

# OCLC Online Computer Library Center, Inc. and Subsidiaries

Consolidated Financial Statements as of and for the  
Years Ended June 30, 2008 and 2007, and  
Independent Auditors' Report

# OCLC ONLINE COMPUTER LIBRARY CENTER, INC. AND SUBSIDIARIES

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets of OCLC Online Computer Library Center, Inc. and its subsidiaries (collectively, the "Corporation") as of June 30, 2008 and 2007, and the related consolidated statements of revenues, expenses, and corporate equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation'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.

As discussed in Note 6 to the consolidated financial statements, the Corporation adopted Financial Accounting Standards Board (FASB) Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, effective June 30, 2007.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Corporation at June 30, 2008 and 2007, 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.



September 5, 2008

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

**CONSOLIDATED BALANCE SHEETS  
AS OF JUNE 30, 2008 AND 2007**

	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 30,222,600	\$ 32,020,900
Short-term investments		1,477,600
Government securities	24,211,900	29,876,700
Corporate notes and bonds	32,785,600	29,721,800
Equity securities	106,098,800	114,879,100
Hedge fund	8,922,300	
Receivables — net	50,002,200	42,142,100
Prepaid expenses and other	<u>12,200,300</u>	<u>11,753,300</u>
Total current assets	264,443,700	261,871,500
<b>FIXED ASSETS</b> — At cost — less accumulated depreciation and amortization	134,988,500	132,301,400
<b>OTHER ASSETS</b>	<u>14,739,000</u>	<u>11,453,500</u>
<b>TOTAL</b>	<u>\$414,171,200</u>	<u>\$405,626,400</u>
 <b>LIABILITIES AND CORPORATE EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt and capital leases	\$ 13,634,300	\$ 10,349,400
Accounts payable	7,908,500	7,846,800
Accrued liabilities	21,834,000	21,139,100
Advance subscription payments	11,725,000	10,878,900
Unearned revenue	<u>63,068,100</u>	<u>70,705,000</u>
Total current liabilities	118,169,900	120,919,200
<b>LONG-TERM DEBT AND CAPITAL LEASES</b> — less current portion	64,019,600	46,169,500
<b>OTHER NONCURRENT LIABILITIES</b>	20,185,100	22,724,500
<b>MINORITY INTEREST</b>		9,392,300
<b>CORPORATE EQUITY</b>	<u>211,796,600</u>	<u>206,420,900</u>
<b>TOTAL</b>	<u>\$414,171,200</u>	<u>\$405,626,400</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, 2008 AND 2007

	<b>2008</b>	<b>2007</b>
REVENUES	<u>\$ 246,415,700</u>	<u>\$ 234,949,700</u>
OPERATING EXPENSES:		
Salaries, wages, and related fringe benefits	115,672,600	110,074,500
Telecommunications and computer support	46,305,100	47,939,300
Selling, general, and administrative	43,720,000	36,209,200
Depreciation and amortization	27,758,800	27,651,100
Building and utilities	<u>9,005,300</u>	<u>8,418,900</u>
Total operating expenses	<u>242,461,800</u>	<u>230,293,000</u>
EXCESS OF REVENUES OVER OPERATING EXPENSES	<u>3,953,900</u>	<u>4,656,700</u>
OTHER INCOME (EXPENSE):		
Investment income	11,069,100	18,808,100
Interest expense	(3,263,200)	(3,204,600)
Income taxes	(217,600)	(1,029,400)
Minority interest in (loss) earnings of majority owned subsidiaries	(17,600)	466,900
Miscellaneous — net	<u>170,400</u>	<u>(174,100)</u>
Total other income	<u>7,741,100</u>	<u>14,866,900</u>
EXCESS OF REVENUES OVER EXPENSES	11,695,000	19,523,600
NET CHANGE IN UNREALIZED (LOSS) GAIN ON INVESTMENTS	(14,913,700)	6,253,200
CHANGE IN VALUE OF INTEREST RATE SWAP AGREEMENT	(14,300)	(28,100)
POSTRETIREMENT BENEFIT PLAN ADJUSTMENT	3,463,200	4,773,300
FOREIGN CURRENCY TRANSLATION ADJUSTMENT	<u>5,145,500</u>	<u>732,600</u>
INCREASE IN CORPORATE EQUITY	5,375,700	31,254,600
CORPORATE EQUITY — Beginning of year	<u>206,420,900</u>	<u>175,166,300</u>
CORPORATE EQUITY — End of year	<u>\$ 211,796,600</u>	<u>\$ 206,420,900</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, 2008 AND 2007**

