

**THE AMERICAN RED CROSS**

Consolidated Financial Statements

June 30, 2006

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
2001 M Street, NW  
Washington, DC 20036

## **Independent Auditors' Report**

The Board of Governors  
The American Red Cross:

We have audited the accompanying consolidated statement of financial position of the American Red Cross as of June 30, 2006, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended. These consolidated financial statements are the responsibility of management of the American Red Cross. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We did not audit the financial statements of certain chapters, which statements reflect total assets constituting 11 percent and total revenues and gains constituting 23 percent of the related consolidated totals. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for such chapters, is based solely on the reports of the other auditors. The prior year summarized comparative information has been derived from the American Red Cross' 2005 consolidated financial statements and, in our report dated September 30, 2005, we expressed an unqualified opinion on those consolidated financial 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the American Red Cross' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the American Red Cross as of June 30, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

January 5, 2007



**DEPARTMENT OF THE ARMY  
U.S. ARMY AUDIT AGENCY  
OFFICE OF THE AUDITOR GENERAL  
3101 PARK CENTER DRIVE  
ALEXANDRIA, VA 22302-1596**

A-2007-0050-FFM

19 March 2007

## Independent Auditor's Report

This report presents the results of our review of the independent certified public accountant's audit of the American Red Cross consolidated financial statements for the fiscal year ended 30 June 2006. In the auditor's opinion, the American Red Cross statements are presented, in all material respects, in accordance with accounting principles generally accepted in the United States.

The Act of Congress that incorporated the American Red Cross, as implemented by DOD Directive 1330.5 and AR 930-5, requires U.S. Army Audit Agency to perform an annual audit of the consolidated financial statements of the American Red Cross. The American Red Cross contracted with the certified public accounting firm of KPMG LLP as the principal auditor to perform the financial audit of its 2006 consolidated financial statements. To fulfill our audit responsibilities, avoid duplication and unnecessary expense, and make the most efficient use of our resources, we reviewed the principal auditor's work and reports.

The American Red Cross is the instrument chosen by an Act of Congress, approved January 5, 1905, to help carry out obligations the United States assumed under certain international treaties known as the Geneva or Red Cross Conventions. Its congressional charter imposes on the American Red Cross the duties to act as the medium of voluntary relief and communications between the American people and the Armed Forces, and to carry on a system of national and international relief to prevent and mitigate suffering caused by disasters.

We conducted our review of the principal auditor's work in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. To determine the reasonableness of the principal auditor's work and the extent to which we could rely on it, we:

- Reviewed the principal auditor's approach and planning of the audit.
- Evaluated the qualifications and independence of the audit staff.
- Reviewed the consolidated financial statements and principal auditor's report to evaluate compliance with generally accepted accounting principles.

- Reviewed and tested the principal auditor's working papers to determine (i) the nature, timing, and extent of audit work performed; (ii) the extent of audit quality control methods the auditor used; (iii) whether a study and evaluation was conducted of the entity's internal accounting controls; and (iv) whether the evidence in the working papers supported the principal auditor's opinion on the consolidated financial statements.

In the opinion of KMPG LLP, the American Red Cross consolidated financial statements present fairly, in all material respects, its financial position as of June 30, 2006 and the related statement of activities, functional expenses, the changes in its net assets, and its cash flow for the year ended, in conformity with accounting principles generally accepted in the United States. Also, KPMG LLP's report to the American Red Cross on internal controls did disclose a material weakness in the design and operation of controls related to financial assistance. However, this material weakness did not have a material effect on the financial statements.

We found nothing during our review to indicate that KPMG LLP's opinion on the American Red Cross 2006 consolidated financial statements is inappropriate or cannot be relied on.

During the course of its audit, KPMG LLP also identified several matters that, although not material to the financial statements, were communicated to the American Red Cross for consideration in a separate management letter.

We believe the consolidated financial statements, together with the KPMG LLP opinion and our review of that work, provide Congress with a dependable basis for evaluating the financial position of the American Red Cross. This report presents the American Red Cross consolidated financial statements and the auditor's opinion thereon.

We are sending copies of this report to the American Red Cross Board of Governors.

  
PATRICK J. FITZGERALD, CPA  
The Auditor General

## THE AMERICAN RED CROSS

### Consolidated Statement of Financial Position

June 30, 2006  
 (with comparative information as of June 30, 2005)  
 (In thousands)

<b>Assets</b>	<b>2006</b>	<b>2005</b>
Current assets:		
Cash and cash equivalents	\$ 427,573	\$ 292,559
Investments (Notes 7, 8, and 13)	1,104,975	741,504
Trade receivables, including grants, net of allowance for doubtful accounts of \$2,674 in 2006 and \$9,836 in 2005	133,748	251,806
Contributions receivable (Note 2)	97,121	102,555
Inventories, net of allowance for obsolescence of \$618 in 2006 and \$549 in 2005	121,831	152,060
Other current assets	17,608	17,252
<b>Total current assets</b>	<b>1,902,856</b>	<b>1,557,736</b>
Investments (Notes 7, 8, and 13)	1,333,560	1,217,875
Contributions receivable (Note 2)	23,211	22,712
Pension intangible asset (Note 9)	-	10,555
Land, buildings, and other property, net (Note 3)	1,165,790	1,098,840
Other assets (Note 8)	87,579	59,604
<b>Total assets</b>	<b>4,512,996</b>	<b>3,967,322</b>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	416,299	385,203
Current portion of debt (Note 4)	42,127	86,697
Postretirement benefits (Note 9)	31,302	27,095
Other current liabilities (Note 8)	24,960	20,451
<b>Total current liabilities</b>	<b>514,688</b>	<b>519,446</b>
Debt (Note 4)	389,023	340,695
Pension and postretirement benefits (Note 9)	306,448	361,815
Other liabilities (Note 8)	117,274	99,245
<b>Total liabilities</b>	<b>1,327,433</b>	<b>1,321,201</b>
Net assets (Note 6):		
Unrestricted net assets	1,596,067	1,319,460
Temporarily restricted net assets	1,095,221	856,594
Permanently restricted net assets	494,275	470,067
<b>Total net assets</b>	<b>3,185,563</b>	<b>2,646,121</b>
Commitments and contingencies (Notes 4, 5, 12, 13 and 14)		
<b>Total liabilities and net assets</b>	<b>\$ 4,512,996</b>	<b>\$ 3,967,322</b>

See accompanying notes to the consolidated financial statements.

