

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

**Consolidated Financial Statements
and Additional Information**

December 31, 2004

(With Independent Auditors' Reports Thereon)

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Executive Council
The Elephant Sanctuary in Tennessee and Subsidiary
Hohenwald, Tennessee

We have audited the accompanying consolidated statement of financial position of The Elephant Sanctuary in Tennessee (a nonprofit organization) and Subsidiary as of December 31, 2004, and the related consolidated statements of activities, functional expenses, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Elephant Sanctuary in Tennessee and Subsidiary as of December 31, 2004, and the changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Lewis, Smith, Smiley & Associates, P.C.

June 10, 2005

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Statement of Financial Position
December 31, 2004

ASSETS

Current assets:	
Cash and cash equivalents	\$1,479,023
Investments	231,048
Accounts receivable	4,437
Inventory	30,068
Current installments of unconditional promises to give	656,813
Prepaid expenses	<u>8,355</u>
Total current assets	<u>2,409,744</u>
Land, buildings and equipment:	
Land and land improvements	2,681,754
Buildings	1,696,154
Equipment	213,358
Fencing	951,796
Vehicle	17,500
Construction in progress	<u>1,141,434</u>
	6,701,996
Less accumulated depreciation	<u>(806,808)</u>
Total land, buildings and equipment, net	<u>5,895,188</u>
Other assets:	
Unconditional promises to give, net of current installments	374,185
Cash restricted to long-term use	300,000
Loan costs, net of amortization	<u>23,959</u>
Total other assets	<u>698,144</u>
Total assets	<u>\$9,003,076</u>

LIABILITIES AND NET ASSETS

Current liabilities:	
Current installments of note payable	\$ 198,270
Accounts payable	64,137
Accrued expenses	<u>16,929</u>
Total current liabilities	279,336
Long-term liabilities:	
Note payable, less current installments	<u>2,061,435</u>
Total liabilities	<u>2,340,771</u>
Net assets:	
Unrestricted	5,421,397
Temporarily restricted	<u>1,240,908</u>
Total net assets	<u>6,662,305</u>
Total liabilities and net assets	<u>\$9,003,076</u>

See accompanying notes to financial statements.

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Statements of Activities
For the Year Ended December 31, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Public support and revenues:			
Public support:			
Membership dues and donations	\$2,253,831	2,644,476	4,898,307
In-kind revenues	252,868	-	252,868
Education	5,093	-	5,093
Total public support	<u>2,511,792</u>	<u>2,644,476</u>	<u>5,156,268</u>
Revenues:			
Merchandise	164,608	-	164,608
Investment and interest income	19,647	1,133	20,780
Gains on investments, net	-	40,627	40,627
Net assets released from restrictions	<u>2,148,568</u>	<u>(2,148,568)</u>	<u>-</u>
Total revenues	<u>2,332,823</u>	<u>(2,106,808)</u>	<u>226,015</u>
Total public support and revenues	<u>4,844,615</u>	<u>537,668</u>	<u>5,382,283</u>
Expenses:			
Program services	1,507,835	-	1,507,835
Management and general	113,237	-	113,237
Fund-raising	<u>87,060</u>	<u>-</u>	<u>87,060</u>
Total expenses	<u>1,708,132</u>	<u>-</u>	<u>1,708,132</u>
Increase in net assets	3,136,483	537,668	3,674,151
Net assets - beginning of year	<u>2,284,914</u>	<u>703,240</u>	<u>2,988,154</u>
Net assets - end of year	<u>\$5,421,397</u>	<u>1,240,908</u>	<u>6,662,305</u>

See accompanying notes to financial statements.

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Schedule of Functional Expenses - Program Services
For the Year Ended December 31, 2004

