

***OCLC Online Computer Library Center,  
Inc. and Subsidiaries***

*Consolidated Financial Statements for the Years Ended June 30, 2002 and  
2001 and Independent Auditors' Report*

Deloitte & Touche LLP  
155 East Broad Street  
Columbus, Ohio 43215-3611

Tel: (614) 221-1000  
Fax: (614) 229-4647  
www.us.deloitte.com

**Deloitte  
& Touche**

## **INDEPENDENT AUDITORS' REPORT**

To the Board of Trustees of  
OCLC Online Computer Library Center, Inc.:

We have audited the accompanying consolidated balance sheets of OCLC Online Computer Library Center, Inc. and its subsidiaries as of June 30, 2002 and 2001, and the related consolidated statements of revenues, expenses and corporate equity and of cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 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 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 the Corporation and its subsidiaries at June 30, 2002 and 2001, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

September 6, 2002

**Deloitte  
Touche  
Tohmatsu**

**OCLC ONLINE COMPUTER LIBRARY CENTER, INC.  
AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS  
JUNE 30, 2002 AND 2001**

<b>ASSETS</b>	<b>2002</b>	<b>2001</b>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 17,439,700	\$ 16,631,800
Government securities	15,298,300	16,309,300
Corporate notes and bonds	17,309,800	15,470,400
Equity securities	57,944,300	64,856,200
Receivables - net	34,265,800	31,039,300
Prepaid expenses and other	<u>7,844,300</u>	<u>6,251,000</u>
Total current assets	150,102,200	150,558,000
<b>FIXED ASSETS - At cost, less accumulated depreciation and amortization</b>	111,188,000	86,079,500
<b>OTHER ASSETS:</b>		
Bond trust accounts	1,300	7,261,400
Other	<u>8,523,700</u>	<u>7,491,700</u>
Total other assets	<u>8,525,000</u>	<u>14,753,100</u>
<b>TOTAL</b>	<u>\$ 269,815,200</u>	<u>\$ 251,390,600</u>
<b>LIABILITIES AND CORPORATE EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt and capital leases	\$ 5,685,700	\$ 4,107,900
Accounts payable	5,904,000	7,024,800
Accrued liabilities	12,542,500	11,556,600
Advance subscription payments	9,892,100	8,526,200
Unearned revenue	<u>33,612,700</u>	<u>26,985,600</u>
Total current liabilities	67,637,000	58,201,100
<b>LONG-TERM DEBT AND CAPITAL LEASES - Less current portion</b>	58,406,000	49,425,000
<b>OTHER NONCURRENT LIABILITIES</b>	17,445,400	14,180,400
<b>MINORITY INTEREST</b>	6,613,400	5,538,000
<b>CORPORATE EQUITY</b>	<u>119,713,400</u>	<u>124,046,100</u>
<b>TOTAL</b>	<u>\$ 269,815,200</u>	<u>\$ 251,390,600</u>

See notes to consolidated financial statements.

**OCLC ONLINE COMPUTER LIBRARY CENTER, INC.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF REVENUES,  
EXPENSES AND CORPORATE EQUITY  
FOR THE YEARS ENDED JUNE 30, 2002 AND 2001**

	<b>2002</b>	<b>2001</b>
REVENUES	\$ 178,224,900	\$ 165,310,600
MEMBER PARTICIPATION CREDITS	<u>(5,656,900)</u>	<u>(5,526,500)</u>
NET REVENUES	<u>172,568,000</u>	<u>159,784,100</u>
OPERATING EXPENSES:		
Salaries, wages and related fringe benefits	84,540,500	77,700,400
Telecommunications and computer support	38,571,500	32,351,600
Selling, general and administrative	27,729,400	29,805,700
Depreciation and amortization	13,245,700	12,675,100
Building and utilities	<u>5,210,300</u>	<u>4,380,300</u>
Total operating expenses	<u>169,297,400</u>	<u>156,913,100</u>
EXCESS OF NET REVENUES OVER OPERATING EXPENSES	<u>3,270,600</u>	<u>2,871,000</u>
OTHER INCOME (EXPENSE):		
Investment income	2,690,500	4,960,100
Interest expense	(3,097,200)	(2,866,400)
Equity in earnings of OCLC PICA B.V.		95,800
Minority interest in excess of revenues over expenses of OCLC PICA B.V.	(129,800)	(110,800)
Miscellaneous - net	<u>(127,900)</u>	<u>(97,400)</u>
Total other income (expense)	<u>(664,400)</u>	<u>1,981,300</u>
EXCESS OF REVENUES OVER EXPENSES	2,606,200	4,852,300
NET UNREALIZED LOSS ON INVESTMENTS AND BOND TRUST ACCOUNTS	(8,135,900)	(6,117,800)
CHANGE IN VALUE OF INTEREST RATE SWAP AGREEMENT	(162,800)	
FOREIGN CURRENCY TRANSLATION ADJUSTMENT	<u>1,359,800</u>	<u>(617,900)</u>
DECREASE IN NET EQUITY	(4,332,700)	(1,883,400)
CORPORATE EQUITY - Beginning of year	<u>124,046,100</u>	<u>125,929,500</u>
CORPORATE EQUITY - End of year	<u>\$ 119,713,400</u>	<u>\$ 124,046,100</u>

