

The Heritage Foundation

Financial Report
December 31, 2006

Contents

Independent Auditor's Report On The Financial Statements	1
Financial Statements	
Balance Sheets	2
Statements Of Activities	3
Statements Of Cash Flows	4
Notes To Financial Statements	5 – 12
Independent Auditor's Report On The Supplementary Information	13
Supplementary Information	
Schedules Of Functional Expenses	14 – 15

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

To the Board of Trustees
The Heritage Foundation
Washington, D.C.

We have audited the accompanying balance sheet of The Heritage Foundation (the Foundation) as of December 31, 2006, and the related statements of activities and cash flows for the year 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 audit. The financial statements of the Foundation for the year ended December 31, 2005, were audited by other auditors whose report, dated April 19, 2006, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Heritage Foundation as of December 31, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Alexandria, Virginia
March 12, 2007

The Heritage Foundation

Balance Sheets

December 31, 2006 And 2005

Assets	2006	2005
Current Assets		
Cash and cash equivalents	\$ 7,578,073	\$ 7,526,263
Contributed stock	126,842	71,338
Contributions receivable	4,056,474	4,556,089
Prepayments and other assets	646,207	457,708
Total current assets	12,407,596	12,611,398
Long-Term Assets		
Investments	119,361,770	98,347,329
Deferred compensation	3,163,857	2,913,576
Contributions receivable, net	4,139,726	6,462,238
Property and equipment, net	37,921,760	38,602,334
Cash surrender value of insurance	509,231	435,221
	165,096,344	146,760,698
	\$ 177,503,940	\$ 159,372,096
Liabilities And Net Assets		
Current Liabilities		
Accounts payable and accrued expenses	\$ 4,580,830	\$ 3,771,010
Notes payable – current portion	242,600	266,294
Total current liabilities	4,823,430	4,037,304
Long-Term Liabilities		
Notes payable	4,213,518	4,389,423
Deferred compensation	3,163,857	2,913,576
Split-interest obligations	10,996,636	10,750,712
	18,374,011	18,053,711
	23,197,441	22,091,015
Net Assets		
Unrestricted		
Board designated	101,029,822	81,554,575
Undesignated	39,163,940	40,396,697
Temporarily restricted – gifts from annuities, trusts and promises to give	12,915,026	14,138,924
Permanently restricted	1,197,711	1,190,885
	154,306,499	137,281,081
	\$ 177,503,940	\$ 159,372,096

See Notes To Financial Statements.

The Heritage Foundation

Statements Of Activities

Years Ended December 31, 2006 And 2005

	2006	2005
Changes in Unrestricted Net Assets		
Revenue and support:		
Public support – contributions	\$ 42,259,180	\$ 32,770,444
Publications, subscriptions, and registration fees	126,008	72,426
Investment income	11,408,272	9,468,389
Other income	1,572,253	1,446,299
Net assets released from restriction – satisfaction of program restrictions	3,415,105	9,285,168
Total unrestricted revenue and support	58,780,818	53,042,726
Expenses:		
Program services:		
Research	19,233,544	16,530,196
Media and government relations	6,661,430	6,470,310
Educational programs	7,820,896	7,429,915
Total program services	33,715,870	30,430,421
Supporting services:		
Management and general	1,269,817	1,154,198
Fundraising	5,552,641	4,960,467
Total supporting services	6,822,458	6,114,665
Total expenses	40,538,328	36,545,086
Change in unrestricted net assets	18,242,490	16,497,640
Changes in Temporarily Restricted Net Assets		
Contributions	1,151,463	6,838,149
Investment income	1,837,794	754,349
Change in value of split-interest agreements	(1,010,118)	(1,386,267)
Change in value of pledges and irrevocable trusts	212,068	179,613
Net assets released from restrictions	(3,415,105)	(9,285,168)
Change in temporarily restricted net assets	(1,223,898)	(2,899,324)
Changes in Permanently Restricted Net Assets – Contributions	6,826	6,047
Change in net assets	17,025,418	13,604,363
Net Assets		
Beginning	137,281,081	123,676,718
Ending	\$ 154,306,499	\$ 137,281,081

See Notes To Financial Statements.

