

AARP Foundation

**Consolidated Financial Statements
December 31, 2006 and 2005
Together With Independent Auditors' Report**

AARP Foundation
Consolidated Financial Statements
December 31, 2006 and 2005

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The Board of Directors of the
AARP Foundation:

We have audited the accompanying consolidated statements of financial position of the AARP Foundation as of December 31, 2006 and 2005, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the AARP Foundation's management. Our responsibility is to express an opinion on these consolidated 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 effectiveness of the AARP Foundation'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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the AARP Foundation as of December 31, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information included in the Schedule of Functional Expenses is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2006 basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2006 basic consolidated financial statements taken as a whole.

KPMG LLP

March 28, 2007

AARP Foundation
Consolidated Statements of Financial Position
As of December 31, 2006 and 2005
(in thousands)

	2006	2005
Assets:		
Cash and cash equivalents	\$ 22,799	\$ 48,678
Cash and cash equivalents held as collateral	1,504	308
Deposit held with bond trustee (Note 7)	1	1,802
Contributions receivable (Note 6)	3,103	1,269
Grants receivable (Note 3)	6,149	3,685
Due from affiliates (Note 10)	7,059	7,180
Prepaid expenses and other assets	794	649
Property and equipment, net (Note 4)	20,847	21,462
Investments (Note 5)	49,843	17,168
Charitable gift annuity investments (Note 5)	9,146	7,929
Debt issuance costs	477	495
	121,722	110,625
Total assets	121,722	110,625
Liabilities:		
Accounts payable and accrued expenses (Note 12)	\$ 9,380	\$ 12,908
Grants payable (Note 9)	907	1,292
Securities loan payable	1,504	308
Deferred revenue	3,060	1,825
Due to affiliates (Note 10)	5,865	2,537
Accrued pension liability (Note 11)	-	6,562
Charitable gift annuity payable	5,861	5,288
Bonds payable (Note 7)	25,000	25,000
	51,577	55,720
Total liabilities	51,577	55,720
Commitments and Contingencies (Notes 10, 12, 13 and 15)		
Net assets:		
Unrestricted:		
Undesignated	33,900	21,513
Board designated quasi-endowment	14,839	12,078
Board designated operating reserves (Note 2a)	8,900	8,256
	57,639	41,847
Total unrestricted	57,639	41,847
Temporarily restricted (Note 14)	12,506	13,058
	70,145	54,905
Total net assets	70,145	54,905
Total liabilities and net assets	\$ 121,722	\$ 110,625

See accompanying notes to financial statements.

AARP Foundation
Consolidated Statements of Activities
Years ended December 31, 2006 and 2005
(in thousands)

	<u>2006</u>			<u>2005</u>		
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Revenues:						
Grant revenue (Note 8)	\$ 81,470	\$ -	\$ 81,470	\$ 83,329	\$ -	\$ 83,329
Related party contributions (Note 10)	27,405	-	27,405	27,028	6,659	33,687
Contributions	17,209	3,243	20,452	12,939	1,118	14,057
Change in value of charitable gift annuities	(493)	-	(493)	(464)	-	(464)
3rd party in-kind contributions	14,319	-	14,319	15,035	-	15,035
Investment income (Note 5)	5,551	-	5,551	2,319	-	2,319
Litigation settlements and other	396	-	396	103	-	103
Net assets released from restrictions	3,795	(3,795)	-	7,316	(7,316)	-
Total revenues	<u>149,652</u>	<u>(552)</u>	<u>149,100</u>	<u>147,605</u>	<u>461</u>	<u>148,066</u>
Expenses:						
Program services (Note 9)						
SCSEP	86,483		86,483	90,347		90,347
Tax Counseling for the Elderly	10,185		10,185	10,411		10,411
Legal Advocacy	5,299		5,299	5,195		5,195
Other programs	14,002		14,002	12,454		12,454
Total program services	<u>115,969</u>	<u>-</u>	<u>115,969</u>	<u>118,407</u>	<u>-</u>	<u>118,407</u>
Supporting services						
Fundraising	17,528		17,528	14,641		14,641
Management and general	6,925		6,925	6,142		6,142
Total supporting services	<u>24,453</u>	<u>-</u>	<u>24,453</u>	<u>20,783</u>	<u>-</u>	<u>20,783</u>
Total expenses	<u>140,422</u>	<u>-</u>	<u>140,422</u>	<u>139,190</u>	<u>-</u>	<u>139,190</u>
Increase in net assets resulting from Pension Plan amendment (Note 11)	6,562	-	6,562	-	-	-
Change in net assets	15,792	(552)	15,240	8,415	461	8,876
Net assets, beginning of year	41,847	13,058	54,905	33,432	12,597	46,029
Net assets, end of year	<u>\$ 57,639</u>	<u>\$ 12,506</u>	<u>\$ 70,145</u>	<u>\$ 41,847</u>	<u>\$ 13,058</u>	<u>\$ 54,905</u>

See accompanying notes to financial statements.