See notes to consolidated financial statements.

# OCLC ONLINE COMPUTER LIBRARY CENTER, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

	<u>2002</u>	<u>2001</u>
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b>		
Excess of revenues over expenses	\$ 2,606,200	\$ 4,852,300
Adjustments for non-cash items:		
Depreciation and amortization	13,245,700	12,675,100
Minority interest in earnings of OCLC PICA B.V.	129,800	110,800
Realized loss (gain) on sale of investments	707,000	(538,000)
Gain on sale of fixed assets	(7,700)	(68,200)
Equity in earnings on investment in OCLC PICA B.V.		(95,800)
Changes in assets and liabilities:		
Increase in receivables	(2,576,900)	(3,470,500)
Increase in other assets	(4,700)	(1,690,200)
Increase in accounts payable	1,107,800	1,283,900
Increase in accrued liabilities, unearned revenue and other	7,951,800	6,729,400
Cash provided by operating activities	<u>23,159,000</u>	<u>19,788,800</u>
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES:</b>		
Payments on revenue bonds and capital leases	(5,441,200)	(3,286,700)
Proceeds from capital lease	16,000,000	
Debt issuance costs	(18,400)	
Decrease in bond trust accounts - net	7,260,100	10,826,400
Cash provided by financing activities	<u>17,800,500</u>	<u>7,539,700</u>
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES:</b>		
Purchases of investments	(58,223,200)	(137,694,400)
Proceeds from sale of investments	55,438,400	92,760,700
Purchases of fixed assets	(19,910,300)	(11,579,700)
Capitalization of internal use software	(8,387,300)	(933,100)
Acquisition of netLibrary (excluding acquired cash of \$13,800)	(8,986,200)	
Acquisition of OCLC PICA B.V. (excluding acquired cash of \$4,264,300)		927,600
Other - net	(1,141,000)	(235,200)
Cash used in investing activities	<u>(41,209,600)</u>	<u>(56,754,100)</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	1,058,000	(222,800)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	807,900	(29,648,400)
CASH AND CASH EQUIVALENTS, Beginning of year	16,631,800	46,280,200
CASH AND CASH EQUIVALENTS, End of year	<u>\$ 17,439,700</u>	<u>\$ 16,631,800</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for interest	<u>\$ 3,106,700</u>	<u>\$ 2,914,400</u>
Fixed asset additions financed by accounts payable	<u>\$ 987,100</u>	<u>\$ 3,215,700</u>
Unrealized loss on investments and bond trust accounts	<u>\$ (8,135,900)</u>	<u>\$ (6,117,800)</u>
Change in fair value of interest rate swap agreement	<u>\$ (162,800)</u>	
Acquisition of netLibrary:		
Fair value of assets acquired	\$ 9,412,000	
Liabilities assumed	(3,540,100)	
Excess of cost over fair value of assets acquired	3,128,100	
Cash paid	<u>\$ 9,000,000</u>	
Acquisition of OCLC PICA B.V.:		
Fair value of assets acquired		\$ 17,593,700
Liabilities assumed		(3,620,300)
Minority interest		(5,642,100)
Less equity interest already owned		(4,994,600)
Cash paid		<u>\$ 3,336,700</u>

See notes to consolidated financial statements.

