

INDEPENDENT AUDITORS' REPORT

Board of Directors
National Endowment for Democracy
Washington, D.C.

We have audited the accompanying statements of financial position of National Endowment for Democracy (the "Endowment") as of September 30, 2006 and 2005, and the related statements of activities and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Endowment'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 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 Endowment's 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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Endowment as of September 30, 2006 and 2005, 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.



January 5, 2007

STATEMENTS OF FINANCIAL POSITION AS OF SEPTEMBER 30, 2006 AND 2005

ASSETS	2006	2005
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,983,264	\$ 2,630,845
Investments	611,909	
Grants receivable—federal appropriation and special funding	117,604,402	117,420,119
Accounts receivable	780	2,323
Prepaid expenses and other assets	18,977	125,880
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Total current assets	120,219,332	120,179,167
FURNITURE AND EQUIPMENT - NET	4,678,115	215,461
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TOTAL	\$ 124,897,447	\$120,394,628
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LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 1,658,025	\$ 894,077
Grants payable	76,639,694	73,447,561
Deferred grant revenue—		
federal appropriation and special funding	40,653,561	44,342,348
Capital lease obligations - current portion	44,935	39,880
Deferred lease obligation - current portion	300,218	
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Total current liabilities	119,296,433	118,723,866
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NON-CURRENT LIABILITIES		
Capital lease obligations - long-term portion	79,814	77,434
Deferred lease obligation - long-term portion	3,025,360	
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Total non-current liabilities	3,105,174	77,434
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Total liabilities	122,401,607	118,801,300
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NET ASSETS:		
Unrestricted	1,320,517	220,867
Temporarily restricted	1,175,323	1,372,461
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Total net assets	2,495,840	1,593,328
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TOTAL	\$ 124,897,447	\$120,394,628
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See notes to financial statements.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006			2005		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
SUPPORT AND REVENUE:						
Grant revenue—government agencies	\$ 109,565,437	\$ 547,650	\$ 109,565,437	\$ 113,026,546	\$ 263,150	\$ 113,026,546
Other grants and contributions		547,650	547,650		263,150	263,150
Other revenue, interest, and miscellaneous income	177,405	41,177	218,582	168,594	26,907	195,501
Total support and revenue	109,742,842	588,827	110,331,669	113,195,140	290,057	113,485,197
NET ASSETS RELEASED FROM RESTRICTIONS—Satisfaction of program restrictions						
	785,965	(785,965)		187,175	(187,175)	
Total revenues	110,528,807	(197,138)	110,331,669	113,382,315	102,882	113,485,197
EXPENSES:						
Program services—Grants programs—						
Federal—USDOS	93,999,784		93,999,784	101,971,387		101,971,387
Other				27,800		27,800
Total grant programs	93,999,784		93,999,784	101,999,187		101,999,187
Other activities—Non-Federal:						
International Forum:						
Management and support	8,325		8,325	5,087		5,087
<i>Journal of Democracy</i>	74,820		74,820	78,829		78,829
Research and conferences	32,600		32,600	22,287		22,287
World Movement for Democracy	732,039		732,039	(3,266)		(3,266)
NED events and development	145,576		145,576	61,525		61,525
Total other activities—Non-Federal	993,360		993,360	164,462		164,462
Other activities—Federal-USDOS:						
International Forum:						
<i>Journal of Democracy</i>	290,071		290,071	298,634		298,634
Democracy Resource Center	300,865		300,865	278,719		278,719
Research and conferences	124,650		124,650	129,094		129,094
Management and support	442,259		442,259	400,841		400,841
Reagan/Fascell Fellowship Program	1,292,738		1,292,738	964,432		964,432
World Movement for Democracy	640,831		640,831	377,998		377,998
World Movement for Democracy—NDRI Program	43,437		43,437	111,037		111,037
World Movement for Democracy—Network Program	94,374		94,374	23,977		23,977
Total other activities—Federal—USDOS	3,229,225		3,229,225	2,584,732		2,584,732
Supporting services—Federal—USDOS	11,206,788		11,206,788	8,422,329		8,422,329
Total other activities and supporting services	15,429,373		15,429,373	11,171,523		11,171,523
Total expenses	109,429,157		109,429,157	113,170,710		113,170,710
CHANGES IN NET ASSETS	1,099,650	(197,138)	902,512	211,605	102,882	314,487
NET ASSETS—Beginning of year	220,867	1,372,461	1,593,328	9,262	1,269,579	1,278,841
NET ASSETS—End of year	\$ 1,320,517	\$ 1,175,323	\$ 2,495,840	\$ 220,867	\$ 1,372,461	\$ 1,593,328