## THE AMERICAN RED CROSS

### Consolidated Statement of Activities

Year ended June 30, 2006  
(with summarized information for the year ended June 30, 2005)  
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2006	2005
Operating revenues and gains:					
Contributions:					
Corporate, foundation and individual giving	\$ 258,002	\$ 2,387,042	\$ -	\$ 2,645,044	\$ 976,674
United Way and other federated	60,025	102,275	-	162,300	158,990
Legacies and bequests	59,666	9,609	23,412	92,687	118,235
Services and materials	25,126	213,215	-	238,341	67,594
Grants	33,520	40,932	-	74,452	55,766
Products and services:					
Biomedical	2,165,172	-	-	2,165,172	2,137,209
Program materials	141,300	387	-	141,687	149,432
Contracts, including federal government	311,435	-	-	311,435	83,307
Investment income (Note 7)	108,570	1,409	-	109,979	68,615
Other revenues	67,528	-	-	67,528	103,435
Net assets released from restrictions	2,517,098	(2,517,098)	-	-	-
<b>Total operating revenues and gains</b>	<b>5,747,442</b>	<b>237,771</b>	<b>23,412</b>	<b>6,008,625</b>	<b>3,919,257</b>
Operating expenses:					
Program services:					
Armed Forces Emergency Services	54,096	-	-	54,096	58,646
Biomedical services (Notes 12 and 13)	2,103,572	-	-	2,103,572	2,161,078
Community services	133,467	-	-	133,467	128,548
Domestic disaster services	2,630,766	-	-	2,630,766	411,187
Health and safety services	224,594	-	-	224,594	220,385
International relief and development services	154,283	-	-	154,283	157,132
<b>Total program services</b>	<b>5,300,778</b>	<b>-</b>	<b>-</b>	<b>5,300,778</b>	<b>3,136,976</b>
Supporting services:					
Fund raising (Note 10)	140,082	-	-	140,082	118,568
Management and general	187,249	-	-	187,249	172,325
<b>Total supporting services</b>	<b>327,331</b>	<b>-</b>	<b>-</b>	<b>327,331</b>	<b>290,893</b>
<b>Total operating expenses</b>	<b>5,628,109</b>	<b>-</b>	<b>-</b>	<b>5,628,109</b>	<b>3,427,869</b>
Change in net assets from operations	119,333	237,771	23,412	380,516	491,388
Nonoperating gains (Notes 4 and 7)	62,804	856	796	64,456	48,222
Additional minimum pension liability (Note 9)	94,470	-	-	94,470	(94,470)
Change in net assets	276,607	238,627	24,208	539,442	445,140
Net assets, beginning of year	1,319,460	856,594	470,067	2,646,121	2,200,981
<b>Net assets, end of year</b>	<b>\$ 1,596,067</b>	<b>\$ 1,095,221</b>	<b>\$ 494,275</b>	<b>\$ 3,185,563</b>	<b>\$ 2,646,121</b>

See accompanying notes to the consolidated financial statements.

**THE AMERICAN RED CROSS**

Statement of Functional Expenses

Year ended June 30, 2006  
(with summarized information for the year ended June 30, 2005)  
(In thousands)

	Program Services							Total Program Services
	Armed Forces Emergency Services	Biomedical Services	Community Services	Domestic Disaster Services	Health and Safety Services	Int'l Relief & Development Services		
Salaries and wages	\$ 29,618	\$ 856,075	\$ 54,146	\$ 96,679	\$ 101,259	\$ 15,161	\$ 1,152,938	
Employee benefits	8,895	259,663	15,993	28,837	28,808	4,783	346,979	
Subtotal	38,513	1,115,738	70,139	125,516	130,067	19,944	1,499,917	
Travel and maintenance	1,063	31,074	3,031	108,732	3,829	2,992	150,721	
Equipment maintenance and rental	953	72,720	5,678	57,057	4,769	1,213	142,390	
Supplies and materials	1,492	449,347	17,791	49,284	41,000	1,286	560,200	
Contractual services	7,521	386,307	19,005	176,475	33,654	8,212	631,174	
Financial and material assistance	2,941	717	12,340	2,101,941	3,039	120,022	2,241,000	
Depreciation and amortization	1,613	47,669	5,483	11,761	8,236	614	75,376	
Total expenses	\$ 54,096	\$ 2,103,572	\$ 133,467	\$ 2,630,766	\$ 224,594	\$ 154,283	\$ 5,300,778	

	Supporting Services					
	Fund Raising	Management and General	Total Supporting Services	Total Expenses		
				2006	2005	
Salaries and wages	\$ 47,473	\$ 83,984	\$ 131,457	\$ 1,284,395	\$ 1,285,965	
Employee benefits	13,853	25,978	39,831	386,810	374,082	
Subtotal	61,326	109,962	171,288	1,671,205	1,660,047	
Travel and maintenance	2,614	5,098	7,712	158,433	74,248	
Equipment maintenance and rental	1,523	5,009	6,532	148,922	95,359	
Supplies and materials	21,512	3,971	25,483	585,683	517,207	
Contractual services	49,277	46,543	95,820	726,994	659,822	
Financial and material assistance	1,248	1,399	2,647	2,243,647	322,984	
Depreciation and amortization	2,582	15,267	17,849	93,225	98,202	
Total expenses	\$ 140,082	\$ 187,249	\$ 327,331	\$ 5,628,109	\$ 3,427,869	

See accompanying notes to the consolidated financial statements.

