Financial Report December 31, 2008



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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 sheets of The Heritage Foundation (the Foundation) as of December 31, 2008 and 2007, and the related 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 financial statements referred to above present fairly, in all material respects, the financial position of The Heritage Foundation as of December 31, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey of Pullen, LLP

Vienna, Virginia July 8, 2009

Balance Sheets December 31, 2008 And 2007

Assets		2008		2007
Current Assets				
Cash and cash equivalents	\$	4,908,428	\$	7,159,395
Contributed stock		8,452		60,880
Contributions receivable		9,060,539		6,360,741
Prepayments and other assets		596,586		850,166
Total current assets		14,574,005		14,431,182
Long-Term Assets				
Investments		89,803,660		136,499,458
Deferred compensation investments		2,603,294		3,519,555
Contributions receivable, net		7,062,655		3,658,645
Property and equipment, net		45,304,488		38,220,475
Cash surrender value of insurance		325,431		516,983
Total long-term assets		145,099,528		182,415,116
Total assets	\$	159,673,533	\$	196,846,298
Liabilities And Net Assets				_
Current Liabilities				
Accounts payable and accrued expenses	\$	8,018,018	\$	6,448,110
Notes payable	Ψ	3,960,918	Ψ	242,600
Total current liabilities		11,978,936		6,690,710
Long-Term Liabilities		· ·		, ,
Notes payable		293,807		4,076,200
Deferred compensation obligations		2,603,294		3,519,555
Split-interest obligations		11,581,358		11,840,723
Total long-term liabilities		14,478,459		19,436,478
Total long-term liabilities		14,470,437		19,430,470
Total liabilities		26,457,395		26,127,188
Net Assets				
Unrestricted				
Board designated		74,490,655		116,502,056
Undesignated		40,492,408		39,597,299
Temporarily restricted – gifts from annuities, trusts and promises to give		17,033,075		13,419,755
Permanently restricted		1,200,000		1,200,000
•		133,216,138		170,719,110
	\$	159,673,533	\$	196,846,298

See Notes To Financial Statements.

Statements Of Activities Years Ended December 31, 2008 And 2007

20		2008	2007
Changes In Unrestricted Net Assets			
Revenue and support:			
Public support – contributions	\$	49,459,247	\$ 41,832,170
Publications, subscriptions, and registration fees		350,932	65,167
Investment (loss) income		(32,740,016)	16,561,712
Other income		858,906	1,108,651
Net assets released from restriction – satisfaction of			
time or program restrictions		5,600,264	4,692,142
Total unrestricted revenue and support		23,529,333	64,259,842
Expenses:			
Program services:			
Research		24,019,945	20,337,144
Media and government relations		14,093,510	8,278,763
Educational programs		13,089,042	10,365,558
Total program services		51,202,497	38,981,465
Supporting services:			
Management and general		1,644,242	1,352,094
Fundraising		11,798,886	8,020,688
Total supporting services		13,443,128	9,372,782
Total expenses		64,645,625	48,354,247
Change in unrestricted net assets		(41,116,292)	15,905,595
Changes In Temporarily Restricted Net Assets			
Contributions		13,759,839	5,211,239
Investment (loss) income		(4,209,243)	678,931
Change in value of split-interest agreements		(28,519)	(786,106)
Change in value of pledges and irrevocable trusts		(308,493)	92,805
Net assets released from restrictions		(5,600,264)	(4,692,142)
Change in temporarily restricted net assets		3,613,320	504,727
Changes In Permanently Restricted Net Assets – Contributions		-	2,289
Change in net assets		(37,502,972)	16,412,611
Net Assets			
Beginning		170,719,110	154,306,499
Ending	\$	133,216,138	\$ 170,719,110

See Notes To Financial Statements.

