

The Nature Conservancy

Consolidated Financial Statements

As of June 30, 2004 and 2003

Together with report of independent auditors

The Nature Conservancy
Consolidated Financial Statements
Contents
June 30, 2004 and 2003

Page(s)

Report of Independent Auditors..... 1

Financial Statements

Consolidated Statements of Financial Position
As of June 30, 2004 and 2003..... 2

Consolidated Statements of Activities
For the year ended June 30, 2004 4

Consolidated Statements of Activities
For the year ended June 30, 2003 5

Consolidated Statements of Cash Flows
For the years ended June 30, 2004 and 2003 6

Notes to financial statements 8

Schedules of functional expenses
For the years ended June 30, 2004 and 2003 21

Report of Independent Auditors

To the Board of Governors of
The Nature Conservancy

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and of cash flows present fairly, in all material respects, the consolidated financial position of The Nature Conservancy (The Conservancy) at June 30, 2004 and 2003, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of The Conservancy's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of functional expenses for the year ended June 30, 2004 with summarized totals for the year ended June 30, 2003 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

November 3, 2004

The Nature Conservancy
Consolidated Statements of Financial Position
As of June 30, 2004 and 2003
(Amounts in thousands)

<i>(Amounts in thousands)</i>	2004	2003
Assets		
Current assets		
Cash and cash equivalents	\$ 8,761	\$ 13,078
Investments	48,784	63,599
Notes receivable - current	4,930	4,828
Government grants receivable	13,316	11,742
Pledges receivable - current	42,370	46,485
Deposits and other current assets	16,866	38,565
Total current assets	<u>135,027</u>	<u>178,297</u>
Restricted cash	12,091	9,754
Notes receivable - long-term	13,001	41,711
Pledges receivable - long-term	49,616	56,136
Investments held for land and other conservation projects	552,467	419,789
Trade lands	12,188	11,915
Property and equipment, net of accumulated depreciation and amortization	79,015	76,733
Planned giving investments	201,479	171,511
Endowment investments	732,306	633,222
Conservation lands	1,402,499	1,336,226
Conservation easements	875,479	795,812
Total assets	<u>\$ 4,065,168</u>	<u>\$ 3,731,106</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy
Consolidated Statements of Financial Position
As of June 30, 2004 and 2003
(Amounts in thousands)

<i>(Amounts in thousands)</i>	2004	2003
Liabilities and net assets		
Current liabilities		
Accounts payable	\$ 9,052	\$ 11,994
Accrued vacation liability	8,022	8,006
Other accrued liabilities	24,295	17,424
Current maturities of notes payable, capital lease obligations, and lines of credit	18,901	38,345
Deferred revenue - current	13,147	13,494
Total current liabilities	<u>73,417</u>	<u>89,263</u>
Notes payable - long-term	363,965	359,578
Deferred revenue - long-term	3,742	4,119
Planned giving liability	105,447	101,448
Total liabilities	<u>546,571</u>	<u>554,408</u>
Net assets		
Unrestricted		
Undesignated	6,927	13,416
Board-designated		
Land, land preservation, and other conservation project funds	2,261,627	2,036,860
Endowment	665,493	570,586
	<u>2,934,047</u>	<u>2,620,862</u>
Temporarily restricted	349,345	323,812
Permanently restricted	235,205	232,024
Total net assets	<u>3,518,597</u>	<u>3,176,698</u>
Total liabilities and net assets	<u>\$ 4,065,168</u>	<u>\$ 3,731,106</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy
Consolidated Statements of Activities
For the year ended June 30, 2004

