

Drug Policy Action

Financial Statements

May 31, 2017

Independent Auditors' Report

Board of Directors Drug Policy Action

We have audited the accompanying financial statements of Drug Policy Action, which comprise the statement of financial position as of May 31, 2017, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 financial position of Drug Policy Action as of May 31, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America

Report on Summarized Comparative Information

We have previously audited Drug Policy Action's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated March 16, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended May 31, 2016 is consistent, in all material respects, with the audited financial statements from which it has been derived.

PKF O'Connor Davies, LLP

April 2, 2018

Drug Policy Action

Statement of Financial Position
May 31, 2017
(with comparative amounts at May 31, 2016)

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and cash equivalents	\$ 13,786,356	\$ 13,639,857
Investments	5,961,255	2,923,522
Note receivable	7,000,000	7,000,000
Prepaid expenses	7,420	-
Grants receivable, net	<u>13,657,291</u>	<u>19,195,656</u>
	<u>\$ 40,412,322</u>	<u>\$ 42,759,035</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	<u>\$ 26,051</u>	<u>\$ 9,156</u>
Net Assets		
Unrestricted	26,728,980	23,554,223
Temporarily restricted	<u>13,657,291</u>	<u>19,195,656</u>
Total Net Assets	<u>40,386,271</u>	<u>42,749,879</u>
	<u>\$ 40,412,322</u>	<u>\$ 42,759,035</u>

See notes to financial statements

Drug Policy Action

Statement of Activities
Year Ended May 31, 2017
(with summarized totals for the year ended May 31, 2016)

	2017			2016 Total
	Unrestricted	Temporarily Restricted	Total	
SUPPORT AND REVENUE				
Major contributions	\$ 1,321,249	\$ 900,000	\$ 2,221,249	\$ 1,300,000
Other contributions	28,104	-	28,104	918
Investment income	59,619	-	59,619	56,562
Interest income on note	160,000	-	160,000	118,333
Ballot and other initiatives income	878,161	-	878,161	60,067
Present value discount adjustment	-	511,635	511,635	1,896,074
Net assets released from restriction	<u>6,950,000</u>	<u>(6,950,000)</u>	<u>-</u>	<u>-</u>
Total Support and Revenue	<u>9,397,133</u>	<u>(5,538,365)</u>	<u>3,858,768</u>	<u>3,431,954</u>
EXPENSES				
Program Services				
Public Policy and Legal Affairs				
Consulting	914,456	-	914,456	500,570
Ballot and other initiatives	4,414,000	-	4,414,000	1,970,000
Grant general	345,000	-	345,000	-
Political reporting retainer	27,040	-	27,040	8,760
Miscellaneous	124,962	-	124,962	37,864
Advertising and marketing	100,754	-	100,754	5,517
Excise tax	<u>1,103</u>	<u>-</u>	<u>1,103</u>	<u>690</u>
Total Program Services	<u>5,927,315</u>	<u>-</u>	<u>5,927,315</u>	<u>2,523,401</u>
Management and General				
Administrative expenses	173,460	-	173,460	115,920
Professional fees	34,800	-	34,800	26,302
Miscellaneous	<u>77,672</u>	<u>-</u>	<u>77,672</u>	<u>16,038</u>
Total Management and General	<u>285,932</u>	<u>-</u>	<u>285,932</u>	<u>158,260</u>
Fundraising	<u>9,129</u>	<u>-</u>	<u>9,129</u>	<u>6,101</u>
Total Expenses	<u>6,222,376</u>	<u>-</u>	<u>6,222,376</u>	<u>2,687,762</u>
Change in Net Assets Before				
Rescinded Grant	3,174,757	(5,538,365)	(2,363,608)	744,192
Rescinded grant	<u>-</u>	<u>-</u>	<u>-</u>	<u>(150,000)</u>
Change in Net Assets	<u>3,174,757</u>	<u>(5,538,365)</u>	<u>(2,363,608)</u>	<u>594,192</u>
NET ASSETS				
Beginning of year	<u>23,554,223</u>	<u>19,195,656</u>	<u>42,749,879</u>	<u>42,155,687</u>
End of year	<u>\$ 26,728,980</u>	<u>\$ 13,657,291</u>	<u>\$ 40,386,271</u>	<u>\$ 42,749,879</u>

