SoundExchange, Inc.

Financial Statements

Year Ended December 31, 2005

FINAL

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SoundExchange, Inc.

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Independent Auditors' Report

To the Board of Directors
SoundExchange, Inc.

We have audited the accompanying statement of financial position of **SoundExchange, Inc.** (the Organization) as of December 31, 2005, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. 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 our audit 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 Organization'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 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 **SoundExchange, Inc.** as of December 31, 2005, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

BDO Seidman, LLP

December 20, 2006
Except for Note 11 for which
the date is April 12, 2007

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SoundExchange, Inc.

Statement of Financial Position

December 31,	2005
Assets	
Current assets	
Cash and cash equivalents	$ 157,923
Funds held in agency (Note 2)	55,158,475
Receivables	3,934,683
Prepaid expenses and other current assets	22,791
Total current assets	59,273,872
Noncurrent assets	
Property and equipment, net (Note 3)	2,145,818
Licensing and organizational costs, net (Note 4)	2,819,056
Total noncurrent assets	4,964,874
Total assets	$ 64,238,746
Liabilities and Net Assets (Deficit)	
Current liabilities	
Accounts payable and accrued expenses	$ 713,499
Funds held in agency (Note 2)	62,660,161
Capital lease obligation, current portion (Note 6)	108,239
Total current liabilities	63,481,899
Noncurrent liabilities	
Note payable (Note 5)	4,495,219
Capital lease obligation, net of current portion	76,447
Total noncurrent liabilities	4,571,666
Total liabilities	68,053,565
Commitments and contingencies	
Unrestricted net assets (deficit)	
Unrestricted net assets - general operations	680,400
Net assets attributable to debt service (Note 7)	(4,495,219)
Total unrestricted net assets (deficit)	(3,814,819)
Total liabilities and net assets (deficit)	$ 64,238,746

See accompanying summary of accounting policies and notes to financial statements.

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SoundExchange, Inc.

Statement of Activities

Year ended December 31,	2005
Revenue - administrative fee	**$ 6,150,696**
Administrative Expenses	
Personnel costs	1,679,528
Depreciation and amortization	1,342,480
Operating expenses	1,083,048
Member services	491,567
Legal and licensing	322,148
Royalty systems	102,924
Total expenses	5,021,695
Change in unrestricted net assets	1,129,001
Unrestricted net assets (deficit), beginning of period	(4,943,820)
Unrestricted net assets (deficit), end of period	**$ (3,814,819)**

See accompanying summary of accounting policies and notes to financial statements.

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SoundExchange, Inc.

Statement of Cash Flows

Year ended December 31,	2005
Cash flows from operating activities	
Change in net assets	$ 1,129,001
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation and amortization	1,342,480
Interest imputed on note payable	300,629
(Increase) decrease in assets:	
Funds held in agency	(21,390,907)
Receivables	(1,363,274)
Prepaid expenses and other current assets	(4,256)
Licensing and organizational costs	(2,730,273)
Increase (decrease) in liabilities:	
Accounts payable and accrued expenses	155,040
Funds held in agency	24,186,247
Net cash provided by operating activities	1,624,687
Cash flows from investing activities	
Purchases of property and equipment	(407,758)
Cash used in investing activities	(407,758)
Cash flows from financing activities	
Payments on note payable	(1,129,001)
Payments on capital lease obligation	(84,976)
Cash used in investing activities	(1,213,977)
Increase in cash and cash equivalents	2,952
Cash and cash equivalents, beginning of period	154,971
Cash and cash equivalents, end of period	$ 157,923

See accompanying summary of accounting policies and notes to financial statements.

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Organization

SoundExchange, Inc. (the Organization) was incorporated on September 22, 2003 in the State of Delaware. It is an independent, non-profit organization exempt from taxation under Section 501(c)(6) of the Internal Revenue Code. It is governed by an 18-member Board of Directors composed of equal numbers of representatives of sound recording copyright owners and recording artists.

