American Legacy Foundation And Affiliate

Consolidated Financial Report
June 30, 2010

McGladrey & Pullen
Certified Public Accountants

Contents

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, 2010 and 2009, 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. 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, 2010 and 2009, 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.

McGladrey & Pullen, LLP

Gaithersburg, Maryland
September 30, 2010

American Legacy Foundation And Affiliate

Consolidated Balance Sheets
June 30, 2010 And 2009
(In Thousands)

Assets		2010		2009
Cash And Cash Equivalents	$	122,651	$	104,391
Investments		797,595		763,293
Accrued Interest Receivable		356		386
Prepaid Expenses		355		932
Grants Receivable		473		-
Trades To Be Settled		-		6,784
Property And Equipment, net		855		1,362
1724 Mass. Ave. Building, net		28,000		28,494
2030 M Street Building, net		25,563		26,265
Bond Issuance Costs, net		569		604
Other Assets		312		752
	$	976,729	$	933,263

Liabilities And Net Assets				
Liabilities				
Grants payable	$	112	$	322
Trades to be settled		748		-
Accrued expenses		7,259		11,358
Loans payable		21,955		23,296
Bonds payable		28,000		28,000
Sublease liability		-		139
Refundable advances		126		120
Liability on interest rate swap agreements		4,588		2,956
Other liabilities		626		928
		63,414		67,119
Contingencies (Note 9)				
Net Assets – Unrestricted		913,315		866,144
	$	976,729	$	933,263

See Notes To Consolidated Financial Statements.

American Legacy Foundation And Affiliate

Consolidated Statements Of Activities
Years Ended June 30, 2010 And 2009
(In Thousands)

	2010	2009
Revenue and support:		
Rental income	$ 4,381	$ 4,355
Other income	3,860	6,126
Investment income (loss), net of fees	117,807	(208,230)
Settlement proceeds:		
Public education	301	-
Total revenue and support	126,349	(197,749)
Expenses:		
Program expenses:		
Counter marketing, communications and government affairs	45,386	51,093
Grants	6,288	12,851
Other programs	9,343	11,007
Schroeder Research Institute	2,297	1,412
	63,314	76,363
Supporting services:		
Development	1,241	1,166
General and administrative	6,428	6,159
Building expenses	8,195	8,192
Total expenses	79,178	91,880
Change in net assets	47,171	(289,629)
Net assets:		
Beginning	866,144	1,155,773
Ending	$ 913,315	$ 866,144

See Notes To Consolidated Financial Statements.

American Legacy Foundation And Affiliate

Consolidated Statements Of Cash Flows
Years Ended June 30, 2010 And 2009
(In Thousands)

	2010	2009
Cash Flows From Operating Activities		
Change in net assets	$ 47,171	$ (289,629)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Realized and unrealized (gain) loss on investments	(106,426)	224,814
Other investment gain	(2,692)	(461)
Depreciation	1,981	2,548
Change in interest rate swap agreements asset/liability	1,632	1,663
Amortization of bond issuance costs	35	119
Changes in assets and liabilities:		
(Increase) decrease in:		
Accrued interest receivable	30	1,592
Trades to be settled	7,532	(7,223)
Other assets	440	401
Prepaid expenses	577	(297)
Increase (decrease) in:		
Accrued expenses	(4,099)	(14,325)
Grants payable	(210)	(228)
Sublease liability	(139)	(187)
Refundable advances	6	120
Other liabilities	(302)	129
Net cash used in operating activities	(54,464)	(80,964)
Cash Flows From Investing Activities		
Purchase of property and equipment	(281)	(538)
Proceeds from sale of investments	4,794,072	4,045,868
Purchases of investments	(4,719,726)	(4,006,268)
Net cash provided by investing activities	74,065	39,062
Cash Flows From Financing Activities		
Principal payments on loan payable	(1,341)	(1,341)
Net cash used in financing activities	(1,341)	(1,341)
Net increase (decrease) in cash and cash equivalents	18,260	(43,243)
Cash And Cash Equivalents		
Beginning	104,391	147,634
Ending	$ 122,651	$ 104,391
Supplemental Disclosures Of Cash Flow Information		
Cash paid for interest	$ 1,997	$ 1,621
Cash paid for income taxes	$ 186	$ 131

See Notes To Consolidated Financial Statements.