<i>(Amounts in thousands)</i>	Unrestricted	Temporarily restricted	Permanently restricted	Total
Support and revenues				
Contributions for operations	\$ 101,935	\$ 40,217	\$ -	\$ 142,152
Contributions for land, land preservation fund, and other conservation projects	92,329	87,357	585	180,271
Contributions to endowments and similar funds	605	20,655	2,596	23,856
Contributions of goods and services	10,126	-	-	10,126
Mitigation and contracts	16,724	-	-	16,724
Government grants	97,751	-	-	97,751
Land and easements contributed for conservation	81,294	-	-	81,294
Contributions of trade lands	5,120	-	-	5,120
Investment income	179,720	-	-	179,720
Change in value of planned giving investments	-	5,860	-	5,860
Royalties, fees, and other	21,546	-	-	21,546
Total support and revenues before sales of conservation land and easements and net assets released from restrictions	607,150	154,089	3,181	764,420
Sales of conservation land and easements to government and others	101,411	-	-	101,411
Net assets released from restrictions	128,556	(128,556)	-	-
Total support and revenues	<u>837,117</u>	<u>25,533</u>	<u>3,181</u>	<u>865,831</u>
Expenses				
Program expenses				
Conservation activities and actions	278,284	-	-	278,284
Book value of conservation land and easements sold or donated to government and others	128,481	-	-	128,481
Total program expenses	<u>406,765</u>	<u>-</u>	<u>-</u>	<u>406,765</u>
Support services expenses				
General and administration	62,834	-	-	62,834
Fund-raising				
General fund-raising	36,188	-	-	36,188
Membership development	18,145	-	-	18,145
Total support services expenses	<u>117,167</u>	<u>-</u>	<u>-</u>	<u>117,167</u>
Total expenses	<u>523,932</u>	<u>-</u>	<u>-</u>	<u>523,932</u>
Increase in net assets	313,185	25,533	3,181	341,899
Net assets at beginning of year	2,620,862	323,812	232,024	3,176,698
Net assets at end of year	<u>\$ 2,934,047</u>	<u>\$ 349,345</u>	<u>\$ 235,205</u>	<u>\$ 3,518,597</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy
Consolidated Statements of Activities
For the year ended June 30, 2003

<i>(Amounts in thousands)</i>	Unrestricted	Temporarily restricted	Permanently restricted	Total
Support and revenues				
Contributions for operations	\$ 103,394	\$ 38,752	\$ -	\$ 142,146
Contributions for land, land preservation fund, and other conservation projects	108,100	64,581	1,242	173,923
Contributions to endowments and similar funds	2,172	9,284	4,874	16,330
Contributions of goods and services	33,000	-	-	33,000
Mitigation and contracts	13,892	-	-	13,892
Government grants	72,755	-	-	72,755
Land and easements contributed for conservation	134,288	-	-	134,288
Contributions of trade lands	5,088	-	-	5,088
Investment income	63,932	-	-	63,932
Change in value of planned giving investments	-	(10,786)	-	(10,786)
Royalties, fees, and other	23,827	-	-	23,827
Total support and revenues before sales of conservation land and easements and net assets released from restrictions	560,448	101,831	6,116	668,395
Sales of conservation land and easements to government and others	172,566	-	-	172,566
Net assets released from restrictions	119,159	(119,159)	-	-
Total support and revenues	852,173	(17,328)	6,116	840,961
Expenses				
Program expenses				
Conservation activities and actions	273,579	-	-	273,579
Book value of conservation land and easements sold or donated to government and others	206,254	-	-	206,254
Total program expenses	479,833	-	-	479,833
Support services expenses				
General and administration	62,847	-	-	62,847
Fund-raising				
General fund-raising	34,577	-	-	34,577
Membership development	19,024	-	-	19,024
Total support services expenses	116,448	-	-	116,448
Total expenses	596,281	-	-	596,281
Increase in net assets	255,892	(17,328)	6,116	244,680
Net assets at beginning of year	2,364,970	341,140	225,908	2,932,018
Net assets at end of year	\$ 2,620,862	\$ 323,812	\$ 232,024	\$ 3,176,698

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy
Consolidated Statements of Cash Flows
For the years ended June 30, 2004 and 2003

<i>(Amounts in thousands)</i>	2004	2003
Cash flows from operating activities		
Increase in net assets	\$ 341,899	\$ 244,680
Adjustments to reconcile the increase in net assets to net cash provided by operating activities		
Contributions restricted for:		
Investment in endowment	(2,596)	(4,874)
Investment in land preservation fund and other capital projects	(585)	(1,242)
Contributions of trade lands	(5,120)	(5,088)
Land and easements contributed for conservation	(81,294)	(134,288)
Gain on trade land sales	(1,135)	(3,574)
Loss on sales of conservation land and easements	24,823	36,427
Depreciation and amortization	3,508	3,375
Net realized and unrealized investment gains	(157,306)	(39,359)
Change in value of planned giving investments	(5,860)	10,786
Changes in assets and liabilities		
Government grant receivables	(1,574)	(1,296)
Deposits and other current assets	21,699	(25,170)
Pledges receivable	10,635	5,294
Accounts payable	(2,942)	(2,926)
Accrued vacation liability	16	278
Other accrued liabilities	6,871	(8,561)
Deferred revenue	(724)	(3,326)
Planned giving liability	3,999	18,509
Additional cash provided by (used in) conservation land activities		
Proceeds from sales of conservation land and easements	101,411	170,603
Purchases of conservation land and easements	(193,708)	(166,241)
Proceeds from sales of trade lands	8,907	15,029
Purchases of trade lands	(97)	-
Net cash provided by operating activities	<u>70,827</u>	<u>109,036</u>