See notes to financial statements

Drug Policy Action

Statement of Cash Flows Year Ended May 31, 2017

(with comparative amounts for the year ended May 31, 2016)

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ (2,363,608)	\$ 594,192
Adjustments to reconcile change in net assets to net cash from operating activities		
Unrealized loss on investments	8,261	11,417
Discount to present value	(511,635)	(1,896,074)
Changes in operating assets and liabilities		
Prepaid expenses	(7,420)	-
Grants receivable	6,050,000	6,650,000
Due from Drug Policy Alliance	-	150,000
Accounts payable and accrued expenses	<u>16,895</u>	<u>(45,645)</u>
Net Cash from Operating Activities	<u>3,192,493</u>	<u>5,463,890</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(5,535,994)	(223,574)
Proceeds from sale of investments	2,490,000	172,056
Issuance of note receivable	(500,000)	(4,000,000)
Repayment from note receivable	<u>500,000</u>	<u>-</u>
Net Cash from Investing Activities	<u>(3,045,994)</u>	<u>(4,051,518)</u>
Net Change in Cash and Cash Equivalents	146,499	1,412,372
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>13,639,857</u>	<u>12,227,485</u>
End of year	<u>\$ 13,786,356</u>	<u>\$ 13,639,857</u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for federal excise tax	\$ 1,103	\$ 690

See notes to financial statements

Drug Policy Action

Notes to Financial Statements
May 31, 2017

1. Nature of Organization

Drug Policy Action is a non-profit organization organized and operated exclusively for the purpose of promoting social welfare within the meaning of section 501(c)(4) of the Internal Revenue Code of 1986, including, specifically to advocate for reform of federal, state, local and foreign laws on drug policy, educating Americans at the grassroots level about drug policy and involving them in efforts to ensure that government policies on these issues effectively advance the public interest.

2. Summary of Significant Accounting Policies

Basis of Presentation and Use of Estimates

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) which 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 revenue and expenses during the reporting period. Accordingly actual results could differ from those estimates.

Cash and Cash Equivalents

For financial statement purposes, Drug Policy Action considers all highly liquid instruments with maturities of three months or less at the time of purchase to be cash equivalents.

Fair Value Measurements

Drug Policy Action follows US GAAP guidance on Fair Value Measurements which defines fair value and establishes a fair value hierarchy organized into three levels based upon the input assumptions used in pricing assets. Level 1 inputs have the highest reliability and are related to assets with unadjusted quoted prices in active markets. Level 2 inputs relate to assets with other than quoted prices in active markets which may include quoted prices for similar assets or liabilities or other inputs which can be corroborated by observable market data. Level 3 inputs are unobservable inputs and are used to the extent that observable inputs do not exist.

Investments and Investment Income Recognition

Investments are stated at fair value. Purchases and sales of securities are recorded on a settlement-date basis. Interest and dividend income is recorded when earned. Realized and unrealized gains and losses are included in the determination of the change in net assets in the statement of activities.

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Notes to Financial Statements
May 31, 2017

2. Summary of Significant Accounting Policies (continued)

Grants Receivable

Management periodically evaluates receivable balances to determine whether an allowance for doubtful accounts should be established to provide for estimated uncollectible amounts.

Grants and Contributions

Grants and contributions are recorded when an unconditional promise to give is made by the donor. Grants and contributions that are restricted by the donor are reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily restricted or permanently restricted net assets depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions.

Revenue Recognition

Ballot and other initiatives income is recognized as revenue when Drug Policy Action has fulfilled its obligation under the terms of the agreement.

Net Asset Presentation

The financial statements report amounts separately by class of net assets based on the presence or absence of donor restrictions. Unrestricted amounts are those currently available at the discretion of Drug Policy Action for use in its programs and operations. Temporarily restricted amounts are those which are subject to donor-imposed restrictions that will be met either by actions of Drug Policy Action or the passage of time. Permanently restricted amounts are subject to donor-imposed restrictions requiring that they be maintained permanently by Drug Policy Action.

Revenue and support are reported as increases in unrestricted net assets unless their use is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. 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

Functional Allocations of Expenses

The costs of providing for the various programs and other activities have been summarized on a functional basis in the financial statements. Accordingly, certain costs have been allocated among the program and supporting services benefited.

