

# ***Rotary International***

*Consolidated Financial Statements as of and  
for the Years Ended 30 June 2006 and 2005,  
and Independent Auditors' Report*

# ROTARY INTERNATIONAL

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## 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 2006 and 2005, 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 2006 and 2005, 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*

15 September 2006

# ROTARY INTERNATIONAL

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

AS OF 30 JUNE 2006 AND 2005

(Thousands of dollars)

	2006	2005
<b>ASSETS</b>		
CASH	\$ 8,725	\$ 8,828
CLUB AND OTHER ACCOUNTS RECEIVABLE, Net of allowance for doubtful accounts of \$198 and \$168 in 2006 and 2005, respectively	5,044	3,274
DEFERRED CHARGES, PREPAID EXPENSES, AND OTHER ASSETS	1,957	2,734
DUE FROM THE ROTARY FOUNDATION	308	2,436
INVESTMENTS:		
Cash and short-term investments	5,374	4,316
Bonds	31,484	28,264
Stocks	<u>47,961</u>	<u>44,885</u>
Total investments	<u>84,819</u>	<u>77,465</u>
PROPERTY AND EQUIPMENT:		
Land	2,960	2,960
Building	53,436	48,096
Furniture and equipment	<u>17,954</u>	<u>14,685</u>
	74,350	65,741
Accumulated depreciation	<u>37,134</u>	<u>31,910</u>
Property and equipment—net	<u>37,216</u>	<u>33,831</u>
TOTAL	<u>\$138,069</u>	<u>\$128,568</u>
<b>LIABILITIES AND UNRESTRICTED NET ASSETS</b>		
LIABILITIES:		
Accounts payable	\$ 6,363	\$ 3,789
Accrued expenses	13,428	18,698
Deferred revenue	<u>5,371</u>	<u>2,040</u>
Total liabilities	<u>25,162</u>	<u>24,527</u>
UNRESTRICTED NET ASSETS:		
Undesignated	99,507	90,688
Board designated:		
Convention expense reserve	1,400	2,661
Investment earnings reserve	<u>12,000</u>	<u>10,692</u>
Total unrestricted net assets	<u>112,907</u>	<u>104,041</u>
TOTAL	<u>\$138,069</u>	<u>\$128,568</u>

See notes to consolidated financial statements.

# ROTARY INTERNATIONAL

## CONSOLIDATED STATEMENTS OF ACTIVITIES FOR THE YEARS ENDED 30 JUNE 2006 AND 2005 (Thousands of dollars)

	2005-2006	2004-2005
REVENUES:		
Dues	\$ 50,841	\$ 46,250
Net investment return	6,753	5,443
Services and other activities	<u>21,533</u>	<u>26,887</u>
Total revenues	<u>79,127</u>	<u>78,580</u>
EXPENSES:		
Administrative	1,326	1,228
Board of Director activities	1,216	1,017
Board support services	1,109	1,003
Committees	772	614
Communications and public relations	5,754	5,711
Currency exchange gains—net	(445)	(157)
District conference representatives	916	848
District governors	7,898	7,760
Finance and investment services	4,672	4,374
Human resources	1,410	1,380
International assembly	3,722	3,130
Information services	6,682	4,591
Membership services	4,112	3,627
Office support services	2,245	2,162
President and president-elect offices	1,784	1,622
Programs and meetings	3,197	4,000
International offices	5,676	5,777
Services and other activities	<u>20,227</u>	<u>21,061</u>
Total expenses	<u>72,273</u>	<u>69,748</u>
CHANGE IN NET ASSETS BEFORE MINIMUM PENSION LIABILITY RECOVERY (ADJUSTMENT)	6,854	8,832
MINIMUM PENSION LIABILITY RECOVERY (ADJUSTMENT)	<u>2,012</u>	<u>(987)</u>
CHANGE IN NET ASSETS	8,866	7,845
UNRESTRICTED NET ASSETS—Beginning of year	<u>104,041</u>	<u>96,196</u>
UNRESTRICTED NET ASSETS—End of year	<u>\$112,907</u>	<u>\$104,041</u>

See notes to consolidated financial statements.

