

FINANCIAL STATEMENTS

Zoological Society of San Diego

Fiscal Years 2002 and 2001 with Report of Independent Auditors

Zoological Society of San Diego

Contents

Report of Independent Auditors.....	1
Statements of Financial Position.....	2
Statements of Activities.....	3
Statements of Cash Flows.....	4
Notes to Financial Statements.....	5

Report of Independent Auditors

The Board of Trustees
Zoological Society of San Diego

We have audited the accompanying statement of financial position of the Zoological Society of San Diego (the Society) as of December 29, 2002, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Society's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Society as of and for the year ended December 30, 2001, were audited by other auditors whose report dated April 8, 2002, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 2002 financial statements referred to above present fairly, in all material respects, the financial position of the Zoological Society of San Diego at December 29, 2002, and its activities and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

April 10, 2003

Zoological Society of San Diego

Statements of Financial Position
(in thousands)

	<u>2002</u>	<u>2001</u>
Assets		
Cash and cash equivalents	\$ 28,351	\$ 6,445
Accounts receivable, less allowance for doubtful accounts	4,031	5,211
Inventories	4,013	4,232
Prepaid expenses and other assets	1,328	694
Investments	61,410	90,570
Bequests and donations receivable	18,700	19,072
Property and equipment, net	109,093	113,603
Total assets	<u>\$ 226,926</u>	<u>\$ 239,827</u>
Liabilities and net assets		
Accounts payable	\$ 10,186	\$ 8,700
Accrued salaries and expenses	7,631	6,872
Deferred support and revenue	10,716	12,977
Line of credit	14,525	14,325
Capital lease obligations	579	953
Accrued pension	5,836	2,104
Total liabilities	<u>49,473</u>	<u>45,931</u>
Net assets:		
Unrestricted	135,001	149,905
Temporarily restricted	27,700	30,048
Permanently restricted	14,752	13,943
Total net assets	<u>177,453</u>	<u>193,896</u>
Total liabilities and net assets	<u>\$ 226,926</u>	<u>\$ 239,827</u>

See accompanying notes.

Zoological Society of San Diego

Statements of Activities (in thousands)

	Fiscal 2002			Fiscal 2001				
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues and other support:								
Exhibition facilities:								
Admissions and memberships	\$ 56,610	\$ -	\$ -	\$ 56,610	\$ 56,449	\$ -	\$ -	\$ 56,449
Auxiliary activities	65,429	-	-	65,429	64,039	-	-	64,039
Tax revenue and other	5,491	-	-	5,491	4,782	-	-	4,782
Total exhibition facilities	127,530	-	-	127,530	125,270	-	-	125,270
Grants	4,159	-	-	4,159	2,185	-	-	2,185
Donations and bequests	6,315	9,570	809	16,694	7,941	7,244	2,510	17,695
Other revenue	420	-	-	420	383	-	-	383
Net assets released from restrictions	138,424	9,570	809	148,803	135,779	7,244	2,510	145,533
Total revenues and other support	11,933	(11,933)	-	-	383	-	-	383
Expenses:	150,357	(2,363)	809	148,803	141,079	1,944	2,510	145,533
Exhibition facility operations	119,384	-	-	119,384	123,773	-	-	123,773
Research and conservation activities	12,915	-	-	12,915	11,383	-	-	11,383
Educational programs	2,828	-	-	2,828	3,130	-	-	3,130
Administration and development	11,559	-	-	11,559	12,869	-	-	12,869
Pension expenses	2,439	-	-	2,439	106	-	-	106
Transfers	-	-	-	-	-	2,140	(2,140)	-
Total expenses	149,125	-	-	149,125	151,261	2,140	(2,140)	151,261
Change in net assets before other income(expense)	1,232	(2,363)	809	(322)	(10,182)	(196)	4,650	(5,728)
Other income (expense):								
Investment income	133	15	-	148	1,819	59	-	1,878
Net realized loss on investments	(672)	-	-	(672)	(803)	-	-	(803)
Net unrealized loss on investments	(13,816)	-	-	(13,816)	(9,340)	-	-	(9,340)
Interest expense	(488)	-	-	(488)	(761)	-	-	(761)
Change in net assets	(13,611)	(2,348)	809	(15,150)	(19,267)	(137)	4,650	(14,754)
Additional minimum pension liability	(1,293)	-	-	(1,293)	-	-	-	-
Net assets at beginning of year	149,905	30,048	13,943	193,896	169,172	30,185	9,293	208,650
Net assets at end of year	\$ 135,001	\$ 27,700	\$ 14,752	\$ 177,453	\$ 149,905	\$ 30,048	\$ 13,943	\$ 193,896

See accompanying notes.

