

The Nature Conservancy

Consolidated Financial Statements

As of June 30, 2006 and 2005

Together with report of independent auditors

The Nature Conservancy
Consolidated Financial Statements
Contents
June 30, 2006 and 2005

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Report of Independent Auditors

To the Board of Directors 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 and subsidiaries (The Conservancy) at June 30, 2006 and 2005, 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 financial statements are the responsibility of The Conservancy's management. Our responsibility is to express an opinion on these 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 our opinion.

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, 2006 with summarized totals for the year ended June 30, 2005 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 9, 2006

The Nature Conservancy
Consolidated Statements of Financial Position
As of June 30, 2006 and 2005

| <i>(Amounts in thousands)</i> | 2006 | 2005 |
|---|---------------------|---------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 16,085 | \$ 38,180 |
| Investments | 231,828 | 27,502 |
| Notes receivable - current | 1,487 | 5,975 |
| Government grants receivable | 16,208 | 16,179 |
| Pledges receivable - current | 94,490 | 50,831 |
| Deposits and other current assets | 19,657 | 12,927 |
| Total current assets | <u>379,755</u> | <u>151,594</u> |
| Restricted cash | 29,478 | 20,700 |
| Notes receivable - long-term | 17,866 | 15,339 |
| Pledges receivable - long-term, net of allowance for doubtful accounts | 49,514 | 66,802 |
| Investments held for conservation projects | 491,305 | 568,854 |
| Trade lands | 10,781 | 8,989 |
| Property and equipment, net of accumulated depreciation and amortization | 88,351 | 83,768 |
| Planned giving investments | 257,656 | 225,367 |
| Endowment investments | 922,044 | 802,880 |
| Conservation lands | 1,502,629 | 1,490,696 |
| Conservation easements | 1,079,115 | 979,737 |
| Total assets | <u>\$ 4,828,494</u> | <u>\$ 4,414,726</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, 2006 and 2005

| <i>(Amounts in thousands)</i> | 2006 | 2005 |
|---|---------------------|---------------------|
| Liabilities and net assets | | |
| Current liabilities | | |
| Accounts payable | \$ 11,788 | \$ 9,739 |
| Accrued salaries and vacation liability | 14,466 | 7,802 |
| Other accrued liabilities - current | 39,641 | 27,799 |
| Current maturities of notes payable and lines of credit | 21,986 | 24,487 |
| Deferred revenue - current | 14,609 | 12,475 |
| Total current liabilities | <u>102,490</u> | <u>82,302</u> |
| | | |
| Notes payable - long-term | 340,864 | 358,697 |
| Accrued liabilities - long-term | 5,734 | 7,683 |
| Deferred revenue - long-term | 4,095 | 4,266 |
| Planned giving liability | 118,736 | 109,585 |
| Total liabilities | <u>571,919</u> | <u>562,533</u> |
| | | |
| Net assets | | |
| Unrestricted | | |
| Undesignated | 2,030 | 9,288 |
| Board-designated | | |
| Land, easements, and project funds | 2,700,167 | 2,476,072 |
| Endowment | 850,283 | 732,216 |
| | <u>3,552,480</u> | <u>3,217,576</u> |
| Temporarily restricted | 462,190 | 395,582 |
| Permanently restricted | 241,905 | 239,035 |
| Total net assets | <u>4,256,575</u> | <u>3,852,193</u> |
| Total liabilities and net assets | <u>\$ 4,828,494</u> | <u>\$ 4,414,726</u> |

