Financial Statements and Report of
Independent Certified Public Accountants

Municipal Securities Rulemaking Board

September 30, 2004 and 2003

Municipal Securities Rulemaking Board

Contents

Grant Thornton

Accountants and Business Advisors

Report of Independent Certified Public Accountants

Board of Directors
Municipal Securities Rulemaking Board

We have audited the accompanying statements of financial position of the Municipal Securities Rulemaking Board (the Board), as of September 30, 2004 and 2003, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Board'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 as established by the Auditing Standards Board of the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits 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 Board'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 financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Securities Rulemaking Board as of September 30, 2004 and 2003, and its changes in net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Vienna, Virginia
November 5, 2004 (except as to Note D, as to which the date is May 12, 2005)

Suite 300
2070 Chain Bridge Road
Vienna, VA 22182-2536
T 703.847.7500
F 703.848.9580
W www.grantthornton.com

Grant Thornton LLP
US Member of Grant Thornton International

Municipal Securities Rulemaking Board

Statements of Financial Position

September 30,		2004		2003
Assets				
Cash	$	990,314	$	825,831
Accounts receivable, including unbilled receivables of $415,606 and $518,627, respectively		2,313,376		2,342,301
Accrued interest receivable		100,328		88,982
Other assets		93,485		128,899
Investments		14,189,277		12,528,703
Fixed assets, net		5,179,132		3,890,046
Total Assets	$	22,865,912	$	19,804,762
Liabilities and Net Assets				
Accounts payable	$	353,900	$	393,452
Accrued vacation payable		245,358		237,774
Tenant deposit		—		10,000
Capital lease obligations		13,594		18,906
Deferred rent		1,558,177		1,355,716
Total Liabilities		2,171,029		2,015,848
Net Assets–Unrestricted		20,694,883		17,788,914
Total Liabilities and Net Assets	$	22,865,912	$	19,804,762

The accompanying notes are an integral part of these statements.

Municipal Securities Rulemaking Board

Statements of Activities and Changes in Net Assets

Year ended September 30,	2004	2003
Revenue		
Underwriting assessment fees	$ 9,752,383	$ 11,223,200
Transaction fees	5,421,603	5,900,332
Annual fees	744,800	515,900
MSIL fees	238,523	274,691
Initial fees	12,900	24,000
Other income	240,827	504,069
Investment return	107,802	173,132
Board manuals	17,520	14,901
Total Revenue	16,536,358	18,630,225
Expenses		
MSIL	4,769,029	4,731,610
Administration and operations	3,754,430	4,186,731
Rulemaking and policy development	2,930,805	3,096,737
Board and committee	1,110,212	688,591
Professional qualifications	744,469	725,001
Education and communications	321,444	266,613
Total Expenses	13,630,389	13,695,283
Change in Net Assets	2,905,969	4,934,942
Net Assets, beginning of year	17,788,914	12,853,972
Net Assets, end of year	$ 20,694,883	$ 17,788,914

The accompanying notes are an integral part of these statements.

Municipal Securities Rulemaking Board

Statements of Cash Flows

Year ended September 30,	2004	2003
Cash Flows from Operating Activities		
Change in net assets	$ 2,905,969	$ 4,934,942
Adjustments to reconcile change in net assets to net cash from operating activities:		
Depreciation and amortization	780,873	791,473
Loss on disposal of fixed assets	472	423
Net amortization of investment premiums	190,881	142,300
Unrealized losses (gains) on investments	88,147	(11,221)
Changes in assets and liabilities:		
Accounts receivable	28,925	97,823
Accrued interest receivable	(11,346)	(33,662)
Other assets	35,414	25,011
Accounts payable	(39,552)	185,867
Accrued vacation payable	7,584	(9,637)
Tenant deposit	(10,000)	—
Deferred rent	202,461	182,455
Net Cash Provided by Operating Activities	4,179,828	6,305,774
Cash Flows from Investing Activities		
Purchases of fixed assets	(2,070,431)	(1,948,691)
Purchases of investments	(7,039,602)	(11,065,432)
Maturities of investments	5,100,000	6,545,794
Net Cash Used in Investing Activities	(4,010,033)	(6,468,329)
Cash Flows from Financing Activities		
Payments on capital lease obligations	(5,312)	(2,451)
Net Increase (Decrease) in Cash	164,483	(165,006)
Cash, beginning of year	825,831	990,837
Cash, end of year	$ 990,314	$ 825,831

Supplemental Information		
Interest paid	$ 712	$ 1,020

The accompanying notes are an integral part of these statements.

NOTE A—NATURE OF OPERATIONS

The Municipal Securities Rulemaking Board (the Board) was established in 1975 pursuant to authority granted by the Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1975, as an independent, self-regulatory organization charged with rulemaking responsibility for the municipal securities industry. Effective May 17, 1989, the Board became incorporated as a tax-exempt, non-stock corporation in the Commonwealth of Virginia.