AARP FOUNDATION
Consolidated Statements of Cash Flows
Years ended December 31, 2006 and 2005
(in thousands)

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Change in net assets	\$ 15,240	\$ 8,876
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	719	651
Amortization of debt issuance costs	18	17
(Decrease) increase in accrued pension	(6,562)	833
Net realized and unrealized gains on investments	(2,707)	(465)
Change in value of charitable gift annuities	493	464
Changes in operating assets and liabilities:		
Increase in cash and cash equivalents held as collateral	(1,196)	(308)
(Increase) decrease in grants receivable	(2,464)	1,369
Increase in contributions receivable	(1,834)	(71)
Decrease (increase) in due from affiliates	121	181
Increase in prepaid expenses and other assets	(145)	(402)
(Decrease) increase in accounts payable and accrued expenses	(3,528)	6,983
(Decrease) increase in grants payable	(385)	1,056
Increase in securities loan payable	1,196	308
Increase in deferred revenue	1,235	1,738
Increase in charitable gift annuity payable	80	339
Increase in due to affiliates	3,328	323
Total adjustments	<u>(11,631)</u>	<u>13,016</u>
Net cash provided by operating activities	<u>3,609</u>	<u>21,892</u>
Cash flows from investing activities:		
Purchase of property and equipment	(104)	(109)
Acquisition of charitable gift annuity investments	(779)	(1,040)
Purchase of investments	(35,889)	(533)
Proceeds from sales and maturities of investments	5,483	9
Net cash used in investing activities	<u>(31,289)</u>	<u>(1,673)</u>
Cash flows from financing activities:		
Net bond proceeds transferred from trustee	1,801	554
Net cash provided by financing activities	<u>1,801</u>	<u>554</u>
Net (decrease) increase in cash and cash equivalents	(25,879)	20,773
Cash and cash equivalents, beginning of year	<u>48,678</u>	<u>27,905</u>
Cash and cash equivalents, end of year	<u>\$ 22,799</u>	<u>\$ 48,678</u>
Cash paid for interest	<u>\$ 852</u>	<u>\$ 583</u>

AARP Foundation
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

1. Description of Organization

The AARP Foundation was organized in 1961 as a District of Columbia not-for-profit corporation. The AARP Foundation is AARP, Inc.'s (AARP) charitable organization, dedicated to enhancing the quality of life for all as we age and to promoting positive social change and value to those 50 and older with emphasis on those at social and economic risk. The AARP Foundation is a non-profit organization qualified under Section 501(c)(3) of the Internal Revenue Code and is therefore exempt from federal income taxes on its charitable operations. In addition, the AARP Foundation is a public charity as defined in Section 509 (a)(1) of the Internal Revenue Code.

The AARP Foundation receives funding principally from the federal government, AARP, foundations, corporations, and individuals. The AARP Foundation's Board of Directors is composed of members appointed by AARP's Board of Directors.

The AARP Institute (the Institute), a wholly owned subsidiary of the AARP Foundation, was organized in 1963 as a District of Columbia not-for-profit corporation.

2. Summary of Significant Accounting Policies

a) Basis of Presentation

These consolidated financial statements include the accounts of AARP Foundation and the Institute (collectively, the Foundation). The Foundation prepares its financial statements on the accrual basis of accounting. The Foundation summarizes the costs of providing its various programs and other activities on a functional basis in the accompanying statements of activities. Accordingly, certain costs are allocated among program and supporting services based on specific identification or allocation methodologies.

Net assets and changes in net assets are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation are classified and reported as follows:

Unrestricted – net assets that are not subject to donor-imposed stipulations including amounts designated by the Board of Directors to function as quasi-endowment and operating reserves.

Temporarily restricted – net assets subject to donor-imposed stipulations that will be met either by actions of the Foundation and/or the passage of time.

