23,056	46,885
Unrealized gain on investments	61,834	76,566
Other investment (loss) gain	(60)	264
	<u>\$ 103,122</u>	<u>\$ 140,885</u>

Custodial and investment advisory fees of \$3,784 and \$3,685 for fiscal years 2005 and 2004, respectively, are reflected in general and administrative expenses on the consolidated statement of activities.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

June 30, 2005 and 2004

(in thousands)

### NOTE D—FIXED ASSETS

Fixed assets consisted of the following at June 30:

	2005	2004
Furniture and fixtures	\$ 1,167	\$ 1,149
Computers	2,091	1,821
Office equipment	814	731
Improvements	568	568
Building and improvements	35,843	35,589
Assets in progress	919	1
Vehicles	1,419	1,419
	42,821	41,278
Less: accumulated depreciation and net disposals	(5,542)	(3,875)
	\$ 37,279	\$ 37,403

### NOTE E—INCOME TAXES

The Foundation is exempt from federal income taxes under Section 501(a) of the Code as an organization described in Section 501(c)(3).

M Street Holdings, LLC is a single-member LLC and, as such, is a “disregarded entity” for federal income tax purposes, pursuant to section 7701 of the Code.

The Foundation had unrelated business income; the Foundation paid \$153 and \$177 in federal and D.C. taxes for 2005 and 2004, respectively.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

June 30, 2005 and 2004

(in thousands)

### NOTE F—COMMITMENTS AND CONTINGENCIES

#### *Operating Leases*

The Foundation leases office space and equipment under non-cancelable operating lease agreements. Minimum future lease payments are as follows:

<i>Year ending June 30,</i>	<b>Minimum Lease Commitments</b>	<b>Sublease Offset</b>	<b>Net Lease Commitment</b>
2006	\$ 679	\$ (543)	\$ 136
2007	691	(554)	137
2008	704	(565)	139
2009	719	(577)	142
2010	547	(440)	107
	<b>\$ 3,340</b>	<b>\$ (2,679)</b>	<b>\$ 661</b>

On January 31, 2000, the Foundation entered into a lease agreement for office space with 15,043 square feet under a 10-year term, and an additional 6,379 square feet under a five-year term that ended in March 2005. The lease includes scheduled rent increases, which are being amortized on a straight-line basis over the term of the lease. Total operating lease expenses under all office and equipment leases were \$879 and \$939 for the years ended June 30, 2005 and 2004, respectively. The Foundation has a sublease liability in the amount of \$658 and \$849 for the years ended June 30, 2005 and 2004 stemming from rental space at 1001 G Street, for which the Foundation is still under contract. The liability will be reduced ratably over the life of the lease.

#### *Financial Instruments*

The Foundation continually monitors its positions with, and the credit quality of, the financial institutions, which are counter-parties to its financial instruments, and does not anticipate non-performance by the counter-parties. Financial instruments representing significant concentrations consist primarily of cash and cash equivalents and investment securities.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

June 30, 2005 and 2004

(in thousands)

### NOTE G—RENTAL INCOME

The following is a schedule of approximate future minimum rental income receivable by the Foundation, as lessor, under non-cancelable operating leases as of year ending June 30:

2006	\$ 2,477
2007	2,507
2008	2,505
2009	2,580
2010	2,641
Thereafter	4,853
	<hr/>
	\$ 17,563

### NOTE H—RETIREMENT PLANS

The Foundation maintains an employees' 401(k) savings plan. Effective in January 2004, the Foundation combined the define contribution money purchase plan into the 401(k) savings plan.

Employees who are at least 21 years of age are eligible for enrollment and participation in the first month following the completion of 90 days of employment. The Foundation contributes 15 percent of the base compensation for each employee. Participants may elect to defer up to 10 percent of their compensation subject to statutory limitations. Expenses related to the retirement plan amounted to \$899 and \$810 for the years ended June 30, 2005 and 2004, respectively.