	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Excess of revenues over expenses	\$ 11,695,000	\$ 19,523,600
Adjustments for non-cash items:		
Depreciation and amortization	27,758,800	27,651,100
Minority interest in loss (earnings) of majority owned subsidiaries	17,600	(466,900)
Realized gain on sale of investments	(6,074,000)	(13,519,300)
Gain on sale of Strata	(216,000)	
Loss on disposal of fixed assets	1,436,800	140,300
Changes in assets and liabilities:		
Increase in receivables	(7,957,900)	(1,761,400)
Increase in other assets	(738,000)	(635,100)
Increase in accounts payable	490,700	1,131,200
(Decrease) increase in accrued liabilities, unearned revenue, and other	<u>(5,743,500)</u>	<u>7,804,400</u>
Net cash provided by operating activities	<u>20,669,500</u>	<u>39,867,900</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments on revenue bonds, long-term debt, and capital leases	(10,761,000)	(11,636,100)
Proceeds from long-term debt and capital leases	28,830,200	
Proceeds from line of credit	5,136,500	1,783,500
Payments on line of credit	(3,040,500)	(1,783,500)
Acquisition of minority interests	(13,903,100)	
Increase in trustee held funds — net	(2,984,900)	(2,700)
Debt issuance costs	(85,000)	
Dividends paid to minority partner		<u>(126,900)</u>
Net cash provided by (used in) financing activities	<u>3,192,200</u>	<u>(11,765,700)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of investments	(124,132,000)	(120,520,800)
Proceeds from sale of investments	120,545,600	116,216,800
Purchases of fixed assets	(13,717,200)	(13,709,200)
Capitalization of internal use software	(6,878,100)	(5,190,700)
Acquisition of EZproxy	(600,000)	
Proceeds from sale of Strata (excluding cash sold of \$18,900)	312,200	
Acquisition of RLG (excluding acquired cash of \$673,100)		673,100
Acquisition of DiMeMa, Inc. (excluding acquired cash of \$228,700)		(3,687,500)
Other — net	<u>(2,447,800)</u>	<u>(791,400)</u>
Net cash used in investing activities	<u>(26,917,300)</u>	<u>(27,009,700)</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>		
	<u>1,257,300</u>	<u>540,700</u>

(Continued)

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007**

	<b>2008</b>	<b>2007</b>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	\$ (1,798,300)	\$ 1,633,200
CASH AND CASH EQUIVALENTS — Beginning of year	<u>32,020,900</u>	<u>30,387,700</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 30,222,600</u>	<u>\$ 32,020,900</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for interest	<u>\$ 3,068,300</u>	<u>\$ 3,289,300</u>
Fixed asset additions financed by accounts payable	<u>\$ 836,300</u>	<u>\$ 1,107,600</u>
Property acquired by capital lease	<u>\$ 166,000</u>	<u>\$ 294,100</u>
Net unrealized (loss) gain on investments	<u>\$ (14,913,700)</u>	<u>\$ 6,253,200</u>
Change in fair value of interest rate swap agreement	<u>\$ (14,300)</u>	<u>\$ (28,100)</u>
ACQUISITIONS:		
Fair value of assets acquired	\$ 600,000	\$ 7,059,500
Liabilities assumed	(395,400)	(7,364,400)
Excess of cost over fair value of assets acquired	<u>395,400</u>	<u>4,221,100</u>
Cash paid	<u>\$ 600,000</u>	<u>\$ 3,916,200</u>
SALES:		
Assets disposed	\$ 407,300	
Liabilities transferred	(292,200)	
Gain on sale	<u>216,000</u>	
Cash received	<u>\$ 331,100</u>	
See notes to consolidated financial statements.		(Concluded)

# OCLC ONLINE COMPUTER LIBRARY CENTER, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

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

OCLC Online Computer Library Center, Inc. (OCLC or the “Corporation”) is a nonprofit 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 Information Distribution, Inc. (OID), DiMeMa, Inc., and OCLC EMEA B.V. (formerly OCLC PICA Group B.V.) and subsidiaries. Effective July 1, 2007, OCLC EMEA B.V. repurchased the outstanding shares from its minority shareholder, Stichting Pica, effectively becoming a wholly-owned subsidiary of OCLC. Operating revenues for OCLC’s wholly-owned for-profit subsidiaries were \$41,096,000 and expenses were \$44,387,300, for the year ended June 30, 2008. Prior to July 1, 2007, OCLC EMEA B.V. was a 60% majority-owned subsidiary. Operating revenues for OCLC’s wholly-owned for-profit subsidiaries were \$162,000, and expenses were \$706,200, for the year ended June 30, 2007. Intercompany transactions have been eliminated in consolidation. See Notes 7, 8, 9, and 10, regarding the acquisition of The Research Library Group, Inc., DiMeMa, Inc., and EZproxy and the sale of Strata Preservation N.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 two banks.

**Investments** — Short-term investments consist of commercial paper and short-term government notes, and are stated at cost, which approximates market. Government securities, corporate notes and bonds, and equity securities are stated at fair value. Fair values for these investments are based on market quotes. Hedge fund consists of an investment in a “fund of funds” which is also stated at fair value. Fair value for this investment is based upon a combination of inputs ranging from market quotes to management estimates.