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

The Nature Conservancy
Consolidated Statement of Activities
For the year ended June 30, 2006

| <i>(Amounts in thousands)</i> | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|--|--------------|---------------------------|---------------------------|--------------|
| Support and revenues | | | | |
| Contributions for operations | \$ 110,779 | \$ 64,338 | \$ - | \$ 175,117 |
| Contributions for land, land preservation fund, and other conservation projects | 105,994 | 121,508 | 300 | 227,802 |
| Contributions to endowments and similar funds | 291 | 9,877 | 2,570 | 12,738 |
| Contributions of goods and services | 9,028 | - | - | 9,028 |
| Mitigation and contracts | 19,747 | - | - | 19,747 |
| Government grants | 101,232 | - | - | 101,232 |
| Land and easements contributed for conservation | 103,839 | - | - | 103,839 |
| Contributions of trade lands | 6,044 | - | - | 6,044 |
| Investment income | 218,978 | - | - | 218,978 |
| Change in value of planned giving investments | - | 9,481 | - | 9,481 |
| Royalties, fees, and other | 25,612 | - | - | 25,612 |
| Total support and revenues before sales of conservation land and easements and net assets released from restrictions | 701,544 | 205,204 | 2,870 | 909,618 |
| Sales of conservation land and easements to governments and others | 176,051 | - | - | 176,051 |
| Net assets released from restrictions | 138,596 | (138,596) | - | - |
| Total support and revenues | 1,016,191 | 66,608 | 2,870 | 1,085,669 |
| Expenses | | | | |
| Program expenses | | | | |
| Conservation activities and actions | 298,474 | - | - | 298,474 |
| Book value of conservation land and easements sold or donated to governments and others | 233,562 | - | - | 233,562 |
| Total program expenses | 532,036 | - | - | 532,036 |
| Support services expenses | | | | |
| General and administration | 86,311 | - | - | 86,311 |
| Fund-raising | | | | |
| General fund-raising | 46,664 | - | - | 46,664 |
| Membership development | 16,276 | - | - | 16,276 |
| Total support services expenses | 149,251 | - | - | 149,251 |
| Total expenses | 681,287 | - | - | 681,287 |
| Increase in net assets | 334,904 | 66,608 | 2,870 | 404,382 |
| Net assets at beginning of year | 3,217,576 | 395,582 | 239,035 | 3,852,193 |
| Net assets at end of year | \$ 3,552,480 | \$ 462,190 | \$ 241,905 | \$ 4,256,575 |

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

The Nature Conservancy
Consolidated Statement of Activities
For the year ended June 30, 2005

| <i>(Amounts in thousands)</i> | Unrestricted | Temporarily restricted | Permanently restricted | Total |
|--|---------------------|-----------------------------------|-----------------------------------|--------------|
| Support and revenues | | | | |
| Contributions for operations | \$ 99,394 | \$ 48,224 | \$ - | \$ 147,618 |
| Contributions for land, land preservation fund, and other conservation projects | 77,569 | 115,219 | - | 192,788 |
| Contributions to endowments and similar funds | 814 | 19,624 | 3,830 | 24,268 |
| Contributions of goods and services | 8,584 | - | - | 8,584 |
| Mitigation and contracts | 21,498 | - | - | 21,498 |
| Government grants | 112,290 | - | - | 112,290 |
| Land and easements contributed for conservation | 101,746 | - | - | 101,746 |
| Contributions of trade lands | 5,718 | - | - | 5,718 |
| Investment income | 139,907 | - | - | 139,907 |
| Change in value of planned giving investments | - | 1,282 | - | 1,282 |
| Royalties, fees, and other | 22,098 | - | - | 22,098 |
| Total support and revenues before sales of conservation land and easements and net assets released from restrictions | 589,618 | 184,349 | 3,830 | 777,797 |
| Sales of conservation land and easements to governments and others | 165,440 | - | - | 165,440 |
| Net assets released from restrictions | 138,112 | (138,112) | - | - |
| Total support and revenues | 893,170 | 46,237 | 3,830 | 943,237 |
| Expenses | | | | |
| Program expenses | | | | |
| Conservation activities and actions | 283,617 | - | - | 283,617 |
| Book value of conservation land and easements sold or donated to governments and others | 190,862 | - | - | 190,862 |
| Total program expenses | 474,479 | - | - | 474,479 |
| Support services expenses | | | | |
| General and administration | 76,148 | - | - | 76,148 |
| Fund-raising | | | | |
| General fund-raising | 42,182 | - | - | 42,182 |
| Membership development | 16,832 | - | - | 16,832 |
| Total support services expenses | 135,162 | - | - | 135,162 |
| Total expenses | 609,641 | - | - | 609,641 |
| Increase in net assets | 283,529 | 46,237 | 3,830 | 333,596 |
| Net assets at beginning of year | 2,934,047 | 349,345 | 235,205 | 3,518,597 |
| Net assets at end of year | \$ 3,217,576 | \$ 395,582 | \$ 239,035 | \$ 3,852,193 |