### NOTE I—SPLIT-DOLLAR LIFE INSURANCE POLICY

In May of 2000, the Foundation began making premium payments under a split-dollar life insurance arrangement on behalf of its president and chief financial officer. The president and chief financial officer own the life insurance policies underlying the arrangement and have assigned certain limited rights in the policies under an Assignment of Life Insurance Policy as Collateral (Assignment) to the Foundation, including the Foundation's right to the cash surrender value of the policies. Under the arrangement, the Foundation pays premiums on the policies (\$36 annually in aggregate for both policies), which are considered advances. The advances are secured by the Assignments. According to the Assignment, the Foundation may, with limitations, receive the cash surrender value. Upon the death of the insured, the Foundation may recover premiums paid before other benefits are paid to the insured's beneficiaries. Upon retirement or termination, the Foundation will release its rights under the Assignment, which includes its cash surrender value rights.

At June 30, 2005, the guaranteed cash surrender value of the policy was \$76. Since the cash surrender value was not considered significant in previous years, no amount was recorded. The cash surrender value is reflected in the statement of financial position as both an asset and a liability.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

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June 30, 2005 and 2004

(in thousands)

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### NOTE J—RELATED-PARTY TRANSACTION

#### *Loan to Officer*

In September 2002, the Foundation provided a \$968 mortgage loan to the President/CEO secured through a note on the D.C. property purchased, as well as other personal assets. The term of the loan is for seven years, with an amortization rate of 15 years, at a fixed interest rate of 4.99 percent. The mortgage loan is funded through an unsecured direct bank loan to the Foundation with the same terms. The balance of the loan due to the Foundation, and, in turn, the financial institution at June 30, 2005, is \$820.

The classification of the notes receivable and offsetting mortgage loan in the accompanying consolidated balance sheet is as follows:

Current portion	\$	59
Long-term portion		761
		<hr/>
	\$	820
		<hr/>

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### NOTE K—DEBT

#### *Terms and Balance*

In February 2003, the Foundation obtained a revolving master borrowing line with a financial institution for \$30,000. The effective interest rate on the line is the London Interbank Offered Rate (LIBOR) plus .10 percent as established on the first business day of each month by the British Bankers Association (BBA). The note will mature on January 31, 2006, unless extended. The balance outstanding at June 30, 2005 is \$30,000.

In October 2003, the Foundation obtained a revolving master borrowing line with a financial institution for \$30,000. This line is used for operating expenses. The effective interest rate on the line is LIBOR plus .10 percent as established on the first business day of each month by the BBA. The note will mature on June 30, 2006, unless extended. The balance outstanding at June 30, 2005 is \$30,000.

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

June 30, 2005 and 2004

(in thousands)

### NOTE K—DEBT—Continued

#### *Terms and Balance—Continued*

On June 30, 2004, the Foundation obtained a 15-year loan with a financial institution for \$20,000 with a LIBOR-based rate plus 25 basis points. In addition, the Foundation entered into an interest-rate swap agreement at a fixed rate of 5.34 percent in exchange for LIBOR plus 0.10 percent. The Foundation's intent is to reduce overall interest expense while maintaining an acceptable level of risk from exposure to increases in interest rates. The Foundation has adopted Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which requires the Foundation to recognize all of its derivative instruments as either assets or liabilities in the balance sheet at fair value. The accounting for change in fair value (i.e., gain or loss) of the derivative instrument is recognized as a change in the statement of activities. The Foundation has recognized a liability in the amount of \$1,166 in the consolidated statement of financial position, and the related unrealized loss in the consolidated statement of activities as of June 30, 2005.

Principal payments are made over the term of the loan with final payment due in 2019. The balance outstanding at June 30, 2005 is \$18,771, and is due as follows:

*Year ending June 30,*

2006	\$	1,340
2007		1,341
2008		1,341
2009		1,341
2010		1,341
Thereafter		12,067
	\$	<u>18,771</u>

The classification of the Foundation's debt in the accompanying consolidated balance sheet is as follows:

Current portion (\$111 is included in accrued expenses)	\$	61,340
Long-term portion		17,431
	\$	<u>78,771</u>

# American Legacy Foundation

## Notes to Consolidated Financial Statements—Continued

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*June 30, 2005 and 2004*

*(in thousands)*

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### NOTE L—LITIGATION

#### *Litigation*

The Foundation is involved in litigation that has arisen from the normal course of Foundation operations. Management is of the opinion that the outcome of the pending litigation would not have a material impact on the Foundation's results of operations.

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### NOTE M—SUBSEQUENT EVENT

On August 2, 2005, the Foundation sold 22,206 square feet, out of 107,564 total square feet, of their office building located at 2030 M Street, NW, Washington, DC, for \$6,932, resulting in a gain of approximately \$300.