Statements Of Cash Flows Years Ended December 31, 2008 And 2007

		2008		2007
Cash Flows From Operating Activities				
Change in net assets	\$	(37,502,972)	\$	16,412,611
Adjustments to reconcile change in net assets to net cash				
(used in) provided by operating activities:				
Net unrealized loss (gain) on investments		43,530,858		(5,019,429)
Net realized gains on sale of investments		(3,917,884)		(9,344,432)
Change in value of split-interest agreements		28,519		786,106
Discount on contributions receivable		229,219		(99,293)
Change in value of terminated split-value agreements		300,171		129,379
Depreciation and amortization		2,559,539		2,478,893
Loss on disposal of assets		3,310		22,908
Change in value of interest rate swap		174,975		177,071
Contributions for permanent restricted endowment		-		(2,289)
Contributed stock		52,428		65,962
Contributed property and equipment		(639,881)		-
Changes in assets and liabilities:				
(Increase) decrease in:				
Contributions receivable		(6,333,027)		(1,723,894)
Prepayments and other assets		253,580		(203,959)
Increase (decrease) in:		•		, , ,
Accounts payable and accrued expenses		1,569,908		1,867,281
Split-interest obligations		(588,055)		(71,398)
Net cash (used in) provided by operating activities	-	(279,312)		5,475,517
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Cash Flows From Investing Activities		101 550		(7.750)
Change in cash surrender value of life insurance		191,552		(7,752)
Purchases of long-term investments		(34,364,450)		(66,085,707)
Sales of long-term investments		41,447,274		63,243,640
Purchases of property, and equipment		(9,006,981)		(2,800,515)
Net cash used in investing activities		(1,732,605)		(5,650,334)
Cash Flows From Financing Activities				
Contributions for permanent restricted endowment		-		2,289
Principal payments on notes payable		(239,050)		(246,150)
Net cash used in financing activities		(239,050)		(243,861)
Net (decrease) in cash and cash equivalents		(2,250,967)		(418,678)
		(2,230,707)		(410,070)
Cash And Cash Equivalents				
Beginning		7,159,395		7,578,073
Ending	\$	4,908,428	\$	7,159,395
Cumplemental Disalogues Of Cook Flow Information				
Supplemental Disclosure Of Cash Flow Information:	.	102 (02	•	400.000
Interest paid	\$	193,602	\$	188,203
Cumplemental Cahadula Of Managah Invasting Activities				
Supplemental Schedule Of Noncash Investing Activities:	•	0.450	•	00.000
Contributed stock	\$	8,452	\$	60,880
Contributed property and equipment	\$	639,881	\$	-
Net, (decrease) increase in cash surrender value of life insurance	\$	(191,552)	\$	7,752
See Notes To Financial Statements.				

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 Foundation 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, the academic and policy communities, and its donors and the public at large. 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:

<u>Basis of accounting</u>: 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.

<u>Basis of presentation</u>: 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, temporarily restricted, and permanently restricted.

Unrestricted net assets – Net assets represent 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, 2008 and 2007, totaled \$74,490,655 and \$116,502,056, 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.

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

<u>Financial risk</u>: 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 balances.

Notes To Financial Statements

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

<u>Financial risk (continued)</u>: The Foundation invests in a professionally managed portfolio that contains corporate debt securities, U.S. government securities, equity securities, 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 would materially affect investment balances and the amounts reported in the financial statements.

<u>Contributed stock</u>: 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. Other investments such those in partnerships, hedge funds, trusts, LLCs and private equity are valued at fair value based on the applicable percentage of ownership of the underlying net assets as determined by the fund at the measurement date. In determining fair value, these funds use valuations provided by the underlying funds or partnerships. The underlying funds or partnerships value securities and other financial instruments on a fair value basis of accounting. The estimated fair values of certain investments of the underlying funds, 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 investments and may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may 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 fund's investment in partnerships, private placements or other securities generally represents the amount the fund would expect to receive if it were to liquidate its investment in those underlying investments, excluding any redemption charges that may apply. Furthermore, liquidity may be affected by gate provisions and holdbacks imposed by certain funds.

<u>Property and equipment</u>: 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.

<u>Derivative financial instruments</u>: 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 6). The interest rate swap exchanged the floating rate (one-month LIBOR plus 60 basis points) for a fixed effective rate of 5.99% for seven years and matures in 2010.