# ROTARY INTERNATIONAL

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 30 JUNE 2006 AND 2005 (Thousands of dollars)

	2005-2006	2004-2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Change in net assets	\$ 8,866	\$ 7,845
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Realized net gain on sale of investments	(4,421)	(2,256)
Unrealized loss (gain) on investments	42	(1,605)
Depreciation and amortization	5,224	4,473
Changes in assets and liabilities:		
Club and other accounts receivable	(1,770)	241
Deferred charges, prepaid expenses and other assets	777	(1,141)
Accounts payable	2,574	202
Accrued expenses	(5,270)	89
Deferred revenue	3,331	1,008
Due from The Rotary Foundation	<u>2,128</u>	<u>(3,403)</u>
Net cash flows from operating activities	<u>11,481</u>	<u>5,453</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of investments	(295,015)	(202,779)
Proceeds from sale of investments	293,098	206,685
Change in investment cash and short-term investments	(1,058)	364
Capital expenditures	<u>(8,609)</u>	<u>(5,338)</u>
Net cash flows from investing activities	<u>(11,584)</u>	<u>(1,068)</u>
(DECREASE) INCREASE IN CASH	(103)	4,385
CASH—Beginning of year	<u>8,828</u>	<u>4,443</u>
CASH—End of year	<u>\$ 8,725</u>	<u>\$ 8,828</u>

See notes to consolidated financial statements.

# ROTARY INTERNATIONAL

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED 30 JUNE 2006 AND 2005 (Thousands of dollars)

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### 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 \$4,697 and \$3,653 at 30 June 2006 and 2005, respectively, subject to certain repatriation restrictions imposed by local governments.

**Due From 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 4). Cash and short-term investments are primarily money market investments held by Rotary’s custodian bank during the process of settling investment transactions.

**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 2006 or 2005.

**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 11).

**Translation of Currency Other Than the U.S. Dollar**—The U.S. dollar is the reporting currency for Rotary. Rotary has operations in countries other than the U.S. that are generally translated to Rotary’s reporting currency. Translation and transaction gains or losses are reflected in currency exchange gains—net on the Consolidated Statements of Activities.

**Risks and Uncertainties**—Rotary has investments in cash and short-term investments, 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 Consolidated Statements of Financial Position and the Consolidated Statements of Activities.

### 3. SERVICES AND OTHER ACTIVITIES

Services and other activities are those activities which generate income to offset the expenses incurred.

	2005-2006	2004-2005
International convention revenue	\$5,613	\$9,575
International convention expense	<u>6,993</u>	<u>8,244</u>
Excess revenue (expense)	<u>(1,380)</u>	<u>1,331</u>
Magazine revenue	6,538	6,710
Magazine expense—(direct cost only)	<u>4,817</u>	<u>4,597</u>
Excess revenue (expense)	<u>1,721</u>	<u>2,113</u>
One Rotary Center revenue	4,865	4,664
One Rotary Center expense	<u>5,671</u>	<u>5,364</u>
Excess revenue (expense)	<u>(806)</u>	<u>(700)</u>
Publications and supplies revenue	659	1,244
Cost of publications and supplies expense	<u>1,488</u>	<u>1,969</u>
Excess revenue (expense)	<u>(829)</u>	<u>(725)</u>
Captive Insurance assessment revenue	670	890
Captive Insurance expense	<u>673</u>	<u>665</u>
Excess revenue (expense)	<u>(3)</u>	<u>225</u>
License fees and royalties revenue	1,628	2,132
Contribution to The Rotary Foundation	585	222
Miscellaneous income	<u>1,560</u>	<u>1,672</u>
Excess revenue (expense)	<u>2,603</u>	<u>3,582</u>
Services and other activities revenue	21,533	26,887
Services and other activities expense	<u>20,227</u>	<u>21,061</u>
Excess revenue (expense)	<u>\$1,306</u>	<u>\$5,826</u>

#### 4. INVESTMENTS

At 30 June 2006, Rotary did not have any investments in bonds denominated in currencies other than the U.S. dollar. Rotary did have \$575 of investments in bonds denominated in currencies other than the U.S. dollar at 30 June 2005. Accrued interest and dividends are included in total investments.