Note 1. Nature Of Activities And Significant Accounting Policies

Nature of activities: American Legacy Foundation and Affiliate consist of two entities: American Legacy Foundation (the Foundation) and M Street Holdings, LLC (the Company).

In November 1998, a coalition of 46 state attorneys general 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 was later renamed American Legacy 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, 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.

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.

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

Nature of activities (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.

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 four major sections: one for administration, fiscal, personnel, legal and Board relations; a second section focusing on public education by means of counter-marketing tobacco use, public relations and government affairs; 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; and a fourth section focusing on advancement of research and policy in the field of tobacco control and cessation.

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 was occupied by the Foundation and is now used as rental property. The Foundation's control, combined with its economic interest, supports consolidation of the Company.

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

Principles of consolidation: The consolidated financial statements include the accounts of the Foundation and the Company. All material intercompany transactions have been eliminated.

Basis of accounting: The accompanying consolidated 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 consolidated financial statement presentation follows the recommendations of the Financial Accounting Standards Board (FASB) Account Standards Codification (the Codification). As required by the Non-Profit Entities Topic of the Codification, 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 had no temporarily or permanently restricted net assets at June 30, 2010 and 2009.

Cash and cash equivalents: For purposes of the consolidated 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.

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

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.

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 consolidated financial statements.

Securities transactions, interest and dividends: Securities transactions are recorded on a trade-date basis and are carried at fair value. Realized gains and losses on securities transactions are determined on a specific identification basis and are included as net realized gain on investments in the accompanying consolidated statements of activities. The difference between the cost and the fair value of open investments is reflected as the net change in unrealized appreciation (depreciation) on investments in the accompanying consolidated statements of activities. Interest income is recognized under the accrual basis. Dividend income is recognized on the ex-dividend date.

Valuation of investments: Investments are presented in the consolidated financial statements at fair value in accordance with accounting principles generally accepted in the United States of America. Investments in securities traded on a national securities exchange, or reported on the NASDAQ national market, are stated at the last reported sales price on the day of valuation; other securities traded on the over-the-counter market and listed securities for which no sale was reported on that date are stated at the last quoted bid price, except for short sales positions and call options written, for which the last quoted asked price is used.

Investments in comingled trust funds, hedge funds, fund of funds, and private equity funds are valued at fair value based on the applicable percentage ownership of the underlying partnerships' net assets as of the measurement date, as provided by the fund managers. The underlying investment partnerships value securities and other financial instruments on a fair value basis of accounting. The estimated fair values of certain investments of the underlying investment partnerships, which may include private placements and other securities for which prices are not readily available, are determined by the general partner or sponsor of the respective other investment partnership and may not reflect amounts that could be realized upon immediate sale, nor amounts that may ultimately be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments. The fair value of the Foundation's investments in other investment partnerships generally represents the amount the Foundation would expect to receive if it were to liquidate its investment in the other investment partnerships, excluding any redemption charges that may apply.

The fund managers of underlying investment partnership funds in which the Foundation invests may utilize derivative instruments with off-balance-sheet risk. The Foundation's exposure to risk is limited to the amount of its investment.

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

Financial instruments with off-balance-sheet risk: In connection with its trading activities, the Foundation enters into transactions with a variety of securities and derivative financial instruments. These derivative financial instruments may have market and/or credit risk in excess of the amounts recorded in the consolidated balance sheets.

Market risk: Market risk arises primarily from changes in the market value of financial instruments. Theoretically, the Foundation's exposure is equal to the notional value of contracts purchased and unlimited on such contracts sold short.

Exposure to market risk is influenced by a number of factors, including the relationships between financial instruments, and the volatility and liquidity in the markets in which the financial instruments are traded. In many cases, the use of financial instruments serves to modify or offset market risk associated with other transactions and accordingly, serves to decrease the Foundation's overall exposure to market risk. The Foundation attempts to control its exposure to market risk through various analytical monitoring techniques.

Concentrations of credit risk: The Foundation is engaged in various trading and brokerage activities in which counter parties primarily include broker-dealers, banks, and other financial institutions. In the event counter parties do not fulfill their obligations, the Foundation may be exposed to risk. The risk of default depends on the credit worthiness of the counter party or issuer of the instrument. It is the Foundation's policy to review, as necessary, the credit standing of each counter party.

