Financial statements and report of independent certified public accountants

Western Asbestos Settlement Trust

December 31, 2005 and 2004

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CONTENTS

	Page
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS	3
FINANCIAL STATEMENTS	
Statements of Net Claimants' Equity	4
Statements of Changes in Net Claimants' Equity	5
Statements of Cash Flows	6
Notes to Financial Statements	7
SUPPLEMENTARY SCHEDULE	
Schedule of Operating Expenses	16

Grant Thornton

Accountants and Business Advisors

Report of Independent Certified Public Accountants

To the Trustees of
Western Asbestos Settlement Trust

We have audited the accompanying special-purpose statements of net claimants' equity of Western Asbestos Settlement Trust (the Trust), organized in the State of Nevada, for the year ended December 31, 2005 and for the period from inception (April 22, 2004) through December 31, 2004, and the related statements of changes in net claimants' equity and cash flows for the periods then ended. These special-purpose financial statements and the exhibits referred to below are the responsibility of the Trust's management. Our responsibility is to express an opinion on these special-purpose financial statements and exhibits based on our audit.

We conducted our audit 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 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 Trust'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.

As described in Note A, these special-purpose financial statements were prepared on a special-purpose basis of accounting and are not intended to be a presentation in conformity with accounting principles generally accepted in the United States. The special-purpose basis of accounting has been used in order to present the amount of equity presently available to current and future claimants.

In our opinion, the accompanying special-purpose financial statements of Western Asbestos Settlement Trust as of and for the year ended December 31, 2005 and for the period ended December 31, 2004, are fairly presented, in all material respects, on the basis of accounting described in Note A.

Our audit was made for the purpose of forming an opinion on the special-purpose financial statements taken as a whole. The supplementary schedule is presented for purpose of additional analysis and is not a required part of the special-purpose financial statements. This information has been subjected to the auditing procedures applied in our audit of the special-purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the special-purpose financial statements taken as a whole.

This report is intended solely for the information and use of the management of the Trust and Trustees, the beneficiaries of the Trust, the Futures' Representative, the Futures' Counsel, the members of the Trust Advisory Committee, and the United States Bankruptcy Court for the Northern District of California, Oakland Division and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report which, upon filing with the United State Bankruptcy Court for the Northern District of California, Oakland Division is a matter of public record.

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Reno, Nevada
February 27, 2006

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Western Asbestos Settlement Trust

STATEMENTS OF NET CLAIMANTS' EQUITY

December 31,

	2005	2004
ASSETS		
Cash equivalents and investments		
Available-for-sale		
Restricted	$ 55,726,169	$ 55,530,671
Unrestricted	1,193,394,834	1,230,717,883
Total cash equivalents and investments	1,249,121,003	1,286,248,554
Accrued interest and dividend receivables	9,097,870	1,769,674
Purchased interest	552,784	828,753
Prepaid federal income tax	1,289,557	682,676
Deferred tax asset	2,910,000	-
Total assets	$ 1,262,971,214	$ 1,289,529,657
LIABILITIES		
Accrued expenses	$ 1,583,820	$ 506,969
Claim processing deposits	551,250	424,750
Unpaid claims (Note D)		
Outstanding offers	10,396,798	4,771,066
Pre-petition liquidated claims	514,931	872,276
Adjustments to previously paid claims (Note D)	62,521,170	-
Reimbursement obligation	25,881,296	29,794,408
Lease commitments payable	109,872	109,872
Total liabilities	$ 101,559,137	$ 36,479,341
NET CLAIMANTS' EQUITY	$ 1,161,412,077	$ 1,253,050,316

The accompanying notes are an integral part of these statements.