# OCLC ONLINE COMPUTER LIBRARY CENTER, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PROCEDURES

OCLC Online Computer Library Center, Inc. (“OCLC”) is a non-profit corporation organized to establish, maintain, and operate an international computerized network of bibliographic cataloging services for libraries and to promote the evolution of library use. The accumulated excess of revenues over expenses (corporate equity) cannot be distributed to the members. OCLC’s corporate equity is unrestricted. In the event of dissolution, the Board of Trustees is to adopt a plan for distribution of remaining assets that is consistent with the purpose of OCLC. OCLC generally provides services to its members on a contract basis. The significant accounting policies of OCLC and its subsidiaries are set forth below:

**Principles of Consolidation** - The consolidated financial statements include the accounts of OCLC and its wholly-owned for-profit subsidiaries, OCLC Educational Services, Inc. (“OESI”), and OCLC Information Distribution, Inc. (“OID”) as well as its majority-owned subsidiary, OCLC PICA B.V. (formerly Pica B.V.). Operating revenues and expenses of OCLC’s wholly-owned for-profit subsidiaries were \$1,956,300 and \$2,618,200 respectively for year ended June 30, 2002 and were immaterial for year ended June 30, 2001. Intercompany transactions have been eliminated in consolidation. See Note 8 regarding the acquisition of OCLC PICA B.V. Until October 2000, the equity method of accounting was used to account for OCLC’s then 35% owned affiliate, OCLC PICA B.V. (See Notes 7 and 8 regarding the acquisitions of netLibrary and OCLC PICA B.V.)

**Cash and Cash Equivalents** - All highly liquid debt investments with an original maturity of three months or less at the time of purchase are considered cash equivalents, and are stated at cost, which approximates market. Cash is primarily held in one bank.

**Investments** - Government securities, corporate notes and bonds and equity securities are stated at fair value. Fair values are based on market quotes.

**Revenue Recognition** - Member service revenues are recognized at the time services are provided, and include member system service revenues, telecommunication revenues, and miscellaneous member service revenues. Software license and consulting revenues are recognized at the time software is shipped and services are provided, or according to contract terms in the case of customized installations and system maintenance billings.

**Minority Interest** - Minority interest represents the 40% of OCLC PICA B. V. owned by Pica Foundation (see Note 8).

**Use of Estimates** - The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America requires in certain instances the use of estimates. Actual results could differ from these estimates.

***Depreciation and Amortization*** - Depreciation is provided using straight-line and accelerated methods at rates based on the estimated useful lives of the equipment and improvements (3 to 20 years) and buildings (30 to 40 years). Costs incurred in connection with the issuance of Franklin County Revenue Bonds are amortized using the effective interest method over the terms of the respective bonds. Goodwill is amortized using the straight-line method (5 to 15 years).

***Software*** - The cost of purchased software is capitalized and amortized using the straight-line method over the estimated economic useful lives (3 to 15 years). OCLC capitalizes the costs associated with purchased databases, enhancements, and certain internal use software costs once certain criteria are met. These costs are amortized using the straight-line method (3 to 15 years). At each balance sheet date, management compares the carrying value of capitalized software to the net realizable value of the software, and the carrying value in excess of future discounted cash flows is expensed currently.

***Research and Development*** - Research and development costs (principally salaries and related fringe benefits), approximating \$15,649,900 and \$14,875,300 for fiscal 2002 and 2001 are charged to operations as incurred.

***Income and Other Taxes*** - OCLC is tax exempt under the appropriate sections of the Internal Revenue Code and various sections of state and local tax statutes and, accordingly, no provision for Federal, state, or local income taxes is currently required for its operations. OCLC PICA B.V., OID and OESI are not exempt from Federal, state, local, or foreign income taxes.

The asset and liability method is used for financial accounting and reporting of income taxes. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted laws and rates applicable to the periods in which differences are expected to affect taxable income. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

***Foreign Currency Translation*** - Branch offices, foreign subsidiary and equity interests are based in Canada, United Kingdom, and the Netherlands. The local currency has been designated as the functional currency for such operations. Income and expense items are translated at the average monthly rate of exchange. Assets and liabilities are translated at the rate of exchange on the balance sheet dates with the resultant translation gains or losses included as a separate component of corporate equity. Corporate equity includes net cumulative translation gains (losses) of \$408,200 and (\$951,600) at June 30, 2002 and 2001, respectively.

***Reclassifications*** – Certain prior year amounts have been reclassified to conform with the current year's presentation.