	Program Services					Total
	Shelter and Care	Research	Education	Management and General	Fund-raising	
Amortization	\$6,511	-	-	-	-	6,511
Asian elephant habitat program	2,000	-	-	-	-	2,000
Auto and truck expense	5,597	-	-	-	-	5,597
Bank charges	-	-	-	98	-	98
Computer software	16	16	30	62	63	187
Depreciation	185,680	4,886	4,886	5,340	593	201,385
Direct mail	-	-	255,945	-	28,440	284,385
Dues and subscriptions	-	-	-	380	-	380
Educational materials/newsletter	-	-	141,328	-	7,400	148,728
Elephant relocation	36,701	-	-	-	-	36,701
Feed and supplements	132,593	-	-	-	-	132,593
In-kind expenses	2,364	2,363	2,363	-	-	7,090
Insurance	40,701	1,071	1,071	9,724	1,348	53,915
Interest expense	118,438	-	-	-	-	118,438
Internship program	3,379	-	-	-	-	3,379
Merchandise	-	-	11,244	-	-	11,244
Miscellaneous	9,070	9,066	9,066	4,072	25,304	36,548
Office supplies	8,449	8,446	8,447	2,982	7,962	39,236
Payroll taxes	11,311	676	1,143	5,908	1,491	29,815
Permits and licenses	784	98	98	-	926	19,964
Postage and delivery	13,306	2,957	13,306	3,479	1,739	34,787
Professional fees	4,138	4,137	4,137	10,374	-	22,786
Repairs and maintenance	73,362	-	-	-	-	73,362
Salaries	134,896	8,064	13,623	69,052	11,312	236,947
Telephone and utilities	25,335	1,490	2,981	1,766	482	32,054
Veterinarian cost	58,134	-	-	-	-	58,134
Web camera services	24,426	24,426	73,280	-	-	122,132
Total functional expenses	\$897,191	67,696	542,948	113,237	87,060	1,708,132

See accompanying notes to financial statements.

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Statement of Cash Flows
For the Year Ended December 31, 2004

Cash flows from operating activities:	\$3,674,151
Increase in net assets	
Adjustments to reconcile increase in net assets to net cash provided by operating activities:	
Amortization	6,511
Depreciation	201,385
Gain on investments	(40,627)
(Increase) decrease in:	
Purchases of Inventory	(21,114)
Unconditional promises to give, net	(615,878)
Prepaid expenses	150
Increase (decrease) in:	
Accounts payable	(233,608)
Construction retainage payable	(52,404)
Accrued expenses	4,168
Net cash provided by operating activities	<u>2,922,734</u>
 Cash flows from investing activities:	
Additions of land, buildings and equipment	(988,095)
Sales of investments, net	6,304
Net cash used by investing activities	<u>(981,791)</u>
 Cash flows from financing activities:	
Proceeds from note payable	189,063
Loan closing cost paid	(390)
Cash restricted for long-term use	(150,000)
Principal payments on note payable	(1,127,600)
Net cash provided by financing activities	<u>(1,088,927)</u>
 Net increase in cash and cash equivalents	852,016
 Cash and cash equivalents - beginning of year	<u>627,007</u>
 Cash and cash equivalents - end of year	<u>\$1,479,023</u>
 Supplemental information:	
Cash paid for interest	<u>\$ 167,267</u>
Cash paid for income taxes	<u>\$ -</u>

See accompanying notes to financial statements.

THE ELEPHANT SANCTUARY IN TENNESSEE AND SUBSIDIARY

Notes to Financial Statements
December 31, 2004

Note (1) Summary of Significant Accounting Policies

(a) Nature of Activities

The Elephant Sanctuary in Tennessee is a nonprofit organization which was organized on December 30, 1994, primarily to provide food, shelter, and medical treatment to sick and needy captive elephants retired from zoos and circuses. Other goals related to the captive elephants include conducting noninvasive research, practicing progressive management and care techniques, and sharing knowledge through education, consultation and collaboration. Virtually all of the Organization's revenues and support for the year ended December 31, 2004, were from the general public, primarily from United States individuals or entities.

(b) Basis of Presentation

The consolidated financial statements include the accounts of The Elephant Sanctuary in Tennessee and its wholly owned subsidiary, Highland Lake Properties, Inc. All material intercompany transactions have been eliminated in consolidation. The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Organization and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Restrictions that are fulfilled in the same accounting period in which the contributions are received are reported in the statement of activities as unrestricted.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by the Organization. Generally, the donors of these assets permit the Organization to use all or part of the income earned and any related investments for general or specific purposes.

(c) Cash and Cash Equivalents

Cash and cash equivalents are those items that have an original maturity date of ninety days or less from the date of issuance. At December 31, 2004, money market funds are included as cash equivalents.

(d) Investments

Investments in marketable securities with readily determinable fair values and all investments in equity securities are reported at their fair values in the Statement of Position. Unrealized gains and losses and investment income are included in the change in net assets in the accompanying Statement of Activities as unrestricted revenues or expenses, unless specified by the donor.

