

Financial Statements and Report of
Independent Certified Public Accountants
Municipal Securities Rulemaking Board
September 30, 2002 and 2001

Municipal Securities Rulemaking Board

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Report of Independent Certified Public Accountants

Board of Directors
Municipal Securities Rulemaking Board

We have audited the accompanying statement of financial position of the Municipal Securities Rulemaking Board (the Board), as of September 30, 2002, and the related statements of activities and change in net assets and cash flows for the year 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 audit. The financial statements of the Board as of and for the year ended September 30, 2001, were audited by other auditors whose report dated November 8, 2001, expressed an unqualified opinion on those statements.

We conducted our audit 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 2002, its activities and change in net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Vienna, Virginia
November 20, 2002

Municipal Securities Rulemaking Board

Statements of Financial Position

<i>September 30,</i>	2002	2001
Assets		
Cash	\$ 990,837	\$ 757,389
Accounts receivable, including unbilled receivables of \$443,549 in 2002 and \$269,702 in 2001	2,440,124	2,139,545
Accrued interest receivable	55,320	93,367
Other assets	153,910	806,771
Investments	8,140,144	5,026,876
Fixed assets, net	2,733,251	2,147,270
Total Assets	\$ 14,513,586	\$ 10,971,218
Liabilities and Net Assets		
Accounts payable	\$ 207,585	\$ 182,110
Accrued vacation payable	247,411	212,705
Tenant deposit	10,000	—
Capital lease obligations	21,357	53,899
Deferred rent	1,173,261	614,361
Total Liabilities	1,659,614	1,063,075
Net Assets—Unrestricted	12,853,972	9,908,143
Total Liabilities and Net Assets	\$ 14,513,586	\$ 10,971,218

The accompanying notes are an integral part of these statements.

Municipal Securities Rulemaking Board

Statements of Activities and Change in Net Assets

<i>Years ended September 30,</i>	2002	2001
Revenue		
Underwriting assessment fees	\$ 9,893,264	\$ 7,009,521
Transaction fees	5,291,195	4,416,510
Annual fees	517,200	503,900
Initial fees	32,200	21,700
MSIL fees	326,548	287,205
Interest	156,367	326,271
Unrealized (losses) gains on investments	(52,215)	123,765
Board manuals	27,392	29,194
Other income	430,217	177,905
Total Revenue	16,622,168	12,895,971
Expenses		
MSIL	4,714,930	4,633,216
Administration and operations	4,357,866	3,240,943
Rulemaking and policy development	3,046,172	2,581,798
Board and committee	715,237	587,844
Professional qualifications	678,911	437,937
Education and communications	163,223	279,852
Total Expenses	13,676,339	11,761,590
Change in Net Assets	2,945,829	1,134,381
Net Assets, beginning of year	9,908,143	8,773,762
Net Assets, end of year	\$ 12,853,972	\$ 9,908,143

The accompanying notes are an integral part of these statements.

Municipal Securities Rulemaking Board

Statements of Cash Flows

<i>Years ended September 30,</i>	2002	2001
Cash Flows from Operating Activities		
Change in net assets	\$ 2,945,829	\$ 1,134,381
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	790,171	599,436
Loss on disposal of fixed assets	46,470	5,462
Net amortization of investment premiums	140,142	10,601
Unrealized losses (gains) on investments	52,215	(123,765)
Increase in accounts receivable	(300,579)	(586,122)
Decrease in accrued interest receivable	38,047	3,425
Decrease (increase) in other assets	652,861	(299,065)
Increase in accounts payable	25,475	21,113
Increase in accrued vacation payable	34,706	34,145
Increase in tenant deposit	10,000	—
Increase in deferred rent	558,900	232,941
Net Cash Provided by Operating Activities	4,994,237	1,032,552
Cash Flows from Investing Activities		
Purchases of fixed assets	(1,422,622)	(1,846,239)
Purchases of investments	(9,005,625)	(6,176,969)
Maturities of investments	5,700,000	6,800,000
Net Cash Used in Investing Activities	(4,728,247)	(1,223,208)
Cash Flows from Financing Activities		
Payments on capital lease obligations	(32,542)	(65,299)
Net Cash Used in Financing Activities	(32,542)	(65,299)
Net Increase (Decrease) in Cash	233,448	(255,955)
Cash, beginning of year	757,389	1,013,344
Cash, end of year	\$ 990,837	\$ 757,389
Supplemental Information		
Interest paid	\$ 3,423	\$ 12,863
Disposal of fixed assets under capital lease	\$ —	\$ 76,882

The accompanying notes are an integral part of these statements.