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, 2006 and 2005

| <i>(Amounts in thousands)</i> | 2006 | 2005 |
|---|---------------|---------------|
| Cash flows from operating activities | | |
| Increase in net assets | \$ 404,382 | \$ 333,596 |
| Adjustments to reconcile the increase in net assets to net cash provided by operating activities: | | |
| Contributions restricted for: | | |
| Investment in endowment | (2,570) | (3,830) |
| Investment in land preservation fund and other capital projects | (300) | - |
| Contributions of trade lands | (6,044) | (5,718) |
| Land and easements contributed for conservation | (103,839) | (101,746) |
| Gain on trade land sales/valuations | (2,662) | (719) |
| Loss on sales of conservation land and easements | 56,804 | 26,020 |
| Depreciation and amortization | 4,797 | 4,017 |
| Net realized and unrealized investment gains | (187,179) | (114,072) |
| Change in value of planned giving investments | (9,481) | (1,282) |
| Changes in assets and liabilities: | | |
| Government grant receivables | (29) | (2,863) |
| Deposits and other current assets | (6,730) | 3,939 |
| Pledges receivable | (26,371) | (25,647) |
| Accounts payable | 2,049 | 687 |
| Accrued salaries and vacation liability | 6,664 | (220) |
| Other accrued liabilities | 9,893 | 11,187 |
| Deferred revenue | 1,963 | (148) |
| Planned giving liability | 9,151 | 4,138 |
| Additional cash provided by (used in) land activities: | | |
| Proceeds from sales of conservation land and easements | 176,051 | 165,440 |
| Purchases of conservation land and easements | (243,994) | (283,116) |
| Proceeds from sales of trade lands | 10,719 | 10,583 |
| Net cash provided by operating activities | <u>93,274</u> | <u>20,246</u> |

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, 2006 and 2005

| <i>(Amounts in thousands)</i> | 2006 | 2005 |
|---|------------------|------------------|
| Cash flows from investing activities | | |
| Increase in restricted cash | \$ (8,778) | \$ (8,609) |
| Proceeds from sale of investments | 932,389 | 1,102,479 |
| Purchases of investments | (991,151) | (1,054,086) |
| Issuance of notes receivable | (5,472) | (6,926) |
| Proceeds received from notes receivable | 7,433 | 3,543 |
| Increase in planned giving investments | (22,808) | (22,606) |
| Purchases of property and equipment | (9,518) | (8,770) |
| Net cash provided by (used in) investing activities | <u>(97,905)</u> | <u>5,025</u> |
| Cash flows from financing activities | | |
| Proceeds from contributions restricted for: | | |
| Investment in endowment | 2,570 | 3,830 |
| Investment in land preservation fund and other capital projects | 300 | - |
| Principle payments on debt, including lines of credit and notes payable | (34,631) | (25,627) |
| Proceeds received from notes payable and advances against lines of credit | <u>14,297</u> | <u>25,945</u> |
| Net cash provided by (used in) financing activities | <u>(17,464)</u> | <u>4,148</u> |
| Net change in cash and cash equivalents | (22,095) | 29,419 |
| Cash and cash equivalents, beginning of year | 38,180 | 8,761 |
| Cash and cash equivalents, end of year | <u>\$ 16,085</u> | <u>\$ 38,180</u> |
| Supplemental data | | |
| Interest paid | \$ 14,136 | \$ 8,980 |
| Seller debt-financed land acquisitions | 2,351 | 3,702 |
| Income taxes paid | 382 | 260 |

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

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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, Africa, Asia, 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 principal 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 Directors to be maintained as land, easements, land preservation funds (for the purchase of conservation land), other conservation project funds, and endowment funds.