The Nature Conservancy
Consolidated Statements of Cash Flows
For the years ended June 30, 2004 and 2003

<i>(Amounts in thousands)</i>	2004	2003
Cash flows from investing activities		
(Increase) Decrease in restricted cash	\$ (2,337)	\$ 2,388
Proceeds from sale of investments	1,815,409	1,684,352
Purchases of investments	(1,875,050)	(1,967,167)
Issuance of notes receivable	(4,702)	(42,909)
Proceeds received from notes receivable	33,310	24,109
Increase in planned giving investments	(24,108)	(4,878)
Purchases of property and equipment	(5,790)	(6,040)
Net cash used in investing activities	<u>(63,268)</u>	<u>(310,145)</u>
Cash flows from financing activities		
Proceeds from contributions restricted for		
Investment in endowment	2,596	4,874
Investment in land preservation fund and other capital projects	585	1,242
Principle payments on debt, including lines of credit, capital lease obligations, and notes payable	(31,617)	(251,883)
Proceeds received from notes payable and advances against lines of credit	16,560	452,655
Net cash provided by (used in) financing activities	<u>(11,876)</u>	<u>206,888</u>
Net change in cash and cash equivalents	(4,317)	5,779
Cash and cash equivalents, beginning of year	13,078	7,299
Cash and cash equivalents, end of year	<u>\$ 8,761</u>	<u>\$ 13,078</u>
Supplemental data		
Interest paid	\$ 5,557	\$ 5,135
Seller debt-financed land acquisitions	1,610	4,908
Taxes paid	170	247

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

1. Organization

The Nature Conservancy (The Conservancy) is a global conservation organization. The mission of The Conservancy is to preserve plants, animals, and natural communities that represent the diversity of life on Earth by protecting the lands and waters they need to survive. The Conservancy conducts its activities throughout the United States, and in Canada, Latin America, the Caribbean, Indonesia, and the Pacific.

The Conservancy's primary sources of revenue are contributions from the public, including gifts of land, investment income, and government grants. These resources are used to conserve portfolios of functional conservation areas within and across ecoregions. Through this portfolio approach, The Conservancy works with partners to conserve a full array of ecological systems and viable native species.

2. Summary of significant accounting policies

Principles of consolidation

The consolidated financial statements include the accounts of all The Conservancy's chapters and affiliates, both domestic and international, including those which are separately incorporated, receive gifts, and perform conservation activities in the name of The Conservancy. All significant intercompany transactions have been eliminated.

Basis of financial statement presentation

The consolidated financial statements are presented on the accrual basis of accounting.

Classification of net assets

The Conservancy's net assets have been grouped into the following three classes:

- **Permanently restricted net assets** – Contributions and other inflows of assets whose use by The Conservancy is limited by donor-imposed stipulations that the resources must be maintained permanently by The Conservancy.
- **Temporarily restricted net assets** – Contributions and other inflows of assets whose use by The Conservancy is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of The Conservancy, such as usage for specific programs.
- **Unrestricted net assets** – Revenues derived from dues, unrestricted contributions, government grants and contracts, investment income, and other inflows of assets whose use by The Conservancy is not limited by donor-imposed restrictions. Certain unrestricted net assets have been designated by the Board of Governors to be maintained as land, land preservation funds (funds that provide a source of internal loans for the purchase of conservation land), other conservation project funds, and endowment funds.

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

Cash and restricted cash

Highly liquid investments purchased with an original maturity of three months or fewer are considered to be cash equivalents. Restricted cash represents monies held in trust related to proceeds from bond issuances and requirements of specific conservation project agreements.

Concentration of credit risk

The Conservancy's financial instruments that are exposed to concentrations of credit risk consist primarily of its cash and cash equivalents balances and notes receivable. The Conservancy invests its excess cash and cash equivalents in a repurchase agreement account with a high quality financial institution. The repurchase agreements are collateralized by U.S. Government securities, and bear minimal risk.