**Revenue Recognition** — Member service revenues are recognized at the time services are provided, and include services to locate, acquire, catalog, lend, and preserve library materials. 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. Certain revenues to acquire access to reference content on behalf of libraries are recorded net of associated database acquisition costs. Unearned revenue and advance subscription payments represent monies advanced to OCLC by members, participating libraries, and certain independent regional service providers in the U.S. and are recognized as revenues when the service is provided. Transaction based

member participation credits (2008 — \$8,142,600; 2007 — \$6,904,500) are issued to libraries for services provided to OCLC for the benefit of the cooperative and are recorded as an expense rather than a reduction of revenue.

**Minority Interest** — At June 30, 2007, minority interest represents the 40% of OCLC EMEA B.V. owned by Stichting Pica and 40% of Strata Preservation N.V. owned by Koninklijke Bibliotheek, the National Library of the Netherlands. Effective July 1, 2007, OCLC EMEA B.V. repurchased the outstanding shares from its minority shareholder, Stichting Pica for 10,272,000 Euros (\$13,903,200), effectively becoming a wholly-owned subsidiary of OCLC. Effective January 1, 2008, OCLC EMEA B.V. sold its shares of Strata Preservation N.V. for 225,000 Euros (\$331,100) to KMM Groep. On July 13, 2006, OCLC EMEA B.V. declared a dividend of 250,000 Euros (\$318,500 paid November 21, 2006) allocated to OCLC and Stichting Pica based on their respective holdings. Minority interest in OCLC EMEA B.V. was reduced accordingly for \$126,900.

**Use of Estimates** — The preparation of these consolidated 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 and premiums received in connection with the issuance of revenue bonds are amortized and accreted, respectively, using the effective interest method over the terms of the respective bonds.

**Software and Goodwill** — 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. Goodwill, which represents the excess of purchase price over the fair value of assets acquired, is amortized using the straight-line method (1 to 15 years). Net book value of goodwill was \$11,073,100 and \$10,503,300 at June 30, 2008 and 2007, respectively. During fiscal year 2008, OCLC EMEA B.V. recorded a 1,060,200 Euros (\$1,652,500) non-cash goodwill impairment charge related to its subsidiary, the OCLC Ltd.

**Research and Development** — Research and development costs (principally salaries and related fringe benefits), approximating \$27,562,700 and \$20,321,700 for fiscal years 2008 and 2007, respectively, are charged to operations as incurred.

**Income and Other Taxes** — OCLC is tax exempt in the United States of America 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 EMEA B.V., OID, and DiMeMa, Inc., 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.

In June 2006 FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB statement No. 109* (“FIN 48”). FIN 48 addresses the accounting for uncertainties in income taxes recognized in an enterprise’s financial statements and prescribes a threshold of “more-likely-than-not” for recognition of tax positions taken or expected to be taken in a tax return. FIN 48 also provides related guidance on measurement, classification, interest and penalties, and disclosure. OCLC evaluated its tax positions at June 30, 2008, in accordance with FIN 48. Based on this evaluation, OCLC determined that there was no material impact to the Corporation’s financial statements as a result of the adoption of FIN 48.

**Foreign Currency Translation** — The local currency has been designated as the functional currency for operations in Australia, Canada, France, Germany, the Netherlands, Switzerland, and United Kingdom. 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 of \$9,794,100 and \$4,648,600 at June 30, 2008 and 2007, respectively.

**Self-Insurance Programs** — OCLC uses various self-insurance plans for certain of its medical insurance programs in the United States of America. The associated liability has been recorded in the financial statements based on information currently available as to the estimated ultimate cost for incidents prior to the balance sheet dates. Losses in excess of certain limits are insured with third-party insurance companies.

**Reclassifications** — Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

## 2. INVESTMENTS

In accordance with Statement of Financial Accounting Standards (SFAS) Statement 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, a hedge fund, 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 trustees and are reflected in the consolidated balance sheets as cash equivalents, short-term investments, government securities, corporate notes and bonds, hedge fund, and equity securities.

Realized gains and losses related to investments are recorded using the specific identification method. Net unrealized gains on the portfolio totaled \$1,427,200 and \$16,340,900 at June 30, 2008 and 2007, respectively. The following schedule details investment returns for the years ended June 30, 2008 and 2007:

	<b>2008</b>	<b>2007</b>
Dividends and interest income	\$ 4,995,100	\$ 5,288,800
Net realized gains	<u>6,074,000</u>	<u>13,519,300</u>
Investment income	11,069,100	18,808,100
Net change in unrealized (loss) gain on investments	<u>(14,913,700)</u>	<u>6,253,200</u>
Total net investment return	<u>\$ (3,844,600)</u>	<u>\$ 25,061,300</u>

The following table shows the gross unrealized losses and fair value, aggregated by investment category and length of time those securities have been in a continuous unrealized loss position, at June 30, 2008 and 2007:

Description of Temporarily Impaired Securities	<b>2008</b>					
	Less than 12 Months		12 Months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government securities	\$ 3,767,700	\$ (78,300)	\$ 3,616,200	\$ (151,000)	\$ 7,383,900	\$ (229,300)
Corporate notes and bonds	<u>7,533,900</u>	<u>(320,200)</u>	<u>9,658,200</u>	<u>(520,000)</u>	<u>17,192,100</u>	<u>(840,200)</u>
Total debt securities	11,301,600	(398,500)	13,274,400	(671,000)	24,576,000	(1,069,500)
Common stock	36,167,400	(7,919,300)	11,024,700	(4,522,100)	47,192,100	(12,441,400)
Hedge fund	<u>8,922,300</u>	<u>(77,700)</u>	_____	_____	<u>8,922,300</u>	<u>(77,700)</u>
Total temporarily impaired securities	<u>\$56,391,300</u>	<u>\$(8,395,500)</u>	<u>\$24,299,100</u>	<u>\$(5,193,100)</u>	<u>\$80,690,400</u>	<u>\$(13,588,600)</u>

  

Description of Temporarily Impaired Securities	<b>2007</b>					
	Less than 12 Months		12 Months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government securities	\$ 7,727,900	\$ (135,000)	\$10,175,800	\$ (596,800)	\$17,903,700	\$ (731,800)
Corporate notes and bonds	<u>8,534,200</u>	<u>(198,200)</u>	<u>8,752,600</u>	<u>(349,600)</u>	<u>17,286,800</u>	<u>(547,800)</u>
Total debt securities	16,262,100	(333,200)	18,928,400	(946,400)	35,190,500	(1,279,600)
Common stock	25,497,100	(1,906,700)	3,813,000	(494,000)	29,310,100	(2,400,700)
Preferred stock	<u>20,500</u>	<u>(1,200)</u>	_____	_____	<u>20,500</u>	<u>(1,200)</u>
Total equity securities	<u>25,517,600</u>	<u>(1,907,900)</u>	<u>3,813,000</u>	<u>(494,000)</u>	<u>29,330,600</u>	<u>(2,401,900)</u>
Total temporarily impaired securities	<u>\$41,779,700</u>	<u>\$(2,241,100)</u>	<u>\$22,741,400</u>	<u>\$(1,440,400)</u>	<u>\$64,521,100</u>	<u>\$(3,681,500)</u>

OCLC reviews its portfolio for impairment and has reached the conclusion, in consultation with OCLC's investment advisors, that these impairments are temporary due to the current market conditions and interest rates. The government securities are backed by the full faith of the U.S. government and the

corporate notes and bonds are investment grade (Standard & Poor rated triple B or better) and OCLC knows of no individual holdings that are permanently impaired or have fallen below investment grade. At June 30, 2008, the Corporation owned the following securities that had unrealized losses: 41 government securities, 361 corporate notes and bonds, 1,075 common stocks, and 1 hedge fund. At June 30, 2007, the Corporation owned the following securities that had unrealized losses: 89 government securities, 314 corporate notes and bonds, 472 common stocks, and 2 preferred stocks.

### 3. FIXED ASSETS

Fixed assets at June 30, 2008 and 2007, include the following:

	<b>2008</b>	<b>2007</b>
Land and improvements	\$ 11,969,500	\$ 10,611,200
Buildings and improvements	69,609,400	64,402,100
Computer and telecommunications equipment	40,144,800	43,689,200
Databases	73,056,200	67,718,800
Intangibles including software	75,656,100	74,334,000
Goodwill	25,160,700	20,570,400
Office furniture and equipment	<u>22,669,500</u>	<u>22,747,900</u>
 Total	 318,266,200	 304,073,600
 Less accumulated depreciation and amortization	 <u>183,277,700</u>	 <u>171,772,200</u>
 Fixed assets — net	 <u>\$ 134,988,500</u>	 <u>\$ 132,301,400</u>

Software development costs, related to internal use software, of \$6,878,100 and \$5,190,700 were capitalized in 2008 and 2007, respectively. Cataloging credits of \$3,584,300 and \$3,645,500 were capitalized in 2008 and 2007, respectively, and included in databases.

**Operating Leases** — Certain buildings and equipment are rented under operating leases. Rental expense, net of subleases, for all leases was \$3,324,800 and \$2,680,300 for fiscal years 2008 and 2007, respectively. Future minimum lease payments under existing noncancelable lease commitments are as follows:

<b>Fiscal Years Ended June 30</b>	
2009	\$ 2,482,000
2010	2,098,900
2011	1,827,500
2012	1,329,000
2013	774,900
Thereafter	<u>1,657,900</u>
 Total	 <u>\$ 10,170,200</u>

#### 4. LONG-TERM DEBT AND CAPITAL LEASES

Long-term debt and capital leases at June 30, 2008 and 2007, consisted of the following:

	<b>2008</b>	<b>2007</b>
Revenue bonds	\$ 33,600,000	\$ 36,765,000
Other long-term debt	14,336,200	4,114,700
Capital leases	<u>29,717,700</u>	<u>15,639,200</u>
	77,653,900	56,518,900
Less current maturities	<u>(13,634,300)</u>	<u>(10,349,400)</u>
Total	<u>\$ 64,019,600</u>	<u>\$ 46,169,500</u>

In April 2003, OCLC issued \$25,000,000 of Franklin County Revenue Bonds (“2003 bonds”). The proceeds were used to refund the remaining portion of the 1993 Franklin County Revenue Bonds, and to improve real property, acquire office systems, software, computers and other equipment, and bibliographic and other databases. The bonds were issued at a premium of \$1,223,000, which is being accreted over the life of the bonds using the effective interest method.