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 requirements of specific conservation project agreements.

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Notes to Consolidated Financial Statements

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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. 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.

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 estimation methods that are reviewed by The Conservancy, and actual valuations could differ from those estimates. Investments may include some short term investments which consist primarily of money market funds and other short term investments 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 conservation projects** – Funds for the acquisition of conservation land, easements, 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. Planned giving investments are recorded at current fair value or at an estimated fair value based on the latest available information. 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 3.6 to 9.5 percent. The present value of the 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 acquisition, if all or part of the land was received as a donation. Fair value is generally 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.

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Notes to Consolidated Financial Statements

June 30, 2006 and 2005

- **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, almost always 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 | 7 – 30 years |
| Computer equipment | 3 – 5 years |
| Furniture, fixtures, and other | 4 – 10 years |

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, state, and local agencies, as well as from private organizations, to be used for specific programs or land purchases. For government grants and contracts, the excess of reimbursable expenditures over cash receipts is included in government grants receivable and any excess of cash receipts over reimbursable expenditures is

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Notes to Consolidated Financial Statements
June 30, 2006 and 2005

included in accounts payable. For private mitigation and other contracts, 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 23 years with varying interest rates from 0 to 10.0 percent. Default interest rates may be higher.

4. Pledges receivable

As of June 30, 2006 and 2005, unconditional promises to give were as follows:

| <i>(In thousands)</i> | 2006 | 2005 |
|-------------------------------------|-------------------|-------------------|
| Amounts due in | | |
| Less than one year | \$ 94,490 | \$ 50,831 |
| One to five years | 53,614 | 68,158 |
| More than five years | 4,062 | 5,900 |
| | <u>152,166</u> | <u>124,889</u> |
| Subtotal | 152,166 | 124,889 |
| Less: | | |
| Discount to present value | 5,662 | 4,756 |
| Allowance for uncollectible pledges | 2,500 | 2,500 |
| | <u>\$ 144,004</u> | <u>\$ 117,633</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.

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As of June 30, 2006 and 2005, The Conservancy had received promises to give totaling approximately \$38,777,000 and \$40,608,000, 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.

5. Investments

Investments consisted of the following at June 30, 2006 and 2005:

(In thousands)

| | 2006 | | | | Total |
|---|----------------------------|---|-----------------------------------|------------------------------|---------------------|
| | Current investments | Investments held for conservation projects | Planned giving investments | Endowment investments | |
| Short term investments | \$ 230,132 | \$ 52,543 | \$ 4,059 | \$ 2,086 | \$ 288,820 |
| Fixed income - bonds | - | 100,001 | 76,952 | 75,281 | 252,234 |
| Equities | 395 | 241,456 | 140,303 | 594,702 | 976,856 |
| Real estate trusts | - | - | 1,714 | - | 1,714 |
| Private equity and hedge fund investments | 1,301 | 98,418 | - | 248,862 | 348,581 |
| Receivables from trusts | - | - | 34,628 | - | 34,628 |
| Interfund loans | - | (1,113) | - | 1,113 | - |
| Total investments | \$ 231,828 | \$ 491,305 | \$ 257,656 | \$ 922,044 | \$ 1,902,833 |

