

# American Legacy Foundation And Affiliate

Consolidated Financial Report  
June 30, 2007

**McGladrey & Pullen**  
Certified Public Accountants

## Contents

---

<b>Independent Auditor's Report On The Financial Statements</b>	<b>1</b>
<b>Financial Statements</b>	
Consolidated Balance Sheets	2
Consolidated Statements Of Activities	3
Consolidated Statements Of Cash Flows	4
<b>Notes To Consolidated Financial Statements</b>	<b>5 – 12</b>
<hr/>	
<b>Independent Auditor's Report On The Supplementary Information</b>	<b>13</b>
<b>Supplementary Information</b>	
Consolidated Statement Of Functional Expenses – 2007	14
Consolidated Statement Of Functional Expenses – 2006	15
M Street Holdings, LLC – Schedule of Building Expenses	16

---

# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

To the Board of Directors  
American Legacy Foundation  
Washington, D.C.

We have audited the accompanying consolidated balance sheets of American Legacy Foundation and Affiliate (the Foundation) as of June 30, 2007 and 2006, and the related consolidated statements of activities and cash flows for the years then ended. These 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 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Legacy Foundation and Affiliate as of June 30, 2007 and 2006, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2007 on our consideration of the Foundation'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. The purpose of that report is 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*McGladrey & Pullen, LLP*

Bethesda, Maryland  
September 26, 2007

American Legacy Foundation And Affiliate

Consolidated Balance Sheets

June 30, 2007 And 2006

(In Thousands)

Assets	2007	2006
Cash and Cash Equivalents	\$ 182,235	\$ 178,940
Investments, at market	1,060,652	969,263
Accrued Interest Receivable	1,110	817
Prepaid Expenses	582	511
Asset on Interest Rate Swap Agreements	981	291
Trades to be Settled	984	-
Property and Equipment, net	3,058	3,325
2030 M Street Building, net	26,945	27,572
1724 Mass. Ave. Building	20,831	-
Other Assets	236	428
<b>Total assets</b>	<b>\$ 1,297,614</b>	<b>\$ 1,181,147</b>

**Liabilities And Net Assets**

Liabilities		
Grants payable	\$ 747	\$ 1,899
Trades to be settled	-	10,204
Accrued expenses	8,011	8,056
Loans payable	76,684	77,318
Sublease liability	505	777
Refundable advances	120	-
Other liabilities	86	101
<b>Total liabilities</b>	<b>86,153</b>	<b>98,355</b>

Commitments and Contingencies (Notes 4 and 7)

Net Assets – Unrestricted	1,211,461	1,082,792
<b>Total liabilities and net assets</b>	<b>\$ 1,297,614</b>	<b>\$ 1,181,147</b>

See Notes To Consolidated Financial Statements.

American Legacy Foundation And Affiliate

Consolidated Statements Of Activities  
 Years Ended June 30, 2007 And 2006  
 (In Thousands)

	2007	2006*
Revenue and Support		
Settlement proceeds:		
Base	\$ 25,000	\$ 25,000
Public education	1,712	937
Smokeless tobacco	16,606	14,880
Investment income	179,592	127,886
Rental income	2,846	2,732
Other income	4,443	4,923
<b>Total revenue and support</b>	<b>230,199</b>	<b>176,358</b>
Expenses		
Program expenses:		
Counter marketing, communications and government affairs	60,289	62,620
Grants	12,087	16,457
Other programs	12,367	13,177
<b>Total program expenses</b>	<b>84,743</b>	<b>92,254</b>
General and administrative	13,475	9,591
Building expenses	3,312	3,913
<b>Total expenses</b>	<b>101,530</b>	<b>105,758</b>
<b>Change in net assets</b>	<b>128,669</b>	<b>70,600</b>
Net Assets		
Beginning	1,082,792	1,012,192
Ending	<b>\$ 1,211,461</b>	<b>\$ 1,082,792</b>

\* Reclassified to conform to current year presentation.

See Notes To Consolidated Financial Statements.