The Heritage Foundation

Statements Of Cash Flows

Years Ended December 31, 2006 And 2005

	2006	2005
Cash Flows From Operating Activities		
Change in net assets	\$ 17,025,418	\$ 13,604,363
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net unrealized gain on investments	(7,253,776)	(5,629,588)
Net realized gains on sale of investments	(3,166,523)	(2,047,938)
Change in value of split-interest agreements	1,010,118	1,386,267
Discount on contributions receivable	(123,358)	(172,680)
Change in value of terminated split-value agreements	122,294	331,933
Depreciation and amortization	2,472,688	2,197,185
Loss on disposal of assets	68,875	5,278
Change in value of interest rate swap	15,821	(101,198)
Contributions for permanent restricted endowment	(6,826)	(6,047)
Contributed stock	(55,504)	2,873
Changes in assets and liabilities:		
(Increase) decrease in:		
Contributions receivable	2,945,485	2,506,458
Prepayments and other assets	(188,499)	(65,011)
Deferred compensation	(250,281)	(296,744)
Increase (decrease) in:		
Accounts payable and accrued expenses	809,820	337,505
Deferred compensation	250,281	296,744
Split-interest obligations	(886,488)	(634,401)
Net cash provided by operating activities	<u>12,789,545</u>	<u>11,714,999</u>
Cash Flows From Investing Activities		
Purchases of long-term investments	(56,049,562)	(24,773,476)
Sales of long-term investments	45,439,600	24,918,444
Purchases of property, and equipment	(1,792,115)	(2,234,871)
Investment in life insurance	(74,010)	(86,878)
Net cash (used in) investing activities	<u>(12,476,087)</u>	<u>(2,176,781)</u>
Cash Flows From Financing Activities		
Contributions for permanent restricted endowment	6,826	6,047
Proceeds from the issuance of notes payable	-	1,310,000
Principal payments on notes payable	(268,474)	(8,338,428)
Net cash used in financing activities	<u>(261,648)</u>	<u>(7,022,381)</u>
Net increase in cash and cash equivalents	51,810	2,515,837
Cash And Cash Equivalents		
Beginning	7,526,263	5,010,426
Ending	<u>\$ 7,578,073</u>	<u>\$ 7,526,263</u>
Supplemental Disclosures Of Cash Flow Information		
Interest paid	<u>\$ 253,439</u>	<u>\$ 278,010</u>
Contributed stock	<u>\$ 126,842</u>	<u>\$ 71,338</u>
Contributed equipment	<u>\$ 110,000</u>	<u>\$ -</u>

The Heritage Foundation

Notes To Financial Statements

Note 1. Nature Of Activities And Significant Accounting Policies

Nature of activities: Founded in 1973, The Heritage Foundation (the Foundation) is an educational and research institute – a think tank – whose mission is to formulate and promote conservative public policies based on the principles of free enterprise, limited government, individual freedom, traditional American values, and a strong national defense. The organization pursues this mission by performing timely, accurate research on key policy issues, and effectively marketing these findings to its primary audiences who are members of Congress, key congressional staff, policy makers in the Executive Branch, the nation's news media, and the academic and policy communities. The Foundation's vision is to build an America where freedom, opportunity, prosperity and civil society flourish.

A summary of significant accounting policies of the Foundation follows:

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.

Principles of consolidation: For the year ended December 31, 2005, the consolidated financial statements included the accounts of The Heritage Foundation and related entity, Capitol Hill Foundation (collectively, the Foundation). The Capitol Hill Foundation was a 501(a) organization organized exclusively for charitable and educational purposes. The Capitol Hill Foundation was dissolved during 2005. All inter-company accounts and transactions were eliminated in the consolidation for the year ended December 31, 2005. All entities were dissolved in 2005.