(In thousands)

| | 2005 | | | | Total |
|---|----------------------------|---|-----------------------------------|------------------------------|---------------------|
| | Current investments | Investments held for conservation projects | Planned giving investments | Endowment investments | |
| Short term investments | \$ 26,088 | \$ 44,552 | \$ 30,750 | \$ 7,239 | \$ 108,629 |
| Fixed income - bonds | - | 110,862 | 69,678 | 83,427 | 263,967 |
| Equities | 299 | 305,734 | 97,030 | 577,383 | 980,446 |
| Real estate trusts | - | - | 1,400 | - | 1,400 |
| Private equity and hedge fund investments | 1,115 | 109,918 | - | 132,619 | 243,652 |
| Receivables from trusts | - | - | 26,509 | - | 26,509 |
| Interfund loans | - | (2,212) | - | 2,212 | - |
| Total investments | \$ 27,502 | \$ 568,854 | \$ 225,367 | \$ 802,880 | \$ 1,624,603 |

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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 \$105,198,000 and \$93,412,000 as of June 30, 2006 and 2005, respectively. The corresponding liability for these annuities was \$63,587,000 and \$58,327,000 as of June 30, 2006 and 2005, respectively, with an increase in net assets for gift annuities in the amount of \$6,526,000 and \$3,477,000 for the years ended June 30, 2006 and 2005, respectively.

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 \$9,688,000 and \$18,467,000 for the years ended June 30, 2006 and 2005, 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 Conservancy has remaining commitments to private equity and hedge fund investments of \$74,388,000 at June 30, 2006.

Investment income consisted of the following for the years ended June 30, 2006 and 2005:

| <i>(In thousands)</i> | 2006 | 2005 |
|--|-------------------|-------------------|
| Dividends and interest income | \$ 40,487 | \$ 32,815 |
| Realized gains (net of expenses of 8,688 and 6,980, respectively) | 122,579 | 90,694 |
| Unrealized gains | 55,912 | 16,398 |
| Investment income | <u>\$ 218,978</u> | <u>\$ 139,907</u> |

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Notes to Consolidated Financial Statements
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6. Restricted net assets

Temporarily restricted net assets are available for the following purposes:

| | 2006 | 2005 |
|--|-------------------|-------------------|
| <i>(In thousands)</i> | | |
| Land acquisition and other conservation projects | \$ 183,760 | \$ 162,693 |
| Time restricted for periods after June 30 | 278,430 | 232,889 |
| Total | <u>\$ 462,190</u> | <u>\$ 395,582</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, 2006 and 2005, such income totaled \$31,915,000 and \$23,608,000, respectively.

7. Property and equipment

Property and equipment consisted of the following at June 30, 2006 and 2005:

| | 2006 | 2005 |
|--|------------------|------------------|
| <i>(In thousands)</i> | | |
| Land | \$ 4,984 | \$ 4,318 |
| Buildings and improvements | 92,931 | 84,170 |
| Construction in progress | 6,016 | 7,256 |
| Computer equipment and software | 2,015 | 1,823 |
| Furniture, fixtures, and other | 6,512 | 5,686 |
| | <u>112,458</u> | <u>103,253</u> |
| Less - Accumulated depreciation and amortization | (24,107) | (19,485) |
| Total | <u>\$ 88,351</u> | <u>\$ 83,768</u> |

Depreciation expense was \$4,797,000 and \$4,017,000 during the years ended June 30, 2006 and 2005, respectively. Of the total assets listed above, \$2,170,000 and \$1,693,000 were fully depreciated at June 30, 2006 and 2005, respectively.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

8. Notes payable and lines of credit

Notes payable and lines of credit consisted of the following at June 30, 2006 and 2005:

| <i>(In thousands)</i> | 2006 | 2005 |
|--|-------------------|-------------------|
| Unsecured borrowings due at various dates through 2012. Interest is payable at various rates based on LIBOR plus 0.50%, depending on repayment terms, 5.85% and 3.84% at June 30, 2006 and 2005, respectively. | \$ 837 | \$ 1,008 |
| 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, 2006 and June 30, 2005, due July, 2027. | 24,496 | 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, 5.15% and 3.30% for Series 2002B-1 and 5.09% and 3.40% for Series 2002B-2 at June 30, 2006 and 2005, respectively, due July, 2032. | 95,375 | 97,150 |
| Unsecured Colorado Educational and Cultural Facilities Authority Taxable Revenue Bonds, Series 2003A-1TX and Series 2003A-2 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, 5.19% and 3.24% at June 30, 2006 and 2005, respectively, due July, 2033. | 167,700 | 193,400 |
| Unsecured Colorado Educational and Cultural Facilities Authority Tax Exempt Revenue Bonds, Series 2003A-1TE issued in the original principal amount of \$22,300,000, converted from the Unsecured Colorado Educational and Cultural Facilities Authority Taxable Revenue Bonds, Series 2003A-1; variable interest rates, 3.95% at June 30, 2006, due July, 2033. | 22,300 | - |
| 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 2022. | 51,772 | 66,203 |
| Other notes payable without interest due on demand | 370 | 370 |
| | <u>362,850</u> | <u>383,184</u> |
| Less - current maturities | <u>(21,986)</u> | <u>(24,487)</u> |
| Total notes payable - long term | <u>\$ 340,864</u> | <u>\$ 358,697</u> |

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

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

| Year ended June 30 | (in thousands) |
|---------------------------|-----------------------|
| 2007 | \$ 21,986 |
| 2008 | 11,495 |
| 2009 | 20,418 |
| 2010 | 9,969 |
| 2011 | 9,267 |
| Thereafter | 289,715 |
| | <u>\$ 362,850</u> |

Interest expense incurred on notes payable and lines of credit for 2006 and 2005 was \$13,769,000 and \$9,368,000, respectively.

The Conservancy has an unsecured line of credit providing total borrowings up to \$15,000,000. Interest is payable at various rates based on LIBOR plus 0.35%, depending on repayment terms. As of June 30, 2006 and 2005 the balance on the \$15,000,000 line of credit was \$0.

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 2006 and 2005, these services totaled \$6,772,000 and \$5,645,000, respectively. In addition, The Conservancy received contributed goods that totaled \$2,256,000 and \$2,939,000 for the years ended June 30, 2006 and 2005, 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 2016. Certain of these leases contain rent escalation clauses based on the consumer price index.

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

| Year ended June 30 | (in thousands) |
|------------------------------|-----------------------|
| 2007 | \$ 5,125 |
| 2008 | 3,890 |
| 2009 | 2,873 |
| 2010 | 2,578 |
| 2011 | 2,122 |
| Thereafter | <u>4,921</u> |
| Total minimum lease payments | <u>\$ 21,509</u> |

Rent expense was \$8,910,000 and \$8,263,000 for the years ended June 30, 2006 and 2005, respectively.

Land acquisitions and other commitments

The Conservancy has entered into contracts for the purchase of land and other purchase commitments that had not closed as of June 30, 2006, in the amount of \$236,716,000.

Since 1999, the Conservancy has had an agreement to provide financial and other support to another not-for-profit organization which provides biodiversity conservation data and information. Under the agreement, which expired on June 30, 2006, the Conservancy has provided \$29,550,000 in financial support to the organization. Effective July 1, 2006, the Conservancy entered into a new agreement with the same organization, which extends a \$9,000,000 endowment matching commitment from the original agreement until December 31, 2006; and which provides for up to \$1,200,000 of additional financial support over a three-year period provided certain conditions are met.

The Conservancy is a party to an agreement whereby under certain circumstances, the Conservancy may be required to establish a special purpose entity and accept a loan from the other party to the agreement. The Conservancy would, in turn, secure the loan with a qualified existing asset, and guarantee repayment of the loan should the special purpose entity fail to perform under the terms of the loan. The Conservancy believes the likelihood of any significant loss related to this guarantee to be remote.

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. As of August 2005 certain employees are also eligible to participate in a non-qualified deferred compensation plan created pursuant to Internal Revenue Code Section 457(b). The Conservancy's contributions to the plans were \$8,443,000 and \$7,685,000 for the years ended June 30, 2006 and 2005, respectively.

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

13. Program expense allocation

Operating expenses are allocated to program and support categories based on separate cost center types as defined below. 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.