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, 2008 and 2007, was (\$283,807) and (\$108,831), respectively, and is included in long-term notes payable in the accompanying balance sheet.

Notes To Financial Statements

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

<u>Valuation of long-lived assets</u>: 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 2008 or 2007.

<u>Contributions receivable and revenue</u>: 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.

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, 2008 and 2007, there was no reserve for uncollectible amounts recorded.

<u>Cash surrender value of insurance</u>: 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.

<u>Split-interest agreements</u>: 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.

Notes To Financial Statements

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

<u>Allocation of joint costs</u>: The Foundation incurred joint costs of \$11,924,186 and \$8,983,109 for the years ended December 31, 2008 and 2007, respectively. The Foundation allocated these joint costs among program and fundraising expenses as follows:

	2008	2007
Educational programs for public information expense	\$ 9,239,466	\$ 5,165,004
Fundraising expense	 2,684,719	3,818,105
	\$ 11,924,185	\$ 8,983,109

<u>Donated materials</u>: 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 \$639,881 during the year ended December 31, 2008.

Advertising costs: Advertising costs are expensed when incurred. Total advertising expense was \$2,453,375 and \$253,244 for the years ended December 31, 2008 and 2007, respectively.

<u>Estimates</u>: 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.

<u>Reclassifications</u>: Certain items in the December 31, 2007 financial statements have been reclassified to conform to the December 31, 2008 financial statement presentation. The reclassifications had no effect on the previously reported change in net assets.

Recently issued accounting pronouncements: In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return including positions that the organization is exempt from income taxes or not subject to income taxes on unrelated business income. If there are changes in net assets as a result of application of FIN 48 these will be accounted for as an adjustment to the opening net asset balance, along with accompanying disclosures about the amounts of liabilities. The Foundation presently discloses or recognizes income tax positions based on management's estimate of whether it is reasonably possible or probable, respectively, that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, Accounting for Contingencies. The Foundation has elected to defer the application of FIN 48 in accordance with FASB Staff Position (FSP) FIN 48-3, which defers the effective date to fiscal years beginning after December 15, 2008. The Foundation will be required to adopt FIN 48 in its 2009 annual financial statements and management is currently assessing the impact of FIN 48 on its financial position and changes in net assets.

Effective January 1, 2008, the Foundation adopted SFAS No. 157, *Fair Value Measurements*, issued by FASB. SFAS No. 157 defines the fair value of 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, and sets out a fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and lowest priority to unobservable inputs (Level 3). Inputs are broadly defined under SFAS No. 157 as assumptions market participants would use in pricing as asset or liability. The Foundation has added the required disclosures in Note 4 of the financial statements.

Notes To Financial Statements

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

The Foundation adopted Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds, at the beginning of the 2008 year.* This standard prescribes new guidelines for expenditure of donor-restricted endowment funds, as well as the disclosures required. See Note 8 to the financial statements for details.

Note 2. Promises To Give

The following are unconditional promises to give at December 31, 2008 and 2007:

	2008	2007
Due in less than one year	\$ 9,060,539	\$ 6,360,741
Due in one to five years	7,527,000	3,938,535
Due in greater than five years	340,875	296,111
Total to be received	16,928,414	10,595,387
Less amounts representing discounting (2%-4.43%)	 (805,220)	(576,001)
	\$ 16,123,194	\$ 10,019,386

Note 3. Investments

Investments at December 31, 2008 and 2007, consist of the following:

	2008	2007
Investments in limited partnerships	\$ 26,597,588	\$ 15,479,495
Equity funds	20,227,325	83,939,074
Trusts and annuities	13,936,286	17,880,779
Hedge funds	11,613,449	-
Fixed income	8,621,713	14,907,542
Money market funds	7,605,970	4,292,568
Private equity	1,201,329	-
	\$ 89,803,660	\$ 136,499,458

The following summarizes investment income for the years ended December 31, 2008 and 2007:

	2008	2007
Net realized gain	\$ 3,917,884	\$ 9,344,432
Net unrealized (loss) gain	(43,530,858)	5,019,429
Interest and dividends	2,663,715	2,876,782
	\$ (36,949,259)	\$ 17,240,643

Notes To Financial Statements

Note 4. Fair Value Of Financial Instruments

The Foundation adopted Financial Accounting Standard No. 157, *Fair Value Measurements* ("FAS 157"), in 2008, with no material impact to the financial statements. FAS 157 requires disclosures of financial position in periods subsequent to initial recognition, whether the measurements are made on a recurring basis or a nonrecurring basis, establishes a framework for measuring fair value in GAAP and expands disclosure about fair market value measurements. This enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking quality and reliability of the information used to determine fair value. FAS 157 applies to all assets and liabilities that are being measured and reported on a fair value basis, and are disclosed in one of the following three categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
- Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.
- Level 3: Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, the Foundation performs a detailed analysis of the assets and liabilities that are subject to FAS 157. Available for sale securities, as well as the split interest agreement investments, are classified as Level 1 instruments because they comprise assets traded on public exchanges with readily determinable fair values and observable market based inputs. Partnerships, hedge funds, and other securities are classified as Level 2 instruments because they comprise equity interests in non-public entities; however, there are observable market based inputs upon which fair market value can be reasonably determined. The remaining investments are classified as Level 3 instruments, due to the fact that they represent closely held partnership interests, which are typically private and do not have observable market inputs, nor are they readily corroborated by broader market data.

Private equity investments are classified as Level 1 instruments because the Foundation made its initial investment in these funds in 2008. As of December 31, 2008, only 12% of capital committed to these funds has been called, and approximately 7% of that balance has been invested. Thus the fair value reported reflects mostly cash balances held by the funds in anticipation of future investment.

The interest rate swap connected to the Foundation's term loan financing is classified as a Level 2 instrument because its value is a function of the difference between the interest rate on the Foundation's note payable and the rate in the swap agreement; hence there are observable market based inputs.

Deferred compensation investments are composed of a cross-section of instruments, including assets traded on public exchanges (Level 1 portion), partnerships, hedge funds & other securities (Level 2 portion), as well as closely held partnership interests (Level 3 portion). Each of these is classified in the appropriate Level in accordance with the methodology stated above.

The estimated fair values of the Foundation's short-term financial instruments, including receivables, cash value of life insurance, and payables arising in the ordinary course of operations, approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization.

The fair value of the Foundation's notes payable approximates fair value as the interest rate on the underlying instruments fluctuate with market rates.

Notes To Financial Statements

Note 4. Fair Value Of Financial Instruments (Continued)

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by hierarchy level.

		December 31, 2008					
Description	Total		Level 1	_	Level 2		Level 3
Available for sale securities	\$ 36,302,842	\$	36,302,842	\$	-	\$	-
Partnerships, hedge funds & other securities	38,363,204		-		38,211,037		152,167
Private investments	1,201,329		1,201,329		-		-
Deferred compensation investments	2,603,294		1,650,885		897,064		55,345
Split interest agreement investments	 13,936,285		13,936,285		-		-
Total Assets	\$ 92,406,954	\$	53,091,341	\$	39,108,101	\$	207,512
Interest rate swap liability	\$ 283,807	\$	-	\$	283,807	\$	-
Total Liabilities	\$ 283,807	\$	-	\$	283,807	\$	-

For assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period, FAS 157 requires reconciliation of the beginning and ending balances, separately for each major category of assets and liabilities, except for derivative assets and liabilities, which may be presented net. The table below represents the reconciliation of the Foundation's assets measured at fair value on a recurring basis using significant unobservable inputs.

	rtnerships & edge Funds	Deferred mpensation
Beginning balance of assets	\$ 152,167	\$ 56,336
Total gains or losses (realized/unrealized) or change in value recorded in revenue	-	(991)
Transfers in and/or out of Level 3	-	-
Ending balance of assets	\$ 152,167	\$ 55,345

Note 5. Property And Equipment

Property and equipment and accumulated depreciation consist of the following at December 31, 2008 and 2007:

	2008	2007
Land, building, and improvements	\$ 54,392,525	\$ 46,398,104
Office furniture and equipment	8,572,391	7,171,372
	62,964,916	53,569,476
Less accumulated depreciation	 (17,660,428)	(15,349,001)
Property and equipment, net	\$ 45,304,488	\$ 38,220,475

Depreciation expense for the years ended December 31, 2008 and 2007, totaled \$2,559,539 and \$2,478,893, respectively.