AARP Foundation
Notes to Consolidated Financial Statements
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b) Cash Equivalents

All short-term deposits and investments with original maturities of three months or less are reported as cash equivalents. The Foundation has classified any cash or money market accounts held by external managers as investments.

c) Investments

Investments in debt securities, institutional mutual funds, and equity securities are measured and reported at fair value. The fair value of debt securities, institutional mutual funds, and equity securities with a readily determinable fair value are based on quotations obtained from national security exchanges.

Debt securities, institutional mutual funds, and equity securities with values that are not readily marketable, are carried at estimated fair values as provided by the investment managers. AARP Foundation management reviews and evaluates the values provided by the investment managers and agrees with the valuation methods and assumptions used in determining their estimated fair value.

Changes in fair value are reported as investment income in the accompanying consolidated statements of activities.

d) Property and Equipment

Property, building improvements, and equipment are stated at cost, less accumulated depreciation. Management periodically evaluates whether events or circumstances have occurred indicating that the carrying amount of long-lived assets may not be recovered.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, which are 26 years for its office condominium, 10 years for building improvements, and 3 years for equipment. Land is not subject to depreciation. Maintenance and repair costs are expensed as incurred.

e) Charitable Gift Annuities

The Foundation has entered into a number of charitable gift annuity (CGA) agreements with its donors. Under the terms of these agreements, the donor contributes assets to the Foundation in exchange for a promise by the Foundation to pay a fixed amount for a specified period of time (usually the donor's lifetime) to the donor or to individuals or organizations designated by the donor.

At the inception of a CGA agreement, the excess of the fair value of assets received over the present value of annuity payments to be made to the donor or beneficiary is recognized as a charitable contribution.

AARP Foundation
Notes to Consolidated Financial Statements
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The assets held for all charitable gift annuities are reported in charitable gift annuity investments on the statements of financial position and stated at fair value. Gains and losses resulting from changes in actuarial assumptions are reported as increases or decreases in unrestricted net assets in the statements of activities. Liabilities for the expected annuity payments are reported at the estimated present value of future cash outflows, based on appropriate discount rates selected at the time of initial contribution and Internal Revenue Code mortality tables. The Foundation invests the charitable gift annuities in accordance with the limitations imposed by relevant state laws.

The AARP Board of Directors has committed to assume the Foundation's charitable gift annuity liabilities in the event the Foundation, at some future date, were to be unable to fulfill its obligations.

f) Grant Revenue and Related Expenses

The Foundation reports all activities under grant agreements as exchange transactions. Accordingly, grant-related revenue is recognized to the extent allowable expenses are incurred under program agreements. Amounts reported as grants receivable represent grant program expenses incurred in advance of the receipt of funds. Funds received in advance of grant program expenses are reported as deferred revenue in the statements of financial position.

g) Contributions

The Foundation reports contributions as revenue when received or pledged by the donor. The Foundation reports contributions as temporarily restricted revenue if such gifts are restricted by the donor to a specific program or include an explicit or implied time restriction.

Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as net assets released from restrictions. Gifts whose donor-stipulated purposes are met in the same year as received are reported as unrestricted revenue.

h) Contributed Services

A significant portion of the Foundation's contributed services involves the Senior Community Service Employment Program (SCSEP) through which the Foundation receives donated supervisory services. These contributed services are recorded at their estimated fair values as both revenue and program expenses in the statements of activities.

Over 32,000 volunteers provide tax preparation assistance each year under the Tax Counseling for the Elderly program. The Foundation has concluded that these donated

AARP Foundation
Notes to Consolidated Financial Statements
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services do not meet the requirements for recognition as contributed services under U.S. generally accepted accounting principles.

In addition, AARP contributes certain services and assets to the Foundation (see note 10).

i) Litigation Settlement Revenue

Litigation settlement revenue from lawsuits in which AARP Foundation attorneys participate is recognized when cash is received.

j) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and disclosures in the financial statements. Actual results could differ from these estimates.

k) Reclassifications

Certain reclassifications have been made to the 2005 reported amounts to conform to the 2006 presentation.