Basis of presentation: The financial statement presentation follows the recommendation 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.

Unrestricted net assets – Net assets representing unrestricted resources available to support the Foundation's operations and temporarily restricted resources that become available for use by satisfying donor-imposed time or purpose restrictions. Unrestricted net assets include both board-designated and undesignated funds. The Board of Trustees has approved the establishment of an operating reserve (designated fund) to provide working capital and financing stability for the Foundation in the future. Funds have also been designated for certain programs and capital acquisitions. Total designated funds at December 31, 2006 and 2005, totaled \$101,029,822 and \$81,554,575, respectively. The undesignated fund constitutes the Foundation's operating fund and investment in property, plant, and equipment net of related liabilities.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that will be met either by actions of the Foundation and/or the passage of time. When a donor-imposed restriction expires due to accomplishing the stipulated purpose or through passage of time, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Foundation, typically with earned investment income used for donor-designated purposes.

Cash and cash equivalents: The Foundation considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents.

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 and believes it is not exposed to any significant financial risk on cash.

The Heritage Foundation

Notes To Financial Statements

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

The Foundation invests in a professionally managed portfolio that contains corporate debt securities, U.S. government securities, and equity securities. 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 would materially affect investment balances and the amounts reported in the financial statements.

Contributed stock: Contributed stock consists of donated securities that are recorded at fair value at the date of receipt and liquidated in a timely manner.

Investments: Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value with gains and losses included in the statement of activities. The Foundation accounts for investments in limited partnerships under the equity method of accounting and adjusts these investments based on the Foundation's share of the partnership's net income or loss.

Property and equipment: Property and equipment consists of land, buildings, building improvements, office furniture, and equipment, which are stated at cost as of the date of acquisition or, for gifts-in-kind, the fair market value at the date of donation. Depreciation is recognized on a straight-line basis over estimated useful lives of 30 years for building and building improvements, and 3 to 10 years for office furniture and equipment. Depreciation for all assets was based on a half-year convention for the year of acquisition and the last year of useful life for assets purchase prior to 2006. Beginning in 2006, assets are depreciated on a full-year convention. The Foundation capitalizes all property and equipment with a cost of \$2,500 or more.

Derivative financial instruments: The Foundation has entered into an interest rate swap agreement to manage interest rate exposure on approximately \$5,000,000 of an original \$10,000,000 note payable to finance construction and building improvements and refinance existing debt (Note 5). The interest rate swap exchanged the floating rate (one-month LIBOR plus 60 basis points) for a fixed effective rate of 4.5% for seven years and matures in 2009.

Such interest rate swaps are accounted for under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. As a not-for-profit organization, the Foundation is not allowed to use cash flow hedging. Therefore, the interest rate swap is recorded in the balance sheet at fair value. The change in the fair value is reflected in other income in the statement of activities. The fair value of the interest rate swap at December 31, 2006 and 2005, was \$68,240 and \$84,061, respectively, and is included in investments in the accompanying balance sheet.

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 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. The Foundation had no impairment of long-lived assets during 2006 or 2005.

Contributions receivable and revenue: The Foundation recognized revenue for contributions received, including those contributions received in the form of unconditional promises to give or pledges. These promises to give are classified as contributions receivable on the statement of financial position.

The Heritage Foundation

Notes To Financial Statements

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

Contributions receivable and revenue (continued): Contributions receivable that are expected to be collected within one year are recorded at net realizable value. Contributions receivable that are expected to be collected in future years are recorded at the present value of estimated future cash flows. The discounts on those amounts are computed using an appropriate risk free rate of return at the date of the promise to give. Amortization of the discounts is included in contribution revenue. An allowance for uncollectible pledges is recorded based on estimated amounts not expected to be collected. At December 31, 2006 and 2005, there was no reserve for uncollectible amounts recorded.