## THE AMERICAN RED CROSS

### Consolidated Statement of Cash Flows

Year ended June 30, 2006

(with comparative information for the year ended June 30, 2005)

(In thousands)

	2006	2005
Cash flows from operating activities:		
Change in net assets	\$ 539,442	\$ 445,140
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	93,225	98,202
Provision for doubtful accounts receivable	(3,307)	3,341
Provision for obsolete inventory	(73)	41
Net gain on sales of property	(53,738)	(76,572)
Net investment and derivative gains	(82,776)	(56,323)
Additional minimum pension liability	(94,470)	94,470
Permanently restricted contributions	(23,412)	(40,216)
Changes in operating assets and liabilities:		
Receivables	126,300	(15,140)
Inventories	30,302	17,253
Other assets	(28,331)	(2,560)
Pension intangible asset	10,555	(10,555)
Accounts payable and accrued expenses	31,096	19,949
Other liabilities	24,030	(4,362)
Pension and postretirement benefits	43,310	54,675
<b>Net cash provided by operating activities</b>	<b>612,153</b>	<b>527,343</b>
Cash flows from investing activities:		
Purchases of property	(172,167)	(206,616)
Proceeds from sales of property	66,068	89,013
Purchases of investments	(743,001)	(1,016,903)
Proceeds from sales of investments	347,847	525,735
<b>Net cash used in investing activities</b>	<b>(501,253)</b>	<b>(608,771)</b>
Cash flows from financing activities:		
Permanently restricted contributions	20,694	36,658
Proceeds from borrowings	441,640	14,049
Repayments of debt	(438,220)	(30,924)
<b>Net cash provided by financing activities</b>	<b>24,114</b>	<b>19,783</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>135,014</b>	<b>(61,645)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>292,559</b>	<b>354,204</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 427,573</b>	<b>\$ 292,559</b>
Supplemental disclosures of cash flow information		
Cash paid during the year for interest	\$ 21,729	\$ 17,629
Noncash investing and financing transactions:		
Acquisition of equipment under capital lease agreement:	338	947
Donated stock and beneficial interest in perpetual trust:	17,628	9,001

See accompanying notes to the consolidated financial statements



# THE AMERICAN RED CROSS

## Notes to Consolidated Financial Statements

June 30, 2006

(With summarized information for the year ended June 30, 2005)

### (1) Summary of Significant Accounting Policies

**Organization and Basis of Presentation:** The American Red Cross (the Organization) was established by an Act of the United States Congress on January 5, 1905 for the primary purposes of furnishing volunteer aid to the sick and wounded of the Armed Forces in time of war and to carry on a system of national and international relief in time of peace to mitigate the suffering caused by fire, famine, floods and other great natural calamities. The mission of the Organization has expanded since that time to help people prevent, prepare for, and respond to emergencies.

The accompanying consolidated financial statements present the consolidated financial position and changes in net assets and cash flows of the Organization. The Organization has national and international programs that are conducted by its headquarters, biomedical services, and chartered local chapters. Also included in the consolidated financial statements are the net assets and operations of Boardman Indemnity Ltd., a 100 percent-owned captive insurance subsidiary. All significant intra-organizational accounts and transactions have been eliminated.

Program activities include armed forces emergency services, biomedical services, community services, disaster services, health and safety services, and international services. Biomedical services includes activities associated with the collection, processing, testing, and distribution of whole blood and components at 35 local blood services region operations, five national testing laboratories, a biomedical research facility, and related national support functions.

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Organization and changes therein are classified and reported as follows:

*Unrestricted net assets* – Net assets that are not subject to any donor-imposed stipulations.

*Temporarily restricted net assets* – Net assets subject to donor-imposed restrictions on their use that may be met either by actions of the Organization or the passage of time.

*Permanently restricted net assets* – Net assets subject to donor-imposed or other legal restrictions requiring that the principal be maintained permanently by the Organization. Generally, the donors permit the Organization to use all or part of the income earned for either general or donor-specified purposes.

The consolidated financial statements are presented with certain prior year summarized comparative information. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Organization's consolidated financial statements for the year ended June 30, 2005, from which the summarized information was derived.

# THE AMERICAN RED CROSS

## Notes to Consolidated Financial Statements

June 30, 2006

(With summarized information for the year ended June 30, 2005)

**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 in the financial statements. Estimates and assumptions may also affect disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses. Actual results could differ from management's estimates.

**Cash Equivalents:** The Organization considers all highly liquid investments purchased with an average maturity of three months or less to be cash equivalents. Cash equivalents consisted of money market mutual funds and overnight investments of approximately \$250 million and \$154 million as of June 30, 2006 and 2005, respectively.

**Investments:** Investments are reported at fair value. The separately managed endowment fund accumulates realized gains and losses on security transactions which are available to meet current expenses to the extent approved by the Board of Governors. Amounts annually available for expenditure are based on the Board of Governors' approved spending rate used under the total-return method.

Investment income classified as operating revenue consists of interest and dividend income on investments and any gains approved for use in operations. All other realized and unrealized gains or losses are classified as nonoperating activity and are available to support operations in future years and to offset potential market declines.

Investments classified as current are available for operations in the next fiscal year.

**Derivative Financial Instruments:** The Organization makes limited use of derivative financial instruments for the purpose of managing interest rate risk. Derivative financial instruments are recorded at their fair value.

**Fair Values of Financial Instruments:** Various methods and assumptions were used to estimate the fair value of each class of financial instruments. Cash and cash equivalents are valued at their carrying amount due to their short maturities. Investments are reported at fair value based on quoted market prices or, in the case of alternative investments, at estimated values provided by the fund managers or general partners based on quoted market prices, if available, or other valuation methods. Management reviews and evaluates the values provided by the fund manager and general partners and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Debt is valued at rates currently available to the Organization for issuances with similar terms and remaining maturities. Interest rate swap agreements are valued at the net present value of future cash flows attributable to the difference between the contractual variable and fixed rates in those agreements.

# THE AMERICAN RED CROSS

## Notes to Consolidated Financial Statements

June 30, 2006

(With summarized information for the year ended June 30, 2005)

The estimated fair value of the Organization's noncurrent debt was as follows at June 30, 2006 and 2005 (in thousands):

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Noncurrent debt	\$ 389,023	\$ 391,444	\$ 340,695	\$ 348,664

The carrying value of all other financial instruments approximates fair value.