3. Grants Receivable

Grants receivable consist of amounts due from the following sources as of December 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Department of Labor	\$ 4,255	\$ 930
Internal Revenue Service	1,494	1,004
Department of Housing and Urban Development	82	1,676
Department of Health and Human Services	112	75
Corporation for National and Community Service and other	206	-
Total grants receivable	<u>\$ 6,149</u>	<u>\$ 3,685</u>

AARP Foundation
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4. Property and Equipment

Property and equipment is summarized as follows at December 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Land	\$ 4,440	\$ 4,440
Building and improvements	17,964	17,864
Equipment	9	5
Accumulated depreciation	<u>(1,566)</u>	<u>(847)</u>
Property and equipment, net	<u>\$ 20,847</u>	<u>\$ 21,462</u>

5. Investments

Foundation investments include shares in AARP's unitized pooled investment fund. The Foundation's share of the investment pool is based on investments of \$28,385,104 in 2006 and an initial investment of \$10,000,000 in 2004 plus accumulated earnings. Income and gains/losses are allocated based on the Foundation's pro rata share of the investment pool.

The fair value of the Foundation's share of pooled assets was \$41,892,000 and \$10,794,637 at December 31, 2006 and 2005, respectively.

Investments, including amounts held for charitable gift annuities, are summarized as follows at December 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Stock index mutual fund	\$ 36,512	\$ 13,436
Fixed income securities	10,713	8,571
U.S government and agency obligations	527	273
Mortgage-backed securities	3,838	913
Institutional mutual funds - Fixed income	6,659	1,807
Externally-managed cash and cash equivalents	<u>740</u>	<u>97</u>
Total investments	<u>\$ 58,989</u>	<u>\$ 25,097</u>

AARP Foundation
Notes to Consolidated Financial Statements
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Investment income for the years ended December 31, 2006 and 2005 is summarized as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Interest and dividend income	\$ 2,844	\$ 1,854
Net realized and unrealized gains	<u>2,707</u>	<u>465</u>
Total investment income	<u>\$ 5,551</u>	<u>\$ 2,319</u>

In December 2005, AARP began lending securities in their investment pool to third parties as a tool to defray fees and expenses paid to its investment custodial bank. As a participant in the pool, the Foundation participates in the securities lending program. Under the securities lending plan, AARP temporarily lends its securities to investment brokers and dealers. AARP receives cash and cash equivalents collateral from the borrowers that is maintained at 102% to 105% of the market value of the securities on loan. The collateral is held in money market accounts. AARP still retains the dividends, interest and all other benefits of ownership attached to the securities on loan. When the securities are returned to AARP, the collateral is returned to the borrower. Income is generated from the investment of the collateral for the securities on loan. At December 31, 2006 and 2005, the Foundation's share of securities loaned was approximately \$1,455,000 and \$300,000, respectively. The Foundation's pro-rata share of the cash and cash equivalents collateral held by AARP at December 31, 2006 and 2005, on these securities was approximately \$1,504,000 and \$308,000, respectively.

6. Contributions Receivable

Contributions receivable at December 31, 2006 and 2005 are expected to be received as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Within one year	\$ 1,120	\$ 400
Between two and five years	2,050	800
Thereafter	<u>203</u>	<u>203</u>
	3,373	1,403
Unamortized discount (4% and 7%)	<u>(270)</u>	<u>(134)</u>
Net contribution receivable	<u>\$ 3,103</u>	<u>\$ 1,269</u>

AARP Foundation
Notes to Consolidated Financial Statements
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7. Bonds Payable

On October 21, 2004, the Foundation issued 30-year District of Columbia Variable Rate Revenue Bonds Series 2004 in the amount of \$25,000,000 to finance the purchase of office space in the AARP headquarters building. The bonds bear interest at a rate determined by the Remarketing Agent based upon market conditions of reselling the bonds in a secondary market sale. Accrued interest is payable monthly. Total interest expense incurred for the years ended December 31, 2006 and 2005 was \$863,100 and \$614,300, respectively. The Foundation may elect at any time to convert to a fixed interest rate.

The bond proceeds were placed in an account held by a trustee. The Foundation used the remaining proceeds to finance the costs of renovating, rehabilitating, and equipping the purchased office space, as well as for the payment of interest costs.

The Foundation has obtained a letter of credit to secure repayment of the bond. The letter of credit constitutes an irrevocable obligation to pay the bond trustee up to an amount equal to the sum of the principal amount of the Series 2004 Bonds outstanding, plus an amount equal to interest for 35 days on the principal amount of each bond outstanding.

AARP has entered into a Standby Bond Purchase Agreement with the Foundation and the issuer of the Letter of Credit to purchase all bonds in the event the Foundation defaults on the bonds under the terms and conditions of the agreement.

