

CONSOLIDATED FINANCIAL STATEMENTS

Foundation for a Smoke-Free World, Inc. and Subsidiary
Years Ended December 31, 2019 and 2018
With Report of Independent Auditors

Ernst & Young LLP



Foundation for a Smoke-Free World, Inc. and Subsidiary

Consolidated Financial Statements

Years Ended December 31, 2019 and 2018

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Report of Independent Auditors

The Board of Directors
Foundation for a Smoke-Free World, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of Foundation for a Smoke-Free World, Inc. and Subsidiary, which comprise the consolidated statements of financial position as of December 31, 2019 and 2018, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s Responsibility

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. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Foundation for a Smoke-Free World, Inc. and Subsidiary at December 31, 2019 and 2018, and the consolidated results of their activities and changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

May 8, 2020

Foundation for a Smoke-Free World, Inc. and Subsidiary

Consolidated Statements of Financial Position

	December 31	
	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 59,305,485	\$ 51,058,812
Interest receivable	36,629	90,389
Prepaid assets	412,700	64,337
Total current assets	<u>59,754,814</u>	<u>51,213,538</u>
Property and equipment, net	2,101,245	80,361
Security deposits	157,312	152,012
Total assets	<u><u>\$ 62,013,371</u></u>	<u><u>\$ 51,445,911</u></u>
Liabilities and net assets without donor restrictions		
Current liabilities:		
Accounts payable	\$ 322,991	\$ 111,612
Grants payable	46,729	264,283
Accrued expenses	1,311,462	2,651,082
Total current liabilities	<u>1,681,182</u>	<u>3,026,977</u>
Net assets without donor restrictions	<u>60,332,189</u>	<u>48,418,934</u>
Total liabilities and net assets without donor restrictions	<u><u>\$ 62,013,371</u></u>	<u><u>\$ 51,445,911</u></u>

See accompanying notes.

Foundation for a Smoke-Free World, Inc. and Subsidiary

Consolidated Statements of Activities and Changes in Net Assets

	Year Ended December 31	
	2019	2018
Revenue and other support		
Contribution revenue	\$ 80,000,000	\$ 80,000,000
Investment income	1,160,854	613,991
Total revenue and other support	81,160,854	80,613,991
Expenses		
Grant expenditures	41,022,460	6,727,344
Salaries and employee benefits	9,347,593	6,603,005
Communications	5,088,721	7,593,097
Professional services	6,643,900	4,553,871
Travel, conferences, and meetings	2,357,191	2,851,593
Legal fees	2,087,984	2,578,537
Occupancy and office expenses	1,777,351	1,509,633
Administrative and other expenses	922,399	743,685
Total expenses	69,247,599	33,160,765
Increase in net assets without donor restrictions	11,913,255	47,453,226
Net assets without donor restrictions at beginning of year	48,418,934	965,708
Net assets without donor restrictions at end of year	\$ 60,332,189	\$ 48,418,934

See accompanying notes.

Foundation for a Smoke-Free World, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2019	2018
Operating activities		
Increase in net assets without donor restrictions	\$ 11,913,255	\$ 47,453,226
Adjustments to reconcile increase in net assets without donor restrictions to net cash provided by operating activities:		
Depreciation and amortization	192,269	48,182
Changes in assets and liabilities:		
Interest receivable	53,760	(90,389)
Prepaid expenses	(348,363)	(14,337)
Security deposits	(5,300)	(122,762)
Accounts payable	211,379	110,024
Grants payable	(217,554)	264,283
Accrued expenses	(1,339,620)	2,214,290
Net cash provided by operating activities	10,459,826	49,862,517
Investing activities		
Purchases of property and equipment	(2,213,153)	(93,579)
Net cash used in investing activities	(2,213,153)	(93,579)
Net increase in cash and cash equivalents	8,246,673	49,768,938
Cash and cash equivalents, beginning of year	51,058,812	1,289,874
Cash and cash equivalents, end of year	\$ 59,305,485	51,058,812

See accompanying notes.

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2019

1. Description and Purpose of the Foundation

Foundation for a Smoke-Free World, Inc. (the Foundation) is a not-for-profit, nonstock corporation organization under the General Corporation Law of the State of Delaware. The Foundation was organized in September 2017 to fund research, promote innovation, and support collaborative initiatives to accelerate progress in reducing harm and deaths from smoking worldwide.

The Foundation's focus includes smoking cessation and harm reduction, as supported by new technologies, therapies, alternative products, behavioral science, and other approaches. In addition, the Foundation looks for solutions to address unique challenges facing developing countries as it aims to eliminate smoking around the globe.

The Foundation's Agricultural Transformation Initiative (ATI), located in Malawi, Africa, is a wholly owned subsidiary of the Foundation and is funded by the Foundation. ATI deploys resources aimed to diversify economies and lessen smallholder farmer dependence on tobacco, better preparing farmers for the future while strengthening their countries' economies. ATI is a not-for-profit by virtue of being incorporated under the laws of Malawi as a company limited by guarantee.