## American Legacy Foundation And Affiliate

### Consolidated Statements Of Cash Flows

Years Ended June 30, 2007 And 2006

(In Thousands)

	2007	2006
Cash Flows From Operating Activities		
Change in net assets	\$ 128,669	\$ 70,600
Adjustments to reconcile change in net assets to net cash (used in) operating activities:		
Realized and unrealized gain on investments	(150,533)	(101,188)
Other investment (gain) loss	(804)	(2,145)
Loss (gain) on disposal of property and equipment	13	(344)
Depreciation	2,241	1,960
Change in interest rate swap agreements asset	(690)	(1,457)
Changes in assets and liabilities:		
(Increase) decrease in:		
Accrued interest receivable	(293)	(178)
Loan receivable	-	820
Trades to be settled, net	(11,188)	10,973
Other assets	192	141
Prepaid expenses	(71)	294
Decrease (increase) in:		
Accrued expenses	(45)	(586)
Grants payable	(1,152)	1,468
Sublease liability	(272)	119
Refundable advance	120	-
Other long-term liability	(15)	(107)
<b>Net cash (used in) operating activities</b>	<b>(33,828)</b>	<b>(19,630)</b>
Cash Flows From Investing Activities		
Proceeds from sale of property and equipment	-	6,932
Purchase of property and equipment	(22,191)	(2,166)
Proceeds from sale of investments	3,173,431	5,913,611
Purchases of investments	(3,113,483)	(5,870,346)
<b>Net cash provided by investing activities</b>	<b>37,757</b>	<b>48,031</b>
Cash Flows From Financing Activities		
Principal payments on loan payable	(1,340)	(2,162)
Advances on line of credit notes, net	706	-
<b>Net cash (used in) financing activities</b>	<b>(634)</b>	<b>(2,162)</b>
<b>Net increase in cash and cash equivalents</b>	<b>3,295</b>	<b>26,239</b>
Cash And Cash Equivalents		
Beginning	178,940	152,701
Ending	<u>\$ 182,235</u>	<u>\$ 178,940</u>
Supplemental Disclosures Of Cash Flow Information		
Cash paid for interest	<u>\$ 3,895</u>	<u>\$ 3,669</u>
Cash paid for income taxes	<u>\$ 193</u>	<u>\$ 99</u>

See Notes To Consolidated Financial Statements.

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

---

#### Note 1. Nature Of Activities And Significant Accounting Policies

American Legacy Foundation and Affiliate consists of two entities: American Legacy Foundation (the Foundation) and M Street Holdings, LLC.

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 reject tobacco and anyone can quit. 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, attorney generals 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;
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;

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

---

#### Note 1. Nature Of Activities And Significant Accounting Policies (Continued)

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 reason 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 government affairs; and a third section focusing on grant-giving for research-commissioned studies, program initiatives related to the Foundation's goals, and the rigorous evaluation of the Foundation's programs.

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% 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.

A summary of the Foundation's significant accounting policies follows:

Principles of consolidation: The consolidated financial statements include the accounts of the Foundation and M Street Holdings, LLC. All material inter-company transactions have been eliminated.

Basis of accounting: The accompanying financial statements are presented in accordance with the accrual basis of accounting, whereby, revenue is recognized when earned and expenses are recognized when incurred.

Basis of presentation: The financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Foundation is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The Foundation has no temporarily or permanently restricted net assets at June 30, 2007 and 2006.

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 3 months or less.

Financial risk: The Foundation maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Foundation has not experienced any losses in such accounts. The Foundation believes it is not exposed to any significant financial risk on cash.

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

---

#### Note 1. Nature Of Activities And Significant Accounting Policies (Continued)

Financial risk (continued): The Foundation invests in various equity, debt, and alternative investments. Such investments are exposed to various risks such as market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term could materially affect investment balances and the amounts reported in the financial statements.

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.

Inventory: Inventory consists of bracelets, pins, necklaces and keychains and is stated at the lower of cost, or market. Management determines the allowance for obsolete inventory by identifying nonmarketable items and by using historical experience applied to recent sales. There is no allowance for obsolescence, based on management's evaluation of the salability of inventory at June 30, 2007 and 2006.