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Western Asbestos Settlement Trust

STATEMENTS OF CHANGES IN NET CLAIMANTS' EQUITY

For the year ended December 31, 2005 and for the period from inception (April 22, 2004) through December 31, 2004

	2005	2004
Net claimants' equity, beginning of year	$ 1,253,050,316	$ -
Additions to net claimants' equity		
Initial funding	3,475,245	2,000,868,050
Investment income	35,089,663	11,943,944
Net unrealized gains on available-for-sale securities	-	255,152
Net decrease in reimbursement obligation	3,913,112	-
Total additions	42,478,020	2,013,067,146
Deductions from net claimants' equity		
Operating expenses	10,812,529	7,671,919
Provision for income taxes	728,145	1,817,324
Reimbursement obligation settled	-	12,411,253
Claims settled	112,881,837	655,575,030
Net realized and unrealized losses on available-for-sale securities	4,068,016	-
Court ordered claimants' attorney fees (Note D)	-	47,865,958
Net increase in lease commitments payable	-	109,872
Net increase in outstanding claim offers	5,625,732	4,771,066
Net increase in reimbursement obligation	-	29,794,408
Total deductions	134,116,259	760,016,830
Net claimants' equity, end of year	$ 1,161,412,077	$ 1,253,050,316

The accompanying notes are an integral part of these statements.

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Western Asbestos Settlement Trust

STATEMENTS OF CASH FLOWS

For the year ended December 31, 2005 and for the period from inception (April 22, 2004) through December 31, 2004

	2005	2004
Cash inflows:		
Initial funding	$ 4,125,245	$ 2,000,868,050
Investment income receipts	28,037,436	9,345,517
Increase in claim processing deposits	126,500	424,750
Total cash inflows	32,289,181	2,010,638,317
Cash outflows:		
Claim payments made	50,718,012	654,702,754
Reimbursement obligation settled	-	12,411,253
Court ordered claimants' attorney fees (Note D)	-	47,865,958
Total cash claim payments	50,718,012	714,979,965
Net realized losses on Available-for-sale securities	3,968,821	-
Disbursements for Trust operating expenses	10,385,678	7,164,950
Disbursements for Trust income taxes	4,245,026	2,500,000
Total cash outflows	69,317,537	724,644,915
Net cash inflows (outflows)	(37,028,356)	1,285,993,402
Non-cash changes:		
Net unrealized gains (losses) on available-for-sale securities	(99,195)	255,152
NET INCREASE (DECREASE) IN CASH EQUIVALENTS AND INVESTMENTS AVAILABLE-FOR-SALE	(37,127,551)	1,286,248,554
Cash equivalents and investments available-for-sale, beginning of year	1,286,248,554	-
Cash equivalents and investments available-for-sale, end of year	$ 1,249,121,003	$ 1,286,248,554

The accompanying notes are an integral part of these statements.

NOTE A - SUMMARY OF ACCOUNTING POLICIES

1. Description of Trust

The Western Asbestos Settlement Trust (the Trust), organized pursuant to the laws of the state of Nevada with its office in Reno, Nevada, was established pursuant to the Western Asbestos Company (Western Asbestos), Western Mac Arthur Co. (Western Mac Arthur) and Mac Arthur Co. (Mac Arthur), (collectively the Debtors), Second Amended Joint Plan of Reorganization (the Plan), dated November 22, 2002. The Trust was formed to assume the Debtors' liabilities resulting from pending and potential litigation involving individuals exposed to asbestos who have manifested asbestos-related diseases or conditions; liquidate, resolve, pay and satisfy all current and future asbestos related claims in accordance with the Plan; preserve, hold, manage and maximize the Trust assets for use in paying and satisfying allowed asbestos related claims; prosecute, settle and manage the disposition of the asbestos in-place insurance coverage; and prosecute, settle and manage asbestos insurance coverage actions. Upon approval of the Plan, the Trust assumed liability for existing and future asbestos health claims against the Debtors. The Trust was created effective April 22, 2004.

The Trust was initially funded with cash, Western Asbestos securities, notes receivable and insurance settlement proceeds. Since its creation, all notes receivable have been collected. The Trust's funding is dedicated solely to the settlement of asbestos health claims and the related costs thereto, as defined in the Plan.

The Trust processes and pays all asbestos related claims in accordance with the Western Asbestos Settlement Trust Agreement, as amended and restated, the Case Valuation Matrix (Matrix) and Trust Distribution Procedures (TDP) (collectively, the Trust Procedures).