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.

**Revenue Bonds** — At June 30, 2008 and 2007, revenue bonds outstanding are as follows:

	<b>2008</b>	<b>2007</b>
Serial bonds:		
1998 bonds, 4.40% to 4.70%, maturing annually through October 1, 2012	\$ 6,225,000	\$ 7,325,000
2003 bonds, 5.00%, maturing annually through April 15, 2013	<u>11,945,000</u>	<u>14,010,000</u>
Total serial bonds	<u>18,170,000</u>	<u>21,335,000</u>
Term bonds:		
1998 bonds, 5.00% and 5.20%, maturing October 1, 2016 and October 1, 2020	11,975,000	11,975,000
2003 bonds, 5.25%, maturing April 15, 2018	<u>3,455,000</u>	<u>3,455,000</u>
Total term bonds	<u>15,430,000</u>	<u>15,430,000</u>
Total revenue bonds outstanding	<u>\$33,600,000</u>	<u>\$36,765,000</u>

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.

Bond fund deposits for the 2003 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 2003 term bonds commence April 15, 2014, in amounts ranging from \$620,000 in 2014 to \$765,000 in 2018. Interest on the 2003 bonds is payable semi-annually to the trustee. The 2003 bonds are callable at par beginning April 15, 2013.

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.

**Other Long-Term Debt** — On May 2, 2005, Strata Preservation N.V. entered into a subordinated loan with its minority shareholder, Koninklijke Bibliotheek, for 240,000 Euros (\$324,900 outstanding at June 30, 2007) with interest (rate of 7%) payable annually. Prior to the January 1, 2008 sale of Strata Preservation N.V., the shareholders agreed to contribute the outstanding balance to capital.

On October 10, 2005, OCLC EMEA B.V. entered into a bank loan for the purposes of financing the purchase of Fretwell-Downing Group Ltd. and subsidiaries (FDI). The 4,000,000 Euro loan has an effective interest rate equal to 1.5% above the 3 month Euribor rate (total of 6.227% and 5.675% at June 30, 2008 and 2007, respectively). The loan is due quarterly in equal principal installments of 200,000 Euros (plus interest) starting January 1, 2006, and continuing through October 1, 2010, and has a balance outstanding of 2,000,000 Euros (\$3,148,600) and 2,800,000 Euros (\$3,789,800) at June 30, 2008 and 2007, respectively. The bank loan is secured by three million Euros of Corporate Bonds. Concurrently, OCLC EMEA B.V. entered into a derivative financial instrument to cap the variable interest rate of the loan to a fixed rate of 5%. The maturity, payment dates, and other fundamental terms match those of the loan. The derivative does not qualify for hedge accounting and, therefore, changes in fair value are reported in income. The derivative had a total positive fair value of 51,100 Euro (\$80,500) and 57,700 Euro (\$78,100) at June 30, 2008 and 2007, respectively.

On July 2, 2007, OCLC EMEA B.V., entered into a bank loan for the purpose of financing the purchase of outstanding shares from its minority shareholder. The 6,000,000 Euro loan has an effective interest rate equal to 0.9% above the 3 month Euribor rate (total of 5.627%). The loan is due quarterly in equal principal installments of 75,000 Euros (plus interest) starting October 1, 2007 and continuing through July 1, 2014, with a final payment of 3,900,000 Euros. The loan has a balance outstanding of 5,775,000 Euros (\$9,091,600) at June 30, 2008. The loan is secured by a mortgage of 8,000,000 Euros on a building, certain computers, equipment, and furniture and fixtures and accounts receivable of OCLC EMEA B.V.

In April 2002, FDI entered into a note payable bearing interest at an imputed rate of 4% to a former majority shareholder of FDI for 36,100 Euros (\$46,300 at June 30, 2006). The loan was paid in April 2007.

**Capitalized Leases** — OCLC leases office and computer equipment and autos with an option to purchase the equipment at a nominal cost at the termination of the lease. The outstanding balance was \$365,300 and \$1,201,100 at June 30, 2008 and 2007, respectively.