Property and equipment: The Foundation capitalizes all property and equipment purchased with a cost of \$5,000 or more. Property and equipment is recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets, which range from 3 to 39½ 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.

Fair value of financial instruments: The carrying amounts including cash and cash equivalents, receivables, accounts payable and accrued liabilities, and current maturities of long-term borrowings approximate fair value because of the short maturity of these instruments. The carrying amount of long-term debt approximates fair value because the interest rates on these instruments fluctuate with market interest rates offered to the Foundation for debt with similar terms and maturities.

Valuation of long-lived assets: The Foundation accounts for the valuation of long-lived assets under Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Interest rate swap agreements: The fair value of the interest rate swap agreements are the estimated amount that the financial institutions would receive or pay to terminate the swap agreements at the reporting date, taking into account current interest rates and the current credit worthiness of the swap counter parties.

Revenue and support: 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.

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

---

#### Note 1. Nature Of Activities And Significant Accounting Policies (Continued)

Revenue and support (continued): 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.

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

Income taxes: The Foundation is generally exempt from federal income tax under Internal Revenue Code Section 501(c)(3). In addition, the Foundation has been classified as an organization that is not a private foundation. Income, which is not related to its exempt purposes, less applicable deductions, is subject to federal and state corporate income taxes. M Street Holding, 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. For the years ended June 30, 2007 and 2006, the Foundation had unrelated business income related to debt financed rental income.

Estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications: Certain amounts in the 2006 financial statements have been reclassified to conform with the 2007 presentation. These reclassification had no effect on the previously reported change in net assets

#### Note 2. Investments

Investments at June 30, 2007 and 2006, consist of the following:

	2007	2006
U.S. and global government bonds	\$ 133,494	\$ 131,147
Inflation hedging	61,324	60,196
U.S. equity securities	393,653	375,349
Non-U.S. securities	257,395	221,430
Venture/private equity	3,700	531
Emerging markets	96,917	79,871
Absolute/hedge funds	114,169	100,739
	<u>\$ 1,060,652</u>	<u>\$ 969,263</u>

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

#### Note 2. Investments (Continued)

Investment income for the years ended June 30, 2007 and 2006, consists of the following:

	2007	2006
Interest, dividends, and accretion income	\$ 28,255	\$ 24,553
Realized and unrealized gain on investments	150,533	101,188
Other investment (loss) gain	804	2,145
<b>Total investment return</b>	<b>\$ 179,592</b>	<b>\$ 127,886</b>

Custodial and investment advisory fees of \$4,196 and \$3,946 for fiscal years 2007 and 2006, respectively, are reflected in general and administrative expenses on the consolidated statement of activities.

#### Note 3. Property And Equipment

Property and equipment and accumulated depreciation at June 30, 2007 and 2006, consists of the following:

		2007			
	Estimated Useful Lives	Cost	Accumulated Depreciation	Net	Depreciation Expense
Furniture and fixtures	7 to 10 years	\$ 1,393	\$ 922	\$ 471	\$ 174
Computers and software	3 years	2,603	1,473	1,130	810
Office equipment	5 years	809	491	318	167
Improvements	8 to 10 years	568	412	156	60
Intangible assets	3 years	1,375	502	873	373
Assets in progress	-	109	-	109	-
Vehicles	5 years	1,419	1,419	-	11
		8,276	5,219	3,057	1,595
Building and improvements	39-1/2 years	20,831	-	20,831	-
Building and improvements	39-1/2 years	29,698	2,752	26,946	646
		<b>\$ 58,805</b>	<b>\$ 7,971</b>	<b>\$ 50,834</b>	<b>\$ 2,241</b>