## Supplemental Information



# American Legacy Foundation

## Consolidating Statements of Financial Position

<i>June 30,</i>			2005	2004
	American Legacy Foundation	M Street Holdings, LLC	Consolidated Total	Total All Funds
<i>(in thousands)</i>				
<b>Assets</b>				
<b>Current Assets</b>				
Cash and cash equivalents	\$ 152,385	\$ 316	\$ 152,701	\$ 177,987
Investments, at market	909,195	—	909,195	871,444
Accrued interest receivable	639	—	639	597
Due to/(from) building fund	5,699	(5,699)	—	—
Loan receivable	59	—	59	57
Prepaid expenses	611	194	805	593
Inventory	80	—	80	26
Trades to be settled	769	—	769	—
<b>Total Current Assets</b>	<b>1,069,437</b>	<b>(5,189)</b>	<b>1,064,248</b>	<b>1,050,704</b>
<b>Fixed Assets, net</b>	<b>2,617</b>	<b>34,662</b>	<b>37,279</b>	<b>37,403</b>
<b>Other Assets</b>	<b>443</b>	<b>46</b>	<b>489</b>	<b>958</b>
<b>Long-term Loan Receivable, net of current portion</b>	<b>761</b>	<b>—</b>	<b>761</b>	<b>821</b>
<b>Total Assets</b>	<b>\$ 1,073,258</b>	<b>\$ 29,519</b>	<b>\$ 1,102,777</b>	<b>\$ 1,089,886</b>
<b>Liabilities and Net Assets</b>				
<b>Current Liabilities</b>				
Accrued expenses	\$ 8,516	\$ 126	\$ 8,642	\$ 17,757
Grants payable	431	—	431	1,735
Other payable	5	127	132	113
Loans payable	50,059	11,229	61,288	61,286
Liability on interest rate SWAP agreement	1,166	—	1,166	—
Trades to be settled	—	—	—	2,230
<b>Total Current Liabilities</b>	<b>60,177</b>	<b>11,482</b>	<b>71,659</b>	<b>83,121</b>
<b>Long-term Liabilities</b>				
Loans payable	762	17,430	18,192	19,592
Sublease liability	658	—	658	849
Other long-term liability	76	—	76	—
<b>Total Long-term Liabilities</b>	<b>1,496</b>	<b>17,430</b>	<b>18,926</b>	<b>20,441</b>
<b>Net Assets—Unrestricted</b>				
Base	37,893	—	37,893	53,338
Public education	738,277	—	738,277	794,345
Income	235,415	607	236,022	138,641
<b>Total Net Assets</b>	<b>1,011,585</b>	<b>607</b>	<b>1,012,192</b>	<b>986,324</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 1,073,258</b>	<b>\$ 29,519</b>	<b>\$ 1,102,777</b>	<b>\$ 1,089,886</b>

# American Legacy Foundation

## Consolidating Statements of Activities and Changes in Net Assets

Year ended June 30, (in thousands)	2005		2004	
	American Legacy Foundation	M Street Holdings, LLC	Consolidated Total	Total All Funds
<b>Revenue and Support</b>				
Settlement proceeds:				
MSA base and public education	\$ 28,687	\$ —	\$ 28,687	\$ 28,407
STMSA smokeless tobacco	13,187	—	13,187	11,607
	41,874	—	41,874	40,014
Investment income:				
Interest and dividends	18,291	1	18,292	17,170
Realized gain	23,056	—	23,056	46,885
Unrealized gain	61,834	—	61,834	76,566
Other investment (loss) gain	(60)	—	(60)	264
	103,121	1	103,122	140,885
Other income:				
Grants and other contributions	666	—	666	2,189
Securities lending income	262	—	262	275
Commission recapture income	63	—	63	68
Rental income	—	3,582	3,582	3,450
Allowance for bad debt	—	—	—	(11)
Interest income	1,326	—	1,326	897
Sale of Sunburst Products	392	—	392	573
Contract services income	110	—	110	—
Miscellaneous	2	12	14	28
	2,821	3,594	6,415	7,469
<b>Total Revenue and Support</b>	<b>147,816</b>	<b>3,595</b>	<b>151,411</b>	<b>188,368</b>
Program expenses:				
Counter marketing, communications and policy	71,967	—	71,967	91,713
Grants	14,744	—	14,744	19,073
Other programs	18,334	—	18,334	20,898
	105,045	—	105,045	131,684
Supporting expenses:				
General and administrative	13,813	—	13,813	15,123
Building operating expenses	—	2,660	2,660	2,489
Interest expense	1,281	1,425	2,706	694
Income tax expense	—	153	153	177
Unrealized loss on interest rate Swap agreement	1,166	—	1,166	—
<b>Total Expenses</b>	<b>121,305</b>	<b>4,238</b>	<b>125,543</b>	<b>150,167</b>
<b>Change in Net Assets, unrestricted</b>	<b>26,511</b>	<b>(643)</b>	<b>25,868</b>	<b>38,201</b>
<b>Net Assets, beginning of year</b>	<b>985,074</b>	<b>1,250</b>	<b>986,324</b>	<b>948,123</b>
<b>Net Assets, end of year</b>	<b>\$ 1,011,585</b>	<b>\$ 607</b>	<b>\$ 1,012,192</b>	<b>\$ 986,324</b>