2. Special-Purpose Accounting Methods

The Trust's financial statements are prepared using special-purpose accounting methods that differ from accounting principles generally accepted in the United States. The special-purpose accounting methods were adopted in order to communicate the amount of equity available for payment of current and future claims. These special-purpose accounting methods are as follows:

a. The financial statements are prepared using the accrual basis of accounting, as modified below.

b. The funding received from Western Asbestos, Western Mac Arthur and its liability insurers is recorded directly to net claimants' equity. These funds do not represent income of the Trust. Settlement offers for asbestos health claims are reported as deductions from net claimants' equity and do not represent expenses of the Trust.

c. Costs of non-income producing assets, which will be exhausted during the life of the Trust and are not available for satisfying claims, are expensed when incurred. These costs include acquisition costs of computer hardware, software, software development, office furniture, leasehold improvements, and other prepaid expenses such as rent and insurance.

d. Future fixed liabilities and contractual obligations entered into by the Trust are recorded directly against net claimants' equity. Accordingly, the future minimum rental commitments outstanding at period end for non-cancelable operating leases, net of any sublease agreements, have been recorded as deductions from net claimants' equity.

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NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

2. Special-Purpose Accounting Methods - Continued

e. The liability for unpaid claims reflected in the statement of net claimants' equity represents settled but unpaid claims and outstanding offers. A claims liability is recorded once a settlement offer is made to the claimant at the amount equal to the expected pro rata payment. No liability is recorded for future claim filings and filed claims on which no offer has been made. Net claimants' equity represents funding available to pay present and future claims on which no fixed liability has been recorded.

f. Available-for-sale securities are recorded at market. All interest and dividend income on available-for-sale securities, net of investment expenses is included in investment income on the statement of changes in net claimants' equity. Net realized and unrealized gains and losses on available-for-sale securities are recorded as a separate component on the statement of changes in net claimants' equity.

g. Realized gains and losses on available-for-sale securities are recorded based on the security's amortized cost. At the time a security is sold, all previously recorded unrealized gains and losses are reversed and recorded net, as a component of other unrealized gains and losses in the accompanying statement of changes in net claimants' equity.

3. Cash and Cash Equivalents

Cash and cash equivalents include demand deposit accounts and cash invested in money market funds.

4. Deposits

Claims processing deposits represent filing fees collected for each unliquidated claim which fees are refunded by the Trust if the claim is paid.

5. Use of Estimates

The preparation of financial statements in conformity with the special-purpose accounting methods described above requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions to net claimants' equity during the reporting period. Actual results could differ from those estimates. Significant accounting estimates made by management include the balance due on reimbursement obligations.

6. Concentration of Credit Risk

Financial instruments that potentially subject the Trust to concentrations of credit risk consist principally of cash, cash equivalents and investments. The Trust maintains its cash and cash equivalents in bank accounts which, at times, may exceed federally insured limits. The Trust has not experienced any losses in such accounts. The Trust believes it is not exposed to any significant credit risk on cash and cash equivalents.

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NOTE B - CASH EQUIVALENTS AND INVESTMENTS

The Trust has classified its investments as available for sale, and recorded the securities at market value, as follows:

	December 31, 2005	
	Cost	Market
Restricted:		
Cash equivalents	$ 55,726,169	$ 55,726,169
Unrestricted:		
Cash demand deposits	$ 294,125	$ 294,125
Cash equivalents	191,616,703	191,616,703
Corporate securities	196,522,674	203,781,499
U.S. Government obligations	67,305,966	67,091,980
Corporate and other debt	737,499,409	730,610,527
	$1,193,238,877	$1,193,394,834

	December 31, 2004	
	Cost	Market
Restricted:		
Cash equivalents	$ 55,530,671	$ 55,530,671
Unrestricted:		
Cash demand deposits	$ 3,541,927	$ 3,541,927
Cash equivalents	462,495,367	462,495,367
U.S. Government obligations	498,416,494	498,491,216
Corporate and other debt	266,008,943	266,189,373
	$1,230,462,731	$1,230,717,883

The maturities of the Trust's available-for-sale securities at market value (excluding cash equivalents) are as follows as of December 31, 2005:

	Less than 1 Year	After 1 Year Through 5 Years	After 5 Years Through 10 Years	After 10 Years
U.S. Government obligations	$15,895,680	$ 32,232,553	$ 18,963,747	$ -
Corporate and other debt	9,736,759	125,428,809	254,876,298	340,568,661
	$25,632,439	$157,661,362	$273,840,045	$340,568,661

NOTE C - FIXED ASSETS

The cost of non-income producing assets that will be exhausted during the life of the Trust and are not available for satisfying claims are expensed as incurred. Since inception, the cost of fixed assets expensed, net of disposals, include:

Acquisition of furniture and equipment	$ 56,662
Acquisition of computer hardware and software	336,389
	$393,051

These items have not been recorded as assets, but rather as operating expenses and direct deductions from net claimants' equity in the accompanying financial statements. The cost of fixed assets that were expensed during the year ended December 31, 2005 and for the period ended December 31, 2004 were $244,446 and $148,605, respectively.

Total depreciation expense related to asset acquisition using accounting principles generally accepted in the United States would have been approximately $117,000 and $22,000 for the year ended December 31, 2005 and for the period ended December 31, 2004, respectively.

NOTE D - CLAIM LIABILITIES

The Trust distinguishes between claims that were resolved prior to the establishment of the Trust and claims received and processed using the Trust Procedures after the creation of the Trust (Trust Claims). The claims filed prior to the creation of the trust were grouped into three categories: default, matrix and settlement claims (Pre-petition Liquidated Claims). The cases underlying the Pre-petition Liquidated Claims were stayed by the courts until the Plan was approved.

The Trust approved and immediately made offers to pay, subject to receiving a claimant release, the approved Payment Percentage (31.5%) of the liquidated value of each claim. Certain Pre-Petition Liquidated Claims were further reduced by payments made by the debtors and their insurers prior to the formation of the Trust. The total dollar amount of the net Pre-Petition Liquidated Claims approved in the period ended December 31, 2004 was approximately $647,168,000. Certain of these claims also included an interest component calculated from the time of the settlement, until the Trust paid the claim. Additionally, the bankruptcy court ordered approximately $47,866,000 of attorney fees to be paid to the Pre-petition claimants' attorneys during the period ended 2004. The fees were paid by the Trust during the period ended December 31, 2004. No additional Pre-petition Liquidated Claims were approved in the year ended December 31, 2005. The Trust processed and approved approximately $54,795,000 and $13,178,000 of Trust Claims during the year ended December 31, 2005 and the period from inception to December 31, 2004, respectively.

As disclosed on the statement of net claimants' equity, unpaid claims represent the liability for outstanding offers made to eligible claimants. Under the TDP, claimants receive an initial pro rata payment equal to the approved Payment Percentage (31.5%) of the liquidated value of their claim. The Trust would only be obligated for the unpaid portion (68.5%) of the liquidated amount if the payment

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NOTE D - CLAIM LIABILITIES - Continued

percentage is increased. In that instance, the Trust would retroactively pay the increased percentage to all previously paid claimants. Further, in the interest of treating all claimants equitably in accordance with the Plan, the Trustees have recommended that all payments made during each calendar year include a Cost of Living Adjustment for inflation based upon the Federal Bureau of Labor Statistics' *Consumer Price Index for Urban Wage Earners and Clerical Workers* (CPI-W) announced in October each year.

In February 2006, the Payment Percentage was retroactively increased to 34.2%. As a result of the increased payment percentage, all claims previously paid, offered or approved will receive an additional 2.7% of the claim's liquidated value (34.2% less 31.5% originally approved). A liability of approximately $61,298,000 has been recorded as of December 31, 2005 to reflect the increase in the Payment Percentage. Of this amount, $60,465,000 relates to claims paid prior to December 31, 2005. The liability for unpaid claims, including outstanding offers and unpaid Pre-petition Liquidated Claims was adjusted by approximately $833,000. This is the first increase to the Payment Percentage approved by the Trust.