## 2. INVESTMENTS

In accordance with Statement of Financial Accounting Standards No. 124 "Accounting for Certain Investments Held by Not-For-Profit Organizations," debt and equity investments are carried at their fair value with related unrealized gains and losses on the portfolio reflected in the change in net equity. Realized gains and losses are included in investment income.

OCLC invests available cash in major banks, federal, state, and local government obligations and investment grade debt and equity securities. Market risk is reduced by investing funds in maturities that match anticipated short and long-term cash needs and by investing in diversified industries and markets, both domestic and international. All investments are held in safekeeping by a trustee and are reflected in the balance sheets as government securities, corporate notes and bonds, and equity securities.

In fiscal year 2001, OCLC adopted the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," to establish accounting and reporting requirements for derivative instruments. See Note 4 for the impact on OCLC's financial position.

Realized gains and losses related to investments are recorded using the specific identification method. During fiscal year 2002, certain equity and corporate bond investments were identified as permanently impaired resulting in a realized loss of \$377,700. Unrealized gains(losses) on the portfolio totaled \$(3,376,400) and \$4,759,500 at June 30, 2002 and 2001, respectively. The following schedule details investment returns for the years ended June 30:

	<b>2002</b>	<b>2001</b>
Dividends and interest income	\$ 3,397,500	\$ 4,422,100
Net realized gains (losses)	<u>(707,000)</u>	<u>538,000</u>
Investment income	2,690,500	4,960,100
Net unrealized losses on investments	<u>(8,135,900)</u>	<u>(6,117,800)</u>
Total net investment return	<u>\$ (5,445,400)</u>	<u>\$ (1,157,700)</u>

## 3. FIXED ASSETS

Fixed assets include the following:

	<b>June 30,</b>	
	<b>2002</b>	<b>2001</b>
Land and improvements	\$ 10,279,400	\$ 10,229,900
Buildings and improvements	57,049,700	54,722,600
Computer and telecommunications equipment	30,439,100	28,076,400
Databases	46,300,900	39,834,200
Intangibles including software and goodwill	30,002,200	11,874,900
Office furniture and equipment	<u>22,330,200</u>	<u>18,288,100</u>
Total	196,401,500	163,026,100
Less accumulated depreciation and amortization	<u>85,213,500</u>	<u>76,946,600</u>
Fixed assets - net	<u>\$ 111,188,000</u>	<u>\$ 86,079,500</u>

Software development costs, related to internal use software, of \$8,387,300 and \$933,100 were capitalized in 2002 and 2001, respectively.

**Operating Leases** - Certain buildings and equipment are rented under operating leases. Rental expense for all leases was \$1,271,300 and \$825,300 for fiscal years 2002 and 2001, respectively. Future minimum lease payments under existing non-cancelable lease commitments are as follows:

Fiscal year ended June 30:	
2003	\$ 1,185,500
2004	972,800
2005	736,100
2006	725,200
2007	601,000
Thereafter	<u>380,300</u>
 Total	 <u>\$ 4,600,900</u>

#### 4. LONG-TERM DEBT

In December 1998, OCLC issued \$32,515,000 of Franklin County Revenue Bonds (“1998 bonds”). The proceeds were used to advance refund and defease a portion of the 1991 Franklin County Revenue Bonds (“1991 bonds”), and to improve real property, acquire office systems, software, computers and other equipment, and bibliographic and other databases. The total 1991 bonds refunded were \$6,675,000. At June 30, 2002 and 2001, undisbursed proceeds of the 1998 bonds and accumulated interest income of \$800 and \$7,259,100, respectively, are included in bond trust accounts on the accompanying consolidated balance sheets and will be released by the trustee as qualifying purchases are made. Additional funds are held in the trust accounts under the terms of the Master Trust Indenture.