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 \$952,400 and \$3,238,100 at June 30, 2008 and 2007, respectively. 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. OCLC follows the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to establish accounting and reporting requirements for derivative instruments. 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 net value of \$3,200 at June 30, 2008, and a total positive fair net value of \$11,000 at June 30, 2007, which is reflected as a current liability or a long-term asset, respectively, and change 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.

On June 14, 2004, the Corporation entered into a seven-year tax-exempt lease agreement through Franklin County, Ohio, for \$14,000,000 with an effective interest rate equal to the LIBOR Rate plus 1.75%, multiplied by 0.65 (total of 2.74% and 4.60% at June 30, 2008 and 2007, respectively). The lease is due monthly in equal principal installments of \$233,300 (plus interest) starting July 2006 and has a balance outstanding of \$8,400,000 and \$11,200,000 at June 30, 2008 and 2007, respectively. Interest only is due July 1, 2004 to July 1, 2006. 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.

On May 23, 2008, the Corporation entered into a seven-year tax-exempt lease agreement through Columbus-Franklin County Finance Authority, for \$20,000,000 with an effective interest rate of 3.22%. The lease is due quarterly in equal principal and interest installments of \$800,700 beginning August 23, 2008. 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. At June 30, 2008, undisbursed proceeds were \$2,983,600 and are included in other assets on the accompanying consolidated balance sheets and will be released by the trustee as qualifying purchases are made.

Cost and accumulated depreciation of the leased equipment included in 2008 and 2007 fixed assets were as follows:

	<b>2008</b>	<b>2007</b>
Equipment, software, and databases	\$ 51,169,600	\$ 31,122,800
Less accumulated depreciation	<u>19,976,000</u>	<u>16,365,800</u>
Capitalized leased assets — net	<u>\$ 31,193,600</u>	<u>\$ 14,757,000</u>

The aggregate maturities of the revenue bonds, other long-term debt, and the capital lease obligations are as follows:

<b>Fiscal Years Ending June 30</b>	
2009	\$ 13,634,300
2010	10,798,600
2011	10,369,100
2012	7,156,400
2013	7,355,900
2014 and later	<u>28,339,600</u>
Total	<u>\$ 77,653,900</u>

## **5. BANK LINE OF CREDIT**

An unsecured revolving line of credit with a bank provided for total borrowings of up to \$6,000,000 during fiscal years 2008 and 2007. Under the terms of the agreement, interest on amounts borrowed is payable at the bank's prime rate of interest. During fiscal years 2008 and 2007, no borrowings were made under such line of credit. The agreement expires December 31, 2008.

On October 10, 2005, OCLC EMEA B.V. obtained a secured revolving line of credit with a bank providing for total borrowings up to 3,000,000 Euros during fiscal year 2006. The line of credit declines quarterly by 125,000 Euros beginning January 1, 2006, decreasing to a balance of 500,000 Euros at October 2010. The line of credit available was 1,750,000 Euros (\$2,755,000) and 2,250,000 Euros (\$3,045,400) at June 30, 2008 and 2007, respectively. Under the terms of the agreement, interest on amount borrowed is payable at an effective interest rate equal to 1.4% above the 3 month Euribor rate at June 30, 2008 (6.127%) and 1.5% above the 3 month Euribor rate at June 30, 2007 (5.675%).

On July 2, 2007, in conjunction with obtaining financing to repurchase the outstanding shares from its minority shareholder, OCLC EMEA B.V. increased its secured revolving line of credit with a bank providing for an additional 2,000,000 Euros. This additional line of credit declines quarterly by 100,000 Euros beginning October 1, 2007 through July 1, 2012. The line of credit available was 1,700,000 Euros (\$2,676,300) at June 30, 2008. Under the terms of the agreement, interest on amounts borrowed is payable at an effective interest rate equal to 1.4% above the 3 month Euribor rate (total of 6.127% at June 30, 2008).

During fiscal 2008, a total of 3,490,200 Euros (\$5,136,500) were borrowed and 1,331,400 Euros (\$2,096,000) remains unpaid at June 30, 2008, and included in current portion of long-term debt and capital leases on the balance sheets. During fiscal 2007, a total of 1,365,500 Euros (\$1,783,500) were borrowed and subsequently repaid during 2007.

## **6. EMPLOYEE BENEFIT PLANS**

A noncontributory, defined contribution retirement plan covers all OCLC employees in the United States of America ("domestic") who have completed two years of service. Voluntary contributory, defined contribution employee savings plans cover all full-time domestic OCLC employees. In 2003, OCLC established a 457(b) nonqualified voluntary contributory, defined contribution savings plan for

key domestic employees with no defined waiting period. The cost of these plans (included in salaries, wages, and related fringe benefits) was \$5,287,400 and \$5,074,600 for fiscal years 2008 and 2007, respectively.

In 1998, OCLC established a nonqualified voluntary contributory savings plan for key domestic employees and Board of Trustee members. OCLC purchases and holds investment assets, recorded at fair value, equal to the participants' voluntary contributions. Due to a change in United States of America federal tax regulations, the plan was frozen effective May 1, 2002. In 2003, OCLC established a 457(f) nonqualified deferred compensation plan for key domestic employees. The assets and liabilities under these plans were both \$7,741,100 and \$7,837,800 (reflected in other assets and other noncurrent liabilities) at June 30, 2008 and 2007, respectively.