The Organization has been designated by the Librarian of Congress to collect royalties paid by services making reproductions and non-interactive digital audio transmissions of sound recordings pursuant to the statutory licenses set forth in Sections 112 and 114 of Title 17 of the United States Code (17 U.S.C. § 112 and 114). The Organization collects royalties from, among others, Internet-only webcasters, terrestrial radio stations simulcasting their transmissions over the Internet, satellite radio services, and services making transmissions to digital cable and satellite television subscribers (collectively "Statutory Licensees").

The royalties collected by the Organization are allocated pursuant to a formula set forth in the United States Code and distributed directly to sound recording copyright owners (50%), featured artists (45%), and an independent administrator responsible for further redistributing the royalties to non-featured vocalists (2½%) and non-featured musicians (2½%). The costs of operating the Organization are deducted, pursuant to federal law, from the royalties collected under the statutory licenses.

The Organization currently represents over 1,300 record companies, over 5,025 labels and over ten thousand artists united in receiving marketplace rates for the licensing of sound recordings in a new digital world.

Basis of Accounting

The financial statements of the Organization have been prepared on the accrual basis of accounting.

Cash and Cash Equivalents

The Organization considers all highly liquid instruments, which are to be used for current operations and which have an original maturity of three months or less, to be cash and cash equivalents.

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Funds Held in Agency

Funds held in agency consist of cash received by the Organization from Statutory Licensees and certain other entities collecting and paying royalties for reproductions or transmissions of sound recordings outside the United States. These royalties are due and will be distributed by the Organization to the parties entitled to receive such royalties. Funds are invested in money market instruments and short-term federal and agency bonds and are recorded at readily determinable fair values.

Receivables

Receivables consist of interest and royalties receivable. Royalties receivable consist of reproduction and performance royalties payable by services availing themselves of the statutory licenses set forth in Sections 112 and 114 of the Copyright Act and by other entities for certain reproductions and transmissions of copyrighted sound recordings made outside the United States.

Property and Equipment

Property and equipment are recorded at historical cost less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the assets. The Organization capitalizes all expenditures for property and equipment over $500. The estimated useful lives of the assets are as follows:

Furniture and fixtures	5 years
Computer equipment	3 years
Capital leased equipment	Lesser of 3 years or life of the lease
Software	5 years

When assets are sold or otherwise disposed of, the asset and related accumulated depreciation and amortization are removed from the accounts, and any remaining gain or loss is included in operations. Repairs and maintenance are charged to expense when incurred.

Licensing and Organizational Costs

Licensing and organizational costs are expenditures incurred in the administration of the collection, distribution, and calculation of the royalties; the settlement of disputes relating to the collection and calculation of the royalties; and the licensing and enforcement of rights with respect to the making of ephemeral recordings and performances subject to statutory licensing including those incurred in participating in negotiations or arbitration proceedings before the Copyright Arbitration Royalty Panel (CARP) or the Copyright Royalty Board (CRB) under the statutory licenses. These costs are recoverable from future license fees pursuant to federal law.

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Licensing costs are recorded at cost. Costs are amortized using the straight-line method over the term of the license from two to five years.

Unrestricted Net Assets (Deficit)

Unrestricted net assets (deficit) are available for use in general operations.

Revenue Recognition

Revenue is recognized when earned. Administrative fees are reported when expenses have been incurred.

Functional Allocation of Expenses

Administrative expenses are presented based on their natural classification, as all administrative costs relate to the operation of the program.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain 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. Actual results could differ from those estimates.

Financial Instruments and Credit Risk

Financial instruments which potentially subject the Organization to concentrations of credit risk consist principally of cash and cash equivalents and funds held in agency held at creditworthy financial institutions. As of December 31, 2005, the Organization was not exposed to excessive risk from uninsured cash balances due to the fact that funds held in agency are trust assets that are not subject to claim in the event of bank default and cash and cash equivalent balances are kept within limits to prevent risk of concentration.

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1. **Tax Status**

The Organization has been granted exemption by the Internal Revenue Service (IRS) from Federal income taxes under Section 501(c)(6) of the Internal Revenue Code. However, the Organization is required to report unrelated business income to the IRS and the District of Columbia. The Organization did not have any unrelated business income for the year ended December 31, 2005.