Municipal Securities Rulemaking Board

Notes to Financial Statements

September 30, 2002 and 2001

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 non-profit, 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 and a U.S. Treasury Bill. The U.S. Treasury Notes have various maturity dates through January 2004. The U.S. Treasury Bill matures in October 2002.

Amortization and accretion of investment premiums and discounts are recorded as a component of interest revenue in the statements of activities and change in net assets.

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.

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.

Municipal Securities Rulemaking Board

Notes to Financial Statements—Continued

September 30, 2002 and 2001

NOTE B—SUMMARY OF ACCOUNTING POLICIES—Continued

Underwriting Assessment Fees—Continued

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 ranges from .001 percent to .003 percent of the par value of the offerings.

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 \$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

The 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 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.

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.

The transaction fees will help pay for the Board's transaction-reporting program, which is designed to provide the public and federal regulators with pricing and other information on bond trades.

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.

Municipal Securities Rulemaking Board

Notes to Financial Statements—Continued

September 30, 2002 and 2001

NOTE B—SUMMARY OF ACCOUNTING POLICIES—Continued

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 consists 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.

Reclassifications

Certain amounts included in the 2001 financial statements have been reclassified to conform to the 2002 presentation.

NOTE C—FIXED ASSETS

Fixed assets consist of the following as of September 30:

	2002	2001
Leasehold improvements	\$ 1,952,712	\$ 1,320,407
Office equipment	1,814,306	2,256,228
Furniture and fixtures	1,332,835	1,277,589
Internal-use computer software	770,156	308,823
	5,870,009	5,163,047
Less accumulated depreciation and amortization	(3,136,758)	(3,015,777)
	\$ 2,733,251	\$ 2,147,270

Office equipment includes assets acquired under capital leases of \$111,788 at September 30, 2002 and 2001. The related accumulated amortization for assets acquired under capital leases totaled \$97,487 and \$67,334 at September 30, 2002 and 2001, respectively.

Municipal Securities Rulemaking Board

Notes to Financial Statements—Continued

September 30, 2002 and 2001

NOTE D—LEASE COMMITMENTS AND RENT EXPENSE

The Board leases office space and certain office equipment under operating and capital leases. In May 2001, the Board moved its headquarters from Washington, DC to new office space in Alexandria, VA. In connection with the move, the Board entered into a lease for the new office space and into various sublease agreements for its former office space in Washington, DC. The lease on the Washington, DC space, and related sublease agreements expire in February 2004. The new office lease expires in fiscal year 2016. The Board also leases office space in Manassas, VA for operations as provided in its emergency readiness plan. This lease expires in April 2008.

Office equipment under capital lease obligations consist of several fax machines, two postage meter machines, and a photocopier.

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

<i>Year ending September 30,</i>	Capital Leases	Operating Leases
2003	\$ 21,337	\$ 1,953,611
2004	812	1,579,767
2005	—	1,355,524
2006	—	1,426,506
2007	—	1,499,966
Thereafter	—	13,346,540
Total minimum lease payments	22,149	\$ 21,161,914
Less: amount representing interest	(792)	
	\$ 21,357	

Future minimum sublease income is as follows:

<i>Year ending September 30,</i>	
2003	\$ 544,533
2004	232,267
	\$ 776,800

Total rent expense for office space and equipment for the years ended September 30, 2002 and 2001, was \$3,312,904 and \$2,279,506, respectively.

Municipal Securities Rulemaking Board

Notes to Financial Statements—Continued

September 30, 2002 and 2001

NOTE E—RETIREMENT PLAN

The Board has a defined contribution pension plan for all employees. Participation commences upon completion of one year of eligibility 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 preceding 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 \$406,450 and \$329,408 for the years ended September 30, 2002 and 2001, respectively.

All administrative expenses of the plan are paid by the Board. Administrative expenses totaled \$29,462 and \$8,705 for the years ended September 30, 2002 and 2001, 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 District of Columbia. No provision for income taxes has been made as of September 30, 2002 and 2001, since the Board believes that any unrelated business income is not significant.