Operations outside the United States of America, including the OCLC Canada division and OCLC EMEA B.V., maintain or participate in separate retirement and defined contribution pension plans. Total contributions recorded under these plans were \$1,091,400 and \$999,500 in fiscal years 2008 and 2007, respectively.

OCLC maintains a voluntary contributory plan providing postretirement health care and noncontributory postretirement life insurance coverage for United States of America employees. OCLC's United States of America 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.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ("SFAS 158"). SFAS 158 requires recognition of the funded status of a defined benefit postretirement plan in the statement of financial position, recognition of the changes in funded status in the year in which changes occur through corporate equity, and measurement of the funded status of a plan as of the date of its fiscal year-end, with limited exceptions. OCLC adopted the recognition and disclosure provisions of SFAS 158 as of June 30, 2007. In accordance with the adoption of the recognition and disclosure provisions of SFAS 158, OCLC recorded the impact of the unrecognized net actuarial gain of \$4,805,200 as a reduction of liability and the impact of the unrecognized prior service cost of \$31,900 as an additional liability on OCLC's balance sheet as of June 30, 2007. Consistent with the provisions of SFAS 158, OCLC recorded corresponding amounts in corporate equity. The net amount, \$4,773,300, was recognized in corporate equity. Gains of \$331,100 and \$4,500 of these prior services costs were amortized into net periodic benefit cost in 2008.

The following table summarizes the incremental effect of applying SFAS 158 on the consolidated financial statements as of June 30, 2007:

	<b>Before Application of SFAS 158</b>	<b>Adjustments</b>	<b>After Application of SFAS 158</b>
Accrued liabilities (current)	\$ 20,882,000	\$ 257,100	\$ 21,139,100
Other noncurrent liabilities	27,754,900	(5,030,400)	22,724,500
Corporate equity	201,647,600	4,773,300	206,420,900

Relevant postretirement benefit information as of June 30, 2008 and 2007, is summarized as follows:

	<b>2008</b>	<b>2007</b>
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of the plan year	\$ 12,658,800	\$ 12,030,700
Service cost	811,500	796,100
Interest cost	783,100	743,900
Plan amendments	(1,281,400)	
Benefits paid	(121,700)	(153,400)
Actuarial gain	(405,100)	(758,500)
Assumption change	<u>(2,103,200)</u>	
Benefit obligation at the end of the plan year	<u>\$ 10,342,000</u>	<u>\$ 12,658,800</u>
Net postretirement benefit cost:		
Service cost	\$ 811,500	\$ 796,100
Interest cost	783,100	743,900
Net amortization	<u>(326,500)</u>	<u>(220,800)</u>
Total	<u>\$ 1,268,100</u>	<u>\$ 1,319,200</u>
Amounts included in equity:		
Unrecognized prior service cost	\$ (1,254,100)	\$ 31,900
Unrecognized net gain	<u>(6,982,400)</u>	<u>(4,805,200)</u>
Total	<u>\$ (8,236,500)</u>	<u>\$ (4,773,300)</u>
Reconciliation of unrecognized net gain:		
Unrecognized net gain at the beginning of the year	\$ (4,805,200)	\$ (4,272,000)
Actuarial gain	(405,100)	(758,500)
Liability gain due to change in assumptions	(2,103,200)	
Amortization amount	<u>331,100</u>	<u>225,300</u>
Unrecognized net gain at the end of the year	<u>\$ (6,982,400)</u>	<u>\$ (4,805,200)</u>
Benefit obligations recognized in equity:		
Net gain	\$ (2,508,400)	
Prior service credit	(1,281,400)	
Amortization of prior service cost	(4,500)	
Amortization of gain	<u>331,100</u>	
Total recognized in equity	<u>\$ (3,463,200)</u>	<u>\$ (4,773,300)</u>
Contributions and benefits paid under the plan:		
Benefits paid by OCLC	\$ 121,700	\$ 153,400
Participant contributions	<u>258,100</u>	<u>241,900</u>
Total benefits paid	<u>\$ 379,800</u>	<u>\$ 395,300</u>

Amounts recognized on the balance sheet:

	<b>2008</b>	<b>2007</b>
Accrued liabilities (current)	\$ 233,000	\$ 257,100
Other noncurrent liabilities	<u>10,109,000</u>	<u>12,401,700</u>
Net amount recognized	<u>\$ 10,342,000</u>	<u>\$ 12,658,800</u>

Actuarial assumptions used in determining these amounts included a weighted-average discount rate of 6.75% and 6.25% at June 30, 2008 and 2007, respectively, and an annual increase in medical and dental expense of 8.75%, declining to 6.25%, in 2014 and thereafter.