At June 30, 2003, The Conservancy had a \$36,000,000 note receivable, less a discount of \$7,952,000, from one company, representing 66% of the total notes receivable at June 30, 2003. The note receivable was repaid in advance of its maturity date of June 2010 during the current fiscal year. In conjunction with the early repayment, The Conservancy agreed to provide a third party investor with a qualified investment vehicle, likely in the form of a conservation project, should certain specified events occur. In the event this third party exercises its rights under this agreement, the investor would provide funding to The Conservancy toward the project, and would be paid a minimum specified return on its investment. The Conservancy believes the likelihood of any significant losses related to this guarantee to be remote.

Investments

Investments are carried at estimated fair market value on the consolidated statements of financial position. Fair values of investments are estimated based on quoted market prices where available. Fair values for certain private equity and real estate investments held through limited partnerships or commingled fund shares or planned giving investments held in trust by third party trustees are estimated by the respective external investment managers if market values are not readily ascertainable. These valuations necessarily involve assumptions and methods that are reviewed by The Conservancy. Investments may include some cash and cash equivalents temporarily held by investment managers or held for a specific purpose. The Conservancy's investments consist of the following:

- **Investments** – Short- and medium-term investments of working capital.
- **Investments held for land and other conservation projects** – Funds, including land preservation funds, for the acquisition of conservation land and for funding other conservation projects.
- **Planned giving investments** – Planned giving investments are donations that are held in trust by The Conservancy or third party trustees, representing beneficial interests in trusts. Income earned on the invested funds is payable to the donor or the donor's designee for a specified period of time or until the donor's death, after which time The Conservancy may use the investments for operations or a restricted use specified by the donor. The Conservancy utilizes an IRS-approved annuity table to actuarially calculate the liability associated with the estimated lead payments where The Conservancy is the trustee. The Conservancy determines the discount rate to be used in the month the planned giving arrangements are entered into with the donor and these rates have ranged from 3.8 to 8.0 percent. The present value of the

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

actuarially determined liability resulting from these gifts is recorded at the date of gift. The remaining portion of the gift is recorded as temporarily restricted revenue.

- **Endowment investments** – Funds held as long-term capital to generate income for The Conservancy’s operations.

Land and Land Interests

The Conservancy records land and land interests at cost, if purchased, or at fair value at the date of donation if received as a gift. Fair value is usually determined by independent appraisal. These assets fall into three primary categories:

- **Conservation lands** – real property with significant ecological value. These properties are either managed in an effort to protect the natural biological diversity of the property, or transferred to other organizations who will manage the lands in a similar fashion.
- **Trade lands** – real property with minimal ecological value. These properties are sold to provide funds for The Conservancy to carry out its conservation work.
- **Conservation easements** – intangible assets comprised of listed rights and/or restrictions over the owned property that are conveyed by a property owner to The Conservancy, in perpetuity, in order to protect the owned property as a significant natural area, as defined in federal regulations. These intangible assets may be sold or transferred to others so long as the assignee agrees to carry out, in perpetuity, the conservation purposes intended by the original grantor.

With the exception of trade lands, which are carried at the lower of cost or fair market value, land and land interests are reported at the original book value. Upon sale or gift, the book value of the land or land interest is removed as an asset from the consolidated statement of financial position and reported as a program expense. The related proceeds, if any, are reported as revenue in the consolidated statement of activities. The majority of land sales and gifts relate to transfers of real property. Conservation easements, by their very nature, do not generate material amounts of cash inflow annually.

Property and equipment

Property and equipment are carried at cost. The Conservancy’s minimum capitalization threshold is \$50,000. Expenditures for maintenance and repairs that do not improve or extend the lives of the respective assets are expensed as incurred. When assets are retired or sold, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss on retirement or disposal of the individual assets is recorded as revenue or expense.

Depreciation is provided using the straight-line method for all depreciable assets over their estimated future lives as follows:

Building and improvements	5 – 30 years
Computer equipment	3 – 5 years
Furniture and fixtures	5 – 7 years

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

Contributions

Unconditional donor promises to give cash and other assets are reported at fair value at the date that there is sufficient verifiable evidence documenting that a promise was made by the donor and received by The Conservancy. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that sufficiently limit the use of the donated assets.

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and are reported on the consolidated statements of activities as net assets released from restrictions.

Grants and contracts

The Conservancy receives grants and contracts from federal and state agencies, as well as from private organizations, to be used for specific programs or land purchases. The excess of reimbursable expenditures over cash receipts is included in government grants receivable. Any excess of cash receipts over reimbursable expenditures is included in deferred revenue.