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.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

15. Subsequent events

On September 18, 2006, The Conservancy purchased approximately 120,000 acres of conservation land in North Carolina, Virginia, Georgia, Florida, Alabama, Arkansas, Tennessee, Louisiana, and Mississippi for \$162,799,000. The Conservancy signed an agreement to purchase the land on February 18, 2006. As a result, The Conservancy liquidated \$145,000,000 from its long-term investment portfolio as of June 30, 2006, in anticipation of the purchase.

The Nature Conservancy
Schedules of Functional Expenses
For the year ended June 30, 2006 with summarized totals for the year ended June 30, 2005

(Amounts in thousands)

| | Program expenses | Support services expenses | | | | | Totals | |
|--|------------------|-------------------------------------|----------------------------|----------------------|------------------------|---------------------------|---------------------|---------------------|
| | | Conservation activities and actions | General and administration | Fund-raising | | Support services expenses | 2006 Total expenses | 2005 Total expenses |
| | | | | General fund-raising | Membership development | | | |
| Personnel | \$ 131,455 | \$ 51,688 | \$ 35,745 | \$ 1,848 | \$ 89,281 | \$ 220,736 | \$ 196,093 | |
| Contract, professional fees | 46,699 | 7,138 | 3,507 | 459 | 11,104 | 57,803 | 56,491 | |
| Grants and allocations | 38,458 | 267 | 44 | - | 311 | 38,769 | 46,015 | |
| Supplies | 8,757 | 3,379 | 783 | 2,100 | 6,262 | 15,019 | 13,592 | |
| Telecommunications | 2,892 | 2,095 | 465 | 16 | 2,576 | 5,468 | 5,601 | |
| Postage and mailing service | 1,520 | 530 | 456 | 6,860 | 7,846 | 9,366 | 9,697 | |
| Occupancy | 2,137 | 6,534 | 239 | - | 6,773 | 8,910 | 8,263 | |
| Equipment rental and maintenance | 3,815 | 806 | 253 | - | 1,059 | 4,874 | 4,950 | |
| Printing and publication | 4,185 | 339 | 970 | 4,937 | 6,246 | 10,431 | 10,953 | |
| Travel | 12,809 | 3,356 | 2,207 | 35 | 5,598 | 18,407 | 15,168 | |
| Conferences and meetings | 4,227 | 2,087 | 377 | 13 | 2,477 | 6,704 | 4,308 | |
| Interest | 13,772 | - | - | - | - | 13,772 | 9,378 | |
| Depreciation and amortization | 4,549 | 245 | 3 | - | 248 | 4,797 | 4,017 | |
| Equipment | 2,418 | 275 | 73 | - | 348 | 2,766 | 2,393 | |
| Taxes and licenses | 572 | 375 | 56 | 3 | 434 | 1,006 | 1,564 | |
| Utilities, repairs, maintenance, and construction | 3,099 | 1,390 | 159 | - | 1,549 | 4,648 | 4,505 | |
| Insurance | 1,860 | 1,391 | 51 | - | 1,442 | 3,302 | 3,583 | |
| Real estate taxes | 6,247 | 527 | 19 | - | 546 | 6,793 | 4,663 | |
| Closing costs | 1,848 | 835 | 1 | - | 836 | 2,684 | 5,336 | |
| Contributed goods and services non-cash expense | 5,501 | 2,356 | 1,171 | - | 3,527 | 9,028 | 8,584 | |
| All other | 1,654 | 698 | 85 | 5 | 788 | 2,442 | 3,625 | |
| Subtotal | 298,474 | 86,311 | 46,664 | 16,276 | 149,251 | 447,725 | 418,779 | |
| Book value of conservation land and easements sold or donated to government and others | 233,562 | - | - | - | - | 233,562 | 190,862 | |
| Total | \$ 532,036 | \$ 86,311 | \$ 46,664 | \$ 16,276 | \$ 149,251 | \$ 681,287 | \$ 609,641 | |