Cash surrender value of insurance: During 1999, the Foundation entered into a split-dollar insurance agreement with the Foundation's president. The Foundation makes premium payments to fund the life insurance policy. The president assigned the cash surrender value and proceeds from death benefit of the policy to the Foundation to the extent of the Foundation's cumulative premium payments.

Guarantees: Guarantees are recorded in accordance with FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, which requires the Foundation to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee.

Split-interest agreements: Contributions received in the form of irrevocable split-interest agreements (charitable gift annuities and charitable trusts) are recorded as contribution revenue at the present value of amounts expected to transfer to the Foundation at the estimated date of death of the current beneficiaries, which is estimated using Internal Revenue Service mortality tables and discount rates ranging from three to six percent. Any subsequent changes in the value of the split-interest agreements are recorded as change in value of split-interest agreements in the statement of activities. Assets are recorded at the present value of amounts to be received and are discounted using an appropriate risk-free rate of return.

During the life of the beneficiary or for the specified period of time, the Foundation pays the donor or other specified parties, amounts as determined in the donor agreement. Upon fulfillment of the beneficiary payments or termination of the trust, the remaining assets are available to the Foundation for unrestricted purposes.

Income tax status: The Foundation is a not-for-profit organization exempt from federal income taxes under Section 501(a), as an entity described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. The Foundation has been classified by the Internal Revenue Service as a public charity and is not a private foundation. Contributions to the Foundation are deductible for federal income, estate, and gift tax purposes. Income, which is not related to exempt purposes, is subject to tax.

Allocation of joint costs: The Foundation incurred joint costs of \$7,102,416 and \$6,040,672 for the years ended December 31, 2006 and 2005, respectively. The Foundation allocated these joint costs among program and fundraising expenses as follows:

	2006	2005
Educational programs for public information expense	\$ 4,771,272	\$ 3,917,935
Fundraising expense	2,331,144	2,122,737
	<u>\$ 7,102,416</u>	<u>\$ 6,040,672</u>

Donated materials: The Foundation receives various property and equipment. The property is recorded at fair value at the date of donation. Total amount of donated property was \$110,000 during the year ended December 31, 2006.

The Heritage Foundation

Notes To Financial Statements

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

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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications: Certain items in the December 31, 2005 financial statements have been reclassified to conform to the December 31, 2006 financial statement presentation. These reclassifications had no effect on the previously reported change in net assets.

Fair value of financial instruments: Fair values of cash and cash equivalents, prepayments, and accounts payable approximate cost due to the short period of time to maturity. Fair values of investments are based on market prices. The carrying amount reported for notes payable approximates fair value as the interest rate on the underlying instruments fluctuate with market rates.

Advertising costs: Advertising costs are expensed when incurred.

Note 2. Promises To Give

The following are unconditional promises to give at December 31, 2006 and 2005:

	2006	2005
Due in less than one year	\$ 4,056,474	\$ 4,556,089
Due in one to five years	4,154,145	5,934,402
Due in greater than five years	660,875	1,326,488
Total to be received	8,871,494	11,816,979
Less amounts representing discounting (2%-4.43%)	(675,294)	(798,652)
	<u>\$ 8,196,200</u>	<u>\$ 11,018,327</u>

In 2005, the Foundation received a pledge of \$1,000,000 and a conditional promise to give of \$2,000,000 benefiting the Thatcher Center for Freedom, conditioned on raising an additional \$6,000,000. During 2005 the Foundation received \$3,712,828 in matching funds and \$991,753 of the \$3,000,000 pledge, and the entire match was completed in 2006.