2. **Funds Held in Agency**

The assets available to meet the Organization's obligation to pay royalties to licensees are as follows:

December 31,	2005
Funds held in agency – asset	$ 55,158,475
Royalties receivable	3,934,683
	$ 59,093,158

December 31,	2005
Funds held in agency - liability	$ 62,660,161
Less: application of administrative rate to licenses in the future years	(3,567,003)
	$ 59,093,158

3. **Property and Equipment**

Property and equipment consists of the following at:

December 31,	2005
Software development	$ 4,757,210
Distribution equipment, capital lease	319,099
Furniture and fixtures	102,824
Computer equipment	23,944
	5,203,077
Less: accumulated depreciation and amortization	3,057,259
	$ 2,145,818

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Depreciation and amortization expense charged to operations for the year ended December 31, 2005 was $1,057,347.

4. Licensing and Organizational Costs

Licensing and organizational costs consists of the following at:

December 31,	2005
Copyright Arbitration Royalty Proceeding and Copyright Royalty Board Proceeding	$ 4,232,894
Less: accumulated amortization	1,413,838
	$ 2,819,056

Amortization expense charged to operations for the year ended December 31, 2005 was $285,133.

5. Notes Payable

On October 7, 2003, the Organization issued a promissory note to RIAA for an unsecured note of $9,000,000. The note includes an imputed interest rate of prime plus two percent. Payment terms are based on the collection of royalties under statutory licenses and cannot be determined. Any amount outstanding on the note as of March 31, 2007 will be due in full at that time. Payments amounting to $1,129,001 were made on the note during the year ended December 31, 2005. The outstanding balance on the note as of December 31, 2005 is $4,495,219.

6. Commitments

Operating Lease

The Organization has a commitment under an operating lease for office space expiring in 2006. The Organization's future minimum rental payments, by year and in the aggregate, under the operating lease for the year ending December 31, 2006 amount to $98,782.

Rent expense charged to operations for the year ended December 31, 2005 was $208,938.

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Capital Lease

The Organization leases computer equipment under capital leases expiring in December 2006 and April 2008. The assets and liability under the capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the assets. Amortization of the assets under the capital leases is included in depreciation and amortization. The interest rates implicit in the lease are 6.68% and 8%.

Following is a summary of the property held under capital leases at:

December 31, 2005	
Computer equipment	$ 319,099
Less: accumulated amortization	141,062
	$ 178,037

Future minimum lease payments, by year and in the aggregate, under capital leases are as follows:

Year Ending December 31,	
2006	$ 118,691
2007	60,640
2008	20,213
Total future minimum lease payments	199,544
Less: amounts representing interest	14,858
Present value of future minimum lease payments	184,686
Current portion	108,239
Long term portion	$ 76,447

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7. **Unrestricted Net Assets (Deficit)** A portion of unrestricted net assets has been reserved for debt service. The deficit in unrestricted net assets resulted from costs incurred prior to separation from the Recording Industry Association of America, Inc. (RIAA). The Organization can fully recover these costs from administrative fees withheld on royalties under statutory licenses as described in Note 5. Based on an estimate of future collections, management expects that the deficit will be fully eliminated by March 31, 2007, when the note to RIAA comes due.

8. **Employee Retirement Plan** The Organization maintains a defined contribution retirement plan for eligible employees. All employees who have completed one year of service are eligible for the Plan. The Organization's contributions to the 401(k) plan are determined by the Board of Directors and based on a mix of matching and non-elective safe harbor contribution percentages of eligible employees' annual earnings. Contributions to the employee benefit plan were $55,526 for the year ended December 31, 2005.

9. **Related Party Transactions** Prior to its separate incorporation in September 2003, the Organization operated as an unincorporated division of the Recording Industry Association of America, inc. (RIAA). During the year ended December 31, 2005, the Organization leased space from RIAA under the operating lease mentioned in note 6 and made repayments on the loan to RIAA disclosed in note 5.

10. **Supplemental Disclosure of Cash Flow Information**

Cash paid during the period for interest	$ 13,501
Non cash financing activity:	
Capital lease obligation	$161,260

11. **Material Subsequent Event** The promissory note to RIAA was paid in full on March 22, 2007.

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