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

Investments

Investments are stated at fair value as determined by quoted market prices. Investments consist entirely of U.S. Treasury Notes. The U.S. Treasury Notes have various maturity dates through May 2006.

Investment return consists of interest income of $195,949 and $161,911 and unrealized (losses)/gains of $(88,147) and $11,221 for the years ended September 30, 2004 and 2003, respectively. Amortization and accretion of investment premiums and discounts are recorded as a component of unrealized gains/(losses).

Fixed Assets

Furniture and fixtures and office equipment are recorded at cost and are depreciated using the straight-line method over five years and three years, respectively. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease period or the estimated useful life of the improvement. Internal-use computer software is recorded at cost and amortized over its estimated useful life.

Capitalized Software Costs

The Board capitalizes certain costs associated with computer software developed or obtained for internal use in accordance with the provisions of Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.* The Board's policy provides for the capitalization of external direct costs of materials and services and directly related payroll related costs. Costs associated with preliminary project stage activities, training, maintenance and post implementation stage activities are expensed as incurred. Costs capitalized are amortized over a three- to five-year period on a straight line basis.

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Underwriting Assessment Fees

On March 10, 1992, the Board filed with the Securities and Exchange Commission (SEC) an amendment to Rule A-13 on assessments relating to the underwriting of municipal securities offerings. The amendment relates to the Board's method of assessment, the scope of offerings which are assessed, and assessment rates.

The underwriting assessment fee is equal to a percentage of the face amount of all municipal securities, which are purchased from an issuer as part of a new issue. The fee charged is .001 percent or .003 percent of the par value of the offerings, as specified in Board Rule A-13. As described in this rule, certain transactions are exempt from underwriting fees.

Revenue from underwriting assessment fees is recognized when the underwriter files the offering statement with the Board.

Annual Fees

With respect to each fiscal year of the Board in which a municipal securities broker or municipal securities dealer conducts business, the municipal securities broker or municipal securities dealer is required to pay an annual fee of $300. Prior to October 1, 2003, the annual fee was $200. Annual fees revenue is recognized when brokers or dealers are billed.

Initial Fees

The initial fee is a one-time fee of $100, which is to be paid by every municipal securities broker or municipal securities dealer registered with the SEC. Initial fees revenue is recognized when received.

Municipal Securities Information Library (MSIL) Fees

MSIL collects, stores, and provides access to information necessary for the municipal securities market. MSIL operates three computer-based information systems: an electronic-document system for the collection, storage and dissemination of official statements and advance-refunding documents (the OS/ARD system); a broadcast system for collection and dissemination of material events and notices from municipal securities issuers (the CDI system); and the collection, processing, and dissemination of all municipal securities transactions for purposes of price transparency and surveillance (the TRS system). Information in these systems is sold to subscribers on a subscription basis with billing quarterly in arrears. In addition, MSIL maintains files for public access of all Forms G-37, G-38 and other documents. Copying fees are levied at time of use for the reproduction of any documents.

Transaction Fees

On May 10, 1996, the SEC approved an amendment to Board Rule A-13 to implement a new transaction fee on each inter-dealer sales transaction in municipal securities. The fee, one-half cent per $1,000 par value of bonds, is levied on the sellers on inter-dealer transactions.

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Transaction Fees—Continued

On April 10, 2000, Board Rule A-13 was expanded to include a fee assessment on the customer sales transaction activities of municipal securities dealers. The customer sales transaction fee was also set at one-half cent per $1,000 par value of bonds. In addition, exemptions from the transaction fees were provided for transactions effected in certain classes of bonds.

Dealers are billed monthly for sales transactions that were settled during the previous month. Revenue is recognized when dealers are billed. The unbilled receivables consist entirely of the September transaction fees revenue that is billed in October.

Concentration of Credit Risk

Financial instruments which potentially subject the Board to a concentration of credit risk consist principally of cash and accounts receivable. Cash balances at times are in excess of federally insured amounts and, as a result, subject the Board to a degree to credit risk. The Board's policy is to limit credit risk by depositing its funds with high quality financial institutions. Accounts receivable consist of fees due from municipal securities brokers and dealers. At times, there are certain significant balances due from individual municipal securities brokers and municipal securities dealers.

NOTE C—FIXED ASSETS

Fixed assets consist of the following as of September 30:

	2004	2003
Leasehold improvements	$ 1,220,541	$ 1,653,895
Office equipment	1,821,096	1,664,324
Furniture and fixtures	1,332,835	1,332,835
Capitalized software costs	4,455,154	2,616,496
	8,829,626	7,267,550
Less: accumulated depreciation and amortization	(3,650,494)	(3,377,504)
	$ 5,179,132	$ 3,890,046

NOTE C—FIXED ASSETS—Continued

Office equipment includes assets acquired under capital leases of $66,717 and $97,227 at September 30, 2004 and 2003, respectively. The related accumulated depreciation for assets acquired under capital leases totaled $57,796 and $82,832 at September 30, 2004 and 2003, respectively.