Zoological Society of San Diego

Statements of Cash Flows (in thousands)

	Year ended	
	2002	2001
Cash flows from operating activities:		
Change in net assets	\$ (15,150)	\$ (14,754)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,418	15,156
Provision for uncollectible receivables	89	157
Donated assets	(533)	(25)
Net realized loss on sale of investments	672	803
Net unrealized loss on investments	13,816	9,340
Net loss on disposal of property and equipment	328	123
Restricted contributions	(10,379)	(9,754)
Changes in operating assets and liabilities:		
Accounts receivable	1,180	352
Inventories	219	(114)
Prepaid expenses and other assets	(101)	1,552
Bequests and donations receivable	283	(2,045)
Accounts payable	1,486	(3,564)
Accrued salaries and expenses	3,198	403
Deferred support and revenue	(2,261)	818
Net cash provided by (used in) operating activities	4,265	(1,552)
Cash flows from investing activities:		
Proceeds from sale of marketable securities	30,298	29,640
Purchase of marketable securities	(15,626)	(24,926)
Purchase of property and equipment	(7,236)	(19,686)
Net cash provided by (used in) investing activities	7,436	(14,972)
Cash flows from financing activities:		
Proceeds from line of credit	7,500	11,350
Payments from line of credit	(7,300)	(6,475)
Principal payments of capital lease obligations	(374)	(449)
Endowment contributions received	809	2,510
Contributions restricted for capital investment and programs	9,570	7,244
Net cash provided by financing activities	10,205	14,180
Net increase (decrease) in cash and cash equivalents	21,906	(2,344)
Cash and cash equivalents at beginning of year	6,445	8,789
Cash and cash equivalents at end of year	\$ 28,351	\$ 6,445
Supplemental schedule of noncash financing activities:		
Cash paid for interest during the year	\$ 488	\$ 864
Equipment acquisitions financed through capital leases	\$ —	\$ 140

See accompanying notes.

Zoological Society of San Diego

Notes to Financial Statements

December 29, 2002

1. Summary of Significant Accounting Policies

Basis of Presentation

The Zoological Society of San Diego (the Society) was incorporated in 1916, as a private, nonprofit corporation directed by a Board of Trustees (the Board). The Society operates two exhibition facilities, the World-Famous San Diego Zoo and the San Diego Wild Animal Park, and conducts conservation programs through its research operation, the Center for the Reproduction of Endangered Species (CRES). The San Diego Zoo and the Wild Animal Park exhibit animals and horticulture in natural botanical settings for the education and entertainment of visitors. At CRES, scientists, technicians and students work to further the conservation of animals, plants and endangered ecosystems. In addition to laboratory work, CRES also promotes in situ conservation via its field programs in key areas and "hotspots" in China, the Pacific Region, the southwestern United States, the Caribbean Islands, South America, Africa and elsewhere. CRES is also home to the Frozen Zoo®, the world's largest collection of genetic and reproductive material from endangered animals.

Fund Accounting and Net Asset Classification

To ensure compliance with restrictions placed on the resources available to the Society, the Society's accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources are classified for accounting and reporting, into funds established according to their nature and purpose. In the financial statements, funds that have similar characteristics are combined into three net asset categories:

- Unrestricted net assets are not restricted by donors or the donor-imposed restrictions have expired.
- Temporarily restricted net assets contain donor-imposed restrictions that permit the Society to use or expend the assets only as specified. These restrictions are satisfied either by the passage of time or by the Society's expenditure for the specified purpose.
- Permanently restricted net assets contain donor-imposed restrictions and stipulate that the resources be maintained permanently but permit the Society to use or expend part or all of the income derived from the donated assets for either specified or unspecified purposes.

Zoological Society of San Diego

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Accounting Period

The Society reports on a 52/53-week year ending the Sunday nearest December 31. The fiscal years ended December 29, 2002 and December 30, 2001 each included 52 weeks and have been designated as fiscal years 2002 and 2001, respectively, in the accompanying financial statements.

Revenue Recognition

The Society records admissions, merchandising, grant and food & beverage revenue as earned. Membership revenue is deferred over the term of the membership, typically one year. In addition, the Society records gifts of long-lived assets as revenue when they are received unconditionally, at their fair value. Conditional contributions are recognized as revenue when the conditions on which they depend have been substantially met.