The Conservancy's costs incurred under its government grants and contracts are subject to audit by government agencies. Management believes that disallowance of costs, if any, would not be material to the consolidated financial position or consolidated changes in net assets of The Conservancy.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

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

3. Notes receivable

Notes receivable relate primarily to sales of land by The Conservancy. Notes receivable are recorded annually at their net realizable value. Maturities range from 1 to 25 years with varying interest rates from 0 to 10.0 percent. Default interest rates may be higher. Interest rates on trade land sales approximate market rates at the time of the sale.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

4. Pledges receivable

As of June 30, 2004 and 2003, unconditional promises to give were as follows:

<i>(In thousands)</i>	2004	2003
Amounts due in		
Less than one year	\$ 42,370	\$ 46,485
One to five years	47,943	53,541
More than five years	<u>8,503</u>	<u>10,431</u>
Subtotal	98,816	110,457
Less:		
Discount to present value	4,630	5,636
Allowance for uncollectible pledges	<u>2,200</u>	<u>2,200</u>
	<u>\$ 91,986</u>	<u>\$ 102,621</u>

Pledges receivable greater than one year in time are discounted at a risk-free rate of return. Amortization of the discount is recorded as additional contribution revenue and is used in accordance with donor-imposed restrictions, if any, on the contributions. An allowance is made for uncollectible pledges based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience, and other relevant factors.

As of June 30, 2004 and 2003, The Conservancy had received promises to give totaling approximately \$39,602,000 and \$46,526,000, respectively, that are conditioned upon The Conservancy raising matching gifts or acquiring certain conservation lands. Conditional promises to give are recognized as contributions when the donor-imposed conditions are substantially met.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

5. Investments

Investments consisted of the following at June 30, 2004 and 2003:

(In thousands)

	2004				
	Current investments	Investments held for land and other conservation projects	Planned giving investments	Endowment investments	Total
Short term investments	\$ 46,932	\$ 91,126	\$ 4,041	\$ 11,817	\$ 153,916
Fixed income - bonds	-	153,727	73,332	117,154	344,213
Equities	355	222,758	106,530	504,242	833,885
Real estate trusts	-	-	313	-	313
Private Investments	1,497	81,588	-	102,361	185,446
Receivables from trusts	-	-	17,263	-	17,263
Interfund loans	-	3,268	-	(3,268)	-
Total investments	<u>\$ 48,784</u>	<u>\$ 552,467</u>	<u>\$ 201,479</u>	<u>\$ 732,306</u>	<u>\$ 1,535,036</u>

(In thousands)

	2003				
	Current investments	Investments held for land and other conservation projects	Planned giving investments	Endowment investments	Total
Short term investments	\$ 61,219	\$ 216,003	\$ 9,125	\$ 17,843	\$ 304,190
Fixed income - bonds	-	78,342	70,681	167,404	316,427
Equities	154	87,370	90,356	393,298	571,178
Real estate trusts	-	-	30	-	30
Private investments	2,226	32,591	-	60,160	94,977
Receivables from trusts	-	-	1,319	-	1,319
Interfund loans	-	5,483	-	(5,483)	-
Total investments	<u>\$ 63,599</u>	<u>\$ 419,789</u>	<u>\$ 171,511</u>	<u>\$ 633,222</u>	<u>\$ 1,288,121</u>

See Note 2 for a description of the classification of The Conservancy's investments.

Planned Giving Investments include gift annuities with a fair market value of \$86,456,000 and \$79,987,000 as of June 30, 2004 and 2003, respectively. The corresponding liability for these annuities was \$54,848,000 and \$54,078,000 as of June 30, 2004 and 2003, respectively, with an increase in net assets for gift annuities in the amount of \$5,699,000 for the year ended June 30, 2004 and a decrease in net assets for gift annuities in the amount of \$5,927,000 for the year ended June 30, 2003.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

Planned Giving Investments include recognition of contribution revenue which is classified as temporarily restricted contributions to endowments and similar funds. The amount of planned giving contribution revenue recognized was \$20,108,000 and \$7,465,000 for the years ended June 30, 2004 and 2003, respectively.

Certain investment managers of The Conservancy utilize derivative instruments for hedging purposes in their portfolios. These investments are intended to hedge currency exposures and interest rate risks. The fair market values of these hedge contracts in the investment balance were approximately \$13,625,000 and \$0 at June 30, 2004 and 2003, respectively.