**Revenue Bonds** - Revenue bonds outstanding are as follows:

	<u>June 30,</u>	
	<u>2002</u>	<u>2001</u>
Serial bonds:		
1991 bonds, 6.80%, maturing and paid in full on July 15, 2001	\$	\$ 1,080,000
1993 bonds, 5.80% to 5.90%, maturing annually through April 15, 2004	2,490,000	3,635,000
1998 bonds, 4.00% to 4.70%, maturing annually through October 1, 2012	<u>19,355,000</u>	<u>20,310,000</u>
Total serial bonds	<u>21,845,000</u>	<u>25,025,000</u>
Term bonds:		
1993 bonds, 6.00%, maturing April 15, 2009 and April 15, 2013	15,605,000	15,605,000
1998 bonds, 5.00% and 5.20%, maturing October 1, 2016 and October 1, 2020	<u>11,975,000</u>	<u>11,975,000</u>
Total term bonds	<u>27,580,000</u>	<u>27,580,000</u>
 Total revenue bonds outstanding	 <u>\$ 49,425,000</u>	 <u>\$ 52,605,000</u>

Bond fund deposits for the 1991 serial bonds sufficient to cover the next principal payment were made to the trustee annually. Interest on the 1991 bonds was payable semi-annually to the trustee.

Bond fund deposits for the 1993 serial bonds sufficient to cover the next principal payment are made annually to the trustee. Annual sinking fund deposits for redemption of the principal balance of the 1993 term bonds commence on April 15, 2005, in amounts ranging from \$1,360,000 in 2005 to \$2,165,000 in 2013. The 1993 term bonds are callable at par beginning in fiscal 2003. Interest on the 1993 bonds is payable semi-annually to the trustee.

Bond fund deposits for the 1998 serial bonds sufficient to cover the next principal payment will be made annually to the trustee. Annual sinking fund deposits for redemption of the principal balance of the 1998 term bonds commence October 1, 2013, in amounts ranging from \$1,375,000 in 2013 to \$1,575,000 in 2020. Interest on the 1998 bonds is payable semi-annually to the trustee. The 1998 bonds are callable at 101% of par if redeemed between October 2008 and September 2009, and at par beginning October 2009.

All bond issues are unsecured. The indenture agreement and its supplements restrict, among other things, the issuance of additional debt and the granting of security interests.

**Capitalized Leases** - OCLC leased computer equipment with an option to purchase the equipment at a nominal cost at the termination of the lease. These capital leases were paid off during fiscal year 2002.

On October 26, 2001, the Corporation entered into a seven-year tax-exempt lease agreement through Franklin County, Ohio for \$16,000,000 with an effective interest rate of 4.11%. The lease is due monthly in equal principal installments of \$190,500 (plus interest) and has a balance outstanding of \$14,666,700 at June 30, 2002. The proceeds were used to finance the acquisition and installation of office systems and equipment, computers, servers, related peripheral equipment and software and bibliographic and other information databases.

The Corporation also simultaneously entered into a \$16,000,000 interest rate swap agreement to manage its exposure to the variability of cash flows primarily related to the interest rate changes on its borrowing costs. The agreement is designated as a cash flow hedge at inception with a remaining maturity of seven years. The Corporation adjusts the swap to market value through equity as the contract is effective in offsetting the interest rate exposure of the forecasted interest rate payments hedged. Hedging effectiveness is assessed periodically by comparing the fair market value of the agreement to similar agreements maintained by the lending facility. The swap agreement had a total negative fair market value of \$162,800 at June 30, 2002, which is reflected as a long-term liability and charge to equity. As the interest rate protection agreement is with a major bank, the Corporation does not expect to be subject to credit risk exposures.

Cost and accumulated depreciation of the leased equipment included in 2002 and 2001 fixed assets were as follows:

	<b>2002</b>	<b>2001</b>
Equipment, software and databases	\$ 16,077,700	\$ 4,062,900
Less accumulated depreciation	<u>766,900</u>	<u>2,622,000</u>
Capitalized leased assets – net	<u>\$ 15,310,800</u>	<u>\$ 1,440,900</u>

The aggregate maturities of the revenue bonds and the capital lease obligations are as follows:

Fiscal Year Ending June 30:	
2003	\$ 5,685,700
2004	5,865,700
2005	4,680,700
2006	4,785,700
2007	4,930,700
2008 and later	<u>38,143,200</u>
Total	<u>\$64,091,700</u>

## 5. BANK LINE OF CREDIT

Unsecured revolving line of credit with a bank provided for total borrowings of up to \$6,000,000 during fiscal years 2002 and 2001. Under the terms of the agreement, interest on amounts borrowed is payable at the bank's prime rate of interest. The line of credit expires in December 2002. During fiscal 2002 and 2001 no borrowings were made under such line of credit.