8. Grant Revenue

Grant revenue from the following sources was recognized in the years ended December 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Department of Labor	\$ 72,758	\$ 76,196
Internal Revenue Service	3,901	3,646
Department of Housing and Urban Development	2,815	2,593
Department of Health and Human Services	419	468
Corporation for National and Community Service	201	-
State Agencies	511	338
Corporations and Foundations	865	88
Total grant revenue	<u>\$ 81,470</u>	<u>\$ 83,329</u>

AARP Foundation
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

9. Program Services

During the years ended December 31, 2006 and 2005, the Foundation's programs were as follows:

Senior Community Service Employment Program (SCSEP) provides subsidized assignments and job training for persons 55 and older whose income is at or below 125% of the federal poverty level. The SCSEP project is primarily funded by the U.S. Department of Labor. Department of Labor revenue represented approximately 49% and 51% of the Foundation's revenue for the years ended December 31, 2006 and 2005, respectively. The current federal grant to the Foundation expires on June 30, 2007.

Tax Counseling for the Elderly (Tax-Aide) provides volunteer assistance for federal income tax preparation to low and moderate income persons throughout the country, with special attention to those 60 and older. In the most recent tax season, approximately 2 million older persons were assisted. The Tax-Aide project is funded by AARP and the Internal Revenue Service. The current federal grant to the Foundation expires on September 30, 2007.

Legal Advocacy protects and preserves the rights of older Americans through both amicus curiae ("friend of the court") briefs on behalf of AARP, and third-party litigation.

Other programs provide information, counseling, training, and technical assistance to older persons and their service providers on various matters including economic security, consumer, legal, and housing issues.

In 2006 and 2005, other programs also include assistance provided to local organizations providing services to individuals 50 and older affected by the Gulf Coast hurricanes. The Foundation made grants of approximately \$716,600 in 2006 and \$1,600,000 in 2005. Approximately \$403,000 remains undisbursed at December 31, 2006. This amount is included as a component of grants payable in the accompanying 2006 statement of financial position.

Management anticipates that the SCSEP and Tax-Aide grants will be renewed. The continuation of grant-funded programs beyond the expiration dates of current agreements is subject to future funding decisions by sponsoring agencies.

10. Related-Party Transactions

a) Contributions

The Foundation obtains services from AARP under a contractual agreement covering personnel costs and other direct and indirect costs. Pursuant to that agreement, AARP made contributions totaling \$27,405,000 and \$32,877,000 for the years ended December 31, 2006 and 2005, respectively. These totals include donated services

AARP Foundation
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valued at \$7,871,000 and \$6,365,000 for the years ended December 31, 2006 and 2005, respectively, and amounts intended to fund future period operations of \$5,852,000 for the year ended December 31, 2005.

AARP contributions represented approximately 18% and 22% of the Foundation's revenue for the years ended December 31, 2006 and 2005, respectively.

AARP Services, Inc., an AARP affiliated entity, contributed \$810,000 to the Foundation in 2005, to support general operations.

b) Due to or from Affiliates

Amounts reported as due to or from affiliates included in the accompanying statements of financial position arise principally from intercompany activities in the normal course of business and are settled on a quarterly basis. In addition, AARP advanced \$1,550,000 for direct expenses of the Tax-Aide program, which is expected to be repaid when the program terminates.

c) Postretirement Health Benefits Obligation

A resolution in 1997 by the AARP Board of Directors stated AARP's intent to assume responsibility for postretirement health benefits relating to the Foundation's employees. The accrued obligation, which totaled \$10,645,300 and \$9,811,000 at December 31, 2006 and 2005, respectively, is recorded by AARP. AARP currently funds these benefits as claims are received from eligible Foundation retirees.

d) Office Space

Under a continuing operations agreement associated with the Foundation's condominium units located within the AARP headquarters building, certain shared facilities costs are billed to the Foundation by AARP, including utilities, maintenance, and security and building management. These costs were approximately \$527,000 and \$412,000 for the years ended December 31, 2006 and 2005, respectively.

A portion of the Foundation's condominium space is occupied by Legal Counsel for the Elderly (LCE), an affiliate of AARP. A portion of the shared occupancy costs, described above, was attributable to the space occupied by LCE. This portion of the costs, which amounted to \$105,300 and \$100,400 in the years ended December 31, 2006 and 2005, respectively, was donated by the Foundation to LCE as an in-kind contribution.

e) Intercompany Grant Awards

The Foundation has awarded grants to AARP for charitable programs that support the AARP Social Impact agenda. Expenses of \$2,377,000 and \$1,231,000 were recognized

AARP Foundation
Notes to Consolidated Financial Statements
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in 2006 and 2005, respectively. Approximately \$1,754,000 and \$573,900 of the recognized amounts remained unpaid as of December 31, 2006 and 2005, respectively, and are included as a component of 'Due to Affiliates' in the accompanying statements of financial position.