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

#### Note 3. Property And Equipment (Continued)

	Estimated Useful Lives	2006			
		Cost	Accumulated Depreciation	Net	Depreciation Expense
Furniture and fixtures	7 to 10 years	\$ 1,393	\$ 748	\$ 645	\$ 190
Computers and software	3 years	2,888	1,442	1,446	721
Office equipment	5 years	877	391	486	171
Improvements	8 to 10 years	568	352	216	61
Intangible assets	3 years	650	129	521	131
Vehicles	5 years	1,419	1,408	11	15
		7,795	4,470	3,325	1,289
Building and improvements	39-1/2 years	29,678	2,106	27,572	671
		<u>\$ 37,473</u>	<u>\$ 6,576</u>	<u>\$ 30,897</u>	<u>\$ 1,960</u>

#### Note 4. Loans Payable And Interest-Rate Swap Agreements

The Foundation had a revolving master borrowing line with a financial institution for \$30,000. The effective interest rate on the line was the London Interbank Offered Rate (LIBOR) plus 0.1%. The note was paid in full during the year ended June 30, 2007 and closed. The balance outstanding at June 30, 2006 was \$30,000.

During the year ended June 30, 2007, the Foundation entered into an "Advised Line of Credit Note" in the amount of \$30,000. The effective interest rate is based on either: LIBOR (as adjusted) plus .09%; the greater of Prime minus 2% or 1%; or a negotiated rate. The Foundation chooses its interest method at the time advances on the line are requested. The note will mature on March 31, 2008. The balance outstanding at June 30, 2007, was \$30,000.

The Foundation has another 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 0.1%. The note was to mature on June 30, 2007, but the Foundation exercised its extension option. Subsequent to June 30, 2007, the Foundation amended the agreement so that the new maturity date is July 31, 2008. The balance outstanding at June 30, 2007 and 2006, was \$10,000 and \$30,000.

The Foundation obtained a loan with a financial institution for \$20,000, with a LIBOR-based interest rate plus 25 basis points. Related to this loan, the Foundation entered into an interest-rate swap agreement at a fixed rate of 5.34% in exchange for LIBOR plus 0.10%. The notional amount was \$16,089 at June 30, 2007. 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 component of changes in net assets in the statement of activities. The Foundation has recognized an asset at June 30, 2007 and 2006, in the amount of \$158 and \$291, respectively, in the consolidated balance sheet, and the related unrealized (loss) gain of \$(133) and \$1,457 as a component of changes in net assets in the consolidated statement of activities as of June 30, 2007 and 2006, respectively.

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

---

#### Note 4. Loans Payable And Interest-Rate Swap Agreements (Continued)

Principal payments are made over the term of the loan with final payment due in 2019. The balance outstanding at June 30, 2007 and 2006, was \$15,978 and \$17,318.

During the year ended June 30, 2007, the Foundation entered into a revolving master borrowing line with a financial institution for \$30,000. The effective interest rate on the line is LIBOR plus 0.09%. The note will mature on April 19, 2008. The balance outstanding at June 30, 2007 was \$20,706.

Also, during the year ended June 30, 2007, the Foundation entered into a second interest-rate swap agreement whereby the Foundation has agreed to a fixed rate of 3.925% in exchange for a floating rate (USD-SIFMA Municipal Swap Index). The notional amount was \$28,000 at June 30, 2007. The Foundation has recognized an asset at June 30, 2007 the amount of \$822 in the consolidated balance sheet, and the related unrealized gain of \$822 as a component of changes in net assets in the consolidated statement of activities as of June 30, 2007.

Principal payments at June 30, 2007, are due in future years as follows:

Years Ending June 30,	
2008	\$ 61,936
2009	1,341
2010	1,341
2011	1,341
2012	1,341
Thereafter	9,384
	<u>\$ 76,684</u>

#### Note 5. Rental Income

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

Years Ending June 30,	
2008	\$ 3,186
2009	3,291
2010	3,398
2011	3,557
2012	1,756
2013	629
	<u>\$ 15,817</u>

## American Legacy Foundation And Affiliate

### Notes To Financial Statements (In Thousands)

---

#### Note 6. Retirement Plans

The Foundation maintains an employees' 401(k) savings plan. Effective in January 2004, the Foundation combined the defined 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% of the base compensation for each employee. Participants may elect to defer their compensation subject to statutory limitations of the IRS. Expenses related to the retirement plan amount to \$1,070 and \$959 for the years ended June 30, 2007 and 2006, respectively.

