

Rotary International

*Consolidated Financial Statements as of and
for the Years Ended 30 June 2005 and 2004,
and Independent Auditors' Report*

ROTARY INTERNATIONAL

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED 30 JUNE 2005 AND 2004:	
Consolidated Statements of Financial Position	2
Consolidated Statements of Activities	3
Consolidated Statements of Cash Flows	4
Notes to Consolidated Financial Statements	5–12

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Rotary International:

We have audited the accompanying consolidated statements of financial position of Rotary International as of 30 June 2005 and 2004, and the related consolidated statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of Rotary International'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. 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 Rotary International'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, such consolidated financial statements present fairly, in all material respects, the financial position of Rotary International at 30 June 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

16 September 2005

ROTARY INTERNATIONAL

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

AS OF 30 JUNE 2005 AND 2004

(Thousands of dollars)

ASSETS	2005	2004
CASH	\$ 8,828	\$ 4,443
CLUB AND OTHER ACCOUNTS RECEIVABLE— Net of allowance for doubtful accounts of \$168 and \$244 in 2005 and 2004, respectively	3,274	3,515
DEFERRED CHARGES, PREPAID EXPENSES, AND OTHER ASSETS	2,734	1,593
DUE FROM THE ROTARY FOUNDATION	2,436	-
INVESTMENTS:		
Cash and short-term investments	4,316	4,679
Bonds	28,264	28,179
Stocks	<u>44,885</u>	<u>45,016</u>
Total investments	<u>77,465</u>	<u>77,874</u>
PROPERTY AND EQUIPMENT:		
Land	2,960	2,231
Building	48,096	45,212
Furniture and equipment	14,685	12,960
	65,741	60,403
Accumulated depreciation	<u>31,910</u>	<u>27,437</u>
Property and equipment—net	<u>33,831</u>	<u>32,966</u>
TOTAL	<u>\$128,568</u>	<u>\$120,391</u>
LIABILITIES AND UNRESTRICTED NET ASSETS		
LIABILITIES:		
Accounts payable	3,789	3,587
Accrued expenses	18,698	18,609
Deferred revenue	2,040	1,032
Due to The Rotary Foundation	<u> </u>	<u>967</u>
Total liabilities	<u>24,527</u>	<u>24,195</u>
UNRESTRICTED NET ASSETS:		
Undesignated	90,688	82,792
Board designated:		
Convention expense reserve	2,661	500
Investment earnings reserve	10,692	8,304
Operating expense reserve	<u> </u>	<u>4,600</u>
Total unrestricted net assets	<u>104,041</u>	<u>96,196</u>
TOTAL	<u>\$128,568</u>	<u>\$120,391</u>

See notes to consolidated financial statements.

ROTARY INTERNATIONAL

CONSOLIDATED STATEMENTS OF ACTIVITIES FOR THE YEARS ENDED 30 JUNE 2005 AND 2004

(Thousands of dollars)

	2004-2005	2003-2004
REVENUES:		
Dues	\$ 46,250	\$41,860
Net investment return	5,443	8,304
Captive insurance assessment	890	874
Magazine	6,710	6,390
Meetings	9,753	11,453
Council on Legislation		3,336
One Rotary Center tenants	4,664	4,408
Publications and supplies	1,244	948
License fees and royalties	2,132	1,802
Miscellaneous income (expense)	<u>1,494</u>	<u>770</u>
Total revenues	<u>78,580</u>	<u>80,145</u>
EXPENSES:		
Administrative	1,228	1,317
Board of Director activities	1,017	1,215
Board support services	1,003	803
Committees	614	590
Communications and public relations	5,711	4,759
Cost of publications and supplies	1,969	2,264
Council on Legislation		3,336
Currency exchange losses (gains)—net	(157)	13
District conference representatives	848	408
District governors	7,760	7,229
Finance and investment services	4,374	3,852
Human resources	1,380	1,384
International Assembly	3,130	3,147
International Convention	8,244	9,670
Magazine	4,597	4,230
Information services	4,591	4,796
Membership services	3,627	3,525
Office support services	2,162	1,924
One Rotary Center	5,364	5,327
Captive insurance expenses	665	869
President and president-elect offices	1,622	1,565
Programs and meetings	4,000	3,079
International Offices	5,777	5,650
Contribution to The Rotary Foundation	<u>222</u>	<u>1,354</u>
Total expenses	<u>69,748</u>	<u>72,306</u>
CHANGE IN NET ASSETS BEFORE MINIMUM PENSION LIABILITY (ADJUSTMENT) RECOVERY	8,832	7,839
MINIMUM PENSION LIABILITY (ADJUSTMENT) RECOVERY	<u>(987)</u>	<u>1,875</u>
CHANGE IN NET ASSETS	7,845	9,714
UNRESTRICTED NET ASSETS—Beginning of year	<u>96,196</u>	<u>86,482</u>
UNRESTRICTED NET ASSETS—End of year	<u>\$104,041</u>	<u>\$96,196</u>