Notes To Financial Statements

Note 6. Notes Payable

Notes payable as of December 31, 2008 and 2007, are as follows:

	2008	2007
Note payable (construction and building improvements) –		
fixed rate (5.99% at December 31, 2008)	\$ 3,949,999	\$ 4,149,999
Note payable (office equipment) – interest free	10,919	49,969
Interest rate swap liability (Note 1)	283,807	108,832
Mortgage note payable	 10,000	10,000
	 4,254,725	4,318,800
Less current portion	(3,960,918)	(242,600)
Notes payable, long term	\$ 293,807	\$ 4,076,200

Note Payable (Construction and Building Improvements) - The Foundation obtained 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 5.99% 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 swap agreement permits the balloon payment to be re-financed, without disturbing the original agreement, to September 2010, and the Foundation plans to take advantage of this option. 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, 2008 and 2007, the Foundation was in compliance with these covenants.

Line of Credit - The Foundation has a \$2 million, annually renewed, 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, 2008 and 2007.

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 (5.825% at December 31, 2008) 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, 2008, are as follows:

Voore	Ending	December	21
Years	-naina	December	.5 I

2009 2010	\$ 3,960,918 293,807
	\$ 4,254,725

Notes To Financial Statements

Note 7. 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 \$1,395,214 and \$907,407 for the years ended December 31, 2008 and 2007, 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 \$766,845 and \$942,159 at December 31, 2008 and 2007, respectively, are includable on the Foundation's balance sheet within deferred compensation obligations.

The total market value of all deferred compensation investments and the related deferred compensation obligations to employees was \$2,603,294 and \$3,519,555 at December 31, 2008 and 2007, respectively.

Note 8. Restricted Net Assets

In August 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds.* FAS 117-1 addresses accounting issues related to guidelines in the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), which was adopted by the National Conferences of Commissioners on Uniform State Laws in July 2006. Management has interpreted UPMIFA as requiring the preservation of the fair value of original donor-restricted contributions as of the date of the gift, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (a) the original value of permanently restricted cash contributions and (b) the discounted value of future permanently restricted cash contributions, net of allowance for uncollectible pledges. The remaining portion of donor-restricted cash contributions are classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted cash contributions:

- The purposes of the Foundation and donor-restricted endowment fund
- The duration and preservation of the fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other available financial resources
- Investment policies

The Foundation has adopted investment and spending policies for permanently restricted cash contributions that attempt to provide a predictable stream of funding to programs while maintaining purchasing power. All earnings from these funds are reflected as temporarily restricted net assets until appropriated for program expenditures.

Notes To Financial Statements

Note 8. Restricted Net Assets (Continued)

Temporarily restricted net assets at December 31, 2008 and 2007, consist of the following:

	2008	2007
Contributions restricted by passage of time	\$ 17,033,075	\$ 13,419,755

Permanently restricted net assets represent funds that are subject to donor-imposed restrictions requiring the corpus to be held in perpetuity. At December 31, 2008 and 2007, permanently restricted net assets consist of the following:

		2008		2007
William E. Simon Fellow – Study of Religion and Free Society Westerman Intern Program	\$	1,000,000 100,000	\$	1,000,000
John R. & Margrite Davis Intern Endowment	\$	100,000 1,200,000	S	1,200,000
	Ψ	1,200,000	Ψ	1,200,000

Note 9. 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, 2008, are as follows:

Years Ending Decemb	er	31	١,
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2009	\$ 126,2	42
2010	125,8	
2011	125,8	
2012	10,4	84
	\$ 388,3	40

Expense incurred under these leases for the years ended December 31, 2008 and 2007, totaled \$115,943 and \$142,218, respectively.

