

CONSOLIDATED FINANCIAL STATEMENTS

Foundation for a Smoke-Free World, Inc. and Subsidiary
Years Ended December 31, 2020 and 2019
With Report of Independent Auditors

Ernst & Young LLP



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

Consolidated Financial Statements

Years Ended December 31, 2020 and 2019

Contents

Report of Independent Auditors 1

Consolidated Financial Statements

Consolidated Statements of Financial Position 3

Consolidated Statements of Activities and Changes in Net Assets 4

Consolidated Statements of Cash Flows 5

Notes to Consolidated Financial Statements 6



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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, 2020 and 2019, 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, 2020 and 2019, 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

April 30, 2021

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

Consolidated Statements of Financial Position

	December 31	
	2020	2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 57,321,779	\$ 59,305,485
Interest receivable	473	36,629
Prepaid assets	830,428	412,700
Total current assets	<u>58,152,680</u>	<u>59,754,814</u>
Property and equipment, net	1,819,984	2,101,245
Security deposits	62,444	157,312
Total assets	<u><u>\$ 60,035,108</u></u>	<u><u>\$ 62,013,371</u></u>
Liabilities and net assets without donor restrictions		
Current liabilities:		
Accounts payable	\$ 283,016	\$ 322,991
Grants payable	-	46,730
Accrued expenses	455,539	1,311,461
Total current liabilities	<u>738,555</u>	<u>1,681,182</u>
Net assets without donor restrictions	<u>59,296,553</u>	<u>60,332,189</u>
Total liabilities and net assets without donor restrictions	<u><u>\$ 60,035,108</u></u>	<u><u>\$ 62,013,371</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	
	2020	2019
Revenue and other support		
Contribution revenue	\$ 45,000,000	\$ 80,000,000
Investment income	74,852	1,160,854
Total revenue and other support	45,074,852	81,160,854
Expenses		
Grant expenditures	25,334,999	41,022,460
Salaries and employee benefits	9,794,290	9,347,593
Communications	2,855,353	5,088,721
Professional services	3,458,654	6,643,900
Travel, conferences and meetings	256,660	2,357,191
Legal fees	444,549	2,087,984
Occupancy and office expenses	1,391,663	1,480,537
Data license fees	997,156	104,545
Depreciation	737,351	192,269
Administrative and other expenses	839,813	922,399
Total expenses	46,110,488	69,247,599
(Decrease) increase in net assets without donor restrictions	(1,035,636)	11,913,255
Net assets without donor restrictions at beginning of year	60,332,189	48,418,934
Net assets without donor restrictions at end of year	\$ 59,296,553	\$ 60,332,189

See accompanying notes.

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

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2020	2019
Operating activities		
(Decrease) increase in net assets without donor restrictions	\$ (1,035,636)	\$ 11,913,255
Adjustments to reconcile increase in net assets without donor restrictions to net cash provided by operating activities:		
Depreciation	737,351	192,269
Changes in assets and liabilities:		
Interest receivable	36,156	53,760
Prepaid expenses	(417,728)	(348,363)
Security deposits	94,868	(5,300)
Accounts payable	(39,975)	211,379
Grants payable	(46,730)	(217,553)
Accrued expenses	(855,922)	(1,339,621)
Net cash (used in) provided by operating activities	(1,527,616)	10,459,826
Investing activities		
Purchases of property and equipment	(456,090)	(2,213,153)
Net cash used in investing activities	(456,090)	(2,213,153)
Net (decrease) increase in cash and cash equivalents	(1,983,706)	8,246,673
Cash and cash equivalents, beginning of the year	59,305,485	51,058,812
Cash and cash equivalents, end of the year	<u>\$ 57,321,779</u>	<u>59,305,485</u>

See accompanying notes.

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

Notes to Consolidated Financial Statements

December 31, 2020

1. Description and Purpose of the Foundation

Foundation for a Smoke-Free World, Inc. (the Foundation) is a not-for-profit, non-stock 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 wholly controlled and funded by the Foundation. ATI deploys resources aimed to lessen smallholder farmer dependence on tobacco, better preparing farmers for the future when the demand for leaf tobacco is reduced.

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 operations of the Foundation and its 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 2020 and 2019.

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 consists of office and equipment and computer software and is stated at cost and depreciated 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 and equipment	5-7 years

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

Notes to Consolidated Financial Statements (continued)

2. Significant Accounting Policies (continued)

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.

Reclassifications

Certain prior year amounts have been reclassified for consistency with current year presentation. These reclassifications had no effect on the reported results of operations.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 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 in its balance sheet. The ASU is effective for annual periods beginning after December 15, 2021. 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. Net Assets

The net assets of the Foundation are classified and reported as follows:

Net Assets Without Donor Restrictions

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.

4. 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. The pledge agreement was amended in 2020 such that PMI agreed to contribute \$45,000,000 in 2020 and expects to contribute on an annual basis as follows: \$40,000,000 in 2021, and \$35,000,000 during the period beginning 2022 and ending 2029. Amounts to be received after the balance sheet 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 and a report from the Foundation's independent, external auditor with respect to certain other conditions. At the point in which conditions are met, the contributions become unconditional promises to give and are recorded in the consolidated statements of activities.