## 6. EMPLOYEE BENEFIT PLANS

A noncontributory, defined contribution pension plan covers all domestic OCLC employees who have completed two years of service, except for employees of OCLC's netLibrary division and employees of OID's MetaText division (see note 12). Voluntary contributory, defined contribution employee savings plans cover all full-time domestic OCLC employees who have completed 90 days of service (employees of OCLC's netLibrary division and OID's MetaText division have no waiting period for their plan). The cost of these plans (included in salaries, wages, and related fringe benefits) was \$4,156,000 and \$3,755,700 for fiscal 2002 and 2001, respectively.

In 1998, OCLC established a non-qualified voluntary contributory savings plan for key domestic employees and Board of Trustee members. OCLC purchases and holds (reflected in Other Assets) investment assets, recorded at fair value, equal to the participants' voluntary contributions. Due to a change in Federal tax regulations, the plan was frozen effective May 1, 2002. The liability under the plan was \$4,332,100 and \$3,667,600 (reflected in Other Noncurrent Liabilities) at June 30, 2002 and 2001, respectively.

Foreign operations, including OCLC PICA B.V., maintain or participate in separate retirement and defined contribution pension plans. Total contributions recorded under these plans were \$577,500 and \$439,600 in fiscal year 2002 and 2001, respectively.

OCLC maintains a voluntary contributory plan providing postretirement health care and non-contributory postretirement life insurance coverage for domestic employees except for employees of OCLC's netLibrary division and employees of OID's MetaText division. OCLC domestic employees meeting certain age and service requirements at the time of their retirement are eligible to participate. OCLC recognizes the cost of postretirement medical and life benefits as the employees render service. These benefits are funded by OCLC when incurred.

As of June 30, 2002 and 2001, relevant postretirement benefit information is summarized as follows:

	<b>2002</b>	<b>2001</b>
Accumulated postretirement benefit obligation:		
Retired participants	\$ 1,446,700	\$ 1,338,900
Fully eligible active plan participants	1,532,200	1,283,300
Other active plan participants	<u>7,441,900</u>	<u>6,690,500</u>
Postretirement benefit obligation	10,420,800	9,312,700
Unrecognized net loss from actuarial experience different than that assumed and changes in assumptions	(56,400)	(353,000)
Unrecognized prior service cost	<u>(54,500)</u>	<u>(59,100)</u>
Accrued postretirement benefit obligation (reflected in Other Noncurrent Liabilities)	<u>\$ 10,309,900</u>	<u>\$ 8,900,600</u>
Net postretirement benefit cost:		
Service cost	\$ 971,800	\$ 701,500
Interest cost	555,500	547,100
Net amortization	<u>(41,300)</u>	<u>(13,800)</u>
Total	<u>\$ 1,486,000</u>	<u>\$ 1,234,800</u>
Contributions and benefits paid under the plan:		
OCLC contribution	\$ 76,700	\$ 39,200
Participant contributions	<u>60,400</u>	<u>44,100</u>
Total benefits paid	<u>\$ 137,100</u>	<u>\$ 83,300</u>

Actuarial assumptions used in determining these amounts included a weighted average discount rate of 7.00% and 7.25% at June 30, 2002 and 2001, an annual increase in medical expense of 9.5% and 7.43%, respectively, declining to 6% in 2008 and thereafter, and a 6% annual increase in dental expense remaining at that level thereafter.

An agreement with a former officer provides for certain benefit payments, which commenced upon retirement. At June 30, 2002 and 2001, OCLC has a liability accrued of \$1,372,900 and \$1,503,600, respectively, for the present value of the estimated future payments under this agreements.

## **7. ACQUISITION OF NETLIBRARY**

On January 25, 2002, the Corporation entered into an agreement to purchase certain assets of netLibrary, Inc., an eBook publisher in Colorado, upon approval granted by the U.S. Bankruptcy Court for the District of Colorado, for \$9 million cash. The sale included both the eBook division and the MetaText eTextbook division of netLibrary and was accounted for by the purchase method. The purchase price was allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. Goodwill, representing the excess of cost over fair value of assets acquired, of \$3,128,100 was recorded and is included in fixed assets. netLibrary's operations subsequent to the date of the sale are included in the consolidated financial statements for the year ended June 30, 2002, and its revenues for the five months ended June 30, 2002 were \$6,092,100. The pro-forma consolidated results for the fiscal year 2002, assuming the merger had been made at the beginning of the fiscal year, would not have been materially different from reported results.