Animal and Horticultural Collections

In accordance with industry practice, animal and horticultural collections are recorded at the nominal amount of \$1, as there is no objective basis for establishing value. Additionally, animal and horticultural collections have numerous attributes, including species, age, sex, relationship and value to other animals, endangered status, and breeding potential, whereby it is impracticable to assign value. Acquisitions are recorded as expenditures in the period of acquisition.

In an ongoing commitment to enhance the worldwide reproduction and preservation of animals, the Society shares animals with other organizations. Consistent with industry practice, the Society does not record any liability for such sharing arrangements, as generally these arrangements are without monetary consideration.

Cash and Cash Equivalents

The Society considers short-term investments with a maturity date of 90 days or less from the date of purchase to be cash equivalents.

Zoological Society of San Diego

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Investments

Investments with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in the statement of activities.

Concentration of Credit Risk

The Society invests its excess cash in various types of investments. The Society has established guidelines relative to diversification and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates. Short-term investments are only placed in investment grade money market instruments. Long-term funds held for reserves and endowments are invested through an independently managed equity portfolio.

Inventories

The Society's inventory is valued at the lower of cost or market, and accounted for using a weighted-average cost basis.

Auxiliary Activities

The Society's auxiliary activities include retail merchandise and food operations, transportation operations, Wild Animal Park parking, educational activities and other similar support activities.

Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation. Depreciation expense is computed using the straight-line method over the estimated useful lives of the related assets which are generally from 3 to 20 years. Assets acquired under capital leases are recorded at the net present value of the minimum lease payments. Amortization expense is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the period of the related lease.

Zoological Society of San Diego

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Society assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made full recovery of the asset's carrying value unlikely. An impairment loss would be recognized when the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset. Should an impairment exist, the impairment loss would be measured based on the excess of the carrying amount of the asset over the asset's fair value.

Donations and Bequests

Donations with donor-imposed restrictions are reported as temporarily or permanently restricted revenue. Temporarily restricted net assets are reclassified to unrestricted net assets when an event occurs which satisfies the donor-imposed restriction.

Operating Agreements

The Society operates the San Diego Zoo and the Wild Animal Park pursuant to lease agreements with the City of San Diego. The agreements provide that title to the Society's property and exhibits is vested in the City. However, the Society's assets are recorded on the books of the Society, as the Society is permitted to pledge these assets.

The San Diego Zoo operating agreement expires in 2034. The Wild Animal Park operates under a renewable short-term agreement with the City of San Diego Water Utilities Department. Every five years, the fair rental value of the land is evaluated and the annual rent amount adjusted. The Society paid \$130,000 as annual rent in 2002 and 2001.

Income Taxes

The Society qualifies as a nonprofit organization under Section 501(c)(3) of the Internal Revenue Code and is not subject to income tax except to the extent of income received which is unrelated to the Society's tax exempt purpose.

Zoological Society of San Diego

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Use of Estimates

In accordance with its established practices, management of the Society has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities in order to prepare its financial statements in accordance with generally accepted accounting principles. Actual results could differ from these estimates.

Accounting Change — Depreciable Lives

At the beginning of fiscal 2002, the Society changed the estimated useful lives of certain assets to reflect the extended use of these assets. The change of estimated useful lives reduced depreciation expense in 2002 by approximately \$5 million.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. Accounts Receivable

A summary of accounts receivable at December 29, 2002 and December 30, 2001 is as follows (in thousands):

	2002	2001
Tax revenue receivable	\$ 2,400	\$ 3,879
Trade receivables	1,162	1,166
Other receivables	499	196
Allowance for doubtful accounts	(30)	(30)
Total receivables	<u>\$ 4,031</u>	<u>\$ 5,211</u>

Zoological Society of San Diego

Notes to Financial Statements (continued)

3. Inventories

A summary of inventories at December 29, 2002 and December 30, 2001 is as follows (in thousands):

	2002	2001
Merchandise	\$ 3,381	\$ 3,655
Food service	469	435
Animal food and other	163	142
Total inventories	\$ 4,013	\$ 4,232

4. Investments

Investments are recorded at fair market value. Included in investments is a cumulative unrealized gain at December 29, 2002 and December 30, 2001 of \$8,685,000 and \$22,501,000 respectively.