American Legacy Foundation

Consolidating Statement of Functional Expenses—2005

Year ended June 30, 2005

(in thousands)

	Counter-marketing Communications and Policy	Grants	Other Programs	General and Administrative	Building	Total
Salaries and Fringe	\$ 2,322	\$ 802	\$ 2,634	\$ 1,378	\$ —	\$ 7,136
Fringe Benefits	791	291	910	459	—	2,451
<b>Total Salaries and Fringe</b>	<b>3,113</b>	<b>1,093</b>	<b>3,544</b>	<b>1,837</b>	<b>—</b>	<b>9,587</b>
<b>Allocated Expenses</b>						
Occupancy	—	—	—	(36)	—	(36)
Telephone	45	4	43	100	—	192
Postage and shipping	36	9	34	19	—	98
Supplies	12	1	89	92	—	194
Computer expense	24	11	29	160	—	224
Printing and publications	231	10	94	24	—	359
Equipment rental, repairs and maintenance	—	—	—	65	—	65
Depreciation	336	4	84	730	—	1,154
Miscellaneous expense	41	24	12	31	—	108
Accounting fees	—	—	—	149	—	149
Advertising	18	1	13	11	—	43
Temporary services	18	—	19	31	—	68
Meetings expenses	142	5	1,095	7	—	1,249
Travel and lodging	242	49	405	210	—	906
Sponsorship/contributions	555	11	432	—	—	998
Honoraria	2	21	101	—	—	124
Meals and entertainment	32	4	63	34	—	133
	1,734	154	2,513	1,627	—	6,028
<b>General and Administrative Allocation</b>	<b>493</b>	<b>170</b>	<b>556</b>	<b>(1,219)</b>	<b>—</b>	<b>—</b>
<b>Non-Allocated Expenses</b>						
Professional development	34	15	28	24	—	101
Employee morale	6	—	—	44	—	50
Consulting	43	—	789	224	—	1,056
Contract services	64,749	103	2,660	284	—	67,796
Grants	1,791	13,209	8,169	—	—	23,169
Investment fees	—	—	—	3,784	—	3,784
Legal fees	—	—	1	6,932	—	6,933
Insurance	4	—	—	276	—	280
Cost of sales	—	—	74	—	—	74
Interest expense	—	—	—	1,281	—	1,281
	66,627	13,327	11,721	12,849	—	104,524
<b>Other Than Personal Services—Subtotal</b>	<b>68,854</b>	<b>13,651</b>	<b>14,790</b>	<b>13,257</b>	<b>—</b>	<b>110,552</b>
<b>American Legacy Foundation Expenses—Subtotal</b>	<b>71,967</b>	<b>14,744</b>	<b>18,334</b>	<b>15,094</b>	<b>—</b>	<b>120,139</b>
<b>Building Expenses</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>4,238</b>	<b>4,238</b>
<b>Unrealized Loss on Interest Rate Swap Agreement</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>1,166</b>	<b>—</b>	<b>1,166</b>
<b>Total Expenses</b>	<b>\$ 71,967</b>	<b>14,744</b>	<b>18,334</b>	<b>16,260</b>	<b>4,238</b>	<b>125,543</b>

American Legacy Foundation

Consolidating Statement of Functional Expenses—2004

Year ended June 30, 2004

(in thousands)

