

# OCCLC Online Computer Library Center, Inc. and Subsidiaries

Consolidated Financial Statements as of and  
for the Years Ended June 30, 2013 and 2012, 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.:

We have audited the accompanying consolidated financial statements of OCLC Online Computer Library Center, Inc. and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of revenues, expenses, and corporate equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

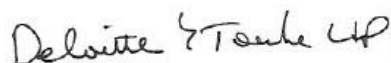
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OCLC Online Computer Library Center, Inc. and its subsidiaries as of June 30, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



September 5, 2013

# OCLC ONLINE COMPUTER LIBRARY CENTER, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

AS OF JUNE 30, 2013 AND 2012

	2013	2012
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 30,648,700	\$ 17,946,100
Short-term investments		6,854,800
Mutual funds	96,716,300	44,426,400
Government securities	2,194,800	25,660,000
Corporate notes and bonds	119,400	18,911,800
Equity securities	103,232,300	82,500,600
Receivables — hedge fund redemption		11,321,900
Receivables — net	31,779,300	32,065,600
Prepaid expenses and other	<u>6,269,100</u>	<u>8,175,300</u>
Total current assets	270,959,900	247,862,500
FIXED ASSETS — At cost — less accumulated depreciation and amortization	112,795,100	114,027,600
OTHER ASSETS	<u>8,127,300</u>	<u>7,923,000</u>
TOTAL	<u>\$ 391,882,300</u>	<u>\$ 369,813,100</u>
<b>LIABILITIES AND CORPORATE EQUITY</b>		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital leases	\$ 9,260,000	\$ 8,403,000
Accounts payable	4,820,600	4,375,000
Accrued liabilities	19,768,300	20,234,500
Advance subscription payments	21,705,000	21,223,800
Unearned revenue	<u>36,016,000</u>	<u>37,408,000</u>
Total current liabilities	91,569,900	91,644,300
LONG-TERM DEBT AND CAPITAL LEASES — Less current portion	40,951,300	29,638,800
OTHER NONCURRENT LIABILITIES	14,384,500	11,846,300
CORPORATE EQUITY	<u>244,976,600</u>	<u>236,683,700</u>
TOTAL	<u>\$ 391,882,300</u>	<u>\$ 369,813,100</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, 2013 AND 2012**

	<b>2013</b>	<b>2012</b>
REVENUES	<u>\$ 206,612,500</u>	<u>\$ 203,469,300</u>
OPERATING EXPENSES:		
Salaries, wages, and related fringe benefits	120,068,000	115,552,500
Selling, general, and administrative	36,852,800	35,738,200
Library services	25,756,400	24,567,500
Depreciation and amortization	22,205,300	23,304,100
Building and utilities	<u>7,581,600</u>	<u>7,141,000</u>
Total operating expenses	<u>212,464,100</u>	<u>206,303,300</u>
DEFICIT OF REVENUES OVER OPERATING EXPENSES	<u>(5,851,600)</u>	<u>(2,834,000)</u>
OTHER INCOME (EXPENSE):		
Investment income	10,428,600	9,500,800
Interest expense	(1,471,000)	(1,848,200)
Income taxes	(727,400)	(539,800)
Gain on sale of product lines		2,584,600
Miscellaneous — net	<u>(25,700)</u>	<u>(27,700)</u>
Total other income	<u>8,204,500</u>	<u>9,669,700</u>
EXCESS OF REVENUES OVER EXPENSES	2,352,900	6,835,700
NET CHANGE IN UNREALIZED GAIN (LOSS) ON INVESTMENTS	8,147,500	(11,508,600)
POSTRETIREMENT BENEFIT PLAN ADJUSTMENT	(2,556,900)	2,899,900
FOREIGN CURRENCY TRANSLATION ADJUSTMENT	<u>349,400</u>	<u>(1,205,600)</u>
INCREASE (DECREASE) IN CORPORATE EQUITY	8,292,900	(2,978,600)
CORPORATE EQUITY — Beginning of year	<u>236,683,700</u>	<u>239,662,300</u>
CORPORATE EQUITY — End of year	<u>\$ 244,976,600</u>	<u>\$ 236,683,700</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, 2013 AND 2012**