Investment income consisted of the following for the years ended June 30, 2004 and 2003:

	2004	2003
<i>(In thousands)</i>		
Dividends and interest income	\$ 28,118	\$ 27,958
Realized gains (losses) (net of expenses of 5,704 and 3,385, respectively)	31,635	(26,681)
Unrealized gains	119,967	62,655
Investment income	<u>\$ 179,720</u>	<u>\$ 63,932</u>

6. Restricted net assets

Temporarily restricted net assets are available for the following purposes:

	2004	2003
<i>(In thousands)</i>		
Land acquisition and other conservation projects	\$ 161,853	\$ 151,653
Time restricted for periods after June 30	187,492	172,159
Total	<u>\$ 349,345</u>	<u>\$ 323,812</u>

Permanently restricted net assets are restricted in perpetuity; the income derived from these investments is expendable to support the operations of The Conservancy. For the years ended June 30, 2004 and 2003, such income totaled \$29,941,000 and \$12,604,000, respectively.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

7. Property and equipment

Property and equipment consisted of the following at June 30, 2004 and 2003:

	2004	2003
<i>(In thousands)</i>		
Land	\$ 4,318	\$ 4,909
Buildings and improvements	76,281	74,073
Construction in progress	8,902	4,823
Computer equipment and software	1,543	1,921
Furniture, fixtures, and other	3,461	3,388
	<u>94,505</u>	<u>89,114</u>
Less - Accumulated depreciation and amortization	(15,490)	(12,381)
Total	<u>\$ 79,015</u>	<u>\$ 76,733</u>

The Conservancy acquired \$879,000 and \$1,386,000 in property through federal grants for the years ended June 30, 2004 and 2003, respectively.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

8. Notes payable and lines of credit

Notes payable and lines of credit consisted of the following at June 30, 2004 and 2003:

<i>(In thousands)</i>	2004	2003
Unsecured Line of Credit providing total borrowings up to \$15,000,000 and \$50,000,000 as of June 30, 2004 and 2003, respectively. Interest is payable at various rates based on LIBOR plus 0.35%, depending on repayment terms.	\$ -	\$ -
Unsecured Line of Credit providing total borrowings up to \$3,000,000, final payments due at various dates through 2012. Interest is payable at various rates based on LIBOR plus 0.50%, depending on repayment terms, 1.84% and 1.54% at June 30, 2004 and 2003, respectively.	1,275	1,478
Unsecured Colorado Educational and Cultural Facilities Authority Tax Exempt Revenue Bonds, Series 2002A issued in the original principal amount of \$25,053,000 to refund the Industrial Development Authority of Arlington County (IDA) Tax Exempt Revenue Bonds Series 1997A and portions of the IDA Revenue Bonds Taxable Series 1997B; fixed interest rate pursuant to interest rate swap, 3.56% as of June 30, 2004 and June 30, 2003, due July, 2027.	25,053	25,053
Unsecured Colorado Educational and Cultural Facilities Authority Taxable Revenue Bonds, Series 2002B-1 through Series 2002B-2 issued in the original principal amount of \$100,000,000 to refund the Industrial Development Authority of Arlington County (IDA) Tax Exempt Revenue Bonds Series 1997A and portions of the IDA Revenue Bonds Taxable Series 1997B; pay bond issuance costs, and finance and refinance acquisition of conservation land and easements; variable interest rates, 1.30% at June 30, 2004 and 1.22% for Series 2002B-1 and 1.15% for Series 2002B-2 at June 30, 2003, due July, 2032.	98,375	100,000
Unsecured Colorado Educational and Cultural Facilities Authority Taxable Revenue Bonds, Series 2003A-1 through Series 2003A-4 issued in the original principal amount of \$200,000,000 to finance acquisition of conservation land and easements; variable interest rates, 1.45% and 1.18% at June 30, 2004 and 2003, respectively, due July, 2033.	196,700	200,000
Loans and mortgages on land held for conservation, some of which are collateralized by the land, and payable in monthly installments, including interest ranging from 0% to 11%; final payments are due at various dates through 2023.	61,083	71,012
Other notes payable without interest due on demand	380	380
	<u>382,866</u>	<u>397,923</u>
Less - current maturities	<u>(18,901)</u>	<u>(38,345)</u>
Total notes payable - long term	<u>\$ 363,965</u>	<u>\$ 359,578</u>

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

The future maturities of notes payable and lines of credit are as follows:

Year ended June 30	(in thousands)
2005	\$ 18,901
2006	23,661
2007	29,236
2008	7,130
2009	7,424
Thereafter	296,514
	<u>\$ 382,866</u>

Interest expense incurred on notes payable and lines of credit for 2004 and 2003 was \$3,050,000 and \$7,985,000, respectively.