	Counter-marketing, Communications and Policy	Grants	Other Programs	General and Administration	Building	Total
Salaries	\$ 1,797	\$ 708	\$ 2,438	\$ 1,616	\$ —	\$ 6,559
Fringe Benefits	602	238	780	492	—	2,112
<b>Total Salaries and Fringe</b>	<b>2,399</b>	<b>946</b>	<b>3,218</b>	<b>2,108</b>	<b>—</b>	<b>8,671</b>
<b>Allocated Expenses</b>						
Occupancy	—	—	—	179	—	179
Telephone	32	4	40	138	—	214
Postage and shipping	23	8	30	18	—	79
Supplies	49	1	26	91	—	167
Computer expense	2	2	16	197	—	217
Printing and publications	299	4	134	44	—	481
Equipment rental, repairs and maintenance	4	9	1	120	—	134
Depreciation	324	—	31	669	—	1,024
Miscellaneous expense	31	11	24	28	—	94
Accounting fees	—	—	—	105	—	105
Advertising	6	—	22	11	—	39
Temporary services	29	—	34	48	—	111
Meeting expenses	723	9	926	48	—	1,706
Travel and lodging	382	24	454	179	—	1,039
Sponsorship/contributions	581	129	707	1	—	1,418
Honoraria	31	14	56	—	—	101
Meals and entertainment	82	3	81	61	—	227
	2,598	218	2,582	1,937	—	7,335
<b>General and Administrative Allocation</b>	<b>515</b>	<b>204</b>	<b>699</b>	<b>(1,418)</b>	<b>—</b>	<b>—</b>
<b>Non-allocated Expenses</b>						
Professional development	5	4	94	26	—	129
Consulting	216	—	407	310	—	933
Contract services	83,728	375	5,211	153	—	89,467
Grants	2,229	17,326	8,611	—	—	28,166
Investment fees	—	—	—	3,685	—	3,685
Gain/loss on sale/disposal of asset	—	—	—	40	—	40
Legal fees	23	—	—	6,430	—	6,453
Insurance	—	—	—	247	—	247
Cost of sales	—	—	76	—	—	76
Interest expense	—	—	—	694	—	694
Loss on sublease agreement	—	—	—	1,605	—	1,605
	86,201	17,705	14,399	13,190	—	131,495
<b>Other Than Personal Services—Subtotal</b>	<b>89,314</b>	<b>18,127</b>	<b>17,680</b>	<b>13,709</b>	<b>—</b>	<b>138,830</b>
<b>American Legacy Foundation Expenses—Subtotal</b>	<b>91,713</b>	<b>19,073</b>	<b>20,898</b>	<b>15,817</b>	<b>—</b>	<b>147,501</b>
<b>Building Expenses</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>2,666</b>	<b>2,666</b>
<b>Total Expenses</b>	<b>\$ 91,713</b>	<b>\$ 19,073</b>	<b>\$ 20,898</b>	<b>\$ 15,817</b>	<b>\$ 2,666</b>	<b>\$ 150,167</b>

# American Legacy Foundation

## M Street Holdings LLC—Statement of Functional Expenses

June 30, 2005

(in thousands)

### Building Expenses

Operating expenses:	
Cleaning	\$ 155
Repairs and maintenance	279
Grounds and security	165
Administrative	126
Management fees	74
Insurance	23
Utilities	397
Permits and other taxes	22
Miscellaneous	1
Real estate taxes	645
Legal fees	24
Depreciation expense	743
Bad debt expense	6
<b>Total Operating Expenses</b>	<b>2,660</b>
<b>Interest Expense</b>	<b>1,425</b>
<b>Income Tax Expense</b>	<b>153</b>
<b>Total Building Expenses</b>	<b>\$ 4,238</b>

# American Legacy Foundation

## M Street Holdings LLC—Statement of Functional Expenses

June 30, 2004

(in thousands)

### Building Expenses

Operating expenses:

Cleaning	\$	141
Repairs and maintenance		353
Grounds and security		161
Administrative		103
Management fees		72
Insurance		26
Utilities		297
Permits and other taxes		18
Real estate taxes		542
Legal fees		73
Depreciation expense		703

**Total Operating Expenses** 2,489

**Interest Expense** —

**Income Tax Expense** 177

**Total Building Expenses** \$ 2,666