**Endowment Fund:** The Organization has maintained a national endowment fund since 1905. Since 1910, as stated in the bylaws of the Organization, and because of public declarations as to their intended use, gifts to the American Red Cross national headquarters under wills, trusts, and similar instruments which do not direct some other use of such funds are recorded as permanently restricted endowment funds to be kept and invested as such in perpetuity. Based upon the manner in which the Organization has solicited and continues to solicit such gifts, it has been determined by independent legal counsel that such gifts must be placed in the endowment fund and, accordingly, reported as permanently restricted net assets.

The Organization makes distributions from the endowment fund for current operations using the total return method. Under the total return method, fund distributions consist of net investment income and may, under certain conditions, include a portion of the cumulative realized gains. The Board of Governors approves the endowment fund spending rate, calculated as a percentage of the three-year calendar moving average fair value of the endowment fund at the beginning of each fiscal year.

A spending rate of 5.5 percent was applied to the endowment fund, and resulted in total distributions related to the endowment fund of approximately \$27 million in each year for the years ended June 30, 2006 and 2005. Approximately \$13 million and \$17 million represented utilization of accumulated realized gains for the years ended June 30, 2006 and 2005, respectively.

**Inventories:** Inventories of supplies purchased for use in program and supporting services are carried at the lower of first-in, first-out cost or market. Whole blood and its components are valued at the lower of average cost or market.

# THE AMERICAN RED CROSS

## Notes to Consolidated Financial Statements

June 30, 2006

(With summarized information for the year ended June 30, 2005)

**Land, Buildings, and Other Property:** Purchases of land, buildings, and other property having a unit cost per established guidelines and a useful life of three or more years are capitalized at cost. Donated assets are capitalized at the estimated fair value at date of receipt. Interest expense incurred during a period of construction, less related interest income earned on proceeds of tax-exempt borrowings, is capitalized. Property under capital leases is amortized over the lease term. Any gain or loss on the sale of land, buildings and other property is reported as other revenues on the consolidated statement of activities.

Application development costs incurred to develop internal-use software are capitalized and amortized over the expected useful life of the software application. Activities that are considered application development include design of software configuration and interfaces, coding, installation of hardware, and testing. All other expenses incurred to develop internal-use software are expensed as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

<u>Class of property</u>	<u>Useful life in years</u>
Buildings	45
Building improvements	10
Equipment and software	3-15

**Property and Casualty Insurance:** The Organization maintains various insurance policies under which it assumes a portion of each insured loss. Assumed losses are retained by the Organization through its wholly owned insurance subsidiary, Boardman Indemnity Ltd. (Boardman). The Organization also purchases insurance to supplement the coverage by Boardman. The liabilities for outstanding losses and incurred but not reported claims have been determined based on actuarial studies and are reported as other liabilities in the consolidated statement of financial position, and were approximately \$90 million and \$79 million at June 30, 2006 and 2005, respectively.

**Revenue Recognition:** Contributions, which include unconditional promises to give (pledges), are recognized as revenues in the period received or promised. Conditional contributions are recorded when the conditions have been met. Contributions are considered to be unrestricted unless specifically restricted by the donor.

The Organization reports contributions in the temporarily or permanently restricted net asset class if they are received with donor stipulations as to their use. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are released and reclassified to unrestricted net assets in the consolidated statement of activities. Donor-restricted contributions are initially reported in the temporarily restricted net asset class, even if it is anticipated such restrictions will be met in the current reporting period.

Products and services revenue, which arises principally from sales of whole blood and components and health and safety course fees, is generally recognized upon delivery of the product or services to the customer.

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## Notes to Consolidated Financial Statements

June 30, 2006

(With summarized information for the year ended June 30, 2005)

Revenues from federal agencies are generally reported as unrestricted contract revenue as qualifying expenses are incurred under the agreement.

Gains and losses on investments and other assets and liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law.

**Contributed Services and Materials:** Contributed services are reported at fair value in the financial statements for voluntary donations of services when those services (1) create or enhance non-financial assets or (2) require specialized skills provided by individuals possessing those skills and are services which would be typically purchased if not provided by donation. The Organization recorded contributed services revenue, and related expense, for the years ended June 30, 2006 and 2005 of approximately \$142 million and \$24 million, respectively, mostly in support of the disaster services program.

Donated materials are recorded at their fair value at the date of the gift. The Organization does not imply time restrictions for gifts of long-lived assets. As a result, in the absence of donor-imposed restrictions, gifts of long-lived assets are reported as unrestricted revenue.

**Research and Development Costs:** Since 1956, the Organization has engaged in blood research to further enhance the safety of the blood supply. For the years ended June 30, 2006 and 2005, research and development expenses incurred by Biomedical Services were approximately \$11 million and \$19 million, respectively.

**Income Taxes:** The American Red Cross is a not-for-profit organization incorporated by the U.S. Congress through the issuance of a federal charter. The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, except on net income derived from unrelated business activities.

**Accounts Receivable Securitization:** The Organization has an accounts receivable securitization program whereby the Organization sells receivables in securitization transactions and retains a subordinated interest and servicing rights to those receivables. The Organization accounts for the program under FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities." The gain or loss on sales of receivables is determined at the date of transfer based upon the relative fair value of the assets sold and the interests retained. The Organization estimates fair value based on the present value of future expected cash flows using management's best estimates of the key assumptions, including collection period and discount rates. See Note 10.

**Reclassifications:** Certain 2005 balances have been reclassified to conform to the 2006 presentation.

## THE AMERICAN RED CROSS

### Notes to Consolidated Financial Statements

June 30, 2006

(With summarized information for the year ended June 30, 2005)

#### (2) Contributions Receivable

The Organization anticipates collection of outstanding contributions receivable as follows at June 30, 2006 and 2005 (in thousands):

	<b>2006</b>	<b>2005</b>
Amount receivable within one year	\$ 98,962	\$ 105,308
Amount receivable in 1 to 5 years	23,211	22,712
Total contributions receivable before allowance for uncollectible amounts	122,173	128,020
Less allowance for uncollectible amounts	(1,841)	(2,753)
Contributions receivable, net	120,332	125,267
Less current portion	(97,121)	(102,555)
Contributions receivable, net, noncurrent	\$ 23,211	\$ 22,712

Amounts presented above have been discounted to present value using rates averaging approximately 3 percent. The Organization had commitments from donors for conditional contributions approximating \$3 million and \$4 million at June 30, 2006 and 2005, respectively. These pledges will be accrued in future periods as the conditions are met.