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Excess of revenues over expenses	\$ 2,352,900	\$ 6,835,700
Adjustments for non-cash items:		
Depreciation and amortization	22,205,300	23,304,100
Realized gain on sale of investments	(9,759,600)	(5,284,700)
Gain on sale of product lines		(2,584,600)
Other-than-temporary declines in investments	4,581,200	1,323,200
Loss on convertible debt		307,100
Inventory writeoff	1,981,200	
Loss (gain) on disposal of fixed assets	2,297,800	(400)
Changes in assets and liabilities:		
Decrease in receivables	286,300	635,100
Decrease in other assets	103,300	562,700
Increase (decrease) in accounts payable	1,338,100	(549,700)
Increase (decrease) in accrued liabilities, unearned revenue, and other	(1,445,800)	902,100
Net cash provided by operating activities	<u>23,940,700</u>	<u>25,450,600</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from long-term debt and capital leases	24,000,000	
Payments on long-term debt and capital leases	(11,865,000)	(10,845,300)
Proceeds from line of credit	9,946,000	4,268,600
Payments on line of credit	(9,946,000)	(4,268,600)
Debt issuance costs	(108,000)	
Net cash provided by (used in) financing activities	<u>12,027,000</u>	<u>(10,845,300)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of investments	(182,783,700)	(198,911,100)
Proceeds from sale of investments	183,424,000	196,257,400
Purchases of fixed assets	(10,594,000)	(10,534,700)
Capitalization of internal use software	(13,356,200)	(11,018,000)
Proceeds from sale of product lines		2,584,600
Other — net	(48,800)	1,529,600
Net cash used in investing activities	<u>(23,358,700)</u>	<u>(20,092,200)</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<u>93,600</u>	<u>(550,200)</u>

(Continued)

# OCLC ONLINE COMPUTER LIBRARY CENTER, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

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	2013	2012
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ 12,702,600	\$ (6,037,100)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>17,946,100</u>	<u>23,983,200</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 30,648,700</u>	<u>\$ 17,946,100</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for interest	<u>\$ 1,530,400</u>	<u>\$ 1,914,800</u>
Fixed asset additions financed by accounts payable	<u>\$ 322,900</u>	<u>\$ 1,215,400</u>
Property acquired by capital lease	<u>\$ 34,500</u>	<u>\$ 58,000</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, 2013 AND 2012

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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. and subsidiaries (OCLC EMEA). Operating revenues for OCLC’s wholly owned for-profit subsidiaries were \$43,333,000 and \$43,672,700 and expenses were \$41,812,500 and \$42,994,500 for the years ended June 30, 2013 and 2012, respectively. Intercompany transactions have been eliminated in consolidation. Effective June 30, 2012, DiMeMa, Inc. was dissolved.

*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 and is invested into money market funds nightly.

*Investments* — Short-term investments, mutual funds, government securities, corporate notes and bonds, and equity securities are stated at fair value. Fair values for these investments are based on market quotes. Fair value changes are reported as unrealized gains and losses and recorded within the changes of corporate equity. Realized gains and losses are calculated based on the specific identification method. Realized gains and losses and other-than-temporary declines in market value from original cost are included in investment income in other income (expense).

*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 United States and are recognized as revenues when the service is provided. Transaction based member participation credits (2013 — \$11,100,700; 2012 — \$13,280,400) 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.

*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 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 consolidated 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.

Net book value of goodwill was \$2,630,200 and \$2,602,100 at June 30, 2013 and 2012, respectively. At June 30, 2013, no goodwill impairment was deemed to exist and changes in net book value between the years exist solely due to foreign currency fluctuations.

*Research and Development* — Research and development costs (principally salaries and related fringe benefits), approximating \$23,284,200 and \$20,572,100 for fiscal years 2013 and 2012, 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, 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.

Accounting Standards Codification (ASC) 740-10, *Income Taxes*. ASC 740-10 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. ASC 740-10 also provides related guidance on measurement, classification, interest and penalties, and disclosure. OCLC evaluated its tax positions at June 30, 2013 and 2012, in accordance with ASC 740-10. Based on this evaluation, OCLC determined that there was no material impact to the Corporation's consolidated financial statements as a result of the adoption of ASC 740-10.

*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 consolidated 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 \$8,797,400 and \$8,448,000 at June 30, 2013 and 2012, 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 consolidated financial statements based on information currently available as to the estimated ultimate cost for incidents prior to the consolidated balance sheet dates. Losses in excess of certain limits are insured with third-party insurance companies.