In the normal course of its business, the Foundation enters into contracts and agreements with certain service providers, such as clearing and custody agents, trustees and administrators that contain a variety of representations and warranties and which provide general indemnifications and guarantees against specified potential losses in connection with their activities as an agent of, or providing services to, the Foundation. The Foundation's maximum exposure under these agreements is unknown, as this may involve future claims that could be made against the Foundation and have not yet occurred. The Foundation expects the risk of any future obligation under these arrangements to be remote and has not recorded any contingent liability in the consolidated financial statements for these indemnifications.

Property and equipment: The Foundation capitalizes all property and equipment purchased with a cost of $5,000 or more. Property and equipment are 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.

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

Valuation of long-lived assets: The Foundation accounts for the valuation of long-lived assets by reviewing the assets 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 asset to future undiscounted net cash flows expected to be generated by the asset. 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 and hedging activities: The fair value of interest rate swap agreements is 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.

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 (IRC) 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. The Company is a single-member, limited liability company (LLC) and, as such, is a “disregarded entity” for federal income tax purposes, pursuant to Section 7701 of the IRC. The Foundation had unrelated business income related to debt financed rental income during the years ended June 30, 2010 and 2009.

The Foundation follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Foundation may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods.

Management evaluated the Foundation’s tax positions and concluded that the Foundation had taken no uncertain tax positions that require adjustment to the financial statements to comply with the provisions of this guidance. With few exceptions, the Foundation is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for years before 2007.

Use of estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent events: The Foundation evaluated subsequent events for potential required disclosures through September 30, 2010, which is the date the consolidated financial statements were available to be issued.

(In Thousands)

Note 2. Investments

Investments at June 30, 2010 and 2009, consist of the following:

	2010	2009
Short-term investments	$ 6,999	$ 24,487
Mutual funds	150,888	131,358
U.S. stocks	156,538	175,741
Global stocks	57,512	56,490
Commingled/common trust funds	232,533	238,355
Hedge funds	22,042	18,638
Fund of funds	72,743	67,500
Private equity funds	28,716	10,264
Private equity fund of funds	51,882	24,926
Other	17,742	15,534
	$ 797,595	$ 763,293

Investment income (loss) at June 30, 2010 and 2009, consists of the following:

	2010	2009
Interest, dividends, and accretion income	$ 13,249	$ 19,955
Realized gain (loss) on investments	25,200	(53,068)
Unrealized gain (loss) on investments	81,226	(171,746)
Other investment gain	2,692	461
Investment fees	(4,560)	(3,832)
Total investment income (loss)	$ 117,807	$ (208,230)

(In Thousands)

Note 2. Investments (Continued)

Alternative investments are less liquid than the Foundation's other investments. The following table summarizes these investments by major category at June 30, 2010:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Common Trust Funds/ Comingled Funds (a)	$ 210,320	$ -	Weekly, Monthly, Bi-Monthly	5 – 10 days
Hedge Funds:				
Hedge Fund – Long/Short (b)	45,827	-	Quarterly, Annually	60 – 75 days
Hedge Fund – Multi Strategy (c)	54,078	-	Quarterly, Longer than one year	60 days
Hedge Fund – Semi Liquid Credit (d)	11,622	-	Annually, Longer than one year	90 days
Private Equity:				
Private Equity – Venture/Buyout (e)	32,387	50,403	Longer than one year	Not Applicable
Private Equity – Private Debt (f)	33,801	30,053	Longer than one year	Not Applicable
Real Assets:				
Real Assets – Commodities (g)	22,216	-	Weekly	5 days
Real Assets – Private Energy (h)	4,917	19,544	Longer than one year	Not Applicable
Real Assets – Real Estate (h)	9,493	43,458	Longer than one year	Not Applicable
	$ 424,661	$ 143,458		

(a) This category invests in common trust funds and comingled funds which pursue a variety of investment strategies. Four of the funds, representing 61% of the value of this category, focus on various mixes of equity securities, including both global and domestic securities, as well as a mix of emerging market, small, and large cap equities. The remaining three funds, representing 39% of the value of the funds, pursue investments in a variety of fixed income financial instruments both in the U.S. and globally. The fair value of investments in this category has been estimated using an equivalent to a net asset value per share and is available to be redeemed at that value.