See notes to financial statements.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 902,512	\$ 314,487
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	245,886	102,085
Loss on disposal of furniture and equipment	7,233	
Unrealized gain on investments	(41,177)	
Changes in assets and liabilities:		
Grants receivable—federal appropriation and special funding	(184,283)	(39,894,655)
Accounts receivable	1,543	4,548
Prepaid expenses and other assets	106,903	(109,434)
Accounts payable and accrued liabilities	763,948	285,821
Grants payable	3,192,133	26,198,025
Deferred grant revenue—federal appropriation and special funding	(3,688,787)	13,542,240
Deferred lease obligation	323,402	
	<u>1,629,313</u>	<u>443,117</u>
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of furniture and equipment	(535,421)	(110,114)
Purchase of leasehold improvements	(1,123,430)	
Purchase of investments	(570,732)	
	<u>(2,229,583)</u>	<u>(110,114)</u>
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Principal payments under capital lease obligations	(47,311)	(40,067)
	<u>(47,311)</u>	<u>(40,067)</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(647,581)	292,936
CASH AND CASH EQUIVALENTS—Beginning of year	<u>2,630,845</u>	<u>2,337,909</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 1,983,264</u>	<u>\$ 2,630,845</u>
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Acquisition of equipment under capital lease	<u>\$ 54,746</u>	<u>\$</u>
Deferred lease obligations - leasehold improvements	<u>\$ 3,002,176</u>	<u>\$</u>
CASH PAYMENTS FOR INTEREST	<u>\$ 10,367</u>	<u>\$ 13,501</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

1. ORGANIZATION AND ACCOUNTING POLICIES

Organization—The National Endowment for Democracy (the “Endowment”) is a private, not-for-profit organization headquartered in Washington, D.C. The Endowment was established coincident to a grant awarded by the United States Information Agency (“USIA”) as mandated by the National Endowment for Democracy Act (the “Act”) of the United States Congress. The purpose of the Endowment is to encourage free and democratic institutions throughout the world through activities that promote individual rights and freedoms. The Endowment awards grants to organizations with programs consistent with its objectives. On October 1, 1999, USIA and the U.S. Department of State (“USDOS”) consolidated. Accordingly, the Endowment receives funding for its annual Congressional Appropriation and other special federal funding from the USDOS.

Basis of Presentation—The accounts of the Endowment are maintained and the financial statements have been prepared on the accrual basis of accounting. The Endowment reports to the U.S. Government on the basis of obligations incurred and cash expenditures made.

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

Cash and Cash Equivalents—Cash and cash equivalents include cash on deposit, overnight repurchase agreements, and investments in money market accounts that are reported at cost and are readily convertible to known amounts of cash. Such instruments have maturities of three months or less from the date of purchase.

Investments—Investments are carried at fair value with any related gain or loss reported in the statements of activities and changes in net assets. The Endowment’s investments consist entirely of mutual funds.

Furniture and Equipment—Furniture and equipment which are not part of direct program costs are recorded at cost and are depreciated or amortized on the straight-line method over their estimated service lives or the terms of the lease, as applicable, ranging from three to ten years.

Grants Receivable—Federal Appropriation and Special Funding—At the time a grant agreement is signed and awarded to the Endowment, a receivable and deferred revenue are recorded. When payments are received from the awarding agency, the receivable is reduced. The deferred revenue is recognized as revenue in accordance with the Endowment’s revenue recognition policy.

Revenue Recognition—Grants received from government agencies specify the periods in which monies are to be expended. Additionally, certain government grants restrict the use of funds for programs in specific countries. Revenues from government grants are recognized as earned in the year in which the Endowment obligates the funds for the intended purpose which is set forth in the grant agreement.

Agreements with the former USIA and USDOS provide for the subsequent audit of costs funded under the grant agreements. It is the policy of the Endowment to provide for cost disallowances based upon its experience in previous contract audits.

Deferred Grant Revenue—Federal Appropriation and Special Funding—Resources awarded in the form of federal grant agreements made to the Endowment in excess of obligations incurred are recorded as deferred grant revenue—federal appropriation and special funding.

Contributions—The Endowment reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified in the statement of activities as net assets released from restrictions. Income on these net assets is classified as temporarily restricted or unrestricted in accordance with the donor’s stipulation.