Note 3. Investments

Investments at December 31, 2006 and 2005, consist of the following:

	2006	2005
Equity funds	\$ 60,082,571	\$ 47,493,695
Fixed income	19,615,668	18,440,477
Trusts and annuities	16,456,009	15,137,986
Money market funds	4,639,454	1,197,596
Investments in limited partnerships	18,568,068	16,077,575
	<u>\$ 119,361,770</u>	<u>\$ 98,347,329</u>

The Heritage Foundation

Notes To Financial Statements

Note 3. Investments (Continued)

The following summarizes investment income for the years ended December 31, 2006 and 2005:

	2006	2005
Interest and dividends	\$ 2,825,767	\$ 2,545,212
Net realized gain	3,166,523	2,047,938
Net unrealized gain	7,253,776	5,629,588
	<u>\$ 13,246,066</u>	<u>\$ 10,222,738</u>

Note 4. Property And Equipment

Property and equipment and accumulated depreciation consist of the following at December 31, 2006 and 2005:

	2006	2005
Land, building, and improvements	\$ 44,588,719	\$ 44,097,360
Office furniture and equipment	6,262,405	8,869,336
	<u>50,851,124</u>	<u>52,966,696</u>
Less accumulated depreciation	(12,929,364)	(14,364,362)
Property and equipment, net	<u>\$ 37,921,760</u>	<u>\$ 38,602,334</u>

Depreciation expense for the years ended December 31, 2006 and 2005 totaled \$2,472,688 and \$2,197,195, respectively.

Note 5. Notes Payable

Notes payable as of December 31, 2006 and 2005, are as follows:

	2006	2005
Note payable (construction and building improvements) – fixed rate (4.24% at December 31, 2006)	\$ 4,349,999	\$ 4,550,000
Note payable (office equipment) – interest free	96,119	66,294
Mortgage note payable	10,000	10,000
Loan guarantee (Note 10)	-	29,423
	<u>4,456,118</u>	<u>4,655,717</u>
Less current portion	(242,600)	(266,294)
Notes payable, net	<u>\$ 4,213,518</u>	<u>\$ 4,389,423</u>

The Heritage Foundation

Notes To Financial Statements

Note 5. Notes Payable (Continued)

Note Payable (Construction and Building Improvements) - The Foundation has a \$10 million note which was used to finance construction and building improvements and refinance existing debt. During 2005, \$4,950,000 of the note was paid off. The remaining outstanding balance of the note is subject to an interest-rate swap agreement, with a fixed interest rate at an effective rate of 4.5% over seven years (Note 1). Principal for the note is payable monthly based on a 25-year amortization with the outstanding principal balance due in full in 2009. The note is secured by certain assets held in the Foundation's investment portfolio. The note requires that the Foundation maintain a debt service coverage ratio (as defined by the lending institution) of at least 1.35 to 1 and a ratio of unrestricted liquidity to funded debt of at least 5 to 1. At December 31, 2006 and 2005, the Foundation was in compliance with these covenants.

Line of Credit - The Foundation has a \$2 million line of credit which was used to finance building improvements and fund short-term working capital needs. The line bears interest at LIBOR plus 60 basis points and is unsecured. The line of credit had no outstanding balance as of December 31, 2006 and 2005.

Note Payable (Office Equipment) - The Foundation has a three-year, interest-free note used to finance the purchase of office equipment. Principal payments are made monthly. The note was used to pay-off existing capital lease obligations, allowing the Foundation to enter into new operating lease agreements. The note is secured by the related office equipment.

Mortgage Note Payable - During 2005, the Foundation obtained an interest-only term loan in the amount of \$10,000 to finance the cost of preliminary design and planning for use of property at 426 3rd Street, NE. The loan bears interest at LIBOR plus 60 basis points (5.95% at December 31, 2006) with principal due at maturity in 2010 and is secured with a deed of trust placed on the property.

Minimum future payments under these notes payable as of December 31, 2006, are as follows:

Years Ending December 31,	
2007	\$ 242,600
2008	242,600
2009	3,960,918
2010	10,000
	<u>\$ 4,456,118</u>

Note 6. Employee Benefits

Discretionary Contribution Plan - The Foundation provides a non-contributory discretionary contribution plan to all employees with at least one year of service who have attained the age of 21 and who worked at least 1,000 hours during the year. Contributions to the plan by the Foundation were \$774,183 and \$741,152 for the years ended December 31, 2006 and 2005, respectively. Employees vest at 25% per year of service beginning after two years and are fully vested after five years.