In addition to the increase in the Payment Percentage, the Trust also approved an Inflation Adjustment of 3.4% to be applied to payments made during the calendar year 2006. As a result, all claim liabilities as of December 31, 2005 were adjusted to reflect the addition of the Inflation Adjustment. The total amount of the adjustment was approximately $2,415,000. Of this amount, $2,056,000 relates to the Payment Percentage increase on claims paid prior to December 31, 2005. The liability for unpaid claims, including outstanding offers and unpaid Pre-petition Liquidated Claims was adjusted by approximately $359,000. This is the first Inflation Adjustment approved by the Trust.

The Trust records a liability for unpaid claims at the time of extending the offer and sending the release form. Funds are released once the release form is signed and received by the Trust.

Unpaid claims liability remains on the Trust's books until the settlement offer is accepted or expires after six months. Offers may be extended an additional six months upon written request and good cause. As of the year ended December 31, 2005 and the period ended 2004, there were no expired offers.

NOTE E - REIMBURSEMENT OBLIGATIONS

Under the Plan, and as detailed in the Trust Agreement, certain parties were given reimbursement rights to the recovery of fees and expenses incurred in their efforts to obtain Plan approval, along with interest. Under the provisions of the Plan, the Trust also owes interest on this amount from the date of payment by the insurer until repayment by the Trust at the 30-day T Bill rate. The Trust has estimated their liability under this provision based on court ordered fee applications; the dates services were provided; and the 30-day T Bill rate. As of December 31, 2004, the liability under this obligation including interest was estimated to be $29,794,408. During 2005, the Trust revised the estimate for the correction of certain errors, including approximately $2.2 million in payments made in 2004 which were improperly included in the obligation. The Trust has also reduced its liability under this obligation by an estimate of an amount due from the parties for over distribution of tax payments while the initial settlements were held in escrow. The trust has estimated this receivable at approximately $1.9 million. The accrual of

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NOTE E - REIMBURSEMENT OBLIGATIONS - Continued

interest on the remaining obligation was adjusted to reflect these changes. No payments were made on the obligation in 2005. The resulting remaining liability at December 31, 2005 was estimated to be $25,881,296. The actual amount paid under this obligation may differ from this estimate.

During the period from inception through December 31, 2004, the Trust also settled and paid a reimbursement obligation with the Johns-Manville Litigation Fund for fees and interest of $12,411,253.

NOTE F - COMMITMENTS AND CONTINGENCIES

The Trust leases its offices in Reno, Nevada, under a non-cancelable operating lease. The lease contains an early release provision, contingent upon the passage of legislation nationalizing the trust fund. If such legislation were to become law, the Trust may terminate the lease with thirty days written notice any time after January 31, 2006. If no such legislation is passed, the lease will expire July 31, 2007.

The Trust prepaid half of the total lease payments upon execution of the lease. The entire amount of this payment was included in the current operating expenses on the statement of change in net claimants' equity in the period ended December 31, 2004. As a result of the prepayment, no payment is due under the lease until 2006. Future minimum rental commitments under this operating lease, as of December 31, 2005, are as follows:

Years ending December 31,	
2006	$ 65,092
2007	44,780
	$109,872

This obligation has been recorded as a liability in the accompanying financial statements.

NOTE G - NET CLAIMANTS' EQUITY

The Trust was created pursuant to the Plan approved by the United States Bankruptcy Court for the Northern District of California, Oakland Division. The TDP was adopted pursuant to the Plan and concurrently with the Trust Agreement. It is designed to provide fair and equitable treatment for all Trust claims that may presently exist or may arise in the future. The TDP prescribes certain procedures for distributing the Trust's limited assets, including pro rata payments and initial determination of claim value based on scheduled diseases values, jurisdictions, and individual factual information concerning each claimant as set forth in the Trust Procedures.

Under the TDP, the Trust forecasts its anticipated annual sources and uses of cash until the last projected future claim has been paid. A pro rata payment percentage is calculated such that the Trust will have no remaining assets or liabilities after the last future claimant receives his/her pro rata share.

NOTE G - NET CLAIMANTS' EQUITY - Continued

Based on research and testimony presented during the bankruptcy, the court approved an initial payment to claimants of 31.5% payment of the liquidated value of then current and estimated future claims (Payment Percentage). The TDP gives the Trustees, with the consent of the TAC and the Futures' Representative, the power to periodically update its estimate of the pro rata payment percentage based on updated assumptions regarding its future assets and liabilities and, if appropriate, propose additional changes in the pro rata payment percentage. In February 2006, the Payment Percentage was increased to 34.2% by the Trustees with the consent of the TAC and Futures' Representative. The increase is retroactive for claims approved since inception.