THE ELEPHANT SANCTUARY IN TENNESSEE AND SUBSIDIARY

Notes to Financial Statements, Continued
December 31, 2004

Note (1) Summary of Significant Accounting Policies, Continued

(e) Inventory

Inventory is stated at the lower of cost (specific identification method) or market. Inventory primarily consists of general merchandise and educational material such as caps, artwork, publications, etc., promoting the Organization, costs of sales, including shipping and handling, are allocated to program and fund-raising expenses.

(f) Land Buildings and Equipment

Land, buildings and equipment are recorded at cost, or, if donated, at the estimated fair market value at the date of donation. It is the Organization's policy to capitalize purchases of equipment over \$500. Depreciation is provided utilizing the straight-line method over the estimated useful lives of the respective assets. Expenditures for repairs and maintenance are charged to expense as incurred.

(g) Functional Allocation of Expenses

The costs of providing program services and supporting services have been summarized on a functional basis in the Statement of Activities. Accordingly, certain costs have been allocated among the programs and supporting services benefitted.

(h) Income Taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (an organization other than a private foundation); therefore, no provision for federal income taxes is reflected in the accompany financial statements. There was no unrelated business income for the year ended December 31, 2004.

(i) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

(j) Fair Value of Financial Instruments

The fair value of the notes payable approximates the carrying amount and is estimated based on current rates offered to the Organization. The carrying values of assets and liabilities approximate their fair values due to the short maturities of these instruments.

(k) Unconditional Promises to Give

Contributions are recognized when the donor makes a promise to give to the Organization that is, in substance, unconditional. Unconditional promises to give are recorded as received at their net realizable value. Unconditional promises to give due in the next year are reflected as current assets. Unconditional promises to give due in subsequent years are reflected as long-term assets and are recorded at the present value of their net realizable value, using interest rates commensurate with the estimated risks involved applicable to the years of anticipated receipt.

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Notes to Financial Statements, Continued
December 31, 2004

Note (1) Summary of Significant Accounting Policies, Continued

(l) Compensated Absences

Employees of the Organization are entitled to paid vacation, paid sick days and personal days off, depending on job classification, length of service, and other factors. It is impracticable to estimate the amount of compensation for future absences, and, accordingly, no liability has been recorded in the accompanying financial statements. The Organization's policy is to recognize the cost of compensated absences when actually paid to employees.

(m) Joint Activity Costs

Joint activities are those which perform a fund-raising function and also have elements of program or management and general functional categories. The costs of these activities are presented in accordance with AICPA Statement of Position (SOP) 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund-Raising*. Accordingly, these costs are allocated entirely to fund-raising activities unless certain purpose, audience, and content criteria are met.

(n) Reclassifications

Reclassifications of certain prior year amounts have been made to conform with current year presentation.

Note (2) Investments

Investments at December 31, 2004 consist of the following:

Equity securities	\$ 72,255
Fixed income securities	15,045
Mutual funds	<u>94,997</u>
Subtotal	182,297
Annuity (matures June 2007)	33,585
Real estate investment trust	<u>15,166</u>
Total investments	<u>\$231,048</u>

The equity securities, fixed income securities, and mutual funds, which total \$182,297, are managed by a national brokerage securities firm and are protected by the Securities Investor Protection Corporation (SIPC) against certain losses of cash or securities held in such accounts if a member brokerage firm fails financially. Losses up to \$500,000, including \$100,000 for claims for cash, are covered; however, losses due to market value fluctuations are not protected. All of these investments are generally temporarily restricted to the care of two elephants. Maturities of the fixed income securities range from four to ten years.

The real estate investment trust (REIT) investment is also temporarily restricted to the care of an elephant. The annuity investment is unrestricted.

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Notes to Financial Statements, Continued
December 31, 2004

Note (2) Investments, Continued

The following schedule summarizes the investment income (return) for the year ended December 31, 2004:

Interest and dividends	\$20,780
Unrealized gain	38,554
Realized gain	<u>2,073</u>
	<u>\$61,407</u>

Note (3) Unconditional Promises to Give

The Organization has received unconditional promises to give which have been discounted to present value using rates ranging from seven percent (5%) to ten percent (10%).