(b) This category includes investments in two hedge funds that invest both long and short in various domestic and international common stocks. Management of the hedge funds have the ability to shift from value to growth strategies, from small to large capitalization stocks, and from a net short position to a net long position. One of the funds, representing approximately 77% of the value of this category, can be redeemed quarterly with 75 days notice. The other fund, representing approximately 23% of the value of this category, can be fully redeemed on an annual basis with 60 days notice, or redeemed on a semi-annual basis for up to 25% of the value of the investment with 60 days notice. The fair value of the investments in this category has been estimated using the net asset value per share of the investments.

Note 2. Investments (Continued)

(c) This category invests in hedge funds that pursue multiple strategies to diversify risk and reduce volatility. The fair value of the investments in this category has been estimated using the net asset value per share of the investments. One fund within this category, representing approximately 21% of the value of this category, includes a restriction that does not allow for redemptions in the first 24 months after acquisition, and another fund, representing approximately 23% of the value of this category, is a close ended fund which does not allow for redemptions. The remaining restriction period for the fund with the lock-up period was 18 months at June 30, 2010.

(d) This category includes investments in a hedge fund that seek to generate superior risk-adjusted returns by investing in a broad array of securities within the leveraged finance marketplace. The fair value of the investments in this category has been estimated using the net asset value per share of the investments. This investment represents two classes of share. The first class of shares, representing approximately 54% of the value of the category, is available to be redeemed annually on the anniversary date of the initial investment, and the second class of shares, representing approximately 46% of the value of the category, is illiquid and is available to be redeemed at a future date determined by the fund.

The following categories, with the exception of the Real Assets – Commodities category, include various private equity funds. These investments can never be redeemed with the funds. Instead, the nature of the investments in these categories is that distributions are received through the liquidation of the underlying assets of the fund. As of June 30, 2010, it is probable that the investments in these categories will be liquidated at an amount different from the net asset value of the Foundation’s ownership interest in partners’ capital. Therefore, the fair value of the investments in this category has been estimated using recent observable transaction information received from potential buyers of the investments. It is estimated that the underlying assets of the funds within these categories would be liquidated over five to ten years. The investment strategies of the funds within these categories are summarized as follows:

(e) This category includes several private equity funds pursuing venture and/or buyout strategies to generate investment returns.

(f) This category includes several private equity funds focusing on private debt. The two largest funds, representing approximately 61% and 30%, respectively, of the value within this category, specifically focus on debt securities of companies undergoing financial distress, operating difficulties, and significant restructuring and on acquiring eligible assets, which include certain commercial mortgage-backed securities and non-agency residential mortgage-backed securities, under the Public-Private Investment Partnership, which seeks to unlock frozen credit markets and expand lending activity.

(g) This category invests in a common trust fund, the objective of which is to provide long-term total return in excess of the custom Index, an equal-sector weighted version of the Goldman Sachs Commodity Index, by investing in commodity-related and fixed income instruments. The fair value of investments in this category has been estimated using an equivalent to a net asset value per share and is available to be redeemed at that value.

(h) These categories invest in various private equity funds focused on generating gains through investments in real assets – specifically real assets within the private energy sector and real estate ventures.

(In Thousands)

Note 3. Property And Equipment

Property and equipment and accumulated depreciation at June 30, 2010, and depreciation expense for the year ended June 30, 2010, consist of the following:

	Estimated Useful Lives	Cost	Accumulated Depreciation	Net	Depreciation Expense
Furniture and fixtures	7 years	$ 1,287	$ 834	$ 453	$ 172
Computers and software	3 years	1,304	1,202	102	130
Office equipment	5 years	871	574	297	152
Improvements	8 – 10 years	568	568	-	37
Intangible assets	3 years	1,500	1,497	3	127
Vehicles	5 years	718	718	-	-
		6,248	5,393	855	618
1724 Mass Ave.	39½ years	29,408	1,408	28,000	567
2030 M Street	39½ years	30,706	5,143	25,563	796
		$ 66,362	$ 11,944	$ 54,418	$ 1,981

Property and equipment and accumulated depreciation at June 30, 2009, and depreciation expense for the year ended June 30, 2009, consist of the following:

	Estimated Useful Lives	Cost	Accumulated Depreciation	Net	Depreciation Expense
Furniture and fixtures	7 years	$ 1,323	$ 699	$ 624	$ 180
Computers and software	3 years	2,275	2,136	139	393
Office equipment	5 years	1,216	785	431	176
Improvements	8 – 10 years	568	531	37	60
Intangible assets	3 years	1,500	1,369	131	371
Vehicles	5 years	752	752	-	-
		7,634	6,272	1,362	1,180
1724 Mass Ave.	39½ years	29,335	841	28,494	563
2030 M Street	39½ years	30,613	4,348	26,265	805
		$ 67,582	$ 11,461	$ 56,121	$ 2,548

Note 4. Loans Payable And Interest Rate Swap Agreements

The Foundation has a revolving master borrowing line with a financial institution for $10,000. This line is used for 2030 M Street financing. The effective interest rate on the line was the London InterBank Offered Rate (LIBOR) plus .90%. Effective June 1, 2010, the line was amended and restated so that the interest rate was changed to LIBOR plus .60% and the maturity date was extended to July 31, 2011. The balance outstanding at June 30, 2010, was $10,000.

(In Thousands)

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

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 .1%. The notional amount was $12,067 and $13,408 at June 30, 2010 and 2009, respectively. 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 follows the Derivatives and Hedging Topic of the Codification, which requires the Foundation to recognize all of its derivative instruments as either assets or liabilities in the consolidated balance sheets 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 change in net assets in the consolidated statements of activities. The Foundation has recognized a liability in the amount of $1,681 and $1,425 in the consolidated balance sheets, and the related unrealized loss of $(256) and $(704) in building expenses in the consolidated statements of activities at June 30, 2010 and 2009, respectively.

Principal payments are made over the term of the loan, with the final payment due in 2019. The balance outstanding at June 30, 2010 and 2009, was $11,955 and $13,296, respectively.

Principal payments at June 30, 2010, are due in future years as follows:

Years Ending June 30,		
2011	$	11,341
2012		1,341
2013		1,341
2014		1,341
2015		1,341
Thereafter		5,250
	$	21,955

Relating to a bond transaction (See Note 5), the Foundation has 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 $26,980 and $27,500 at June 30, 2010 and 2009, respectively. The Foundation has recognized a liability in the amount of $2,907 and $1,531 in the consolidated balance sheets, and the related unrealized loss of $(1,376) and $(959) in building expenses in the consolidated statements of activities at June 30, 2010 and 2009, respectively.

Note 5. Bond Transaction

The Foundation has a promissory note agreement with the District of Columbia (D.C.) through a D.C. Revenue Bonds transaction (American Legacy Foundation Issue, Series 2008). The Foundation borrowed $28,000 from D.C. with interest accruing at variable rates through a remarketing process, as stipulated in the Indenture of Trust between D.C. and the Bond Trustee. The interest rate in effect at June 30, 2010, was 0.29%. The Foundation has the option to prepay the note in whole or in part at anytime without penalty. The note matures on December 1, 2043. However, the note may become due prior to the maturity date in certain circumstances, as stipulated in the financing agreements.

(In Thousands)

Note 5. Bond Transaction (Continued)

In connection with this transaction, the Foundation entered into a Standby Bond Purchase Agreement with the Bond Trustee and a financial institution, whereby, the financial institutions would provide liquidity to purchase the bonds in the event the bonds were not marketable. This agreement was terminated on September 1, 2009.

On September 1, 2009, the Foundation has issued a Remarketing Memorandum, which in effect cancels the Standby Bond Purchase Agreement and provides for the Foundation to provide “self liquidity” in the event the bonds need to be re-purchased in the marketing process.

Note 6. Rental Income

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

Years Ending June 30,		
2011	$	4,503
2012		3,029
2013		4,294
2014		4,469
2015 – 2020		30,065
	$	46,360

Note 7. Retirement Plans

The Foundation maintains an employee 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 Internal Revenue Service. Expenses related to the retirement plan amounted to $1,216 and $1,183 at June 30, 2010 and 2009, respectively.

The Foundation has 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 IRC §457. The plan is funded entirely from the compensation of the participants and vests with the employees immediately. At June 30, 2010 and 2009, participants in the 457(b) plan had deferred balances, including income earned, totaling $239 and $128, respectively.