2. GRANTS RECEIVABLE—FEDERAL APPROPRIATION AND SPECIAL FUNDING

Grants receivable are from the U.S. Government and represent balances of Federal Reserve Letters of Credit and direct funding established by the former USIA and USDOS grant agreements. The Endowment collects U.S. Government funds by filing requests for direct funding and by presenting payment vouchers against letters of credit when it disburses cash for program grants and administrative costs.

3. FURNITURE AND EQUIPMENT

Furniture and equipment less accumulated depreciation and amortization as of September 30, 2006 and 2005, is as follows:

	2006	2005
Furniture and equipment	\$ 745,859	\$253,957
Equipment under capital lease	222,311	213,963
Leasehold improvements	<u>4,125,605</u>	<u> </u>
Total	5,093,775	467,920
Less accumulated depreciation and amortization	<u>(415,660)</u>	<u>(252,459)</u>
Furniture and equipment—net	<u>\$4,678,115</u>	<u>\$215,461</u>

4. GRANTS PAYABLE

Grants payable represent the undisbursed balances of funds obligated to the Endowment's grantees. Grantee organizations are entitled to collect grant funds as needed by presenting requests for funds to the Endowment. Such grants payable are generally disbursed within a 12-month period after the funds have been obligated to the Endowment's grantees.

5. DEFERRED REVENUE—FEDERAL APPROPRIATION AND SPECIAL FUNDING

Changes in deferred grant revenue from agencies of the U.S. Government as of and for the years ended September 30, 2006 and 2005, are summarized in the following schedule:

	Deferred Grant Revenue, Beginning of Year	Add Grants Awarded/ Amended	Less Grants Obligated	Grant Adjustments	Deferred Grant Revenue, End of Year
USDOS Grants:					
Grants Program:					
Primary Funding	\$ 6,713,825	\$ 74,042,100	\$ 73,705,233	\$ (42,830)	\$ 7,093,522
Special Funding—Africa 2004	3,304,807	1,980,000	2,980,528		2,304,279
Special Funding—Balkans	63,967			63,967	
Special Funding—Balkans (2001)	(48,497)		86,756	(135,253)	
Special Funding—Balkans (2003)	152,896		183,908		(31,012)
Special Funding—Balkans (2004)	3,733,236	842,000	2,193,798		2,381,438
Special Funding—Belarus Elections	5,193			5,193	
Special Funding—BRU 2006		3,954,000	475,421		3,478,579
Special Funding—Burma	5,995			171	5,824
Special Funding—Burma (2001)	84,029		111,612	(27,583)	
Special Funding—Burma (2003)	1,395,074		1,426,393		(31,319)
Special Funding—Burma (2006)		2,750,000	2,443,375		306,625
Special Funding—China/Tibet	32,315		32,315		
Special Funding—China/IRI	2,567			2,567	
Special Funding—China 2003	89,750		94,894	(5,144)	
Special Funding—China 2004	191,234		65,819		125,415
Special Funding—Cuba 2005	572,007	1,000,000	499,242		1,072,765
Special Funding—Greater China	4,178,564	2,970,000	3,512,990		3,635,574
Special Funding—Iraq (2004)	11,418,630	3,000,000	10,993,393		3,425,237
Special Funding—Iraq (2006)		5,000,000			5,000,000
Special Funding—M.E. Southeast Asia	999,975		928,576		71,399
Special Funding—Muslim (2002)	179,927		185,738	(4,089)	(1,722)
Special Funding—Muslim (2004)	4,263,280		2,075,894		2,187,386
Special Funding—Muslim (2006)		2,970,000			2,970,000
Special Funding—NIS (2002)	(57,484)			(57,484)	
Special Funding—NIS (2003)	229,017		229,016		1
Special Funding—NIS (2004)	4,489,211	450,000	4,644,363		294,848
Special Funding—North Korea 2003	511,700	990,000	445,442		1,056,258
Special Funding—Russia/CA	836			836	
Special Funding—Russia 2006		990,000	225,540		764,460
Special Funding—Tibet (2002)	13,989			13,989	
Special Funding—Tibet (2003)	83,011		124,047		(41,036)
Special Funding—Tibet (2006)		248,000			248,000
Special Funding—Venezuela	33,316		53,206	(19,890)	
Special Funding—Venezuela 2006		1,980,000			1,980,000
International Forum and World Movement for Democracy:					
World Movement for Democracy—NDRI	45,627		43,437		2,190
World Movement for Democracy—Durban Conference	105				105
World Movement for Democracy—Networks/SC	149,678		94,374		55,304
World Movement for Democracy—Istanbul Conference	250,000		250,000		
World Movement for Democracy—MEPI		318,000	167,389		150,611
Media Assistance Center		999,000			999,000
Reagan/Fascell Fellowship Program Year 3 & 4 & 5 & 6	1,254,568	1,188,000	1,292,738		1,149,830
Total 2006	<u>\$44,342,348</u>	<u>\$ 105,671,100</u>	<u>\$ 109,565,437</u>	<u>\$ (205,550)</u>	<u>\$40,653,561</u>
Total 2005	<u>\$30,800,108</u>	<u>\$ 126,568,786</u>	<u>\$ 113,026,546</u>	<u>\$</u>	<u>\$44,342,348</u>