Note 10. Related Party Transactions

During 2008, 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, 2008, through August 31, 2009. Annual lease payments total \$51,652. Lease payments relating to this lease amounted to approximately \$17,217 during the year ended December 31, 2008. Future minimum lease payments relating to this lease will amount to approximately \$34,434 for the year ending December 31, 2009. Rental income recognized during the years ended December 31, 2008 and 2007 was \$49,860 and \$48,964, respectively.

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

McGladry of Pullen, LCP

Vienna, Virginia July 8, 2009

The Heritage Foundation

Schedule Of Functional Expenses Year Ended December 31, 2008

	Program Services													
	Re	esearch	G	Media and overnment Relations		Educational Programs		Total		lanagement nd General	F	und-raising	Total	Total Expenses
Supplies	\$	298,766	\$	135,815	\$	40,775	\$	475,356	\$	17,703	\$	66,196	\$ 83,899	\$ 559,255
Telephone		226,279		123,183		30,513		379,975		11,284		38,945	50,229	430,204
Leased equipment		89,431		75,904		41,944		207,279		6,122		-	6,122	213,401
Staff training		212,448		93,440		35,512		341,400		47,773		23,367	71,140	412,540
Postage and freight		167,674		119,883		3,421,706		3,709,263		4,237		1,619,385	1,623,622	5,332,885
Professional fees		129,646		101,747		37,196		268,589		78,235		3,409	81,644	350,233
Rent		72,745		42,683		11,513		126,941		5,058		11,808	16,866	143,807
Occupancy charges		854,923		499,801		134,790		1,489,514		58,395		1,232	59,627	1,549,141
Insurance		82,833		48,602		13,109		144,544		12,606		2,923	15,529	160,073
Data processing		11,568		6,728		1,815		20,111		20,271		81,163	101,434	121,545
Photography, copying, and recording		24,628		58,583		3,512		86,723		360		40,158	40,518	127,241
Books		40,363		13,216		3,641		57,220		1,943		57,052	58,995	116,215
Subscriptions		151,694		143,114		6,752		301,560		8,260		9,621	17,881	319,441
Taxes and licenses		209,103		83,966		29,696		322,765		82,501		5,543	88,044	410,809
Maintenance		128,292		75,062		20,869		224,223		8,742		-	8,742	232,965
Travel and subsistence		53,199		28,133		3,065		84,397		2,619		401,440	404,059	488,456
Miscellaneous		17,997		6,038		90,629		114,664		1,219		56,338	57,557	172,221
Printing and mailing		91,925		186,221		4,879,026		5,157,172		2,379		2,891,883	2,894,262	8,051,434
Conferences		2,629,441		1,163,655		72,555		3,865,651		53,911		1,316,347	1,370,258	5,235,909
Advertising		34,832		2,327,039		12,060		2,373,931		3,775		75,669	79,444	2,453,375
Other programs and grants		36,909		32,263		3,847		73,019		1,664		1,250	2,914	75,933
Salaries		11,957,538		5,452,283		1,311,787		18,721,608		865,711		2,400,436	3,266,147	21,987,755
Fringe benefits		2,696,256		1,122,179		378,958		4,197,393		170,508		502,822	673,330	4,870,723
Scholars and consultants		1,790,887		1,068,922		1,806,877		4,666,686		46,536		2,074,714	2,121,250	6,787,936
Honoraria and writer's fees		136,351		17,745		71,980		226,076		750		62,250	63,000	289,076
Temporary assistance and agency fees		91,557		12,099		254,968		358,624		8,862		31,770	40,632	399,256
Agency fees		75,425		19,905		5,369		100,699		11,100		3,700	14,800	115,499
On-line service fees		189,058		144,523		124,316		457,897		7,794		19,465	27,259	485,156
Interest expense		106,759		62,640		16,895		186,294		7,308		-	7,308	193,602
Depreciation and amortization		1,411,418		828,138		223,367		2,462,923		96,616		-	96,616	2,559,539
Total expenses	\$ 2	24,019,945	\$	14,093,510	\$	13,089,042	\$	51,202,497	\$	1,644,242	\$	11,798,886	\$ 13,443,128	\$ 64,645,625