## 2. INVESTMENTS

In accordance with ASC 958, *Not-For-Profit Entities*, debt and equity investments are carried at their fair values 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, short-term bond fund investments, mutual funds, 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 trustees and are reflected in the consolidated balance sheets as cash equivalents, short-term investments, mutual funds, government securities, corporate notes and bonds, and equity securities.

Realized gains and losses related to investments are recorded using the specific identification method. Net unrealized gains on the portfolio totaled \$19,987,500 and \$11,840,000 at June 30, 2013 and 2012, respectively. The following schedule details investment returns for the years ended June 30, 2013 and 2012:

	2013	2012
Dividends and interest income	\$ 5,250,200	\$ 5,846,400
Net realized gains	9,759,600	5,284,700
Other-than-temporary impairment	(4,581,200)	(1,323,200)
Loss on convertible debt		(307,100)
Investment income	10,428,600	9,500,800
Net change in unrealized gain (loss) on investments	8,147,500	(11,508,600)
Total net investment gain (loss)	\$ 18,576,100	\$ (2,007,800)

OCLC reviews its portfolio for other-than-temporary impairment each fiscal year end. The investment securities portfolio is generally evaluated for other-than-temporary impairment with consideration given to: 1) the length of time and extent to which the fair value has been less than cost, 2) the financial condition and near-term prospects of the issue, and 3) the intent and ability to retain a security for a period of time sufficient to allow for any anticipated recovery in fair value.

Debt securities held by OCLC are recorded in accordance with the provisions of ASC 320, *Investments — Debt and Equity Securities*. For those debt securities for which the fair value of the security is less than its amortized cost and OCLC does not intend to sell such security and it is not more likely than not that it will be required to sell such security prior to the recovery of its amortized cost basis less any credit losses, ASC 320 requires that the credit component of the other-than-temporary impairment losses be recognized in investment income (loss) while the noncredit component is recognized in corporate equity.

At June 30, 2013, OCLC is repositioning its investment portfolio and does not intend to hold its securities for a period of time sufficient to allow for any anticipated recovery in fair value and has deemed any losses at June 30, 2013 to be other-than-temporary and therefore has no securities temporarily impaired.

The following table of temporarily impaired securities 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, 2012.

Description of Temporarily Impaired Securities	2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government securities	\$ 4,908,000	\$ (35,900)	\$ 763,700	\$ (12,800)	\$ 5,671,700	\$ (48,700)
Corporate notes and bonds	<u>3,109,600</u>	<u>(134,400)</u>	<u>11,000</u>	<u>(1,100)</u>	<u>3,120,600</u>	<u>(135,500)</u>
Total debt securities	<u>8,017,600</u>	<u>(170,300)</u>	<u>774,700</u>	<u>(13,900)</u>	<u>8,792,300</u>	<u>(184,200)</u>
Preferred stock	1,242,600	(187,000)	113,500	(10,200)	1,356,100	(197,200)
Common stock	<u>16,660,700</u>	<u>(1,972,400)</u>	<u>330,900</u>	<u>(26,200)</u>	<u>16,991,600</u>	<u>(1,998,600)</u>
Total equity securities	<u>17,903,300</u>	<u>(2,159,400)</u>	<u>444,400</u>	<u>(36,400)</u>	<u>18,347,700</u>	<u>(2,195,800)</u>
Mutual fund	<u>21,008,400</u>	<u>(526,400)</u>	<u>9,814,200</u>	<u>(443,700)</u>	<u>30,822,600</u>	<u>(970,100)</u>
Total temporarily impaired securities	<u>\$ 46,929,300</u>	<u>\$ (2,856,100)</u>	<u>\$ 11,033,300</u>	<u>\$ (494,000)</u>	<u>\$ 57,962,600</u>	<u>\$ (3,350,100)</u>

At June 30, 2012, the Corporation owned the following securities that had unrealized losses: 34 government securities, 84 corporate notes and bonds, 37 preferred stocks, 403 common stocks, and 66 mutual funds.

The other-than-temporary impairment losses for the years ended June 30, 2013 and 2012, are as follows:

	2013	2012
Equity securities	\$ (3,286,100)	\$ (1,306,600)
Mutual funds	(1,219,300)	
Government securities	(50,200)	
Corporate notes and bonds	<u>(25,600)</u>	<u>(16,600)</u>
Total	<u>\$ (4,581,200)</u>	<u>\$ (1,323,200)</u>

The following summarizes the general rationale, by investment type, for the recognition of impairments as either unrealized losses or other-than-temporary impairments at June 30, 2013 and 2012:

*Equity Securities* — Impairments were generally considered other-than-temporary on those securities that had been in a continual loss position for over one year, or for those securities which have deterioration of value in excess of any anticipated recovery in the near-term. Impairments were considered temporary for those securities that OCLC has the ability and intent to hold for a reasonable period of time sufficient for an anticipated recovery of fair value at June 30, 2012. At June 30, 2013, due to the repositioning of the investment portfolio and plan to sell, all impairments were considered other than temporary.