See notes to consolidated financial statements.

ROTARY INTERNATIONAL

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 30 JUNE 2005 AND 2004 (Thousands of dollars)

	2004-2005	2003-2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 7,845	\$ 9,714
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Realized net gain on sale of investments	(2,256)	(229)
Unrealized gain on investments	(1,605)	(7,112)
Loss on disposal of property and equipment		72
Depreciation and amortization	4,473	5,098
Changes in assets and liabilities:		
Club and other accounts receivable	241	179
Deferred charges, prepaid expenses and other assets	(1,141)	295
Accounts payable	202	(1,646)
Accrued expenses	89	4,300
Deferred revenue	1,008	(2,697)
Due from/to The Rotary Foundation	(3,403)	(2,457)
	<u>5,453</u>	<u>5,517</u>
Net cash flows from operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(202,779)	(182,467)
Proceeds from sale of investments	206,685	178,007
Change in investment cash and short-term investments	364	(27)
Capital expenditures	(5,338)	(5,297)
	<u>(1,068)</u>	<u>(9,784)</u>
Net cash flows from investing activities		
INCREASE (DECREASE) IN CASH	4,385	(4,267)
CASH—Beginning of year	<u>4,443</u>	<u>8,710</u>
CASH—End of year	<u>\$ 8,828</u>	<u>\$ 4,443</u>

See notes to consolidated financial statements.

ROTARY INTERNATIONAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED 30 JUNE 2005 AND 2004 (Thousands of dollars)

1. NATURE OF OPERATIONS

Rotary International (“Rotary”) is a corporation organized under the Illinois Not-for-Profit Corporation Act. Rotary is an organization of business and professional leaders united worldwide, who provide humanitarian service, encourage high ethical standards in all vocations and help build goodwill and peace in the world. Rotary’s fiscal operations include vocational, community, and international service programs; international meetings and conventions; publishing; and investment of funds. Operating support is derived principally from membership dues, publication activities, investment income, tenant rent, international meetings and conventions, and license fees and royalties.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Estimates—The preparation of financial statements in conformity with generally accepted accounting principles 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.

Cash—Cash includes \$3,653 and \$1,197 at 30 June 2005 and 2004, respectively, subject to certain withdrawal restrictions imposed by local governments.

Due from/to The Rotary Foundation—Rotary and The Rotary Foundation handle certain fiscal matters on behalf of each other, including transfers of funds within countries, payment of general and administrative expenses, and payment of employee salaries and benefits. The balances resulting from these transactions are settled on a periodic basis.

Investments—Investments are carried at fair value, based on quoted market prices (Note 3).

Property and Equipment—Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets: building (31.5 years); furniture and equipment (3 to 10 years).

Financial Instruments—Rotary, from time to time, enters into futures, option, forward, swap, and foreign exchange options and forward contracts. All financial instruments are recorded at fair value with gains and losses resulting from changes in fair value recognized in net assets in the period of change.

Dues—Dues are recognized as revenue in the membership year to which they relate. Prepaid dues, as well as the Council on Legislation per capita levy in noncouncil years, are reported as deferred revenue.

Tax Status—Rotary is a qualified not-for-profit organization exempt from income tax under Section 501(c)(4) of the Internal Revenue Code, but is subject to U.S. tax on any unrelated business income. There was no recorded liability for unrelated business income at 30 June 2005 or 2004.