The following are the estimated cash flows from unconditional promises to give at December 31, 2004:

Due within one year	\$ <u>656,813</u>
Due in one to five years	320,296
Due in more than five years	<u>200,000</u>
	520,296
Less discounts to present value	<u>(146,111)</u>
Net long-term portion	<u>374,185</u>
Total unconditional promises to give	<u>\$1,030,998</u>

Note (4) Assets Related to Highland Lake Properties, Inc.

On October 9, 2002, the Organization purchased 100% of the outstanding common stock of Highland Lake Properties, Inc. (HLPI), a real estate developer, at a cost of \$1,126,236 for the purpose of acquiring its only significant asset, 701 acres of real estate adjacent to other real property owned by the Organization. The real estate obtained by the acquisition of HLPI is used as part of the Organization's nature habitat refuge for elephants.

For its investment in HLPI, the Organization uses the consolidated method of accounting. Under this method, the assets HLPI were reported as a part of the cost of land, buildings and equipment as follows:

Land and land improvements	\$ 710,318
Buildings	125,000
Fencing	<u>290,918</u>
	<u>\$1,126,236</u>

At December 31, 2004, the remaining net book value of the HLPI assets was \$1,042,952, and related appreciation for 2004 was \$41,642.

**THE ELEPHANT SANCTUARY IN
TENNESSEE AND SUBSIDIARY**

Notes to Financial Statements, Continued
December 31, 2004

Note (4) Investment in Highland Lake Properties, Inc., Continued

The Organization is seeking to have HLPI qualify as a nonprofit corporation exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code, on the basis that its assets are being used for an exempt purpose. If the Organization's effort is unsuccessful, however, approximately \$585,000 of the purchase price of HLPI may be subject to corporate income taxes upon the sale or distribution of HLPI's assets. No accrual for income taxes has been reflected in the accompanying financial statements because of management's intention to use the assets for the Organization's exempt purpose.

Note (5) Note Payable

As of December 31, 2004, the note payable consist of the following:

Installment note payable to Bank of America in monthly installments of \$26,250, including interest at 4.47% through maturity in September 2008, secured by deeds of trust on approximately 2,000 acres of land, deposit accounts at Bank of America, unconditional promises to give, life insurance proceeds on the two co-founders who are also executive management members, and other unencumbered assets.	\$2,259,705
Less current installments	<u>(198,270)</u>
	<u>\$2,061,435</u>

A summary of future maturities of notes payable as of December 31, 2004 is as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2005	\$ 198,270
2006	209,203
2007	220,740
2008	232,913
2009	245,758
Thereafter	<u>1,152,821</u>
	<u>\$2,259,705</u>

The note payable to Bank of America includes certain restrictive covenants and other requirements, primarily as follows:

- 1) Minimum reserve account balance of at least \$150,000 through June 29, 2004, increasing to \$300,000 as of June 30, 2004 and at all times thereafter;
- 2) Life insurance coverage of \$2,000,000 on the Executive Director and \$1,000,000 the Vice President and Facilities Director;
- 3) Maintenance of certain financial ratios; and
- 4) Compliance with other non-financial requirements.

THE ELEPHANT SANCTUARY IN TENNESSEE AND SUBSIDIARY

Notes to Financial Statements, Continued
December 31, 2004

Note (5) Note Payable, Continued

As of December 31, 2004, management believes that it has complied with the note payable covenants as required by the bank. The proceeds of this note were primarily used to acquire land and land improvements; accordingly, the related interest expense, net of \$50,000 capitalized as cost of construction in progress (property), has been reported as program expense (shelter and care).

Note (6) Donated Services and Materials

The Organization estimates that it received over 5,500 man-hours of donated services, in 2004 from unpaid volunteers who assist in facilities maintenance, administrative duties, and fund raising. No amounts have been recognized in the Statement of Activities because the criteria for recognition under current accounting standards have not been satisfied.

Donated materials or equipment, when received, are reflected as contributions in the accompanying financial statements at their estimated fair market values. The estimated amount of donated materials ("in-kind revenues") for 2004 was \$150,000, including \$96,000 in web camera services, 30,000 in food, and \$20,000 for public service announcements from a local radio station. In addition, the value of tools and equipment donated in 2004 was \$19,858.

Note (7) Fund-raising Activities

During 2003, the Organization initiated a capital campaign with a goal to raise \$15,000,000 over five years for the purposes of expanding and improving its physical facilities and educational programs, reducing its long-term debt, hiring additional trained keepers, and establishing endowments for the care of its elephants. The campaign raised approximately \$770,000 in 2003, and \$107,000 in 2004. Unpaid pledges receivable at December 31, 2004 related to the Capital Campaign were approximately \$227,000.