*Corporate Notes and Bonds* — At June 30, 2012, impairments were generally considered other-than-temporary for those securities, which either had a history of missed contractual payments or for those issuers where their long-term prospects — as evidenced by credit ratings for the issue in question and other financial and nonfinancial factors — indicate that the corporation may not recover its amortized cost basis. Impairments were considered temporary for those securities of investment grade (Standard & Poor's rated triple B or better) which have exhibited the ability to meet all contractual payments and which OCLC has the ability and intent to hold the investments for a period of time, which may be to maturity, to recover its amortized cost basis. Such impairments are primarily attributable to interest rate changes. At June 30, 2013, due to the repositioning of the investment portfolio and plan to sell, all impairments were considered other than temporary.

*Government Securities* — At June 30, 2012, all impairments were considered temporary for OCLC's investments in government securities, which are backed by the full faith of the U.S. Government. For those instruments subject to prepayment of principal, expected cash flow analysis was performed, indicating either no credit loss or insignificant credit losses. At June 30, 2013, due to the repositioning of the investment portfolio and plan to sell, all impairments were considered other than temporary.

*Mutual Funds* — At June 30, 2012, all impairments were considered temporary given that both the duration and extent of the impairments were not significant considering OCLC's ability and intent to hold those investments for a reasonable period of time sufficient for an anticipated recovery of fair value. At June 30, 2013, due to the repositioning of the investment portfolio and plan to sell, all impairments were considered other than temporary.

*Short-Term Investments* — None of OCLC's short-term bond investment holdings were impaired as of June 30, 2012. OCLC held no short-term investment holdings at June 30, 2013.

The following table presents the roll-forward of the balance of credit-related impairment losses on debt securities held at June 30, 2013 and 2012:

	<b>2013</b>	<b>2012</b>
Balance — beginning of period	\$ (46,400)	\$ (155,200)
Additions for credit component for which other-than-temporary impairment loss was not previously recognized		(16,600)
Reductions for securities sold during the period	<u>46,400</u>	<u>125,400</u>
Balance — end of period	<u>\$ -</u>	<u>\$ (46,400)</u>

OCLC held various convertible bond instruments as part of its diversified investment portfolio strategy to support long-term growth opportunities, debt retirement, and security for advanced subscription payment and unearned revenue of OCLC. These instruments featured derivative options that allow for the conversion of the bonds into equity of the issuer at terms specific to each individual instrument. The derivatives are not designated by OCLC as hedging instruments. The derivatives are included in OCLC's corporate notes and bonds balance at their fair values of \$1,478,000 as of June 30, 2012. Their fair values are a function of the price of the underlying stock conversion price, interest rates, volatility of the underlying stock, and the time to expiration. Gains or losses arising from the change in fair value of these derivatives are reflected in investment income (loss) and were (\$307,100) for the year ended June 30, 2012. During the year ended June 30, 2013, all convertible bond instruments were sold.

### 3. FIXED ASSETS

Fixed assets at June 30, 2013 and 2012, include the following:

	2013	2012
Land and improvements	\$ 11,856,100	\$ 13,074,000
Buildings and improvements	73,993,700	70,903,700
Computer and telecommunications equipment	27,688,900	27,127,900
Databases	81,446,400	78,572,100
Intangibles including software	121,488,100	113,532,800
Goodwill	21,468,800	19,971,900
Office furniture and equipment	<u>20,256,400</u>	<u>21,323,800</u>
Total	358,198,400	344,506,200
Less accumulated depreciation and amortization	<u>245,403,300</u>	<u>230,478,600</u>
Fixed assets — net	<u>\$ 112,795,100</u>	<u>\$ 114,027,600</u>

Software development costs, related to internal use software, of \$13,356,200 and \$11,018,000 were capitalized in 2013 and 2012, respectively.

Database enhancement costs of \$2,597,000 and \$2,291,000 were capitalized in fiscal year 2013 and 2012, respectively, and included in databases.