The Internal Revenue Service has ruled that the charitable corporation, Foundation for a Smoke-Free World, Inc., is a tax-exempt organization that is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code.

2. Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The consolidated financial statements and accompanying notes reflect the financial position and activities of the Foundation and its wholly owned subsidiary after elimination of intercompany accounts and transactions. The consolidated financial statements and accompanying notes are prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration of Credit Risk

Financial instruments that potentially expose the Foundation to concentrations of credit risk include cash and cash equivalents. As a matter of policy, the Foundation only maintains cash balances with financial institutions having a high credit quality; however, in the event of a financial institution's insolvency, recovery of the Foundation's assets on deposit may be limited to account insurance by the Federal Deposit Insurance Corporation.

One donor contributed all of the contributions in 2019 and 2018.

Cash and Cash Equivalents

Cash and cash equivalents consist of money market funds with an independent broker-dealer and are held for operating purposes. The Foundation considers all highly liquid instruments with maturities of three months or less at the time of purchase to be cash equivalents. Amounts held could exceed federally insured limits.

Property and Equipment

Property and equipment mainly consist of office equipment and computer software, stated at cost and depreciated or amortized using the straight-line method over estimated useful lives of the assets. Estimated useful lives are as follows:

<u>Description</u>	<u>Useful Life</u>
Computer software	2 – 5 years
Office equipment	5 – 7 years

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

Net Assets Without Donor Restrictions

Net assets without donor restrictions are net assets that are not subject to donor-imposed stipulations and that may be expended for any purpose in achieving the primary objectives of the Foundation.

Contribution Revenue

Contributions, including unconditional promises to give, are recorded at fair market value when received or pledged. All contributions are available for unrestricted use unless specifically restricted by the donor. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

Grant Expenditures

Unconditional grants are recognized as expense when the promise to give is approved by the Board of Directors. Conditional grants are recognized as expense in the period in which the recipient meets the terms of the condition.

Taxes

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income tax. However, because the Foundation is classified as a private foundation, it is subject to a federal excise tax on net investment income, and the Foundation provides for deferred federal excise tax at an estimate of the effective rate expected to be paid.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*. This ASU requires a lessee to recognize a right-of-use asset and a lease liability under most operating leases on its balance sheet. The ASU is effective for annual periods beginning after December 15, 2020. Early adoption is permitted. The Foundation is currently evaluating the effects that the adoption of ASU 2016-02 will have on its consolidated financial statements.

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements (continued)

3. Contributions

In 2018, the Foundation entered into a pledge agreement with PMI Global Services, Inc. (PMI), in which PMI agreed to contribute \$80,000,000 annually beginning in 2018 and ending in 2029 to be used exclusively in furtherance of the Foundation's purpose. Future amounts to be received after December 31, 2019, are considered to be conditional promises to give. The annual contributions from PMI will be provided to the Foundation once PMI receives the annual attestation from the Foundation's Board of Directors that agreed-upon conditions have been met for the respective annual funding period. At the point in which conditions are met, the contributions become unconditional promises to give and are recorded on the consolidated statements of activities and changes in net assets.

4. Grant Expenditures

As of December 31, 2019, the Board of Directors has authorized grants of unconditional and conditional promises to give of \$161,651,670, of which \$135,552,214 and \$25,732,547 were new grants authorized in 2019 and 2018, respectively. Payments are expected to be made through the year 2024.

As the majority of the grants are conditional, for the years ended December 31, 2019 and 2018, grant expenditures were \$41,022,460 and \$6,727,344, respectively, as conditions were satisfied.

Changes in grants payable related to unconditional grants are as follows:

	<u>2019</u>	<u>2018</u>
Grants payable at beginning of year	\$ 264,283	\$ –
Unconditional grants expensed	123,342	950,364
Payments made	340,896	686,081
Grants payable at end of year	<u>\$ 46,729</u>	<u>\$ 264,283</u>

Grants payable of \$46,729 at December 31, 2019, are scheduled to be disbursed in 2020. Grants payable of \$264,283 at December 31, 2018, include \$217,554 disbursed in 2019 and \$46,729 scheduled to be disbursed in 2020.

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Grant Expenditures (continued)

Subsequent to December 31, 2019, and as of the date of these financial statements, \$4,255,569 of conditional grants have been authorized by the Board of Directors with expected payments to occur over the period 2020 through 2021. These conditional grants will be recognized as grant expenditures on the consolidated statements of activities and changes in net assets in accordance with the grant expenditure policy described in Note 2 and will be funded with existing cash and future contributions received as described in Note 3.

5. Operating Leases

The Foundation leases office spaces under operating lease agreements that were set to expire in 2020. Rental expense was \$958,393 and \$654,807 during the years ended December 31, 2019 and 2018, respectively. Future minimum rental commitments under the noncancelable primary operating lease at December 31, 2019, are \$343,085 in 2020.

Subsequent to December 31, 2019, the Foundation extended one operating lease, terminated two lease agreements, and entered into a new operating lease agreement, which expire in 2020 and 2021. These leases resulted in additional future minimum rental commitments of \$335,168 and \$46,326 in 2020 and 2021, respectively.