11. Defined-Benefit Pension Plan

The Foundation participates with other AARP affiliates in the AARP Employees' Pension Plan (the Plan), a noncontributory defined-benefit pension plan. The Plan covers all Foundation employees after they meet specified eligibility requirements.

Plan assets, investment income, and administrative expenses generally are allocated to the Foundation based on its proportion of the Plan's total projected benefit obligation as determined by the Plan actuaries. The general funding policy for the Plan is to contribute an amount equal to or greater than the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as actuarially determined, calculated on a level percentage of payroll costs basis, but not greater than the maximum tax deductible limit. There were no employer contributions by the Foundation to the Plan in 2006 and 2005. The Foundation will not be required to make a contribution to the pension plan in 2007. However, supplemental contributions may be made that are not estimable at this time.

In December 2006, the Benefits Committee of AARP approved an amendment to the Plan, which included clarification that the Plan is a single-employer plan, sponsored by AARP. As a result, AARP has assumed all financial and fiduciary obligations for future funding of benefits related to the Foundation's participants in the Plan.

All actuarially-determined liabilities and assets relating to accrued pension expenses will henceforth be recorded on the books of AARP, including the liability previously recorded by the Foundation. Any future cash contributions to the Plan will be recorded as expenses in the year in which they are made.

The transfer of the actuarially-determined liability from the Foundation to AARP results in a one-time increase in the Foundation's unrestricted net assets of approximately \$6,562,000.

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The following table sets forth the Foundation's portion of the Plan's funded status at September 30, 2005 (the actuarial measurement date) and the amounts recognized in the Foundation's financial statements as of and for the years ended December 31, 2005 (in thousands):

	<u>2005</u>
Change in benefit obligation:	
Benefit obligation at beginning of year	\$ (27,293)
Service cost	(1,242)
Interest cost	(1,562)
Actuarial gain (loss)	218
Benefits paid	679
	<u>Benefit obligation at end of year</u>
	<u>\$ (29,200)</u>
Change in plan assets:	
Fair value at beginning of year	\$ 18,331
Expected return on plan assets	1,634
Actuarial gain	-
Benefits paid	(679)
	<u>Fair value at end of year</u>
	<u>\$ 19,286</u>
Funded status	\$ (9,914)
Unrecognized net actuarial loss	3,308
Unrecognized prior service cost	44
	<u>Accrued pension liability</u>
	<u>\$ (6,562)</u>

The accumulated benefit obligation for the plan was approximately \$25,258,000 as of September 30, 2005. The net periodic pension expense for the year ended December 31, 2005 was \$893,000.

The assumptions used to determine net periodic benefit cost in the actuarial valuations at the September 30, 2005 measurement date are as follows:

Discount rate	5.80%
Expected long-term rate of return on plan assets	8.50%
Future salary increases	4.00%

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The assumptions used to determine the benefit obligation in the actuarial valuations at the September 30, 2005 measurement date are as follows:

Discount rate	5.70%
Expected long-term rate of return on plan assets	8.00%
Future salary increases	4.00%

As of December 31, 2005, the weighted-average asset allocation for the Plan is as follows:

Asset Categories:	
Equity securities	68%
Debt securities	30%
Cash equivalents	2%
	<hr/>
	100%
	<hr/> <hr/>

The targeted allocation of the investment assets in the Plan is for equities to comprise 65% of the investment portfolio, debt securities to comprise 30%, and alternatives to comprise the remaining 5%. These targets are not intended to serve as a rigid constraint on the investment allocation. The following chart sets out the minimum and maximum positions for the various asset classes in the Plan:

Asset Class:	Minimum	Target	Maximum
Equity securities	61%	65%	71%
Debt securities	24%	30%	32%
Alternatives	0%	5%	7%
Cash equivalents	0%	0%	7%

12. Employee Healthcare Benefits

The Foundation provides certain healthcare and other welfare benefits for active employees as a participating employer in the AARP Employees' Welfare Plan. The Welfare Plan receives contributions from all participating employers to provide benefits based on expected costs of providing these benefits. Expenses incurred by the Foundation for healthcare benefits were \$1,428,000 and \$1,606,000 for the years ended December 31, 2006 and 2005, respectively. The total estimated liability, including incurred but not reported claims, at December 31, 2006 and 2005 was approximately \$324,000 and \$454,000, respectively, and is included as a component of accounts payable and accrued expenses in the accompanying statements of financial position.