The Heritage Foundation

Schedule Of Functional Expenses Year Ended December 31, 2007

	 Program Services									Supporting Services							
	Research	G	Media and overnment Relations		Educational Programs		Total		anagement nd General		Fund-raising		Total	-	Total Expenses		
Supplies	\$ 283,117	\$	87,637	\$	57,693	\$	428,447	\$	13,788	\$	29,497	\$	43,285	\$	471,732		
Telephone	199,455		90,204		30,301		319,960		10,905		25,106		36,011		355,971		
Leased equipment	157,132		63,965		26,264		247,361		10,447		, <u> </u>		10,447		257,808		
Staff training	208,559		58,109		44,264		310,932		10,104		6,934		17,038		327,970		
Postage	106,190		112,295		2,518,462		2,736,947		4,095		1,213,406		1,217,501		3,954,448		
Professional fees	180,970		67,926		49,222		298,118		59,202		817		60,019		358,137		
Rent	33,352		13,577		8,724		55,653		2,235		3,655		5,890		61,543		
Occupancy charges	848,865		345,314		141,785		1,335,964		56,396		50		56,446		1,392,410		
Insurance	118,687		48,314		19,838		186,839		7,891		_		7,891		194,730		
Data processing	12,655		5,108		2,097		19,860		16,044		127,066		143,110		162,970		
Photography, copying, and recording	28,441		37,616		7,385		73,442		672		22,712		23,384		96,826		
Books	61,186		36,747		37,675		135,608		6,574		114,466		121,040		256,648		
Subscriptions	99,592		86,698		6,672		192,962		4,413		5,122		9,535		202,497		
Taxes and licenses	151,695		26,701		18,884		197,280		52,670		7,643		60,313		257,593		
Maintenance	91,737		42,990		15,581		150,308		6,061		, <u>-</u>		6,061		156,369		
Travel and subsistence	57,055		23,149		32,342		112,546		1,153		265,393		266,546		379,092		
Miscellaneous	22,446		7,432		78,831		108,709		1,587		47,300		48,887		157,596		
Printing and mailing	25,264		60,974		3,581,822		3,668,060		863		1,565,454		1,566,317		5,234,377		
Conferences	2,159,351		920,593		87,222		3,167,166		50,778		854,102		904,880		4,072,046		
Advertising	45,018		20,462		11,398		76,878		1,813		174,553		176,366		253,244		
Other programs and grants	37,938		13,698		4,001		55,637		2,138		386		2,524		58,161		
Salaries	10,214,844		4,281,146		1,459,677		15,955,667		739,824		1,828,095		2,567,919		18,523,586		
Fringe benefits	2,163,398		844,477		399,000		3,406,875		154,456		396,784		551,240		3,958,115		
Scholars and consultants	1,163,276		261,587		1,353,705		2,778,568		23,028		1,273,711		1,296,739		4,075,307		
Honoraria and writer's fees	116,269		3,556		26,337		146,162		1,752		825		2,577		148,739		
Temporary assistance and agency fees	24,967		624		22,275		47,866		126		11,041		11,167		59,033		
Agency fees	7,314		2,977		1,223		11,514		486		-		486		12,000		
On-line service fees	92,987		53,255		51,207		197,449		4,184		46,570		50,754		248,203		
Interest expense	114,517		46,594		19,132		180,243		7,961		-		7,961		188,204		
Depreciation and amortization	1,510,867		615,038		252,539		2,378,444		100,448		_		100,448		2,478,892		
Total expenses	\$ 20,337,144	\$	8,278,763	\$	10,365,558	\$	38,981,465	\$	1,352,094	\$	8,020,688	\$	9,372,782	\$	48,354,247		