Deferred Compensation Plan - The Foundation provides employees the opportunity to defer current compensation under both 403(b) and a 457(b) plan. Although the Foundation makes no contributions to these plans, the 457(b) plan assets and related liability to employees of \$786,727 and \$545,400 at December 31, 2006 and 2005, respectively, are includable on the Foundation's balance sheet within deferred compensation obligations.

The Heritage Foundation

Notes To Financial Statements

Note 6. Employee Benefits (Continued)

In addition, the Foundation had an option-based compensation plan under which certain employees were granted options to buy shares of designated mutual funds at a specified exercise price. No additional grants will be awarded under this plan, and no grants were made during the 2006 and 2005. The market value of these assets was \$145,675 and \$553,765 as of December 31, 2006 and 2005, respectively. The Foundation is not at risk for any market fluctuation related to these investments.

The Foundation also maintains a deferred compensation plan for a key employee under which annual contributions of \$35,000 were made for the years ended December 31, 2006 and 2005.

The total market value of all deferred compensation investments and the related deferred compensation obligations to employees was \$3,163,857 and \$2,913,576 at December 31, 2006 and 2005, respectively.

Note 7. Restricted Net Assets

Temporarily restricted net assets at December 31, 2006 and 2005, consist of the following:

	2006	2005
Contributions restricted by passage of time	\$ 12,915,026	\$ 14,138,924

Permanently restricted net assets represent funds that are subject to donor-imposed restrictions requiring the corpus to be held in perpetuity. At December 31, 2006 and 2005, permanently restricted net assets consist of the following:

	2006	2005
William E. Simon Fellow – Study of Religion and Free Society	\$ 1,000,000	\$ 1,000,000
Westerman Intern Program	100,000	100,000
John R. & Margrite Davis Intern Endowment	97,711	90,885
	\$ 1,197,711	\$ 1,190,885

Note 8. Operating Leases

The Foundation leases equipment under noncancelable operating lease agreements. Future minimum lease payments under noncancelable operating leases with initial or remaining terms in excess of one year at December 31, 2006, are as follows:

Years Ending December 31,	
2007	\$ 142,218
2008	107,736
2009	8,978
	\$ 258,932

Expense incurred under these leases for the years ended December 31, 2006 and 2005 totaled \$232,153 and \$207,068, respectively.

The Heritage Foundation

Notes To Financial Statements

Note 9. Related Party Transactions

During 2005, the Foundation renewed a lease to provide space to a company affiliated with a member of the Board of Trustees. The lease runs from September 1, 2005, through August 31, 2008. Annual lease payments total \$48,964. Future minimum lease payments relating to this lease amount to approximately \$49,000 for the year ending December 31, 2007, and approximately \$33,000 for the year ending December 31, 2008. Rental income recognized during the years ended December 31, 2006 and 2005, was \$48,964 and \$47,033, respectively.

Note 10. Town Hall

During 2004, the Board of Trustees approved spinning off a division of the Foundation called Townhall.com, a website that disseminates news and information from the conservative movement. The separation was completed on March 15, 2005, and Townhall.com, now operates as a separate, autonomous, for-profit company, with no shared governance.

The Foundation received consideration of \$100,000 for Townhall.com in 2005, based upon an independent valuation, in exchange for accounts receivable and fixed assets with a book value of approximately \$76,000. The Foundation agreed to act as guarantor of a loan for Townhall.com for up to \$1,000,000 and was to receive 10% of Townhall.com free cash flow, calculated on an annual basis, as defined in the agreement, up to an aggregate of \$1,500,000; however, no payments were due until 2012. In accordance with FIN 45, a liability in the amount of \$29,423 for the fair value of the loan guarantees was recognized.