The Foundation has 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 IRC §457. The plan is funded entirely from the compensation of the participants and the participants will become fully vested by January 1, 2014, with forfeiture if employment ends either voluntarily or involuntarily before this date. At June 30, 2010 and 2009, participants in the 457(f) plan had deferred balances, including income earned, totaling $320 and $179, respectively.

Note 8. Fair Value Measurements

The Codification defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Foundation utilizes valuation techniques to maximize the use of observable inputs and minimize the use of unobservable inputs. Assets and liabilities recorded at fair value are categorized within the fair value hierarchy based upon the level of judgment associated with the inputs used to measure their value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy are described below:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. The types of investments included in Level 1 include listed equities and listed derivatives. As required by the guidance provided by the Codification, the Foundation does not adjust the quoted price for these investments, even in situations where the Foundation holds a large position and a sale could reasonably impact the quoted price.

Level 2: Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly and fair value is determined through the use of models or other valuation methodologies. Investments which are generally included in this category include corporate bonds and loans, less liquid and restricted equity securities and certain over-the-counter derivatives. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.

Level 3: Inputs are unobservable for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation. Investments which are generally included in this category include equity and debt positions in private companies and general and limited partnership interests in corporate private equity and real estate funds, debt funds, certain funds of hedge funds and distressed debt.

During the year ended June 30, 2010, the FASB issued additional guidance for Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent), which, among other things, provides new guidance on classifying these investments within the fair value hierarchy. This new guidance states that if the Foundation has the ability to redeem its investments with the investee at the net asset value per share in the near term (three months following June 30, 2010), the fair value measurement of the investment is categorized as a Level 2 fair value measurement. If the Foundation does not have the ability to redeem its investment at the net asset value per share in the near term due to a provision that allows redemptions at other times than those defined as in the near term or funds that are in a lock-up, gate, or other redemption restriction, the investment is categorized as a Level 3 fair value measurement. This additional guidance resulted in a reclassification of some of the Foundation’s assets within the fair value hierarchy from Level 3 to Level 2 as of July 1, 2009.

(In Thousands)

Note 8. Fair Value Measurements (Continued)

The table below presents the balances of assets measured at fair value on a recurring basis by level within the hierarchy as of June 30, 2010:

		Fair Value Measurements Using		
	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Repurchase agreements	$ 42,914	$ -	$ 42,914	$ -
Money market funds	8,173	-	8,173	-
State Street institutional reserve fund	28,104	-	28,104	-
Deposits held at futures broker	13,272	13,272	-	-
Total cash equivalents	92,463	13,272	79,191	-
Short-term investments	6,999	-	6,999	-
Mutual funds	150,888	150,888	-	-
U.S. stocks	156,538	156,538	-	-
Global stocks	57,512	57,512	-	-
Commingled/common trust funds	232,533	-	232,533	-
Hedge funds	22,042	-	-	22,042
Fund of funds	72,743	-	62,404	10,339
Private equity funds	28,716	-	-	28,716
Private equity fund of funds	51,882	-	-	51,882
Other	16,742	-	5,538	11,204
Total investments	796,595	364,938	307,474	124,183
	$ 889,058	$ 378,210	$ 386,665	$ 124,183
Liabilities:				
Liability on interest rate swap agreements	$ 4,588	$ -	$ 4,588	$ -

(In Thousands)

Note 8. Fair Value Measurements (Continued)

The table below presents the balances of assets measured at fair value on a recurring basis by level within the hierarchy as of June 30, 2009:

		Fair Value Measurements Using		
	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Repurchase agreements	$ 33,156	$ -	$ 33,156	$ -
Short-term corporate notes	3,200	-	3,200	-
State Street institutional reserve fund	28,040	-	28,040	-
Deposits held at futures broker	14,642	14,642	-	-
Total cash equivalents	79,038	14,642	64,396	-
Short-term investments	24,487	-	24,487	-
Mutual funds	131,358	131,358	-	-
U.S. stocks	175,741	175,741	-	-
Global stocks	56,490	56,490	-	-
Commingled/common trust funds	238,355	-	238,355	-
Hedge funds	18,638	-	-	18,638
Fund of funds	67,500	-	-	67,500
Private equity funds	10,264	-	-	10,264
Private equity fund of funds	24,926	-	-	24,926
Other	15,534	-	-	15,534
Total investments	763,293	363,589	262,842	136,862
	$ 842,331	$ 378,231	$ 327,238	$ 136,862
Liabilities:				
Liability on interest rate swap agreements	$ 2,956	$ -	$ 2,956	$ -