6. TEMPORARILY RESTRICTED NET ASSETS

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes specified by donors during the years ended September 30, 2006 and 2005, as follows:

	2006	2005
International Forum:		
<i>Journal of Democracy</i>	\$ 74,820	\$ 78,829
Research and conferences	32,600	22,287
World Movement for Democracy	532,969	24,534
NED events and development	<u>145,576</u>	<u>61,525</u>
Total net assets released from restrictions	<u>\$ 785,965</u>	<u>\$ 187,175</u>

Temporarily restricted net assets at September 30, 2006 and 2005, are available for the following purposes:

	2006	2005
International Forum:		
<i>Journal of Democracy</i>	\$ 5,733	\$ 553
Visiting Fellows Program	551	551
World Movement for Democracy		149,373
Research and conferences	15,319	2,713
NED events and development	<u>1,153,720</u>	<u>1,219,271</u>
Total temporarily restricted net assets	<u>\$ 1,175,323</u>	<u>\$ 1,372,461</u>

7. RELATED PARTIES

The Endowment awards grants to various organizations to be used for programs which the Board of Directors determines are consistent with the purposes of the Act. Some of the organizations which submit proposals and are awarded funds have members of their Board of Directors represented on the Board of Directors of the Endowment. There were no awards to related parties during the years ended September 30, 2006 and 2005.

Article VI, Section V, of the Endowment's bylaws provides that any Board member who is an officer or director of an organization seeking to receive grants from the Endowment must abstain from considering and voting on such grant. The provision does not prevent any director from supplying factual information that the Board requests.

8. COMMITMENTS

The Endowment has noncancelable operating leases for office space that expire in June 2016. The lease for office space includes a provision for rent escalations. In addition, the Endowment leases equipment under capital leases that expire on various dates through 2011.

Accumulated amortization for property under capital leases was \$182,643 and \$156,882 as of September 30, 2006 and 2005, respectively. Future minimum lease payments for the year ending September 30, 2006, expire as follows:

	Capital Leases	Operating Leases
2007	54,257	2,278,086
2008	50,838	2,335,038
2009	13,284	2,393,412
2010	13,284	2,453,252
2011	13,284	2,523,570
Thereafter	<u> </u>	<u>13,003,406</u>
Total minimum payments	144,947	24,986,764
Less interest	<u>20,198</u>	<u> </u>
Future minimum lease payments	<u>\$124,749</u>	<u>\$24,986,764</u>

Rent expense was \$1,698,857 and \$1,008,648 for the years ended September 30, 2006 and 2005, respectively.

9. BANK LETTER OF CREDIT

During fiscal year 2005, the Endowment obtained a standby letter of credit in the amount of \$377,323 from a commercial bank. The letter of credit represents the security deposit for the Endowment's noncancelable operating lease for office space.

10. INCOME TAXES

The Endowment is exempt from income taxes, except for unrelated business income activities, under Section 501(c)(3) of the U.S. Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a).

11. RETIREMENT PLAN

The Endowment has a defined contribution annuity plan for all of its employees, under which the Endowment contributes a percentage of eligible employees' annual earnings to individually owned tax-deferred annuity contracts. The Endowment's contribution to the plan is based on 10% of an eligible employee's annual earnings. The employer contributions to the plan for the years ended September 30, 2006 and 2005, were \$476,966 and \$444,048, respectively.

12. TRANSFERS TO GOVERNMENT AGENCIES

Commencing in fiscal year 1987, the U.S. Government established a policy whereby recipients of federal funds are required to deposit grant funds in interest-bearing accounts. Interest earned in excess of \$250 per fiscal year must be remitted back to the U.S. Government. Total interest earned on federal funds in fiscal year 2006 and 2005 was approximately \$3,040 and \$2,793, respectively.

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