9. Contributed goods and services

The Conservancy periodically receives contributed professional services from third parties and recognizes revenue at the fair value of those services. During 2004 and 2003, these services totaled \$6,381,000 and \$24,492,000, respectively. In addition, The Conservancy received contributed goods that totaled \$3,745,000 and \$8,508,000 for the years ended June 30, 2004 and 2003, respectively. Contributed goods are recorded at fair value on the date of donation.

10. Fair value of financial instruments

The carrying amounts of cash, receivables, accrued liabilities, and payables on the consolidated statements of financial position approximate fair value due to the short-term nature of these items.

The carrying amounts of long-term debt and notes receivable on the consolidated statements of financial position approximate fair value, which is estimated based on current market rates offered to or by The Conservancy for similar instruments.

11. Commitments and contingencies

Leases

The Conservancy has entered into noncancelable operating leases for office space, which expire at various dates through 2014. Certain of these leases contain rent escalation clauses based on the consumer price index.

In June 1997, the Industrial Development Authority (the Authority) of Arlington County, Virginia, issued \$18,170,000 of tax-exempt bonds (Series 1997A) and \$12,090,000 of taxable bonds (Series 1997B). The proceeds of these bonds were used to construct a new headquarters building located in Arlington County, Virginia, for use by The Conservancy and its tenants.

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

The Conservancy leased the new building from the Authority under the terms of a capital lease, which was due to expire on July 1, 2027. The interest component of the lease payments was capitalized by The Conservancy during construction. As of June 30, 2004 and 2003, \$3,483,000 of net interest and financing costs were capitalized. No amounts were capitalized by The Conservancy in either of the years ended June 30, 2004 or 2003. The building was completed in November 1998. The Conservancy occupies the majority of the building and subleases the remaining portions. Interest expense incurred on the capital lease obligation was \$0 and \$2,222,000 for 2004 and 2003, respectively.

On December 17, 2002, the capital lease expired as a result of the issuance of Colorado Educational and Cultural Facilities Authority bonds to refund the Industrial Development Authority of Arlington County (IDA) Revenue Bonds Series 1997A and portions of the IDA Revenue Bonds Taxable Series 1997B.

The following is a schedule of future minimum lease payments for all operating leases:

Year ended June 30	(in thousands)
2005	\$ 3,261
2006	2,941
2007	2,588
2008	1,963
2009	1,172
Thereafter	<u>3,777</u>
Total minimum lease payments	<u>\$ 15,702</u>

Rent expense was \$7,765,000 and \$7,254,000 for the years ended June 30, 2004 and 2003, respectively.

Land acquisitions and other purchase commitments

The Conservancy has entered into contracts for the purchase of land and other purchase commitments that had not closed as of June 30, 2004, in the amount of \$59,569,000.

On July 1, 1999, The Conservancy entered into an agreement with The Association for Biodiversity Information: The International Network of Natural Heritage Programs and Conservation Data Centers (ABI), subsequently renamed NatureServe, to further manage, analyze, and deliver biodiversity conservation data and information. The Conservancy initially committed to provide up to \$40,000,000 of financial support to NatureServe over a seven-year period if certain conditions are met. The Conservancy has provided \$24,388,000 of this commitment to NatureServe through June 30, 2004. In addition, a line of credit in the amount of \$1,000,000 has been extended by The Conservancy to NatureServe as of May 1, 2001, with an extended maturity date of April 30, 2005. As of June 30, 2004, NatureServe owed \$400,000 at an interest rate of 1.72 percent.

Other

During the fiscal year ended June 30, 2004, The Conservancy was the subject of an inquiry by the United States Senate Finance Committee and an audit by the Internal Revenue Service. Based upon information currently available, management believes the ultimate disposition of these matters will

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

not have a material adverse effect on The Conservancy's financial position, changes in net assets, or cash flows.

12. Retirement plans

The Conservancy's employees are eligible after one month of service to participate in The Nature Conservancy Savings and Retirement Plan (the Plan), in which employees can make voluntary, tax-deferred contributions within specified limits. The Plan was established under the provisions of Internal Revenue Code Section 401(k) and has received a favorable determination as to its tax status from the Internal Revenue Service. The Conservancy's contributions to the Plan were \$6,518,000 and \$6,820,000 for the years ended June 30, 2004 and 2003, respectively.