NOTE H - EMPLOYEE BENEFIT PLANS

Effective April 22, 2004, the Trust established a defined contribution retirement savings plan under Section 401(k) of the Internal Revenue Code for all eligible employees after completion of certain age and service requirements. Employees may voluntarily elect to defer their compensation and invest in a various options for their retirement. The plan allows employees to defer a percentage of their salaries within limits set by the Internal Revenue Code with the Trust matching contributions by employees of up to 4% of their salaries. The total employer contributions and expenses under the plan were approximately $16,700 and $9,900 for the year ended December 31, 2005 and the period ended December 31, 2004, respectively.

NOTE I - RESTRICTED CASH EQUIVALENTS AND INVESTMENTS

To avoid the high costs of director and officer liability insurance, and pursuant to the Trust Agreement, the Trust has elected to be self insured and has established a segregated security fund of $40 million. These funds are devoted exclusively to securing the obligations of the Trust to indemnify the former and current Trustees and officers, employees, agents and representatives of the Trust. The funds are held in a separate Trust bank account, and the investment earnings on these funds accrue to the benefit of the Trust.

As a condition of the Plan, the Trust was required to establish various indemnity and property damage defense funds for the benefit of certain Debtors, related parties and insurers. The total sum of $15,500,000 is required to be held to secure the payment of future claims. A portion of the investment earnings are also restricted for the benefit of the indemnity and property defense funds.

As of December 31, 2005 and 2004, cash and equivalents of $55,726,169 and $55,530,671 were respectively restricted for these purposes.

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NOTE J - INCOME TAXES

For Federal income tax purposes, the Trust is taxed as a Qualified Settlement Fund (QSF). Income and expenses associated with the QSF are taxed in accordance with Section 468B of the Internal Revenue Code, which obligates the Trust to pay for any federal income tax liability imposed upon the QSF. The statutory income tax rate for the QSF is 35%.

The Trust accounts for income taxes in accordance with the Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." SFAS No. 109 requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the book and tax basis of assets and liabilities. As of December 31, 2004, the temporary differences were not significant, and therefore the Trust did not record any deferred tax assets or liabilities at that date.

The provision for income taxes consists of the following for the year ended December 31, 2005 and the period ended December 31, 2004:

	2005	2004
Federal income tax – current	$3,638,145	$1,817,324
Deferred income tax benefit	(2,910,000)	-
	$ 728,145	$1,817,324

The components of the deferred income tax asset, as presented in the statements of net claimants' equity consisted of the following at December 31, 2005:

Deferred tax asset	
Depreciation and amortization	$1,537,000
Capital loss carryforwards	1,389,000
Other, net	(16,000)
	$2,910,000

Management expects to realize the deferred tax assets through the generation of future taxable income and, accordingly, has not established a valuation allowance.

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SUPPLEMENTARY SCHEDULE

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SCHEDULE OF OPERATING EXPENSES

For the year ended December 31, 2005 and for the period from inception (April 22, 2004) through December 31, 2004

	2005	2004
Accounting	$ 214,699	$ 162,453
Claims processing/claims system development	564,571	828,520
Computer equipment	243,211	55,907
Contract labor	67,530	13,845
Database development	42,099	65,035
Futures' representatives	361,389	528,188
Insurance	41,236	257,501
Internet	5,795	6,950
Legal fees	7,575,452	4,534,197
Meeting expense	1,625	11,070
Office expense	37,902	69,354
Office furniture and equipment	1,235	91,274
Payroll and related taxes	414,204	174,966
Pension plan contribution and fees	16,656	13,200
Rent	2,363	115,403
Taxes and licenses	1,400	2,095
Telephone	20,717	7,978
Temporary staffing	-	25,800
Travel, meals and entertainment	15,776	16,818
Trust advisory committee	344,778	217,685
Trustee fees	839,891	473,680
	$ 10,812,529	$ 7,671,919

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