**Operating Leases** — Certain buildings and equipment are rented under operating leases. Rental expense for all leases was \$2,925,900 and \$2,539,500 for fiscal years 2013 and 2012, respectively. Future minimum lease payments under existing noncancelable lease commitments are as follows:

<b>Fiscal Years Ending June 30</b>	
2014	\$ 2,694,600
2015	1,813,000
2016	1,146,600
2017	744,900
2018	420,700
Thereafter	<u>666,100</u>
Total	<u>\$ 7,485,900</u>

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

Long-term debt and capital leases at June 30, 2013 and 2012, consisted of the following:

	2013	2012
Revenue bonds	\$ -	\$ 6,065,000
Capital leases	<u>50,211,300</u>	<u>31,976,800</u>
Subtotal	50,211,300	38,041,800
Less current maturities	<u>(9,260,000)</u>	<u>(8,403,000)</u>
Total	<u>\$40,951,300</u>	<u>\$29,638,800</u>

**Revenue Bonds** — At June 30, 2013 and 2012, revenue bonds outstanding are as follows:

	2013	2012
Serial bonds — 2003 bonds, 5.00%, maturing annually through April 15, 2013	\$ -	\$ 2,610,000
Term bonds — 2003 bonds, 5.25%, maturing April 15, 2018	<u>                    </u>	<u>3,455,000</u>
Total revenue bonds outstanding	<u>\$ -</u>	<u>\$ 6,065,000</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 was being accreted over the life of the bonds using the effective interest method.

Bond fund deposits for the 2003 serial bonds sufficient to cover the next principal payment were made annually to the trustee. Annual sinking fund deposits for redemption of the principal balance of the 2003 term bonds were to commence April 15, 2014, in amounts ranging from \$620,000 in 2014 to \$765,000 in 2018. Interest on the 2003 bonds was payable semiannually to the trustee. On June 1, 2013, the remaining balance of the \$3,455,000 on the 2003 issue was redeemed at par.

All bond issues were 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 leases office, 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 \$116,000 and \$153,200 at June 30, 2013 and 2012, respectively.

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, and has a balance outstanding of \$6,179,400 and \$9,123,600 at June 30, 2013 and 2012, 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.

On August 10, 2009, the Corporation entered into a ten-year tax-exempt lease agreement through Columbus-Franklin County Finance Authority for \$30,000,000 with an effective interest rate of 4.0773%. The lease is due monthly in equal principal and interest installments of \$304,800 beginning September 10, 2009, and has a balance outstanding of \$19,915,900 and \$22,700,000 at June 30, 2013 and 2012, respectively. The proceeds were used to refund the remaining portion of the 1998 Franklin County Revenue bonds and 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 June 19, 2013, the Corporation entered into a seven-year tax-exempt lease agreement through Columbus-Franklin County Finance Authority for \$24,000,000 with an effective interest rate of 1.615%. The lease is due monthly in equal principal and interest installments of \$302,400 beginning July 19, 2013, and has a balance outstanding of \$24,000,000 at June 30, 2013. The proceeds were used to finance the acquisition and installation of office systems and equipment, computers, servers, related peripheral equipment and software, real property renovations and improvements, and bibliographic and other information databases.

Cost and accumulated depreciation of the leased equipment included in 2013 and 2012 fixed assets are as follows:

	<b>2013</b>	<b>2012</b>
Equipment, software, and databases	\$ 57,476,400	\$ 33,411,600
Less accumulated depreciation	<u>25,635,900</u>	<u>22,901,300</u>
Capitalized leased assets — net	<u>\$ 31,840,500</u>	<u>\$ 10,510,300</u>

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

**Fiscal Years Ending  
June 30**

2014	\$ 9,260,000
2015	9,510,600
2016	6,538,100
2017	6,710,600
2018	6,895,100
2019 and later	<u>11,296,900</u>
Total	<u>\$ 50,211,300</u>

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

An unsecured revolving line of credit with a bank in the U.S. provided for total borrowings of up to \$6,000,000 during fiscal year 2011. Under the terms of the agreement, interest on amounts borrowed was payable at the bank's prime rate of interest. On November 28, 2011, the line of credit was amended to a total of \$15,000,000. Under the terms of the agreement, interest on amounts borrowed is payable at an effective interest rate equal to 1.35% above LIBOR rate at June 30, 2013 and 2012 (total of 1.5% and

1.6%, respectively). During fiscal years 2013 and 2012, no borrowings were made under such line of credit. The agreement expires December 31, 2013.