13. Program expense allocation

Operating expenses are allocated to program and support categories based on estimated percentages collected during the annual budget process. Conservation land and easements that are acquired by The Conservancy, but not sold or donated, are reflected as an increase in conservation land and easements on the consolidated statements of financial position and are excluded from the program expense categories on the consolidated statements of activities.

The Conservancy accounts for its program expenditures in the following categories:

- **Conservation Activities and Actions** – Expenditures related to the broad spectrum of activities and actions critical to advancing The Conservancy's ecoregion-based approach to conservation. Expenditures related to understanding, monitoring, maintaining, restoring, and managing natural areas owned by The Conservancy and others are included, as are expenditures for developing and enhancing The Conservancy's ability to gather and share ecological information and to assess and evaluate threats to the elements of natural diversity within ecoregions in which The Conservancy works. In addition, this area includes expenditures necessary for developing and implementing ecoregion-based plans and strategies to mitigate, prevent, or slow the effects of threats to the elements of biodiversity, including investments in the institutional development of domestic and international conservation organizations. Finally, this category includes expenditures relating to community outreach and education of key stakeholders and land users in areas where Conservancy conservation programs reside.
- **General and Administration** – Expenditures related to building and maintaining an efficient business infrastructure, including those related to corporate governance, to support and advance the programmatic conservation objectives of The Conservancy.
- **General Fund-Raising** – Expenditures related to fund-raising strategies that provide the revenue stream for both operations and capital needs to further the accomplishment of The Conservancy's mission and objectives.
- **Membership Development** – Expenditures related to the acquisition and retention of The Conservancy members, primarily through the use of a direct-mail program.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2004 and 2003

14. Income taxes

The Conservancy has been granted an exemption from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Internal Revenue Service has classified The Conservancy as other than a private foundation.

The Conservancy pays a nominal amount of tax relating to several unrelated business income activities, primarily rental income from debt-financed property. At June 30, 2004 and 2003, The Conservancy had a cumulative unrelated business income net operating loss of \$0.

The Nature Conservancy
Schedules of Functional Expenses
For the year ended June 30, 2004 with summarized totals for the year ended June 30, 2003
(Amounts in thousands)

	Program expenses Conservation activities and actions	Support services expenses				Totals	
		General and administration	Fund-raising		Support services expenses	2004 Total expenses	2003 Total expenses
			General fund-raising	Membership development			
Personnel	\$ 124,904	\$ 38,590	\$ 22,400	\$ 1,124	\$ 62,114	\$ 187,018	\$ 183,236
Telecommunications	3,588	1,114	647	10	1,771	5,359	5,367
Travel and meetings	9,748	2,993	1,737	20	4,750	14,498	13,094
Supplies and equipment	9,035	2,696	1,565	2,381	6,642	15,677	21,512
Postage and mailing service	1,809	552	320	7,825	8,697	10,506	11,660
Printing, newsletter, and public relations	7,176	918	533	4,934	6,385	13,561	31,555
Direct-mail lists	-	-	-	1,206	1,206	1,206	1,330
Contract/Professional fees	56,195	9,083	5,258	639	14,980	71,175	53,021
Dues, fees, and licenses	667	188	106	2	296	963	1,111
Interest and bank charges	4,424	135	78	-	213	4,637	9,224
Rent	5,241	1,597	927	-	2,524	7,765	7,254
Utilities, repair, maintenance, and construction	2,883	725	404	4	1,133	4,016	3,670
Equipment and vehicle operating expense	3,208	976	566	-	1,542	4,750	4,459
Insurance	2,131	671	381	-	1,052	3,183	2,921
Real estate taxes	4,148	876	477	-	1,353	5,501	5,582
Closing costs	2,242	364	4	-	368	2,610	6,011
Depreciation and amortization	3,420	56	32	-	88	3,508	3,375
Other	8,523	1,300	753	-	2,053	10,576	4,911
Grants to others	28,942	-	-	-	-	28,942	20,734
Subtotal	278,284	62,834	36,188	18,145	117,167	395,451	390,027
Book value of conservation land and easements sold or donated to government and others	128,481	-	-	-	-	128,481	206,254
Total	\$ 406,765	\$ 62,834	\$ 36,188	\$ 18,145	\$ 117,167	\$ 523,932	\$ 596,281