Consolidation Policy—The accompanying consolidated financial statements include the accounts of Rotary and its wholly owned captive insurance subsidiary (collectively referred to as Rotary). All significant intercompany transactions have been eliminated (Note 10).

Translation of Currency Other Than the U.S. Dollar—The U.S. dollar is the functional currency for Rotary. Rotary has operations in countries other than the U.S. Translation gains or losses are reflected in currency exchange gains—net on the Statement of Activities.

Risks and Uncertainties—Rotary has investments in cash equivalents, debt and equity securities. Investment securities are exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the amounts reported in the Statement of Financial Position and the Statement of Activities.

3. INVESTMENTS

Investments in bonds include \$575 and \$1,074 at 30 June 2005 and 2004, respectively, denominated in currencies other than the U.S. dollar. Accrued interest and dividends are included in total investments.

The components of net investment return are as follows:

	2004–2005	2003–2004
Interest and dividends	\$ 2,173	\$ 1,637
Net realized gain	2,256	229
Net unrealized gain	1,605	7,112
Investment and banking fees	<u>(591)</u>	<u>(674)</u>
Total	<u>\$ 5,443</u>	<u>\$ 8,304</u>

4. FINANCIAL INSTRUMENTS

Rotary utilizes forward and option contracts in an effort to mitigate the risk associated with the volatility of fluctuations in foreign currency exchange rates in regular transactions with International Offices. These transactions are entered into to hedge other positions or transactions and, therefore, are subject to varying degrees of market and credit risks. Rotary also utilizes futures, option, forward, and swap contracts in connection with their investments in certain fixed income securities. These instruments are used to manage portfolio risk and may be used as a substitute for direct investment in the underlying security. All financial instruments are recorded at fair value with gains and losses resulting from changes in fair value recognized in net assets in the period of change.

5. ONE ROTARY CENTER

The revenue for One Rotary Center, Rotary's world headquarters office building, reflects rental income from non-Rotary tenants. The expense reported for One Rotary Center reflects the total costs of building operations. Building operating expense is as follows:

	2004-2005	2003-2004
One Rotary Center operating expense	\$ 5,889	\$ 5,930
Less revenues from tenants	<u>(4,664)</u>	<u>(4,408)</u>
Net cost to Rotary	<u>\$ 1,225</u>	<u>\$ 1,522</u>
Allocated as follows:		
Rotary International occupancy costs	\$ 700	\$ 919
The Rotary Foundation occupancy costs	<u>525</u>	<u>603</u>
Total	<u>\$ 1,225</u>	<u>\$ 1,522</u>

6. BENEFIT PLANS

Pension Benefits—The Rotary International Retirement Plan, covering substantially all Rotary and The Rotary Foundation employees, is a defined benefit pension plan. The benefits are determined by application of a benefit ratio to the employee's highest average annual earnings for five consecutive plan years. The pension plan assets are invested in certain fixed income and equity funds.

Rotary's funding policy, subject to the minimum funding requirements under the Employee Retirement Income Security Act of 1974, is to contribute such amounts as are determined on an actuarial basis to provide the assets sufficient to meet the benefit obligations. Rotary uses a 30 June measurement date for its plan.

	2005	2004
Summary Information:		
Projected benefit obligation	\$ 36,352	\$ 31,102
Plan assets at fair value	<u>26,458</u>	<u>24,368</u>
Funded status	<u>\$ (9,894)</u>	<u>\$ (6,734)</u>
Minimum pension liability	<u>\$ (2,733)</u>	<u>\$ (1,399)</u>
Minimum pension liability (adjustment) recovery recognized in the Statement of Activities	<u>\$ (987)</u>	<u>\$ 1,875</u>
Accumulated benefit obligation	<u>\$ 29,190</u>	<u>\$ 25,767</u>

The Rotary Foundation recorded a minimum pension liability adjustment of (\$347) and \$659 during 2005 and 2004, respectively.