#### (3) Land, Buildings, and Other Property

The cost and accumulated depreciation of land, buildings, and other property were as follows at June 30, 2006 and 2005 (in thousands):

	<b>2006</b>	<b>2005</b>
Land	\$ 102,646	\$ 100,868
Buildings and improvements	1,008,861	958,543
Equipment and software	727,168	699,133
Buildings and equipment under capital lease	27,250	28,110
Total cost of assets placed in service	1,865,925	1,786,654
Less accumulated depreciation and amortization	(881,668)	(829,848)
Construction-in-progress	181,533	142,034
Land, buildings, and other property, net	\$ 1,165,790	\$ 1,098,840

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### Notes to Consolidated Financial Statements

June 30, 2006

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#### (4) Debt

Debt consists of the following at June 30, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Borrowings on lines of credit, due in 2007, bearing interest at various rates averaging 4.15% in 2006 and 2.4% in 2005	\$ 20,000	\$ 80,000
Various notes, mortgages and bonds payable, bearing interest at rates ranging from 2.2% to 7.8% due 2007 through 2031, repayment terms generally require monthly payments of interest and annual principal reductions, and are generally backed only by the full faith and credit of the American Red Cross	<u>405,996</u>	<u>340,769</u>
Total bonds and notes payable	425,996	420,769
Obligations under capital leases (Note 5)	<u>5,154</u>	<u>6,623</u>
Total debt	431,150	427,392
Less current portion	<u>(42,127)</u>	<u>(86,697)</u>
Debt, noncurrent portion	<u>\$ 389,023</u>	<u>\$ 340,695</u>

Certain bonds are subject to redemption prior to maturity at the option of the Organization. Additionally, registered owners of these bonds may demand repurchase of the bonds by the bond agent or the depository for an amount equal to the principal price plus accrued interest. Letters of credit or standby credit facilities have been established with multiple banks in the aggregate amount of \$238 million and \$221 million as of June 30, 2006 and 2005, respectively, to provide liquidity in the event other funding is not available to repurchase these bonds. The depository and bond agent have the authority to use standby credit facilities for the repurchase of certain bonds.

# THE AMERICAN RED CROSS

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(With summarized information for the year ended June 30, 2005)

Scheduled maturities and sinking fund requirements of the debt and credit agreements as of June 30, 2006 are as follows (in thousands):

<b>Years ending June 30:</b>	
2007	\$ 42,127
2008	15,615
2009	22,597
2010	17,917
2011	18,293
Thereafter	<u>314,601</u>
Total	<u>\$ 431,150</u>

Interest expense was approximately \$21 million and \$17 million for the years ended June 30, 2006 and 2005, respectively, which is included in contractual services on the statement of functional expenses.

**Bank Lines of Credit:** The Organization maintained numerous committed and uncommitted lines of credit with various banks for its working capital requirements. As of June 30, 2006 and 2005, \$20 million and \$80 million respectively had been borrowed under lines of credit to support operations. The Organization had unused lines of credit outstanding of approximately \$180 million at June 30, 2006.

**Interest Rate Swap Agreements:** Interest rate swap agreements are used by the Organization to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Under such arrangements, a portion of variable rate indebtedness is converted to fixed rates based on a notional principal amount. The Organization held variable rate debt of approximately \$268 million and \$279 million at June 30, 2006 and 2005, respectively. At June 30, 2006, the aggregate notional principal amount under the interest rate swap agreements, which mature in 2008, totaled \$47 million. At June 30, 2006, the estimated fair value of the interest rate swap agreements was a liability of approximately \$1 million.

The Organization applies the provisions of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This standard requires certain derivative financial instruments to be recorded at fair value. The interest rate swap agreements described above are derivative instruments that are required to be recorded at fair value. The change in fair value on these interest rate swap agreements for the years ended June 30, 2006 and June 30, 2005 was a gain of approximately \$1 million each year, and is included as a nonoperating gain in the consolidated statement of activities.

**Letters of Credit:** The Organization had unused letters of credit outstanding of approximately \$62 million at June 30, 2006.



## THE AMERICAN RED CROSS

### Notes to Consolidated Financial Statements

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(With summarized information for the year ended June 30, 2005)

#### (5) Leases

The Organization leases certain buildings and equipment for use in its operations. The following summarizes, as of June 30, 2006, minimum future rental payments under capital and noncancelable operating leases for the fiscal years ending June 30 (in thousands):

	<b>Operating</b>	<b>Capital</b>
2007	\$ 30,955	2,231
2008	23,258	1,302
2009	18,101	1,019
2010	13,180	689
2011	9,323	454
Thereafter	21,177	15
Total minimum lease payments	\$ 115,994	5,710
Less amounts representing interest		(556)
Present value of net minimum lease payments (Note 4)		\$ 5,154

Total rent expense was approximately \$84 million and \$67 million for the years ended June 30, 2006 and 2005, respectively, and is included in contractual services on the statement of functional expenses.

#### (6) Net Assets

Unrestricted net assets consisted of the following at June 30, 2006 and 2005 (in thousands):

	<b>2006</b>	<b>2005</b>
Designated for the following purposes:		
Biomedical services	\$ 416,395	\$ 355,340
Endowment inflation adjustment reserve	113,200	95,500
Endowment distribution reserve	48,800	38,400
Funds functioning as endowment	273,286	262,384
Fund for retiree health care premium subsidies	107,585	104,811
Replacement and improvement of buildings and equipment	135,279	148,622
Contingencies and other purposes	206,539	112,817
Undesignated	294,983	201,586
Total unrestricted net assets	\$ 1,596,067	\$ 1,319,460

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At June 30, 2006 and 2005, respectively, \$162 million and \$134 million of cumulative net realized gains on endowed investments were reported as unrestricted net assets. Of these amounts, as of June 30, 2006 and 2005, respectively, approximately \$113 million and \$96 million have been designated by the Board of Governors as an inflation adjustment reserve to protect donor corpus. This reserve increases each year at a rate equal to 100 percent of the increase in the Consumer Price Index applied against the book value of the original donor corpus. The remaining \$49 million and \$38 million as of June 30, 2006 and 2005, respectively, were designated as a distribution reserve to provide funds for operations in those years when net interest and dividends are less than the approved distribution rate.