During the year ended June 30, 2007, the Foundation established a deferred compensation plan to provide certain eligible employees the ability to defer a portion of their compensation to provide supplemental retirement benefits under code section 457. The plans are funded entirely from the compensation of the participants and vest with the employees immediately. At June 30, 2007, participants in the 457(b) plan have deferred balances, including income earned totaling \$68.

#### Note 7. 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:

Years Ending June 30,	Minimum Lease Commitments	Sublease Income	Net Lease Commitment
2008	\$ 704	\$ 521	\$ 183
2009	719	534	185
2010	547	410	137
	<u>\$ 1,970</u>	<u>\$ 1,465</u>	<u>\$ 505</u>

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 5-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 \$158 and \$151 for the years ended June 30, 2007 and 2006, respectively. The Foundation has a sublease liability in the amount of \$505 and \$777 for the years ended June 30, 2007 and 2006, respectively, 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.

##### Building improvements in progress

The Foundation has begun rehabilitation on its newly purchased building on Massachusetts Avenue, Washington, D.C. The total estimated cost of the project under contract is approximately \$1,334 and incurred costs are approximately \$144 through June 30, 2007.

##### Investments

In connection with certain private equity investments, the Foundation has committed to make additional investments totaling approximately \$39,073 over the next several years.

# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report On The Supplementary Information

To the Board of Directors  
American Legacy Foundation  
Washington, D.C.

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

*McGladrey & Pullen, LLP*

Bethesda, Maryland  
September 26, 2007

## American Legacy Foundation And Affiliate

### Consolidated Statement Of Functional Expenses Year Ended June 30, 2007 (In Thousands)

	Counter-Marketing Communications and Government		Other Programs	General and Administrative	Building Fund		Total
	Affairs	Grants			1724 Mass Avenue	2030 M Street	
Salaries	\$ 1,934	\$ 388	\$ 3,282	\$ 2,676	\$ -	\$ -	\$ 8,280
Fringe benefits	688	137	1,163	910	-	-	2,898
<b>Total salaries and fringe</b>	<b>2,622</b>	<b>525</b>	<b>4,445</b>	<b>3,586</b>	<b>-</b>	<b>-</b>	<b>11,178</b>
Occupancy	-	-	-	158	-	-	158
Telephone	62	4	70	115	-	-	251
Postage and shipping	27	6	26	22	-	-	81
Supplies	20	1	15	160	-	-	196
Computer expense	20	17	13	449	-	-	499
Printing and publications	106	2	61	12	-	-	181
Equipment rental, repairs and maintenance	2	-	-	55	-	246	303
Depreciation	121	7	12	1,455	-	646	2,241
Auditing/accounting/payroll processing	-	-	-	151	-	-	151
Temporary services	41	3	24	38	-	-	106
Meeting expense	258	-	724	77	-	-	1,059
Travel and lodging	224	29	290	113	-	-	656
Fellowships/scholarships	-	-	12	-	-	-	12
Sponsorship/contributions	365	291	254	1	-	-	911
Honorarium	-	22	24	-	-	-	46
Meals and entertainment	23	2	50	14	-	-	89
Professional development	21	8	24	39	-	-	92
Consulting	8	-	101	420	-	-	529
Contract services	55,585	291	2,234	494	-	-	58,604
Grants	188	10,727	2,953	-	-	-	13,868
Custodial and investment advisory fees	-	-	-	4,196	-	-	4,196
Legal fees	-	-	-	287	-	8	295
Insurance	29	-	-	227	-	25	281
Cost of sales	-	-	11	-	-	-	11
Interest expense	-	-	-	2,599	-	1,480	4,079
Unrealized (gain) on interest rate swap	-	-	-	133	(822)	-	(689)
Fundraising	-	-	62	-	-	-	62
Other building operating expenses	-	-	-	-	-	1,022	1,022
Income tax expense	-	-	-	-	-	193	193
Real estate taxes	-	-	-	-	-	514	514
Other expenses	50	44	62	199	-	-	355
<b>Total expenses</b>	<b>59,772</b>	<b>11,979</b>	<b>11,467</b>	<b>15,000</b>	<b>(822)</b>	<b>4,134</b>	<b>101,530</b>
Overhead allocations	517	108	900	(1,525)	-	-	-
	<b>\$ 60,289</b>	<b>\$ 12,087</b>	<b>\$ 12,367</b>	<b>\$ 13,475</b>	<b>\$ (822)</b>	<b>\$ 4,134</b>	<b>\$ 101,530</b>