The components of net investment return are as follows:

	2005-2006	2004-2005
Interest and dividends	\$ 2,963	\$ 2,173
Net realized gain	4,421	2,256
Net unrealized (loss) gain	(42)	1,605
Investment and banking fees	<u>(589)</u>	<u>(591)</u>
Total	<u>\$ 6,753</u>	<u>\$ 5,443</u>

#### 5. FINANCIAL INSTRUMENTS

Rotary utilizes 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.

#### 6. 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:

	2005-2006	2004-2005
One Rotary Center operating expense	\$ 6,310	\$ 5,889
Less revenues from tenants	<u>(4,865)</u>	<u>(4,664)</u>
Net cost to Rotary	<u>\$ 1,445</u>	<u>\$ 1,225</u>
Allocated as follows:		
Rotary International occupancy costs	\$ 806	\$ 700
The Rotary Foundation occupancy costs	<u>639</u>	<u>525</u>
Total	<u>\$ 1,445</u>	<u>\$ 1,225</u>

## 7. 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.

	2006	2005
Summary information:		
Projected benefit obligation	\$ 34,212	\$ 36,352
Plan assets at fair value	<u>29,492</u>	<u>26,458</u>
Funded status	<u>\$ (4,720)</u>	<u>\$ (9,894)</u>
Accrued pension liability	\$ (13)	\$ (13)
Minimum pension liability recovery (adjustment) recognized in the Statement of Activities	2,012	(987)
Additional minimum pension liability	-	(2,720)
Accumulated benefit obligation	27,955	29,190

The Rotary Foundation recorded a minimum pension liability recovery (adjustment) of \$707 and \$(347) during 2006 and 2005, respectively.

The following table sets forth amounts recognized by the plan as of 30 June 2006 and 2005:

	2005–2006	2004–2005
Benefits paid	\$ 1,255	\$ 1,236
Pension expense	2,035	1,533
Employer contribution	2,035	1,533

The net periodic pension benefits expense recognized by Rotary based upon its proportionate share of payroll expense for 2006 and 2005 was \$1,529 and \$1,124, respectively.

The weighted actuarial assumptions used to determine net periodic benefit cost for the years ended 30 June 2006 and 2005, respectively, were:

	2006	2005
Discount rate	5.25 %	6.00 %
Expected long-term rate of return	8.00	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 2006 and 2005, respectively, were:

	<b>2006</b>	<b>2005</b>
Discount rate	6.25 %	5.25 %
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>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Equity securities	70 %	70 %	71 %	70 %
Debt securities	<u>30</u>	<u>30</u>	<u>29</u>	<u>30</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 \$1,533 to its pension plan in fiscal year 2007. The following benefit payments which reflect future services, as appropriate, are expected to be paid in the following fiscal years:

<b>Year Ending 30 June</b>	<b>Amount</b>
2007	\$ 1,399
2008	1,477
2009	1,554
2010	1,596
2011	1,649
Years 2012–2016	<u>9,899</u>
Total	<u>\$ 17,574</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 2006 and 2005, was \$393 and \$365, respectively. The Plan’s assets are invested in certain fixed income, money market, and equity funds.

## 8. LEASING ARRANGEMENTS

As lessee, Rotary leases certain office facilities and equipment. At 30 June 2006, the future minimum lease commitments under these noncancellable operating leases are as follows:

<b>Year Ending 30 June</b>	<b>Amount</b>
2007	\$ 789
2008	674
2009	640
2010	544
2011	<u>320</u>
Total future minimum lease commitments	<u>\$ 2,967</u>

Rental expense was \$1,058 and \$1,050 for the years ended 30 June 2006 and 2005, respectively.