Effective January 3, 2012, OCLC obtained an additional unsecured revolving line of credit with a bank in the U.S. for \$15,000,000. Under the terms of the agreement, interest on amounts borrowed is payable at an effective interest rate equal to LIBOR, plus 0.75% at June 30, 2013 and 2012 (total of 0.9% and 1.0%, respectively). No borrowings were made under such line of credit in fiscal year 2012. During fiscal year 2013, a total of \$5,000,000 was borrowed and subsequently repaid during 2013. The agreement expires January 3, 2014.

On May 19, 2011, OCLC EMEA B.V. modified its secured revolving line of credit with a bank for a total of 3,000,000 Euros. The line of credit declines quarterly by 125,000 Euros beginning April 1, 2012 through January 1, 2015. The line of credit available was 2,375,000 Euros (\$3,090,000) at June 30, 2013 and 2,875,000 Euros (\$3,640,200) at June 30, 2012. For the period January 23, 2012 through March 1, 2012, the line of credit was temporarily increased by 500,000 Euros (\$669,900). During fiscal year 2013, the bank has reserved 329,100 Euros (\$428,100) of the available line of credit to guarantee payment of certain operational activities. Under the terms of the agreement, interest on amounts borrowed is payable at an effective interest rate equal to 1.7% above the three-month Euribor rate at June 30, 2013 and 2012 (total of 1.910% and 2.471%, respectively).

During fiscal year 2013, a total of 3,822,000 Euros (\$4,946,000) was borrowed and subsequently repaid during 2013. During fiscal year 2012, a total of 3,186,200 Euros (\$4,268,600) was borrowed and subsequently repaid during 2012.

## **6. EMPLOYEE BENEFIT PLANS**

A noncontributory, defined contribution retirement plan covers all OCLC employees in the United States ("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 \$6,077,300 and \$5,830,600 for fiscal years 2013 and 2012, respectively.

In 1998, OCLC established a nonqualified voluntary contributory savings plan for key domestic employees and Board of Trustee members. OCLC holds investment assets, recorded at fair value, purchased with the participants' voluntary contributions. Due to a change in U.S. federal tax regulations, the plan was frozen effective May 1, 2002. The assets and liabilities under the plan were \$3,484,700 and \$3,210,000 (reflected in other assets and other noncurrent liabilities) at June 30, 2013 and 2012, respectively.

Operations outside the United States, including the OCLC Canada division and OCLC EMEA, maintain or participate in separate retirement and defined contribution pension plans. Total expenses recorded under these plans were \$1,244,800 and \$1,357,200 in fiscal years 2013 and 2012, respectively.

OCLC maintains a voluntary contributory plan providing postretirement health care and noncontributory postretirement life insurance coverage for U.S. employees. OCLC's U.S. 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.



Relevant postretirement benefit information as of June 30, 2013 and 2012, is summarized as follows:

	<b>2013</b>	<b>2012</b>
Reconciliation of benefit obligation:		
Benefit obligation at the beginning of the plan year	\$ 7,044,000	\$ 9,884,600
Service cost	474,000	681,900
Interest cost	291,400	573,300
Benefits paid	(169,500)	(83,100)
Actuarial loss (gain)	1,546,200	(5,044,300)
Assumption change	<u>(517,300)</u>	<u>1,031,600</u>
Benefit obligation at the end of the plan year	<u>\$ 8,668,800</u>	<u>\$ 7,044,000</u>
Net postretirement benefit cost:		
Service cost	\$ 474,000	\$ 681,900
Interest cost	291,400	573,300
Net amortization	<u>(1,528,000)</u>	<u>(1,112,800)</u>
Total	<u>\$ (762,600)</u>	<u>\$ 142,400</u>
Amounts included in equity:		
Unrecognized prior service cost	\$ (658,600)	\$ (777,700)
Unrecognized net gain	<u>(10,721,500)</u>	<u>(13,159,300)</u>
Total	<u>\$ (11,380,100)</u>	<u>\$ (13,937,000)</u>
Reconciliation of unrecognized net gain:		
Unrecognized net gain at the beginning of the year	\$ (13,159,300)	\$ (10,140,300)
Actuarial loss (gain)	1,546,200	(5,044,300)
Liability (gain) loss due to change in assumptions	(517,300)	1,031,600
Amortization amount	<u>1,408,900</u>	<u>993,700</u>
Unrecognized net gain at the end of the year	<u>\$ (10,721,500)</u>	<u>\$ (13,159,300)</u>
Benefit obligations recognized in equity:		
Net loss (gain)	\$ 1,028,900	\$ (4,012,700)
Amortization of prior service cost	119,100	119,100
Amortization of gain	<u>1,408,900</u>	<u>993,700</u>
Total recognized in equity	<u>\$ 2,556,900</u>	<u>\$ (2,899,900)</u>