Temporarily restricted net assets are available for the following purposes or periods at June 30, 2006 and 2005 (in thousands):

	<b>2006</b>	<b>2005</b>
Disaster services	\$ 208,169	\$ 84,905
Hurricanes Katrina, Rita & Wilma Disaster Relief	243,721	—
Liberty disaster relief - September 11 response	46,462	117,812
Biomedical services	8,127	9,678
Health and safety services	3,189	5,065
International services	37,138	31,183
Tsunami relief and recovery	385,491	445,826
Community services	12,427	11,008
Buildings and equipment	20,999	20,768
Other specific purposes	39,772	28,310
For periods after June 30, 2006 and 2005, respectively	89,726	102,039
Total temporarily restricted net assets	\$ 1,095,221	\$ 856,594

As a result of Hurricanes Katrina, Rita and Wilma, that hit the gulf coast in August and September 2005, the Organization received donations of approximately \$2.6 billion during Fiscal Year 2006. The Organization has provided approximately \$2.4 billion in immediate assistance for the relief and recovery efforts for these hurricanes. The remaining net asset balance of approximately \$244 million will be devoted primarily to long-term recovery needs of the local communities in the wake of these storms.

Due to the hundreds of thousands of people potentially eligible for assistance as a result of these hurricanes, the multiple sources for accessing assistance, and evolving assistance guidelines, there were risks of both potential overpayments to eligible beneficiaries and assistance to ineligible beneficiaries. The Organization established procedures to mitigate the instances of fraud and to detect instances that occurred. In addition, the Organization established an internal task force to conduct investigations and ensure cooperation with law enforcement officials in an ongoing effort to identify and take action against identified fraudulent claims. This task force has implemented procedures for responding to requests from investigators in a timely manner and is actively reviewing case files for suspicious claims. Wherever feasible, the Organization has and will continue to seek restitution through civil or criminal processes. The Organization's practice is to restore recovered amounts to the funds designated for these hurricanes to benefit other eligible individuals.

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As a result of the terrorist attacks of September 11, 2001, the Organization received donations of over \$1 billion. A separate fund, the Liberty Disaster Relief Fund, was set up to receive the donations and to pay for the immediate and long-term needs of those directly affected by the attacks. To date, the Organization has spent approximately \$1 billion to assist victims of the tragedies. The remaining net asset balance of approximately \$46 million will be devoted primarily to providing long-term services to those directly affected in the form of counseling, health care services and other assistance.

On December 26, 2004, a 9.0 magnitude earthquake hit off the coast of Indonesia causing a large tsunami and unprecedented damage to over 13 countries. As a result of the generous support of the American public, the Organization has received over \$575 million of donations for the Tsunami Relief Fund. The Organization has provided approximately \$189 million in immediate assistance for the Tsunami relief and recovery efforts. The remaining net asset balance of approximately \$385 million will be used for long-term tsunami relief and recovery efforts primarily in the form of community health services and disease control, disaster preparedness, and community restoration and rebuilding.

Permanently restricted net assets consist primarily of endowed contributions, the income from which is available principally to fund general operations.

#### (7) Investments

The following schedule summarizes the composition of investment income for the years ended June 30, 2006 and 2005 (in thousands):

	2006			
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Dividends and interest	\$ 87,949	\$ 1,107	\$ —	\$ 89,056
Net operating investment gains	20,621	302	—	20,923
Investment income available for operations	108,570	1,409	—	109,979
Net nonoperating investment gains	59,607	856	796	61,259
Total return on investments	\$ 168,177	\$ 2,265	\$ 796	\$ 171,238

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	<b>2005</b>			
	<b>Unrestricted</b>	<b>Temporarily restricted</b>	<b>Permanently restricted</b>	<b>Total</b>
Dividends and interest	\$ 62,273	\$ 592	\$ —	\$ 62,865
Net operating investment gains	5,266	484	—	5,750
Investment income available for operations	67,539	1,076	—	68,615
Net nonoperating investment gains	48,120	567	796	49,483
Total return on investments	\$ 115,659	\$ 1,643	\$ 796	\$ 118,098

The fair value of investments was as follows at June 30, 2006 and 2005 (in thousands):

	<b>2006</b>	<b>2005</b>
U.S. Government securities	\$ 317,806	\$ 319,857
Corporate bonds and notes	151,845	169,056
Common and preferred stocks	525,277	535,508
Mortgage and asset backed securities	121,029	121,817
Marketable and nonmarketable alternative funds	82,939	64,994
Partnership funds	145,244	118,600
Money market and other	1,094,395	629,547
Total investments at fair value	2,438,535	1,959,379
Less current portion	(1,104,975)	(741,504)
Investments, noncurrent portion	\$ 1,333,560	\$ 1,217,875

#### (8) Split Interest Agreements

The Organization is the beneficiary of split interest agreements in the form of charitable gift annuities, perpetual trusts held by third parties, charitable remainder trusts and pooled income funds. Assets of split interest agreements of \$157 million and \$149 million are included in investments and other assets on the consolidated statement of financial position at June 30, 2006 and 2005, respectively. The value of split interest agreements is measured as the Organization's share of fair value of the assets. Liabilities associated with these agreements are \$23 million, of which \$5 million is included with other current liabilities and \$18 million is included with other noncurrent liabilities on the consolidated statement of financial position.

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### (9) Benefit Plans

**Pension and Postretirement Plans:** Employees of the American Red Cross, including participating local chapters, are covered by the Retirement System of the American National Red Cross (the Plan) after one year of employment.