Of the total capitalized software costs at September 30, 2004, approximately $3.3 million relates to the development of the Real-Time Transaction Reporting System (RTRS), which will be used to collect, process and disseminate municipal securities pricing information on a real time basis. This system is expected to be functional in 2005.

NOTE D—COMMITMENTS

Operating and Capital Leases

The Board leases office space and certain office equipment under operating and capital leases. In May 2001, the Board moved its headquarters from Washington, D.C. to new office space in Alexandria, Virginia, and entered into a lease which will expire in fiscal year 2016. The operating lease agreement for this office space contains provisions for future rent increases. The total amount of rental payments due over the lease term is being charged to rent expense on the straight-line method over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is included in the liabilities in the accompanying statements of financial position. In connection with the move, the Board entered into various sublease agreements for its former office space in Washington, D.C. The lease on the Washington, D.C. space, and related sublease agreements, expired in February 2004. The Board also leases office space in Manassas, Virginia for operations as provided in its emergency readiness plan. This lease expires in April 2008.

Office equipment under capital lease obligations consists of a postage meter machine and a photocopier.

Future minimum lease payments under non-cancelable capital and operating leases are as follows:

Year ending September 30,	Capital Leases	Operating Leases
2005	$ 5,280	1,440,501
2006	5,280	1,473,086
2007	3,960	1,519,374
2008	—	1,530,694
2009	—	1,553,988
Thereafter	—	11,761,824
Total minimum lease payments	14,520	$ 19,279,467
Less: amount representing interest	926	
Capital lease obligation at September 30, 2004	$ 13,594	

NOTE D—COMMITMENTS—Continued

Operating and Capital Leases—Continued

Total rent expense for office space and equipment for the years ended September 30, 2004 and 2003, was $2,495,492 and $2,944,262, respectively.

Sublease income for the office space in Washington, DC for the years ended September 30, 2004 and 2003, was $211,726 and $501,062, respectively. Sublease income is a component of other income.

Employment Agreement

As of September 30, 2004, the Board had an employment agreement with its Executive Director, based in major part on the employment agreement first agreed to by the parties on October 1, 1992, which provided, *inter alia*, for a specific term, salary, general employee benefits, and certain other benefits, including a supplemental retirement, life insurance, and others. A Supplemental Executive Retirement Plan (SERP), which was created in 1989, and has been part of the employment agreement since 1992, provides a benefit equal to 50 percent of the Executive Director's base pay, reduced by retirement contributions already provided by the Board under the existing retirement and supplemental plans and estimated Social Security. Vesting would have occurred if the Executive Director's employment had terminated at or after age 60 and in certain other limited circumstances. No accrual was made as of September 30, 2004, because vesting would not have occurred during the then-existing contract period.

As of September 30, 2004, the Board and the Executive Director were in the process of renegotiating the contract, including an extension of the term. On May 12, 2005, a new contract has been entered into by the parties with a term ending on September 30, 2007. Given this extension, the SERP benefit, which the parties agreed to fix at $1,561,394, is payable at the end of term of the new three-year contract subject to the terms thereof. As a result, one-third of that amount will be accrued in each of the next three years.

NOTE E—RETIREMENT PLAN

The Board has a defined contribution pension plan for all employees. Participation commences upon completion of one year of eligible service as described in the plan document. For all active participants employed on the first day of the calendar quarter, the Board makes a quarterly contribution as required by the plan document. These contributions are based on the participants' quarterly compensation for the calendar quarter immediately proceeding the first day of the calendar quarter. The contribution percentage ranges from 9 percent to 12 percent depending on the length of vested service as scheduled in the plan document. Each employee is fully vested upon being credited with five plan years of service. Employees may also make voluntary contributions to the plan. The Board made contributions to the plan totaling $443,251 and $440,510 for the years ended September 30, 2004 and 2003, respectively.

All administrative expenses of the plan are paid by the Board. Administrative expenses totaled $19,323 and $13,671 for the years ended September 30, 2004 and 2003, respectively.

In addition, the Board has entered into separate agreements with three employees to provide supplemental benefits in excess of IRS limitations. Contributions made by the Board in accordance with these agreements totaled $161,580 and $166,660 for the years September 30, 2004 and 2003, respectively.

NOTE F—INCOME TAXES

The Board is exempt from taxes on income other than unrelated business income under Section 501(c)(6) of the Internal Revenue Code and applicable income tax regulations of the Commonwealth of Virginia. No provision for income taxes has been made as of September 30, 2004 and 2003, since the Board believes that there is no unrelated business income.