Approximately \$160,000 revenue was received in 2004 related to a 2003 direct mail campaign conducted by a professional fund-raiser; all costs of this campaign were recorded in 2003 as fund-raising expenses.

In 2004, the Organization also initiated a fund-raising campaign for the purpose of building a new elephant barn. Approximately \$1,900,000 was raised in 2004 for this purpose. Subsequently an opportunity arose to receive custody of 16 elephants owned by an Illinois circus animal trainer, the "Hawthorn Herd", because a federal agency had concluded they were being mistreated. Several of the herd were received by the Organization in 2004. If custody of the remainder of the herd is obtained, the Organization currently plans to use the new elephant barn to care for these elephants.

Note (8) Commitments and Contingencies

During the year ended December 31, 2003, the Organization made a non-binding pledge of up to a total of \$10,000 to the Asian Elephant Habitat Program. This commitment is to support park rangers hired to protect the Asian elephants from poaching in northern India. In 2003, a payment of \$2,500 and in 2004 a payment of \$2,000 was made for this pledge. No liability has been recorded for the remaining pledge due to its discretionary nature.

THE ELEPHANT SANCTUARY IN TENNESSEE AND SUBSIDIARY

Notes to Financial Statements, Continued
December 31, 2004

Note (9) Concentration of Credit Risk

The Organization maintains its cash in bank deposit accounts at high credit quality financial institutions located in Tennessee. The balances, at times, may exceed federally insured limits. The Organization has not experienced any losses in such accounts. The Organization believes it is not exposed to any significant credit risk on cash and cash equivalents.

Note (10) Concentration of Public Support

Unconditional promises to give include four promises totaling \$491,046 with a discounted present value of \$468,292, or 47.1% of the total receivable as of December 31, 2004. Also, seven contributors gave significant public support revenue in 2004 as follows:

	<u>Capital Campaign</u>	<u>Unrestricted</u>	<u>Total</u>
Foundations (2)	\$157,000	250,000	407,000
Charitable trust (1)	-	510,000	510,000
Web camera services provider (1)	-	96,000	96,000
Non-profit organization (1)	-	50,000	50,000
	<u>\$157,000</u>	<u>906,000</u>	<u>1,063,000</u>
Percent of total public support	<u>3.0%</u>	<u>17.6%</u>	<u>20.6%</u>

Note (11) Temporarily Restricted Net Assets

At December 31, 2004, the temporarily restricted net assets were recorded as follows:

	<u>Care of Specific Elephants</u>	<u>Facility Expansion and Related Custody of the "Hawthorn Herd"</u>	<u>Passage of Time</u>	<u>Total</u>
Cash and cash equivalents	\$ 11,446	-	-	11,446
Investments	198,464	-	-	198,464
Unconditional promises to give	<u>90,000</u>	<u>423,673</u>	<u>517,325</u>	<u>1,030,998</u>
Total	<u>\$299,910</u>	<u>423,673</u>	<u>517,325</u>	<u>1,240,908</u>

Note (12) Joint Costs

For the year ended December 31, 2004, the joint costs were reported as follows:

	<u>Program Education</u>	<u>Fund- raising</u>	<u>Total</u>
Direct mailing (re Hawthorn Herd Care and Shelter)	\$255,945	28,440	284,385
Educational Material (Newsletter)	<u>66,674</u>	<u>7,400</u>	<u>74,074</u>
	<u>\$322,619</u>	<u>35,840</u>	<u>358,459</u>

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INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

The Board of Directors and Executive Council
The Elephant Sanctuary in Tennessee and Subsidiary
Hohenwald, Tennessee

Our report on our audit of the basic consolidated financial statements of The Elephant Sanctuary in Tennessee and Subsidiary for 2004 appears on page 1. We conducted our audit in accordance with auditing standards generally accepted in the United States of America for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The chart of functional expenses is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Lewis, Smith, Smiley & Associates, P.C.

June 10, 2005

THE ELEPHANT SANCTUARY IN TENNESSEE AND SUBSIDIARY

Allocation of Functional Expenses
Year Ended December 31, 2004

(See Independent Auditor's Report on Additional Information)