Amounts recognized on the consolidated balance sheet:

	<b>2013</b>	<b>2012</b>
Accrued liabilities-current	\$ 132,000	\$ 110,000
Other noncurrent liabilities	<u>8,536,800</u>	<u>6,934,000</u>
Total amount recognized	<u>\$8,668,800</u>	<u>\$7,044,000</u>

Actuarial assumptions used in determining these amounts included a weighted-average discount rate of 5.09% and 4.17% at June 30, 2013 and 2012, respectively, and an annual increase in medical expense of 8.75%, declining to 5.5% in 2020 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 2014:

Net gain	\$ (952,100)
Prior service credit	<u>(119,100)</u>
Total	<u>\$ (1,071,200)</u>

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

**Fiscal Years Ending  
June 30**

2014	\$ 132,000
2015	192,000
2016	242,000
2017	273,000
2018	315,000
2019–2023	2,309,000

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, 2013 and 2012, OCLC has a liability accrued of \$1,285,900 and \$1,269,900, respectively, for the present value of the estimated future payments under this agreement.

## **7. SALE OF DATABASES**

On December 21, 2011, OCLC entered into an agreement to transfer the rights to license vendor-owned databases previously sold on the OCLC FirstSearch service to EBSCO Publishing for \$2,584,600.

## **8. INCOME TAXES**

OCLC has a net deferred tax asset of \$519,000 for operating loss carryforwards (\$411,000 domestic and \$108,000 foreign). The net deferred tax asset is fully offset by a valuation allowance due to the uncertainty of recoverability of these items. OCLC EMEA also has a deferred tax asset of \$191,000 and \$211,000 at June 30, 2013 and 2012, respectively, relating to the fixed asset depreciation and the BOND acquisition, which is recorded as a non-current asset in other assets.

At June 30, 2013, domestic and foreign net operating loss carryforwards for income tax reporting purposes are approximately \$1,656,000 (\$1,208,000 domestic and \$448,000 foreign, principally in the United Kingdom). The domestic carryforwards expire through fiscal year 2033.

## **9. FAIR VALUE MEASUREMENTS**

ASC 820, *Fair Value Measurements and Disclosures*, establishes a framework for measuring fair value by providing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (“Level 1 inputs”) and the lowest priority to unobservable inputs (“Level 3 inputs”). The three levels of the fair value hierarchy under ASC 820 are described below:

*Level 1* — Quoted prices in active markets for identical assets

*Level 2* — Other significant inputs (including quoted prices of similar securities, interest rates, prepayment speeds, credit risk, etc.)

*Level 3* — Significant unobservable inputs (which may include OCLC’s own assumptions in determining the fair value of investments)

The asset’s or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following tables set forth by level, within the fair value hierarchy, OCLC's assets at fair value as of June 30, 2013 and 2012:

	<b>Assets at Fair Value 2013</b>			<b>Total</b>
	<b>Quoted Prices in Active Markets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>	
Equity securities:				
Large Cap Value	\$ 31,317,100	\$ -	\$ -	\$ 31,317,100
Large Cap Growth	30,314,400			30,314,400
Real Estate Investment Trust	15,352,800			15,352,800
International Value	13,717,300			13,717,300
Emerging Markets	<u>12,530,700</u>			<u>12,530,700</u>
Total equity securities	<u>103,232,300</u>	<u>-</u>	<u>-</u>	<u>103,232,300</u>
Mutual funds:				
Fixed income	71,047,000			71,047,000
Commodities	<u>25,669,300</u>			<u>25,669,300</u>
Total mutual funds	<u>96,716,300</u>	<u>-</u>	<u>-</u>	<u>96,716,300</u>
Debt securities:				
U.S. Treasury/U.S. Government		2,194,800		2,194,800
Collateralized Mortgage Obligation		63,200		63,200
Collateralized debt		<u>56,200</u>		<u>56,200</u>
Total debt securities	<u>-</u>	<u>2,314,200</u>	<u>-</u>	<u>2,314,200</u>
Total assets at fair value	<u>\$ 199,948,600</u>	<u>\$ 2,314,200</u>	<u>\$ -</u>	<u>\$ 202,262,800</u>