The following table sets forth amounts recognized by the plan as of 30 June 2005 and 2004:

	2004–2005	2003–2004
Benefits paid	\$ 1,236	\$ 1,193
Pension expense	1,533	1,957
Employer contribution	1,533	1,957

The net periodic pension benefits expense recognized by Rotary based upon its proportionate share of payroll expense for 2005 and 2004 was \$1,124 and \$1,528, respectively.

The weighted actuarial assumptions used to determine net periodic benefit cost for the years ended 30 June 2005 and 2004, respectively, were:

	2005	2004
Discount rate	6.00 %	6.00 %
Expected long-term rate of return	8.50	8.50
Assumed rate of compensation increases	5.00	5.00

The weighted actuarial assumptions used to determine the benefit obligation for the years ended 30 June 2005 and 2004, respectively, were:

	2005	2004
Discount rate	5.25 %	6.00 %
Assumed rate of compensation increases	5.00	5.00

In developing the expected long-term rate of return on assets, the plan trustees considered the average rate of earnings expected on the classes of funds invested or to be invested to provide for the future obligation of this pension plan. This included considering the trust's targeted asset allocation for the year and the expected returns likely to be earned over the next 20 years. Amounts are tested for reasonableness against the historical averages. The expected return on asset assumption is intended to be a long-term assumption and is not expected to be modified frequently.

The following table sets forth the allocation of plan assets:

	<u>Target</u>		<u>Actual</u>	
	2005	2004	2005	2004
Equity securities	70 %	70 %	70 %	71 %
Debt securities	<u>30</u>	<u>30</u>	<u>30</u>	<u>29</u>
Total	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

The plan assets are managed solely in the interest of the participants and their beneficiaries. Based on the plan's objectives, the Trustees have developed the target asset allocations shown above, as well as re-balancing ranges. The investment objective is to achieve a rate of return consistent with the above target allocations and is designed to generate returns that will enable the plan to meet its future obligations. The investment performance is monitored on a regular basis to ensure that managers are meeting expectations. The plan is to be broadly diversified so as to limit the impact of large losses in individual investments on the total portfolio. Consideration is also given to the proper long-term level of risk for the plan.

Rotary International expects to contribute \$2,100 to its pension plan in fiscal year 2006. The following benefit payments which reflect future services, as appropriate, are expected to be paid in the following fiscal years:

Year Ending 30 June	Amount
2006	\$ 1,411
2007	1,406
2008	1,451
2009	1,534
2010	1,589
Years 2011–2015	<u>9,359</u>
 Total	 <u>\$ 16,750</u>

401(k) Plan—The Rotary International 401(k) Plan (the “Plan”) is a defined contribution plan. Employees voluntarily make contributions to the Plan in amounts based upon a percentage of their total compensation, up to a maximum of 15%, subject to limitations imposed by the Internal Revenue Service. Rotary matches 50% of the first 6% contributed of the participant’s annual compensation. The expense to Rotary for the years ended 30 June 2005 and 2004, was \$365 and \$360, respectively. The Plan’s assets are invested in certain fixed income, money market, and equity funds.

7. LEASING ARRANGEMENTS

As lessee, Rotary leases certain office facilities and equipment. At 30 June 2005, the future minimum lease commitments under these noncancellable operating leases are as follows:

Year Ending 30 June	Amount
2006	\$ 838
2007	738
2008	642
2009	620
2010	<u>530</u>
 Total future minimum lease commitments	 <u>\$ 3,368</u>

Rental expense was \$1,050 and \$1,289 for the years ended 30 June 2005 and 2004, respectively.

At 30 June 2005, 50.0% of One Rotary Center space was available for lease. Of the available space for lease, 86.7% was leased to third parties with terms ranging from two to twelve years. Future minimum rental income to be received on these leases is as follows:

Year Ending 30 June	Amount
2006	\$ 4,317
2007	3,992
2008	3,646
2009	3,405
2010	3,111
Thereafter	<u>9,193</u>
Total	<u>\$27,664</u>

8. THE ROTARY FOUNDATION EXPENSE

Rotary charges The Rotary Foundation for expenses incurred on its behalf based on time and usage studies. The Boards of Rotary and The Rotary Foundation approved new allocation percentages effective 1 July 2001. These new allocations resulted in increased charges to The Rotary Foundation and are being phased in over four years. These expense allocations flow through intercompany accounts of the two entities and are as follows:

	2004-2005	2003-2004
World headquarters general administration	\$ 6,844	\$ 5,796
Information Services	5,458	5,762
International Offices	2,972	2,223
One Rotary Center occupancy costs	525	603
International Assembly	1,086	700
Other	<u> </u>	<u>25</u>
Total	<u>\$16,885</u>	<u>\$15,109</u>

9. FUNCTIONAL EXPENSES

Rotary classifies expenses functionally as follows:

	2004-2005	2003-2004
Membership programs and services	\$ 10,121	\$ 11,245
Publications	12,277	11,253
Meetings and conventions	15,374	19,232
Governance	12,864	11,810
Building operations	5,364	5,327
Management and general	<u>13,748</u>	<u>13,439</u>
Total	<u>\$69,748</u>	<u>\$72,306</u>

10. CAPTIVE INSURANCE COMPANY

During fiscal year 2001, the Board of Directors of Rotary approved the implementation of a blanket general liability insurance program to provide coverage for Rotary and all clubs in the U.S. and its territories through a captive insurance company. PPH National Insurance Co. (“PPH”), a wholly owned subsidiary of Rotary, was incorporated under the laws of the State of Vermont on 24 April 2001, and became fully operational 1 July 2001. The following is a summarization of PPH’s financial activity found in Rotary’s Consolidated Statements of Financial Position and Statements of Activities.

Balance Sheets	2005	2004
Cash and other	\$ 103	\$ 193
Investments—Bonds	<u>2,714</u>	<u>2,024</u>
Total assets	<u>\$2,817</u>	<u>\$2,217</u>
Accrued expenses	\$2,108	\$1,836
Accounts payable and other	<u>88</u>	<u>47</u>
Total liabilities	2,196	1,883
Undesignated net assets	<u>621</u>	<u>334</u>
Total liabilities and unrestricted net assets	<u>\$2,817</u>	<u>\$2,217</u>
Statements of Income	2004–2005	2003–2004
Direct assessment income	\$ 890	\$ 874
Investment income	<u>64</u>	<u>69</u>
Total revenue	954	943
Captive insurance expense	<u>665</u>	<u>869</u>
Net income	<u>\$ 289</u>	<u>\$ 74</u>

11. AFFINITY CARD PROGRAM

Effective 3 August 2000, the Board of Directors of Rotary, supported by the Trustees of The Rotary Foundation, approved an affinity credit card program with a financial institution. As of 30 June 2005, the affinity card program operates in the United States, Brazil, United Kingdom, Japan, Ireland, Canada, Taiwan, Philippines, India, Spain and Italy. Rotary recognized affinity card royalty revenue of \$787 and \$666 in fiscal years 2005 and 2004, respectively.

12. COUNCIL ON LEGISLATION

The Council on Legislation, the legislative body of Rotary, meets triennially and has the authority to amend the constitutional documents of the organization. The 2004 Council was held in Chicago, Illinois on 13-19 June 2004. As of 30 June 2005, the per capita levy deferred to cover the cost of the next Council on Legislation, scheduled for April 2007, has increased \$1,595 for a total of \$1,767.

13. DESIGNATION OF NET ASSETS

In fiscal year 2002, the Board of Directors approved a Convention Expense Reserve to reduce the impact of Conventions on the administrative reserve funds of Rotary in the event of the Convention expenses exceeding revenues in any given year. In fiscal year 2005, the Board amended the Convention Expense Reserve to include the current year's convention net operating results.

In fiscal year 2003, the Board of Directors of Rotary approved the establishment of an Investment Earnings Reserve to mitigate the volatility of annual investment returns on the administrative reserve funds of Rotary.

The Board of Directors is permitted under the by-laws to designate net assets in order to balance the budget in any given year. At 30 June 2004, an amount not to exceed \$4,600 was designated for the fiscal year 2004-05 budget. At 30 June 2005, no reserve was designated since budgeted revenues are expected to exceed budgeted expenses in fiscal year 2005-06.

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