Townhall.com was then acquired by Salem Communications in 2006. All outstanding debt obligations for which the Foundation acted as guarantor were satisfied in the agreement, relieving the Foundation of future liability. In addition, Salem Communications agreed to a cumulative payoff to the Foundation of \$1,050,000 to satisfy all obligations made in the original agreement between the Foundation and Townhall.com in 2004.

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report On The Supplementary Information

To the Board of Trustees
The Heritage Foundation
Washington, D.C.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of functional expenses for the year ended December 31, 2006, is presented for the purposes of additional analysis and is not a required part of the basic financial statements. This schedule is the responsibility of the Foundation's management. The schedule has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, when considered in relation to the basic financial statements taken as a whole. The supplementary information for the year ended December 31, 2005, was audited by other auditors whose report, dated April 19, 2006, expressed an unqualified opinion on such information in relation to the basic financial statements taken as a whole.

McGladrey & Pullen, LLP

Alexandria, Virginia
March 12, 2007

The Heritage Foundation

Schedule Of Functional Expenses
Year Ended December 31, 2006

	Program Services				Supporting Services				Total Expenses
	Research	Media and Government Relations	Educational Programs	Total	Management and General	Fund-raising	Total		
Salaries	\$ 9,412,982	\$ 3,248,629	\$ 1,311,520	\$ 13,973,131	\$ 663,640	\$ 1,457,601	\$ 2,121,241	\$ 16,094,372	
Printing and mailing	46,766	55,831	2,659,851	2,762,448	4,472	1,341,947	1,346,419	4,108,867	
Fringe benefits	1,972,478	734,051	415,839	3,122,368	145,743	336,520	482,263	3,604,631	
Conferences	2,222,590	678,621	64,428	2,965,639	42,954	131,167	174,121	3,139,760	
Scholars and consultants	904,044	278,310	971,665	2,154,019	21,548	869,054	890,602	3,044,621	
Postage	130,538	84,352	1,595,384	1,810,274	5,073	1,006,767	1,011,840	2,822,114	
Depreciation and amortization	1,574,036	545,158	249,575	2,368,769	103,919	-	103,919	2,472,688	
Occupancy charges	830,386	287,503	131,613	1,249,502	54,795	11	54,806	1,304,308	
Supplies	238,362	57,715	44,559	340,636	12,035	38,385	50,420	391,056	
Professional fees	163,305	48,119	34,675	246,099	107,276	1,388	108,664	354,763	
Subscriptions	213,810	92,598	8,496	314,904	8,977	8,360	17,337	332,241	
Telephone	177,157	80,629	28,295	286,081	11,035	12,090	23,125	309,206	
Staff training	142,501	48,875	38,060	229,436	10,545	14,736	25,281	254,717	
Interest expense	160,922	55,734	25,515	242,171	11,267	-	11,267	253,438	
Insurance	156,054	54,030	26,271	236,355	10,299	40	10,339	246,694	
Taxes and licenses	181,117	29,014	21,005	231,136	5,679	6,773	12,452	243,588	
Leased equipment	147,781	51,183	23,432	222,396	9,756	-	9,756	232,152	
Travel and subsistence	58,580	21,340	16,880	96,800	1,592	133,315	134,907	231,707	
On-line service fees	100,920	30,117	20,458	151,495	4,137	909	5,046	156,541	
Maintenance	95,565	33,210	15,112	143,887	6,305	3	6,308	150,195	
Books	30,150	33,782	7,248	71,180	5,335	56,771	62,106	133,286	
Miscellaneous	18,490	7,760	47,465	73,715	1,878	45,474	47,352	121,067	
Honoraria and writer's fees	89,730	5,550	25,000	120,280	-	-	-	120,280	
Photography, copying, and recording	30,468	48,511	6,084	85,063	562	28,574	29,136	114,199	
Temporary assistance and agency fees	37,681	11,808	14,048	63,537	1,839	21,210	23,049	86,586	
Other programs and grants	56,419	15,457	2,690	74,566	1,145	110	1,255	75,821	
Data processing	14,912	5,165	2,364	22,441	15,630	37,101	52,731	75,172	
Rent	18,415	6,088	9,057	33,560	1,159	2,407	3,566	37,126	
Advertising	7,385	12,290	4,307	23,982	1,222	1,928	3,150	27,132	
Total expenses	\$ 19,233,544	\$ 6,661,430	\$ 7,820,896	\$ 33,715,870	\$ 1,269,817	\$ 5,552,641	\$ 6,822,458	\$ 40,538,328	