(In Thousands)

Note 8. Fair Value Measurements (Continued)

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows:

Balance, July 1, 2008	$ 148,669
Purchases of investments	39,948
Sales of investments	(32,518)
Net realized and unrealized losses on investments	(19,237)
Balance, June 30, 2009	136,862
Transfer – Level 3 to Level 2	(71,995)
Purchases of investments	48,393
Sales of investments	(3,266)
Investment income:	
Net realized and unrealized losses on investments	11,646
Interest and dividends	2,543
Balance, June 30, 2010	$ 124,183

The total change in unrealized appreciation included in the consolidated statements of activities attributable to Level 3 investments held at June 30, 2010 and 2009, was $9,139 and $(24,207), respectively.

Note 9. Commitments And Contingencies

Contingency: The Foundation participates in a federally-assisted grant program that is subject to a financial and compliance audit by the federal agency or its representative. As such, there exists a contingent liability for potential questioned costs that may result from such an audit. Management does not anticipate any significant adjustments as a result of such an audit.

Line of credit: The Foundation has a line of credit with a bank with a total amount available of $40,000. Any amounts drawn on the line will bear interest at a rate of LIBOR plus 0.75%. The Foundation had no amount outstanding on this line at June 30, 2010. Subsequent to June 30, 2010, the expiration date on the line was extended to September 30, 2012.

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 audits 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

Gaithersburg, Maryland
September 30, 2010

American Legacy Foundation And Affiliate

Consolidated Statement Of Functional Expenses
Year Ended June 30, 2010
(In Thousands)

	Counter Marketing, Communications And Government Affairs	Grants	Other Programs	Schroeder Research Institute	Development	General And Administrative	Building Fund 1724 Mass. Avenue	Building Fund 2030 M Street	Total
Salaries	$ 2,070	$ 454	$ 2,949	$ 1,338	$ 381	$ 3,201	$ -	$ -	$ 10,393
Fringe benefits	783	178	1,126	428	130	1,175	-	-	3,820
Relocation expense	-	-	7	-	-	-	-	-	7
Long-term care	10	-	11	-	-	50	-	-	71
Deferred compensation agreements	-	-	-	17	-	129	-	-	146
	2,863	632	4,093	1,783	511	4,555	-	-	14,437
Telephone	57	7	63	16	7	170	-	-	320
Postage and shipping	13	5	14	2	18	14	-	-	66
Supplies	8	-	16	17	2	174	-	-	217
Computer expense	38	-	22	17	10	157	-	-	244
Printing and publications	62	-	82	7	63	5	-	-	219
Equipment rental, repairs and maintenance	-	-	-	-	-	33	-	-	33
Depreciation	12	1	1	1	-	603	-	-	618
Occupancy	-	-	-	-	187	99	-	-	286
Auditing, accounting, and payroll processing	-	-	-	-	-	214	-	-	214
Temporary services	12	-	5	-	2	4	-	-	23
Meetings expense	148	-	110	32	60	38	-	-	388
Travel and lodging	220	18	307	34	55	139	-	-	773
Fellowships/scholarships	-	-	22	-	-	-	-	-	22
Sponsorship/contributions	202	-	133	2	3	1	-	-	341
Honorarium	1	-	3	-	-	-	-	-	4
Meals and entertainment	24	3	39	9	5	18	-	-	98
Professional development	16	6	37	12	5	40	-	-	116
Consulting	210	-	59	57	31	10	-	-	367
Contract services	41,137	145	2,780	132	196	181	-	-	44,571
Grants	-	5,415	1,172	-	-	-	-	-	6,587
Miscellaneous expense	58	2	33	11	39	188	-	-	331
Legal fees	-	-	-	-	-	400	-	-	400
Insurance	59	-	-	26	-	219	-	-	304
Cost of sales	4	-	-	-	-	-	-	-	4
Building expense	-	-	-	-	-	-	4,288	3,907	8,195
Total expenses	45,144	6,234	8,991	2,158	1,194	7,262	4,288	3,907	79,178
Overhead allocations	242	54	352	139	47	(834)	-	-	-
	$ 45,386	$ 6,288	$ 9,343	$ 2,297	$ 1,241	$ 6,428	$ 4,288	$ 3,907	$ 79,178