At 30 June 2006, 50.0% of One Rotary Center space was available for lease. Of the available space for lease, 88.8% was leased to third parties with terms ranging from two to eleven years. Future minimum rental income to be received on these leases is as follows:

<b>Year Ending 30 June</b>	<b>Amount</b>
2007	\$ 4,066
2008	3,754
2009	3,514
2010	3,253
2011	3,020
Thereafter	<u>6,630</u>
Total	<u>\$ 24,237</u>

## 9. THE ROTARY FOUNDATION EXPENSE

In accordance with an administrative services agreement dated 28 June 2006, Rotary charges The Rotary Foundation for expenses incurred on its behalf. Both boards meet annually to adjust the agreement as needed. These expense allocations flow through intercompany accounts of the two entities and are as follows:

	2005-2006	2004-2005
World headquarters general administration	\$ 9,034	\$ 6,844
Information Services	7,071	5,458
International Offices	3,217	2,972
One Rotary Center occupancy costs	639	525
International Assembly	<u>1,063</u>	<u>1,086</u>
Total	<u>\$ 21,024</u>	<u>\$ 16,885</u>

## 10. FUNCTIONAL EXPENSES

Rotary classifies expenses functionally as follows:

	2005-2006	2004-2005
Membership programs and services	\$ 10,789	\$ 10,121
Publications	12,059	12,277
Meetings and conventions	13,912	15,374
Governance	13,695	12,864
Building operations	5,671	5,364
Management and general	<u>16,147</u>	<u>13,748</u>
Total	<u>\$ 72,273</u>	<u>\$ 69,748</u>

## 11. 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 Consolidated Statements of Activities.

<b>Balance Sheets</b>	<b>2006</b>	<b>2005</b>
Cash and other	\$ 403	\$ 103
Investments—Vanguard Short-Term Treasury Fund	<u>2,786</u>	<u>2,714</u>
Total assets	<u>\$ 3,189</u>	<u>\$ 2,817</u>
Accrued expenses	\$ 2,168	\$ 2,108
Accounts payable and other	<u>343</u>	<u>88</u>
Total liabilities	2,511	2,196
Undesignated net assets	<u>678</u>	<u>621</u>
Total liabilities and unrestricted net assets	<u>\$ 3,189</u>	<u>\$ 2,817</u>
<b>Statements of Income</b>	<b>2005–2006</b>	<b>2004–2005</b>
Direct assessment income	\$ 670	\$ 890
Investment income	<u>104</u>	<u>64</u>
Total revenue	774	954
Captive insurance expense	<u>673</u>	<u>665</u>
Net income	<u>\$ 101</u>	<u>\$ 289</u>

## 12. AFFINITY CARD PROGRAM

The Board of Directors of Rotary, in consultation with the Trustees of The Rotary Foundation, renewed the U.S. affinity credit card program with a financial institution during fiscal year 2006. As of 30 June 2006, the affinity card program operates in the United States, Taiwan, Japan, India, United Kingdom, Canada, Mexico, the Philippines, South Korea, Spain, Thailand, Brazil, Ireland and Italy. Rotary recognized affinity card royalty revenue of \$605 and \$787 in fiscal years 2006 and 2005, respectively.

**13. COUNCIL ON LEGISLATION**

The Council on Legislation (the “Council”), the legislative body of Rotary, meets triennially and has the authority to amend the constitutional documents of the organization. The 2007 Council is scheduled to be held in Chicago, Illinois in April 2007. As of 30 June 2006, the per capita levy recognized as deferred revenue to cover the cost of the next Council has increased \$1,187 for a total of \$2,954.

**14. 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. The Board amended the Convention expense reserve to include the net operating gains and losses of future conventions subject to a floor of \$500.

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 reserve is increased by the amount that investment earnings exceeds budgeted investment earnings, limited to \$12,000. Alternatively, the reserve will be reduced by the amount that investment earnings falls short of budgeted investment earnings. The reserve is to provide for any shortfall in investment earnings and is not for the use of additional general operating expenses.

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