The Heritage Foundation

Schedule Of Functional Expenses

Year Ended December 31, 2005

15

	Program Services				Supporting Services			Total Expenses
	Research	Media and Government Relations	Educational Programs	Total	Management and General	Fund-raising	Total	
Salaries	\$ 8,418,916	\$ 3,114,134	\$ 1,380,736	\$ 12,913,786	\$ 636,482	\$ 1,350,478	\$ 1,986,960	\$ 14,900,746
Printing and mailing	13,600	108,396	2,395,250	2,517,246	2,610	1,231,834	1,234,444	3,751,690
Fringe benefits	1,819,675	697,253	390,286	2,907,214	137,220	330,288	467,508	3,374,722
Scholars and consultants	709,924	234,439	890,020	1,834,383	17,053	785,404	802,457	2,636,840
Conferences	1,640,775	624,060	87,583	2,352,418	38,351	41,173	79,524	2,431,942
Postage	99,666	133,136	1,307,184	1,539,986	5,318	876,075	881,393	2,421,379
Depreciation and amortization	1,312,767	513,848	278,908	2,105,523	91,662	-	91,662	2,197,185
Occupancy charges	744,952	291,400	158,024	1,194,376	51,950	527	52,477	1,246,853
Supplies	182,267	61,665	46,925	290,857	8,670	19,134	27,804	318,661
Professional fees	116,883	39,561	84,460	240,904	72,698	452	73,150	314,054
Insurance	170,398	66,698	36,203	273,299	11,898	-	11,898	285,197
Interest expense	165,822	64,895	35,224	265,941	12,069	-	12,069	278,010
Subscriptions	142,232	90,833	17,738	250,803	8,616	5,279	13,895	264,698
Travel and subsistence	66,596	25,191	7,838	99,625	2,514	162,079	164,593	264,218
Telephone	138,650	70,407	27,442	236,499	10,144	8,686	18,830	255,329
Leased equipment	123,719	48,426	26,285	198,430	8,638	-	8,638	207,068
On-line service fees	124,197	40,168	21,048	185,413	5,743	6,046	11,789	197,202
Taxes and licenses	119,066	25,108	28,479	172,653	4,819	6,806	11,625	184,278
Honoraria and writer's fees	148,198	14,347	8,600	171,145	375	125	500	171,645
Staff training	75,522	22,261	27,941	125,724	7,954	15,424	23,378	149,102
Maintenance	71,658	28,308	14,724	114,690	5,521	71	5,592	120,282
Books	9,584	42,485	54,042	106,111	95	10,666	10,761	116,872
Miscellaneous	10,712	5,203	40,012	55,927	502	37,828	38,330	94,257
Photography, copying, and recording	19,644	52,620	7,103	79,367	852	12,947	13,799	93,166
Data processing	11,348	4,442	2,411	18,201	7,763	48,406	56,169	74,370
Other programs and grants	31,889	8,255	29,328	69,472	3,045	705	3,750	73,222
Advertising	13,413	34,664	8,878	56,955	299	3,804	4,103	61,058
Rent	17,480	6,842	8,819	33,141	1,252	1,802	3,054	36,195
Temporary assistance and agency fees	10,643	1,265	8,424	20,332	85	4,428	4,513	24,845
Total expenses	\$ 16,530,196	\$ 6,470,310	\$ 7,429,915	\$ 30,430,421	\$ 1,154,198	\$ 4,960,467	\$ 6,114,665	\$ 36,545,086