The following is a summary of investments at December 29, 2002 and December 30, 2001 (in thousands):

	2002	2001
Equity securities	\$ 61,410	\$ 80,396
Fixed income securities	–	10,174
	\$ 61,410	\$ 90,570

5. Bequests and Donations Receivable

Bequests and donations of private support are recorded as revenue upon the receipt of the unconditional promise to give. The Society believes that certain bequests and donations may not be collected due to a variety of circumstances and has provided an allowance for such amounts. Bequests and donations receivable are expected to be collected as follows (in thousands):

	2002	2001
Within one year	\$ 1,158	\$ 2,006
In more than five years	18,351	17,786
	19,509	19,792
Allowance for uncollectible amounts	(809)	(720)
Net bequests and donations receivable	\$ 18,700	\$ 19,072

Zoological Society of San Diego

Notes to Financial Statements (continued)

5. Bequests and Donations Receivable (continued)

Bequests and donations receivable are primarily comprised of split-interest agreements consisting of pooled-income funds, irrevocable trusts and charitable remainder trusts. Items that are expected to be collected in more than one year have been recorded at net present value, calculated using a discount rate of 4.2% and 6% for the years ended December 29, 2002 and December 30, 2001, respectively. Due to the nature of these items, it is difficult to estimate the time frame during which these will be collected. Consequently, all bequests receivable are shown above as collectible in more than five years.

6. Property and Equipment

A summary of property and equipment at December 29, 2002 and December 30, 2001 is as follows (in thousands):

	2002	2001
Buildings, exhibits and improvements	\$ 167,239	\$ 168,679
Transportation and equipment	41,493	42,328
Construction in progress	12,965	9,080
	<u>221,697</u>	<u>220,087</u>
Less accumulated depreciation and amortization	(112,604)	(106,484)
Net property and equipment	<u>\$ 109,093</u>	<u>\$ 113,603</u>

The estimate to complete the construction in progress is approximately \$45 million as of December 29, 2002.

Capital lease obligations are secured by equipment with a net book value of approximately \$1,149,000 and \$1,213,000 at December 29, 2002 and December 30, 2001, respectively. Accumulated amortization related to leased assets was \$796,000 and \$687,000 at December 29, 2002 and December 30, 2001, respectively.

Zoological Society of San Diego

Notes to Financial Statements (continued)

7. Capital Lease Obligations

The Society has capital lease obligations, with interest rates ranging from approximately 5.8% to 10.2% (a weighted average interest rate on all lease obligations is approximately 8.6%). Future installment amounts are as follows (in thousands):

2003	\$	283
2004		245
2005		113
Total minimum lease payments		641
Less imputed interest		(62)
Present value of minimum lease payments	\$	<u>579</u>

8. Line of Credit

The Society has an unsecured financing agreement with a commercial bank that permits multiple borrowings, at variable rates of interest, up to \$25 million. The financing agreement, which expires on November 1, 2003, provides that the Society may elect for each individual borrowing on the line of credit, to have interest calculated using rates based on one of the following: (1) the bank's reference rate, (2) LIBOR, or (3) IBOR. The outstanding balance of \$14,525,000 bears interest at rates ranging from 1.9% to 2.3% with an overall effective rate of 2.1% at the end of 2002. Interest payments are required to be made monthly. The line of credit contains certain covenants of which the Society was in full compliance at December 29, 2002.

At December 29, 2002, the Society has an outstanding letter of credit for \$952,000 under this agreement. The letter of credit reduces the amount eligible for borrowing.

Zoological Society of San Diego

Notes to Financial Statements (continued)

9. Temporarily and Permanently Restricted Net Assets

Temporary and permanently restricted net assets at December 29, 2002 and December 30, 2001 are available for the following purposes (in thousands):

	Temporarily Restricted	
	2002	2001
Restricted for capital investment:		
CRES center	\$ 3,837	\$ 3,010
Heart of the Zoo III	1,101	528
Education pavilion	994	1,461
Simang and orangutan exhibit	821	308
Other capital items	924	4,241
	7,677	9,548
Restricted for programs:		
Panda research	977	1,037
Education	135	118
CRES research	90	271
Other projects	121	2
	1,323	1,428
Restricted until received	18,700	19,072
	\$ 27,700	\$ 30,048
	Permanently Restricted	
	2002	2001
Endowments:		
CRES	\$ 10,618	\$ 9,829
Education	2,455	2,435
Steel Foundation – Director’s endowment	1,679	1,679
	\$ 14,752	\$ 13,943

In 2001, \$2,140,000 in net assets previously reported in temporarily restricted was reclassified as permanently restricted to conform to the donors’ specification.