For funding purposes under the Plan, normal pension costs are determined by the projected unit credit method and are funded currently. The Plan provides a pension funded entirely by the employer. Voluntary contributions may be made by active members to fund an additional, optional annuity benefit. Defined benefits are based on years of service and the employee's final average compensation, which is calculated using the highest consecutive 48 months of the last 120 months of service before retirement.

The Organization's funding policy was to set the employer contribution rate at a percentage of covered payroll that is intended to fund toward a target range of not less than 105 percent and no more than 115 percent of the projected unit credit accrued liability through June 30, 2005. Effective July 1, 2005, the target range is 115 percent to 120 percent of accrued liabilities. To the extent that the current funding is more or less than the target's upper bound, the difference is amortized over ten years in calculating the contribution rate. During fiscal years 2006 and 2005, the Organization contributed 4.25 percent and 4.5 percent, respectively, of covered payroll to the Retirement System.

The Organization has investment guidelines for Plan assets. The overall objective of the guidelines is to ensure the Plan assets provide capital growth over an extended period of time, while also considering market risks and ensuring that the portfolio income and liquidity are appropriate to meet the Plan benefit payments and other expenses. The Plan investments are required to be diversified by asset class and within each asset class, in order to ensure that no single investment will have a disproportionate impact on the total portfolio. The Plan asset allocation is reviewed each year with current market assumptions to ensure the asset mix will achieve the long-term goals of the Plan. The Plan assets were invested in the following categories at June 30, 2006 and 2005:

	<b>Pension Assets</b>	
	<b>2006</b>	<b>2005</b>
Cash and short-term investments	3%	2%
Domestic equity	41%	42%
International equity	24%	23%
Fixed income deflation hedge	15%	17%
Inflation hedge	8%	9%
Marketable and nonmarketable alternative funds	9%	7%
	<b>100%</b>	<b>100%</b>

The Plan assets were within authorized asset allocation ranges at June 30, 2006 and 2005.

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The Organization also provides medical and dental benefits to eligible retirees and their eligible dependents. Generally, retirees and the Organization each pay a portion of the premium costs. The medical and dental plans pay a stated percentage of expenses reduced by deductibles and other coverages. The Organization has the right to modify cost-sharing provisions at any time. In addition, life insurance benefits of \$5,000 are provided with no contributions required from the retirees.

The American Red Cross postretirement benefit plans are unfunded. However, as discussed in Note 6, the Board of Governors has designated \$108 million of unrestricted net assets to fund a portion of premiums for retirees' postretirement medical benefits.

The following table presents the changes in benefit obligations, changes in Plan assets, and the composition of accrued benefit costs in the consolidated statements of financial position for the years ended June 30, 2006 and 2005 (in thousands):

	<b>Pension benefits</b>		<b>Postretirement benefits</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Changes in benefit obligations</b>				
Benefit obligations at beginning of year	\$ 1,811,549	\$ 1,418,029	\$ 241,268	\$ 185,060
Service cost	55,060	72,105	16,785	14,326
Interest cost	96,762	91,874	12,499	11,380
Plan participants' contributions	20	6,854	—	—
Plan amendment	—	—	—	(26,201)
Actuarial (gain) loss	(225,762)	265,403	(49,268)	63,152
Benefits paid	(49,167)	(42,716)	(6,848)	(6,449)
Benefit obligations at end of year	\$ 1,688,462	\$ 1,811,549	\$ 214,436	\$ 241,268
<b>Changes in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 1,374,385	\$ 1,230,276	\$ —	\$ —
Actual return on plan assets	159,134	132,169	—	—
Employer contributions	45,404	47,802	—	—
Plan participants' contributions	20	6,854	—	—
Benefits paid	(49,167)	(42,716)	—	—
Fair value of plan assets at end of year	\$ 1,529,776	\$ 1,374,385	\$ —	\$ —
<b>Accrued benefit costs</b>				
Funded status	\$ (158,686)	\$ (437,164)	\$ (214,436)	\$ (241,268)
Unrecognized net actuarial loss	21,351	327,157	20,136	72,638
Unrecognized prior service cost	8,472	10,555	(14,587)	(15,803)
Additional minimum liability	—	(105,025)	—	—
<b>Accrued benefit costs</b>	<b>\$ (128,863)</b>	<b>\$ (204,477)</b>	<b>\$ (208,887)</b>	<b>\$ (184,433)</b>

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The provisions of FASB Statement No. 87, Employers' Accounting for Pensions, require recognition of an additional minimum liability, if the accrued benefit costs for a pension plan are less than the excess of the accumulated benefit obligation over plan assets.

At June 30, 2005, the accumulated benefit obligation exceeded the fair value of plan assets by approximately \$204 million, which resulted in a minimum pension liability adjustment of approximately \$94 million. This adjustment was recorded as a non-operating loss on the consolidated statement of activities. At June 30, 2006, the value of Plan assets was sufficient such that no additional minimum liability was required, and the effects of the prior year adjustment were reversed, resulting in a minimum pension liability adjustment of approximately \$94 million, recorded as a non-operating gain on the consolidated statement of activities.

The accumulated benefit obligation for the pension plan was approximately \$1.5 billion and \$1.6 billion as of June 30, 2006 and 2005, respectively.

Significant assumptions used in accounting for the plans as of June 30, 2006 and 2005 were:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Discount rate	6.25%	5.25%	6.25%	5.25%
Expected return on plan assets	7.50%	7.50%		
Rate of compensation increase	5.00%	5.00%		

The expected rate of return assumption on Plan assets was determined by considering current economic and market conditions and by reviewing asset class allocations, historical return analysis and forward looking capital market expectations. Asset class allocations were established by considering each class' risk premium commensurate for the level of risk, duration that matches the Plan's liabilities, and incremental diversification benefits. Historical returns and forward looking capital market expectations were gathered from, and compared among the Plan's investment managers, and a sampling of the consultant community.

For measurement purposes, a 9.5 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for fiscal year 2006. The rate was assumed to decrease gradually to 6.3 percent for 2010 and remain at that level thereafter.