## American Legacy Foundation And Affiliate

### Consolidated Statement Of Functional Expenses

Year Ended June 30, 2006

(In Thousands)

	Counter- Marketing Communications and Government Affairs	Grants	Other Programs	General and Administrative	Building	Total*
Salaries	\$ 1,536	\$ 573	\$ 2,944	\$ 2,364	\$ -	\$ 7,417
Fringe benefits	604	249	1,202	510	-	2,565
<b>Total salaries and fringe</b>	<b>2,140</b>	<b>822</b>	<b>4,146</b>	<b>2,874</b>	<b>-</b>	<b>9,982</b>
Occupancy	-	-	-	151	-	151
Telephone	41	5	78	106	-	230
Postage and shipping	29	6	27	20	-	82
Supplies	20	1	16	128	-	165
Computer expense	20	45	19	202	-	286
Printing and publications	192	1	56	24	-	273
Equipment rental, repairs and maintenance	1	-	1	34	-	36
Depreciation	109	6	13	1,161	671	1,960
Auditing/accounting/payroll processing	-	-	-	136	-	136
Temporary services	32	-	16	31	-	79
Meeting expense	260	-	1,268	99	-	1,627
Travel and lodging	258	47	400	137	-	842
Fellowships/scholarships	-	-	15	-	-	15
Sponsorship/contributions	368	32	232	11	-	643
Honorarium	-	13	13	-	-	26
Meals and entertainment	22	5	61	17	-	105
Professional development	11	14	19	56	-	100
Emergency preparedness	-	-	-	244	-	244
Consulting	18	1	369	171	-	559
Contract services	57,593	43	2,080	16	-	59,732
Grants	891	15,168	3,229	-	-	19,288
Custodial and investment advisory fees	-	-	-	3,946	-	3,946
Legal fees	-	4	1	627	-	632
Insurance	5	-	-	238	-	243
Cost of sales	-	-	56	-	-	56
Interest expense	-	-	-	2,260	1,409	3,669
Unrealized (gain) on interest rate swap	-	-	-	(1,457)	-	(1,457)
Other building operating expenses	-	-	-	-	1,734	1,734
Income tax expense	-	-	-	-	99	99
Other expenses	83	42	57	93	-	275
<b>Total expenses</b>	<b>62,093</b>	<b>16,255</b>	<b>12,172</b>	<b>11,325</b>	<b>3,913</b>	<b>105,758</b>
Overhead allocations	527	202	1,005	(1,734)	-	-
	<b>\$ 62,620</b>	<b>\$ 16,457</b>	<b>\$ 13,177</b>	<b>\$ 9,591</b>	<b>\$ 3,913</b>	<b>\$ 105,758</b>

\* Reclassified to conform to current year presentation.

American Legacy Foundation And Affiliate

M Street Holdings, LLC – Schedule of Building Expenses  
 Years Ended June 30, 2007 And 2006  
 (In Thousands)

	2007	2006
Building Expenses		
Operating expenses:		
Cleaning	\$ 140	\$ 143
Repairs and maintenance	246	324
Grounds and security	136	131
Administrative	114	102
Management fees	68	66
Insurance	25	26
Utilities	550	390
Permits and other taxes	14	28
Miscellaneous	-	1
Real estate taxes	514	502
Legal fees	8	17
Bad debt expense	-	4
<b>Total operating expenses</b>	<b>1,815</b>	<b>1,734</b>
Interest expense	1,480	1,409
Income tax expense	193	99
Depreciation	646	671
<b>Total building expenses</b>	<b>\$ 4,134</b>	<b>\$ 3,913</b>