The following table summarizes the amounts in equity expected to be amortized and recognized as a component of net periodic benefit cost in 2009:

	<b>2008</b>
Net gain	\$ (556,000)
Prior service credit	<u>(119,000)</u>
Total	<u>\$ (675,000)</u>

The following table presents estimated future benefit payments for the next ten fiscal years:

<b>Fiscal Years Ending June 30</b>	
2009	\$ 233,000
2010	326,000
2011	396,000
2012	476,000
2013	546,000
2014–2018	4,122,000

An agreement with a former officer provides for certain benefit payments to the employee and spouse, which commenced upon retirement. After the officer's death, payments continue for the surviving spouse. At June 30, 2008 and 2007, OCLC has a liability accrued of \$1,423,700 and \$1,333,500, respectively, for the present value of the estimated future payments under this agreement.

## **7. ACQUISITION OF RLG**

Effective July 1, 2006, OCLC combined operations with The Research Libraries Group, Inc. (RLG). The purchase was accounted for by the purchase method of accounting. The fair values of assets acquired with the transaction were \$3,022,300 and liabilities assumed were \$7,243,400. Goodwill, representing the excess of cost over fair value of assets acquired, of \$4,221,100 was recorded and expensed over its useful life of one year. RLG's online products and services were integrated with OCLC's and a new RLG unit was created within OCLC Programs and Research. RLG's operations were fully consolidated with OCLC beginning July 1, 2006, and revenues of \$11,265,400 were included in OCLC's consolidated results for the year ended June 30, 2007.

## **8. ACQUISITION OF DIMEMA**

On August 14, 2006, OCLC through OID, acquired DiMeMa, Inc., the organization that developed and supports CONTENTdm for \$3,916,200. CONTENTdm software offers a complete set of tools to store, manage, and deliver digital collections on the web. OCLC has distributed CONTENTdm software since 2002 to libraries, cultural heritage, and other nonprofit organizations. The purchase was accounted for by the purchase method of accounting. Assets acquired of \$4,037,200 and liabilities assumed of \$121,000 were based on their fair market values at the date of acquisition. DiMeMa revenues subsequent to the purchase date of \$3,183,700 and related operating costs are included in the consolidated financial statements for the year ended June 30, 2007. The pro-forma consolidated results for the fiscal year 2007, assuming the acquisition had been made in the beginning of the fiscal year, would not have been materially different from the reported results.

## **9. SALE OF STRATA**

Effective January 1, 2008, OCLC EMEA B.V. and the minority shareholder, Koninklijke Bibliotheek, the National Library of the Netherlands, sold all their shares in Strata Preservation N.V. to KMM Groep for a total of 375,000 Euros. OCLC EMEA B.V. received its 60% share of the purchase price, 225,000 Euros (\$331,100). A gain of \$216,000 was recognized on the sale.

## **10. ACQUISITION OF EZPROXY**

Effective January 11, 2008, OCLC acquired certain assets and related liabilities of Useful Utilities, LLC, ("EZproxy") the owner of the EZproxy software for \$600,000. EZproxy provides libraries a solution for authenticating remote user access to licensed databases. The purchase was accounted for by the purchase method of accounting. Assets acquired of \$600,000 and liabilities assumed of \$395,400 were based on their fair market values at the date of acquisition. Goodwill, representing the excess of cost over fair value of assets acquired, of \$395,400 was recorded and is included in fixed assets. EZproxy's operations subsequent to the date of the sale are included in the consolidated financial statements for the year ended June 30, 2008, and its revenues for the six months ended June 30, 2008, were \$5,100. The pro-forma consolidated results for the fiscal year 2008, assuming the purchase had been made at the beginning of the fiscal year, would not have been materially different from reported results.

## **11. INCOME TAXES**

OCLC has a net deferred tax asset of \$13,300,000 for operating loss carryforwards (\$12,500,000 domestic and \$800,000 foreign). The net deferred tax asset is fully offset by a valuation allowance due to the uncertainty of recoverability of these items. OCLC EMEA B.V. also has a deferred tax asset of \$117,500 at June 30, 2008, relating to the fixed asset depreciation which is recorded as a non-current asset in other assets.

At June 30, 2008, domestic and foreign net operating loss carryforwards for income tax reporting purposes are approximately \$39,127,300 (\$36,821,500 domestic and \$2,305,800 foreign, principally in the Netherlands). The domestic carryforwards expire through the fiscal year 2027.

## **12. FAIR VALUE OF FINANCIAL INSTRUMENTS**

SFAS 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, 2008 and 2007, 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:

	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets — Interest rate swap			\$ 11,000	\$ 11,000
Liabilities:				
Long-term debt	47,936,200	48,812,900	40,879,700	41,606,200
Interest rate swap	3,200	3,200		

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, 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 and Interest Rate Swap** — Fair values for these instruments have been calculated with pricing models using current rate assumptions for debt with similar yields and maturities.

### 13. 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.

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