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The components of net periodic benefit cost for the years ended June 30, 2006 and 2005 were (in thousands):

	<u>Pension benefits</u>		<u>Postretirement benefits</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Service cost	\$ 55,060	\$ 72,105	\$ 16,785	\$ 14,326
Interest cost	96,762	91,874	12,499	11,380
Expected return on plan assets	(99,075)	(95,087)	—	—
Amortization of prior service cost	2,083	2,083	(1,216)	1,690
Recognition of actuarial loss	19,985	—	3,234	—
Net periodic benefit cost	<u>\$ 74,815</u>	<u>\$ 70,975</u>	<u>\$ 31,302</u>	<u>\$ 27,396</u>

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects (in thousands):

	<u>Point increase</u>	<u>Point decrease</u>
Effect on total of service and interest cost components	\$ 588	\$ (459)
Effect on postretirement benefit obligation	2,120	(1,711)

The Organization expects to contribute approximately \$50 million to its pension plan and \$6 million to its postretirement benefit plan during the year ended June 30, 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid, as of June 30, 2006 (in thousands):

	<u>Pension Benefits</u>	<u>Postretirement Benefits</u>
2007	\$ 55,019	\$ 6,021
2008	62,264	6,324
2009	70,078	6,665
2010	78,134	7,078
2011	86,703	7,531
2012 - 2016	568,545	56,491
	<u>\$ 920,743</u>	<u>\$ 90,110</u>



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**American Red Cross Savings Plan – 401(k) Plan:** The Organization participates in the American Red Cross Savings Plan (the Savings Plan), a defined contribution plan. Employees of the Organization hired prior to July 1, 2005, including participating chapters, were eligible to participate upon hire and are vested 100 percent in all contributions to the Savings Plan. Participants hired on or after July 1, 2005 are immediately vested in their own contributions, but will not vest in the American Red Cross' matching contributions for a period of three years. Prior to July 1, 2005, the Organization matched 50 cents for every dollar up to the first 4 percent of annual compensation contributed by the participant. Effective July 1, 2005, the Organization will match 100 percent of every dollar up to the first 4 percent of annual compensation contributed. For the 2005 and 2004 calendar years, contribution limits were based on a maximum annual compensation of \$210,000 and \$205,000, respectively. There are eleven investment options that an employee can choose from as well as a self-managed brokerage account. The Organization contributed approximately \$27 million and \$13 million to the Savings Plan for fiscal years 2006 and 2005, respectively.

### (10) Receivables Securitization Program

In August 2005, the Organization initiated a \$100 million program to sell (securitize), on a revolving basis, certain biomedical hospital accounts receivable, while retaining a subordinated interest in a portion of the receivables. The eligible receivables are sold without legal recourse to a third party conduit through a wholly owned bankruptcy-remote special purpose entity that is consolidated for financial reporting purposes. The Organization continues servicing the sold receivables and charges the third party conduit a monthly servicing fee at market rates (1 %); accordingly no servicing asset or liability has been recorded.

The program qualifies for sale treatment under SFAS 140. As of June 30, 2006, the outstanding balance of securitized accounts receivable held by the third party conduit was approximately \$109 million of which the Organization's subordinated retained interest was approximately \$12 million. Accordingly, \$97 million of accounts receivable balances, net of applicable allowances, were removed from the consolidated statement of financial position as of June 30, 2006. Expenses associated with the program totaled approximately \$3 million in Fiscal Year 2006, and are recorded in contractual services on the statement of functional expenses.

The Organization measures the fair value of the receivable to determine the fair value of its retained interest. No present value calculation is done since the life of the receivable is usually less than 30 days.

### (11) Joint Costs

For the year ended June 30, 2006, the Organization incurred joint costs of approximately \$4.6 million for informational materials and activities that included fund raising appeals. Of those costs, \$2.4 million was allocated to fund raising, \$0.7 million to disaster services, \$0.7 million to health and safety services, and \$0.8 million to other services.

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### (12) Commitments and Contingencies

**Litigation:** The Organization is a defendant in a number of lawsuits incidental to its operations. In the opinion of management, the outcome of such lawsuits will not have a materially adverse effect on the Organization's financial position or its activities.

**Consent Decree:** In April 2003, the American Red Cross signed an amended consent decree (the Decree) with the United States Food and Drug Administration (FDA) affecting Biomedical Services and its blood services regional operations. The Decree requires compliance with specific standards on how the Organization will manage and monitor its Biomedical Services' operations and formalized management of compliance related issues and provides timelines for their resolution. The Decree subjects the Organization to potential monetary penalties if it fails to meet the compliance standards. The compliance penalty provisions cover two general areas: (1) penalties for violations of the law, including FDA regulation; and (2) penalties for the release of unsuitable blood products. Potential penalty amounts are limited to one percent of gross annual revenues generated by Biomedical Services for products and services in the first year (April 15, 2003 through April 14, 2004) of the Decree. The limit is increased to two percent in the second year, three percent in the third year, and four percent starting in the fourth year and annually thereafter. It is the opinion of management that the financial statements adequately provide for potential penalties resulting from the Consent Decree.

**Government Grants:** Costs charged to the federal government under cost-reimbursement grants and contracts are subject to government audit. Therefore, all such costs are subject to adjustment. Management believes that adjustments, if any, would not have a significant effect on the financial statements.

### (13) Risks and Uncertainties

The Organization's invested assets consist of common stocks, fixed income securities and other investment securities. Investment securities are exposed to various risks, such as interest rate, market and credit. Due to the level of uncertainty related to changes in interest rates, market volatility and credit risks, it is at least reasonably possible that changes in these risks could materially affect the fair value of investments reported in the statement of financial position as of June 30, 2006. However, the diversification of the Organization's invested assets among these various asset classes should mitigate the impact of any dramatic change on any one asset class.

### (14) Subsequent Event

In October 2006, the Organization entered into an agreement to sell the land and building of one of its headquarters buildings located in Falls Church, Virginia. The sales price was approximately \$44 million and the net book value of the land and building was approximately \$29 million as of the date of the sale, resulting in a gain of approximately \$15 million. The Organization is also required to repay bonds associated with the purchase of the building within 90 days of the disposition of the building. The total outstanding balance of these bonds was approximately \$24 million as of June 30, 2006.