## **8. ACQUISITION OF OCLC PICA B.V.**

Effective December 23, 1999, OCLC and Stichting Pica (Pica Foundation) (a tax-exempt foundation based in Leiden, the Netherlands, providing online cataloging, interlibrary loans, local library systems, reference and end-user services to libraries in the Netherlands, France and Germany) established a jointly-owned taxable organization, Pica B.V. The Pica Foundation transferred its operating assets and related liabilities to Pica B.V. OCLC purchased an initial 35% interest in Pica B.V. for \$5,358,000. OCLC accounted for its initial investment in Pica B.V. under the equity method.

On September 29, 2000, OCLC purchased, under the terms of the purchase agreement, an additional 25% of Pica B.V. for \$3,336,700, increasing OCLC's ownership to 60%. OCLC accounts for the majority ownership of Pica B.V. under the purchase method of accounting; accordingly, the results of Pica B.V.'s operations have been consolidated with those of OCLC since October 1, 2000. The purchase price, including the initial investment, was allocated to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition with a minority interest of \$5,642,100. Pica B.V.'s revenues for the nine months ended June 30, 2001 were \$5,684,600. Accordingly, twelve months of revenues are included in the year ended June 30, 2002. The pro-forma consolidated results for the fiscal year 2001, assuming the acquisition had been made at the beginning of the fiscal year, would not be materially different from reported results.

## **9. INCOME TAXES**

OCLC has a net deferred tax asset of \$14,700,000 for operating loss carryforwards (\$12,300,000 domestic and \$2,400,000 foreign). The net deferred tax asset is fully offset by a valuation allowance due to the uncertainty of recoverability of these items.

At June 30, 2002, domestic and foreign net operating loss carryforwards for income tax reporting purposes are approximately \$43,100,000 (\$36,300,000 domestic and \$6,800,000 foreign, principally the United Kingdom). The domestic carryforwards expire through the fiscal year 2022.

## 10. FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, "Disclosures About Fair Value of Financial Instruments," requires fair value disclosures about substantially all balance sheet financial instruments. Certain assets and liabilities, the most significant being Fixed Assets, do not meet the Statement's definition of financial instruments and are excluded from this disclosure. Similarly, Corporate Equity is not considered a financial instrument and is also excluded from this disclosure. Many of the assets and liabilities subject to the disclosure requirements are not actively traded, requiring fair values to be estimated by management. These estimations necessarily involve the use of judgment about a variety of factors, including but not limited to, materiality, relevancy of market prices of comparable instruments and appropriate discount rates. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following table summarizes financial instruments at fair value that differ from carrying amounts as of June 30, 2002 and 2001 but it is not intended to, and does not, represent the Corporation's underlying value nor is it indicative of the amounts that could be realized in a current market exchange of these instruments:

	2002		2001	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Liabilities:				
Long-term debt	\$49,425,000	\$50,639,400	\$52,605,000	\$52,842,700

The following methods and assumptions were used to estimate the fair value of each material class of financial instruments:

***Cash and Cash Equivalents, Investments, Receivables, Bond Trust Accounts, Accrued and Other Liabilities (excluding postretirement benefit obligations and deferred compensation) and Accounts Payable*** - The carrying amounts of these items are a reasonable estimate of their fair value.

***Long-Term Debt*** - Fair values for these instruments have been calculated with pricing models using current rate assumptions for debt with similar yields and maturities.

## 11. CONTINGENCIES

The Corporation is involved in various claims and legal actions in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Corporation's consolidated financial statements.

## 12. SUBSEQUENT EVENTS

On August 9, 2002, OCLC sold the assets of its MetaText division to XanEdu, a division of ProQuest Information & Learning, for \$1.375 million in cash and the net working capital at that date of approximately \$1.2 million (unaudited). The Company anticipates any gain or loss will not be material to the consolidated financial condition of OCLC.

On August 21, 2002, OCLC purchased 60% interest in Strata Preservation N.V., a for-profit organization founded by the Royal Library of the Netherlands for \$542,300, to provide preservation microfilming services for the European market.

Effective July 1, 2002, the Company is required to adopt the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets to be held and used, to be disposed of other than by sale, and to be disposed of by sales. The adoption of this statement is not expected to have a material impact on the Company's consolidated results of operations or financial condition.

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