6. Property and Equipment

Property and equipment, net consist of the following as of December 31:

	<u>2019</u>	<u>2018</u>
Office equipment	\$ 399,748	\$ 132,079
Computer software	1,945,484	—
	<u>2,345,232</u>	132,079
Less accumulated depreciation and amortization	<u>(243,987)</u>	<u>(51,718)</u>
Property and equipment, net	<u>\$ 2,101,245</u>	<u>\$ 80,361</u>

Depreciation and amortization expense was \$192,269 and \$48,182 for the years ended December 31, 2019 and 2018, respectively, and is recorded in occupancy and office expenses on the consolidated statements of activities.

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements (continued)

7. Financial Assets and Liquidity Resources

As of December 31, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses, are as follows:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 59,305,485	\$ 51,058,812
Interest receivable	36,629	90,389
	<u>\$ 59,342,114</u>	<u>\$ 51,149,201</u>

As part of the Foundation's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due.

8. Functional Classification of Expenses

The Foundation's primary program is to fund research to improve global health by ending smoking worldwide. Indirect expenses incurred in support of this primary program activity include employee salaries and benefits, facilities, office expenses, marketing, professional services and travel, and meeting expenses. Natural expenses attributable to more than one functional expense category are allocated using a variety of cost allocation techniques, such as square footage and time and effort.

Expenses by functional classification for the year ended December 31, 2019, consist of the following:

	<u>Health Science & Technology</u>	<u>Agriculture & Livelihoods</u>	<u>Industry Transformation</u>	<u>Communications</u>	<u>Education & Awareness</u>	<u>Administrative & Other</u>	<u>Total</u>
Grant expenditures	\$ 28,372,652	\$ 7,015,014	\$ 5,353,217	\$ –	\$ 281,577	\$ –	\$ 41,022,460
Salaries and employee benefits	1,121,739	2,106,147	103,787	1,015,242	135,812	4,864,866	9,347,593
Communications	215,967	187,869	–	4,354,898	–	329,987	5,088,721
Professional services	931,914	1,936,334	–	38,011	125,000	3,612,641	6,643,900
Travel, conferences, and meetings	462,037	733,297	22,272	34,477	175,012	930,096	2,357,191
Legal fees	–	6,157	–	–	–	2,081,827	2,087,984
Occupancy and office expenses	16,204	113,003	475	4,854	500	1,642,315	1,777,351
Administrative and other expenses	–	–	–	–	–	922,399	922,399
	<u>\$ 31,120,513</u>	<u>\$ 12,097,821</u>	<u>\$ 5,479,751</u>	<u>\$ 5,447,482</u>	<u>\$ 717,901</u>	<u>\$ 14,348,131</u>	<u>\$ 69,247,599</u>

Foundation for a Smoke-Free World, Inc. and Subsidiary

Notes to Consolidated Financial Statements (continued)

8. Functional Classification of Expenses (continued)

Expenses by functional classification for the year ended December 31, 2018, consist of the following:

	Health Science & Technology	Agriculture & Livelihoods	Industry Transformation	Communications	Education & Awareness	Administrative & Other	Total
Grant expenditures	\$ 2,412,236	\$ 2,997,526	\$ –	\$ –	\$ 1,317,582	\$ –	\$ 6,727,344
Salaries and employee benefits	1,242,806	1,244,450	108,403	873,115	–	3,134,231	6,603,005
Communications	–	–	–	7,593,097	–	–	7,593,097
Professional services	1,960,084	1,396,237	121,134	17,294	–	1,059,122	4,553,871
Travel, conferences, and meetings	543,500	822,611	–	141,635	–	1,343,847	2,851,593
Legal fees	60,158	3,340	–	–	–	2,515,039	2,578,537
Occupancy and office expenses	59,063	54,300	–	54,522	–	1,341,748	1,509,633
Administrative and other expenses	–	–	–	–	–	743,685	743,685
	<u>\$ 6,277,847</u>	<u>\$ 6,518,464</u>	<u>\$ 229,537</u>	<u>\$ 8,679,663</u>	<u>\$ 1,317,582</u>	<u>\$ 10,137,672</u>	<u>\$ 33,160,765</u>

9. Subsequent Events

In preparing these consolidated financial statements, the Foundation evaluated subsequent events through the time the consolidated financial statements were available to be issued on May 8, 2020, in compliance with applicable accounting standards. All material subsequent events have been either recognized in the consolidated financial statements or disclosed in the notes to the consolidated financial statements.

Due to the global viral outbreak caused by coronavirus disease 2019 (COVID-19) in 2020, there have been resulting effects in the general economy that could delay the timing and expenditures of the Foundation's and grantee's work activities as the broader economic impact of COVID-19 develops. The ultimate impact of these matters to the Foundation and its financial condition is presently unknown. The effect of this subsequent event did not result in any changes to the accompanying consolidated financial statements as of and for the year ended December 31, 2019.

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