5. Grant Expenditures

As of December 31, 2020, the Board of Directors has authorized grants of unconditional and conditional promises to give of \$124,481,162. For the years ended December 31, 2020 and 2019, the Board of Directors authorized new grants of unconditional and conditional promises to give of \$15,189,078 and \$135,552,214, respectively. As of December 31, 2020, there was a net reduction in unpaid conditional grants of \$52,359,586 as agreements were finalized with grant recipients. Payments are expected to be made through the year 2024.

For the years ended December 31, 2020 and 2019, grant expenditures were \$25,334,999 and \$41,022,460, respectively, as conditions were satisfied.

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

Notes to Consolidated Financial Statements (continued)

5. Grant Expenditures (continued)

Changes in grants payable are as follows:

	<u>2020</u>	<u>2019</u>
Grants payable at beginning of year	\$ 46,729	\$ 264,282
Unconditional grants expensed	1,930,000	123,342
Payments made	1,976,729	340,896
Grants payable at end of year	<u>\$ —</u>	<u>\$ 46,729</u>

There are no unconditional grants payable at December 31, 2020. Grants payable of \$46,729 at December 31, 2019, were disbursed in 2020.

Subsequent to year end, \$2,163,793 of conditional grants have been authorized by the Board of Directors with expected payments to occur over the period 2021 through 2022. These conditional grants will be recognized as grant expenditures in the consolidated statements of activities 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 4.

6. Operating Leases

The Foundation leases office spaces under operating lease agreements, which expire in 2021. Rental expense was \$700,449 and \$958,393 in 2020 and 2019, respectively. Future minimum rental commitments under the non-cancelable primary operating leases at December 31, 2020, are \$58,326 in 2021.

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

Notes to Consolidated Financial Statements (continued)

7. Property and Equipment

Property and equipment consists of the following as of December 31, 2020 and 2019:

	<u>2020</u>	<u>2019</u>
Office and equipment	\$ 415,838	\$ 399,748
Computer software	2,385,484	1,945,484
	<u>2,801,322</u>	<u>2,345,232</u>
Less accumulated depreciation	(981,338)	(243,987)
Property and equipment, net	<u>\$ 1,819,984</u>	<u>\$ 2,101,245</u>

Depreciation expense was \$737,351 and \$192,269 for the years ended December 31, 2020 and 2019, respectively.

8. Financial Assets and Liquidity Resources

As of December 31, 2020 and 2019, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses are:

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 57,321,779	\$ 59,305,485
Interest receivable	473	36,629
	<u>\$ 57,322,252</u>	<u>\$ 59,342,114</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.

9. 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, 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. Occupancy and office expenses include rent, subscriptions, insurance, and office supplies. Administrative and other expenses include honorarium, accounting fees, and taxes.

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

Notes to Consolidated Financial Statements (continued)

9. Functional Classification of Expenses (continued)

Expenses by functional classification for the year ended December 31, 2020, consist of the following:

	Health Science & Technology	Agriculture & Livelihoods	Industry Transformation	Communications	Education & Awareness	COVID-19 Grants	Administrative & Other	Total
Grant expenditures	\$ 11,966,470	\$ 4,538,499	\$ 2,938,712	\$ -	\$ 3,761,811	\$ 2,129,507	\$ -	\$ 25,334,999
Salaries and employee benefits	2,831,483	2,681,466	268,116	625,894	1,086,572	-	2,300,759	9,794,290
Communications	-	-	173,032	2,682,321	-	-	-	2,855,353
Professional services	820,292	913,712	6,238	31,000	1,360,481	5,000	321,931	3,458,654
Travel, conferences and meetings	80,453	80,088	393	3,225	35,453	-	57,048	256,660
Legal fees	19,077	88,242	48,114	-	-	-	289,116	444,549
Occupancy and office expenses	330,757	139,419	25,349	3,892	24,337	475	867,434	1,391,663
Data license fees	997,131	-	-	-	-	-	25	997,156
Depreciation	647,778	42,046	-	-	-	-	47,527	737,351
Administrative and other expenses	-	34,688	-	-	-	-	805,125	839,813
	<u>\$ 17,693,441</u>	<u>\$ 8,518,160</u>	<u>\$ 3,459,954</u>	<u>\$ 3,346,332</u>	<u>\$ 6,268,654</u>	<u>\$ 2,134,982</u>	<u>\$ 4,688,965</u>	<u>\$ 46,110,488</u>

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

	Health Science & Technology	Agriculture & Livelihoods	Industry Transformation	Communications	Education & Awareness	Administrative & Other	Total
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	94,821	475	4,854	500	1,363,683	1,480,537
Data license fees	-	-	-	-	-	104,545	104,545
Depreciation	-	18,182	-	-	-	174,087	192,269
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>\$ 14,384,131</u>	<u>\$ 69,247,599</u>

10. 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 April 30, 2021, 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.

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