	Assets at Fair Value 2012			Total
	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	
Equity securities:				
Large Cap Value	\$ 24,446,100	\$ -	\$ -	\$ 24,446,100
Large Cap Growth	25,971,200			25,971,200
Real Estate Investment Trust	13,820,500			7,009,000
International Value	7,009,000			8,929,200
Emerging Markets	8,929,200			13,820,500
Convertible preferred	2,324,600			2,324,600
Total equity securities	82,500,600	-	-	82,500,600
Short-term investments — fixed income funds	6,854,800			6,854,800
Mutual funds:				
Fixed income	29,510,600			29,510,600
Commodities	14,915,800			14,915,800
Total mutual funds	44,426,400	-	-	44,426,400
Debt securities:				
U.S. Treasury/U.S. Government		25,622,200		25,622,200
Corporate		14,039,300	1,478,000	15,517,300
Collateralized Mortgage Obligation		2,596,100		2,596,100
Collateralized debt		798,400		798,400
U.S. States		37,800		37,800
Total debt securities	-	43,093,800	1,478,000	44,571,800
Total assets at fair value	\$ 133,781,800	\$ 43,093,800	\$ 1,478,000	\$ 178,353,600
Contingent consideration due under BOND acquisition agreement	\$ -	\$ 202,600	\$ -	\$ 202,600
Total liabilities at fair value	\$ -	\$ 202,600	\$ -	\$ 202,600

Corporate bonds and notes classified as Level 3 fair value measurements represent the amount of the conversion option derivatives associated with OCLC's convertible bond holdings.

The reconciliation of OCLC's Level 3 assets for the year ended June 30, 2012, are as follows:

	<b>Corporate Bonds and Notes</b>
Balance — July 1, 2011	\$ 1,915,100
Realized loss included in investment income	(307,100)
Purchases	1,622,800
Sales	(1,643,200)
Settlements	<u>(109,600)</u>
Balance — June 30, 2012	<u>\$ 1,478,000</u>

As of June 30, 2013, OCLC has sold all of its Level 3 assets.

ASC 825, *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, 2013 and 2012:

	<b>2013</b>		<b>2012</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
Liabilities — long-term debt	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,065,000</u>	<u>\$ 6,260,500</u>

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

*Cash and Cash Equivalents, Receivables, Accrued and Other Liabilities (Excluding Postretirement Benefit Obligations and Deferred Compensation), Capital Leases, and Accounts Payable* — The carrying amounts of these items are a reasonable estimate of their fair values.

*Investments* — Investments are stated at fair value based upon quoted market prices except for the convertible bond options which are based upon various factors including stock prices, bond spreads, and volatility factors.

*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.

Contingent consideration due under the BOND acquisition agreement is valued at fair value based upon undiscounted cash flows due to the seller determined by revenue performance of the acquired entity.

The valuation methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while OCLC believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

## **10. 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.

On July 28, 2010, a complaint was filed in the U.S. District Court of Northern California alleging federal and state antitrust violations and unfair competition against OCLC. The complaint was subsequently transferred to the U.S. District Court, Southern District of Ohio. OCLC's General Counsel, working with trial counsel, responded to this action by SkyRiver Technology Solutions, LLC and Innovative Interfaces, Inc. following procedures and timetables dictated by the court. On March 4, 2013, the Plaintiffs SkyRiver Technology Solutions, LLC and Innovative Interfaces, Inc. dismissed the lawsuit against OCLC. While the case was not dismissed by the Plaintiffs with prejudice, OCLC has no reason to believe that it will be re-filed.

On March 12, 2012, Godfrey Memorial Library, Inc. ("Godfrey") commenced a civil action against OCLC alleging breach of contract, quantum meruit, implied contract, and unjust enrichment. Godfrey contends that OCLC owes it \$322,500, exclusive of interest and costs, for unpaid cataloging work that it allegedly performed to OCLC's benefit. OCLC's General Counsel, working with trial counsel, responded to this action by, among things, filing a third party claim against Lyrasis, Inc. and defending against Godfrey's claims in accordance with timetables dictated by the court. On March 8, 2013, the Plaintiff Godfrey dismissed the lawsuit against OCLC. The lawsuit was dismissed with prejudice, which forecloses any further activity in this matter.

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