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Notes to Financial Statements
May 31, 2017

2. Summary of Significant Accounting Policies *(continued)*

Accounting for Uncertainty in Income Taxes

Drug Policy Action recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Management has determined that Drug Policy Action had no uncertain tax positions that would require financial statement recognition or disclosure. Drug Policy Action is no longer subject to examination by the applicable taxing jurisdictions for the periods prior to 2014.

Subsequent Events Evaluation by Management

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which date is April 2, 2018.

Prior Year Summarized Comparative Information

Information as of and for the year ended May 31, 2016 is presented for comparative purposes only. Certain activity by net asset classification is not included in these financial statements. Accordingly, such information does not include sufficient detail to constitute a presentation in conformity with US GAAP. Accordingly, such information should be read in conjunction with Drug Policy Action's financial statements as of and for the year ended May 31, 2016, from which the summarized comparative information was derived.

3. Concentration of Credit Risk

Drug Policy Action's financial instruments that are potentially exposed to concentration of credit risk consist primarily of cash and cash equivalents and investments. Drug Policy Action maintains its cash with a financial institution which at times, may be in excess of the Federal Deposit Insurance Corporation's insurance limit. Investments are managed by professional investment management firms and are monitored by the Board of Directors and an investment advisor engaged by Drug Policy Action.

4. Investments

The following are major categories of investments measured at fair value as of May 31:

<u>Description</u>	<u>2017</u>	<u>2016</u>
Mutual Funds, at Fair Value		
Short-term bond index fund	\$ 2,020,266	\$ 1,998,663
Short-term grade fund	2,422,917	901,853
Stock market index fund	<u>27,072</u>	<u>23,006</u>
	4,470,255	2,923,522
CDs at cost, plus accrued interest	1,491,000	-
Total	<u>\$ 5,961,255</u>	<u>\$ 2,923,522</u>

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4. Investments (continued)

As of and for the years ended May 31, 2017 and 2016 all of Drug Policy Action's investments bought, sold, and held were valued using Level 1 inputs under the fair value hierarchy.

The composition of investment income as reported in the statement of activities for the years ended May 31, consisted of the following:

	<u>2017</u>	<u>2016</u>
Interest and dividends	\$ 67,880	\$ 67,979
Unrealized loss	<u>(8,261)</u>	<u>(11,417)</u>
Total Investment Income	<u>\$ 59,619</u>	<u>\$ 56,562</u>

5. Grants Receivable

Grants receivable are due within one to five years. Payments expected to be received after May 31, 2018 are discounted to their present value using an interest rate of 4.03%. At May 31, 2017 and 2016, management has deemed all amounts outstanding to be collectible. Grants receivable at May 31, are summarized as follows:

	<u>2017</u>	<u>2016</u>
Receivable within one year	\$ 3,950,000	\$ 6,500,000
Receivable within two-five years	10,500,000	14,000,000
Discount to present value	<u>(792,709)</u>	<u>(1,304,344)</u>
Total	<u>\$ 13,657,291</u>	<u>\$ 19,195,656</u>

6. Note Receivable-Related Party

During 2015, Drug Policy Action entered into a revolving note receivable with Drug Policy Alliance to lend the Alliance up to \$5,000,000. During 2016, the amount the Alliance can borrow was increased to \$10,000,000. During 2017, the amount the Alliance can borrow was increased to \$15,000,000. Interest on outstanding borrowings under the agreement is fixed at 2% per annum. As of May 31, 2017 and 2016, outstanding balances were \$7,000,000. The note has no maturity and is payable on demand. Interest earned on the note amounted to \$160,000 and \$118,333 for the years ended May 31, 2017 and 2016.

7. Temporarily Restricted Net Assets

As of May 31, 2017 and 2016, Drug Policy Action's temporarily restricted net assets consisted of \$13,657,291 and \$19,195,656 of time restricted grants. Net assets released from restriction in fiscal 2017 and 2016 due to time restriction expiration were \$6,950,000 and \$6,500,000.

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8. Related Party Transactions

As per an administrative service agreement between Drug Policy Action and Alliance, Drug Policy Action reimburses Alliance for all administrative, personnel and related expenses, and use of facilities. During the years ended May 31, 2017 and 2016, Drug Policy Action reimbursed Alliance approximately \$182,089 and \$122,000 for expenses paid by Alliance.

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