Zoological Society of San Diego

Notes to Financial Statements (continued)

10. Board Designated Net Assets

Certain unrestricted net assets have been designated by the Board of Trustees to only be used for specific purposes. These designations include a fund for CRES designated to fund research improving the husbandry and reproduction of rare and endangered species. In addition, the Board has designated amounts for an emergency reserve and a strategic reserve. The emergency reserve is to provide for unexpected or unanticipated expenditures when other sources of funds are not available. The strategic reserve is to provide for future operating needs. As these board restrictions are not binding, they are not reflected as restricted net assets in the accompanying financial statements.

11. Pension and Benefit Plans

The Society has two defined benefit pension plans that cover substantially all of its full-time employees. The plans provide benefits based upon years of service and final average earnings.

The following table sets forth the plans' funded status based on the latest actuarial report (as of December 29, 2002) and the accrued benefit cost recognized in the Society's statements of financial position (in thousands):

	2002	2001
Plan assets at fair value	\$ 37,786	\$ 48,219
Projected benefit obligation	(48,095)	(40,908)
Funded status	(10,309)	7,311
Accrued benefit cost	4,543	2,104
Additional minimum liability	\$ 1,293	\$ —

Weighted-average assumptions:

Discount rate	7.0%	7.5%
Expected return on plan assets	8.0%	8.0%
Rate of compensation increase	3.0%	4.0%

Zoological Society of San Diego

Notes to Financial Statements (continued)

11. Pension and Benefit Plans (continued)

The following table sets forth benefit cost and benefits paid (in thousands):

	<u>2002</u>	<u>2001</u>
Benefit cost (credit)	\$ 4,117	\$ (96)
Benefits paid	2,360	922
Funds appropriated for employer contributions	\$ 500	\$ –

In 2002, the Society offered an early retirement package to employees who met certain eligibility requirements. The eligible participants that selected the early retirement package retired on March 31, 2002 in exchange for certain additional benefits under the program. The additional benefits included a one-time lump sum cash payment based on years of service. The lump sum payments to participants totaled \$880,000 and are included in benefits paid for 2002. The other additional benefits under the program increased the projected benefit obligation by \$2,837,000 as of December 29, 2002.

The Society has two 403(b) defined contribution plans, which covers employees who meet certain age and service requirements. Eligible employees may contribute a portion of their earnings each plan year subject to certain Internal Revenue Service limitations. In addition, the Society has a 403(b) defined contribution plan with allows for employer matching contributions to eligible employees.

12. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate fair value of each class of financial instruments for which it is practicable to estimate fair value:

- The carrying values of cash equivalents and accounts and other receivables approximate fair value of these financial instruments.
- Investments are reported at fair value based on quoted market prices for those investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.
- The carrying amount of bequests and donations receivable approximates fair value as these donations, which are anticipated to be collected in cash, are recorded at the net present value of the amounts pledged, in accordance with SFAS No. 116, *Accounting for Contributions Received and Contributions Made*.

Zoological Society of San Diego

Notes to Financial Statements (continued)

12. Fair Value of Financial Instruments (continued)

- The carrying amount of the capital lease and line of credit obligations approximates fair value as the obligations are recorded at the net present value of future payments at market interest rates.

13. Commitments and Contingencies

The accompanying financial statements are subject to claims and legal actions arising in the ordinary course of business. In the opinion of management, based in part upon the advice of legal counsel, these matters are of such a nature that unfavorable disposition would not have a material adverse effect on the financial position or results of operations of the Society.

In 2001, the Society entered into an agreement with its electricity provider for the purchase of a fixed quantity of electricity at a rate based on agreed-upon terms. The purpose of the agreement is to secure a continuing source of electricity for the five-year term of the agreement and to mitigate risks associated with potential decreases in supply or increases in costs of electricity. The rate established under the agreement is based on certain market conditions and is subject to fluctuation.

The Society has entered into certain noncancelable lease agreements for a warehouse facility and office space. The Society has also entered into noncancelable lease agreements for computer equipment, vehicles and office equipment. Rent expense was \$1,055,000 and \$1,445,000 for the years ended 2002 and 2001, respectively. Minimum lease payments under these agreements are as follows (in thousands):

2003	\$ 870
2004	488
2005	300
2006	287
2007	287
Thereafter	1,078
	<u>\$ 3,310</u>