AARP Foundation
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

13. Defined-Contribution Plan

The Foundation participates in a single-employer defined-contribution plan called the AARP Employees' 401(k) Plan. To participate in the 401(k) Plan, an employee must be at least 18 years of age and have been employed for a minimum of one month of continuous service with the Foundation.

The Foundation makes contributions to the 401(k) Plan for its employees, matching employee contributions at 100% of the first 3%, and 50% of the next 2% of employee compensation up to the maximum limits allowed by current law.

Employer contributions totaled \$495,000 and \$494,000 for the years ended December 31, 2006 and 2005, respectively.

14. Temporarily Restricted Net Assets

Temporarily restricted net assets consist of balances restricted for, a) specific programs providing information, education and direct services, and b) amounts restricted for use in future periods.

The balances at December 31, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Purpose-restricted	\$ 9,403	\$ 11,789
Available in future periods	3,103	1,269
Total temporarily restricted net assets	<u>\$ 12,506</u>	<u>\$ 13,058</u>

15. Contingencies

The Foundation is a party to various claims and potential legal actions. Management believes, based upon advice of counsel, that the disposition of these matters will not have a significant effect on the financial position of the Foundation.

The Foundation receives a substantial portion of its revenue from government grants, which are subject to audit by various federal and state agencies. The ultimate determination of amounts received under these grants generally is based upon allowable costs reported to and audited by the governments or their designees. The liabilities, if any, arising from such compliance audits cannot be determined at this time. In the opinion of management, adjustments resulting from such audits, if any, will not have a significant effect on the financial position of the Foundation.

AARP Foundation
Schedule of Functional Expenses
For the Year Ended December 31, 2006
(with Comparative Totals for the Year Ended December 31, 2005)

	Program Services				Supporting Services				2006 Total Expenses	2005 Total Expenses
	SCSEP	Tax Counseling for the Elderly	Legal Advocacy	Other Programs	Total Program Services	Fundraising	Management and General	Total Supporting Services		
Expenses										
Enrollee wages & benefits	\$ 58,061	\$ -	\$ -	\$ -	\$ 58,061	\$ -	\$ -	\$ -	\$ 58,061	\$ 61,393
In-kind services	14,319	-	-	-	14,319	-	-	-	14,319	15,035
Personnel costs	8,650	1,018	3,669	3,345	16,682	2,676	1,159	3,835	20,517	19,582
Printing & postage	184	747	64	649	1,644	8,108	37	8,145	9,789	7,843
Promotion	127	8	10	238	383	2,733	24	2,757	3,140	2,757
Volunteer travel	2	4,901	1	99	5,003	5	29	34	5,037	4,488
Meetings & travel	964	33	69	602	1,668	490	40	530	2,198	1,345
Facilities	1,341	53	125	307	1,826	129	55	184	2,010	1,846
Telephone	428	16	23	69	536	26	7	33	569	551
Office supplies	509	197	-	89	795	25	232	257	1,052	832
Computers & software	129	1,837	-	99	2,065	-	41	41	2,106	3,261
Consulting & professional services	365	14	318	1,114	1,811	1,510	531	2,041	3,852	3,965
Data processing	396	91	2	9	498	792	-	792	1,290	1,215
Grant awards	-	-	-	5,882	5,882	-	-	-	5,882	5,389
Depreciation & amortization	72	56	135	277	540	139	58	197	737	669
Insurance & taxes	38	28	76	135	277	68	139	207	484	442
Interest	85	66	157	324	632	162	69	231	863	614
Miscellaneous	153	6	33	46	238	131	84	215	453	989
Information technology	660	1,114	617	718	3,109	534	174	708	3,817	2,959
AARP allocated general & administrative	-	-	-	-	-	-	4,246	4,246	4,246	4,015
Total expenses	\$ 86,483	\$ 10,185	\$ 5,299	\$ 14,002	\$ 115,969	\$ 17,528	\$ 6,925	\$ 24,453	\$ 140,422	\$ 139,190

See accompanying notes to financial statements.