American Legacy Foundation And Affiliate

Consolidated Statement Of Functional Expenses
Year Ended June 30, 2009
(In Thousands)

	Counter Marketing, Communications And Government Affairs	Grants	Other Programs	Schroeder Research Institute	Development	General And Administrative	Building Fund 1724 Mass. Avenue	Building Fund 2030 M Street	Total
Salaries	$ 2,036	$ 467	$ 3,025	$ 789	$ 274	$ 2,885	$ -	$ -	$ 9,476
Fringe benefits	816	202	1,118	269	92	1,063	-	-	3,560
Relocation expense	1	-	5	52	-	-	-	-	58
Long-term care	-	-	9	-	-	45	-	-	54
Deferred compensation agreements	4	-	14	16	4	153	-	-	191
	2,857	669	4,171	1,126	370	4,146	-	-	13,339
Occupancy	-	-	-	-	166	155	-	-	321
Telephone	51	3	61	7	4	173	-	-	299
Postage and shipping	14	10	17	-	19	20	-	-	80
Supplies	11	1	7	14	3	226	-	-	262
Computer expense	26	13	31	38	2	236	-	-	346
Printing and publications	47	-	17	1	18	7	-	-	90
Equipment rental, repairs and maintenance	-	-	2	-	-	28	-	-	30
Depreciation	51	1	1	-	-	1,127	-	-	1,180
Auditing, accounting, and payroll processing	-	-	-	-	-	148	-	-	148
Temporary services	16	-	7	-	-	3	-	-	26
Meeting expense	145	2	293	1	276	89	-	-	806
Travel and lodging	209	21	222	22	41	134	-	-	649
Fellowships/scholarships	-	-	15	-	-	-	-	-	15
Sponsorship/contributions	182	267	172	-	-	-	-	-	621
Honorarium	-	17	17	-	-	-	-	-	34
Meals and entertainment	42	3	43	5	4	23	-	-	120
Professional development	18	6	26	3	1	50	-	-	104
Consulting	160	-	18	40	14	61	-	-	293
Contract services	46,772	580	2,906	2	160	105	-	-	50,525
Grants	-	11,152	2,348	-	-	-	-	-	13,500
Legal fees	-	-	-	6	-	289	-	-	295
Insurance	36	-	-	-	-	216	-	-	252
Building expense	-	-	-	-	-	-	3,769	4,423	8,192
Miscellaneous expense	63	17	46	10	33	184	-	-	353
Total expenses	50,700	12,762	10,420	1,275	1,111	7,420	3,769	4,423	91,880
Overhead allocations	393	89	587	137	55	(1,261)	-	-	-
	$ 51,093	$ 12,851	$ 11,007	$ 1,412	$ 1,166	$ 6,159	$ 3,769	$ 4,423	$ 91,880

American Legacy Foundation And Affiliate

1724 Massachusetts Avenue – Schedules Of Building Expenses
Years Ended June 30, 2010 And 2009
(In Thousands)

	2010	2009
Operating expenses:		
Real estate taxes	$ 283	$ 291
Utilities	192	188
Repairs and maintenance	135	162
Cleaning	118	114
Grounds and security	100	106
Administrative	51	37
Management fees	30	30
Insurance	19	15
Total operating expenses	928	943
Bond issuance amortization	35	34
Bond fees	196	32
Interest expense	1,186	1,238
Unrealized loss on interest rate swap	1,376	959
Depreciation	567	563
Total building expenses	$ 4,288	$ 3,769

American Legacy Foundation And Affiliate

M Street Holdings, LLC – Schedules Of Building Expenses
Years Ended June 30, 2010 And 2009
(In Thousands)

	2010	2009
Operating expenses:		
Real estate taxes	$ 531	$ 634
Utilities	453	435
Repairs and maintenance	289	268
Grounds and security	150	164
Cleaning	168	158
Administrative	87	82
Management fees	70	67
Insurance	31	26
Bad debt expense	25	-
Permits and other taxes	-	13
Legal fees	41	1
Total operating expenses	1,845	1,848
Interest expense	824	935
Depreciation	796	805
Unrealized loss on interest rate swap	256	704
Income tax expense	186	131
Total building expenses	$ 3,907	$ 4,423