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William Marsh Rice University

Consolidated Financial Statements
June 30, 2006 and 2005

William Marsh Rice University
Index
June 30, 2006 and 2005

PricewaterhouseCoopers LLP
1201 Louisiana
Suite 2900
Houston TX 77002-5678
Telephone (713) 356 4000
Facsimile (713) 356 4717

Report of Independent Auditors

To the Board of Trustees of
William Marsh Rice University

In our opinion, the accompanying consolidated statement of financial position and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of William Marsh Rice University (the "University") as of June 30, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's 2005 financial statements, and in our report dated October 11, 2005, we expressed an unqualified opinion on those financial statements. We conducted our audit 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 audit provides a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, in 2006, the University changed its method of accounting for asset retirement obligations as a result of adopting the provisions of FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*.

PricewaterhouseCoopers LLP

October 27, 2006

William Marsh Rice University
Consolidated Statements of Financial Position
As of June 30, 2006 and 2005

(in thousands of dollars)	2006	2005
Assets		
Cash and cash equivalents	$ 12,305	$ 3,466
Accounts receivable and other assets	43,629	39,386
Pledges receivable, net	94,039	60,650
Investments	4,282,956	3,898,505
Property and equipment, net	588,889	571,981
Total assets	5,021,818	4,573,988
Liabilities		
Accounts payable and other liabilities	50,217	41,867
Notes and bonds payable	222,568	205,400
Actuarial liability for annuities payable	101,884	94,754
Refundable advances and amounts held in trust	6,906	7,010
Total liabilities	381,575	349,031
Net assets		
Unrestricted net assets	3,532,627	3,223,663
Temporarily restricted net assets	273,708	223,372
Permanently restricted net assets	833,908	777,922
Total net assets	4,640,243	4,224,957
Total liabilities and net assets	$ 5,021,818	$ 4,573,988

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

William Marsh Rice University
Consolidated Statement of Activities
For the Year Ended June 30, 2006 with Summarized Financial Information for the Year Ended June 30, 2005

	2006				2005
(in thousands of dollars)	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Operating revenues					
Investment returns distributed for operations	$ 164,900	$ 10,706	$ -	$ 175,606	$ 167,494
Student tuition and fees, net	71,354	-	-	71,354	64,312
Grants and contracts	73,355	8	-	73,363	73,125
Gifts and pledges	21,456	20,257	-	41,713	22,793
Gifts and trusts released from restrictions	11,664	(11,664)	-	-	-
Auxiliary enterprises	24,653	-	-	24,653	28,539
Other revenues	13,437	-	-	13,437	7,215
Total operating revenues	380,819	19,307	-	400,126	363,478
Operating expenses					
Educational and general activities	337,863	-	-	337,863	298,252
Auxiliary enterprise expenditures	33,475	-	-	33,475	52,035
Total operating expenses	371,338	-	-	371,338	350,287
Net operating income	9,481	19,307	-	28,788	13,191
Nonoperating changes					
Gifts and pledges for property and endowment	-	7,148	49,842	56,990	19,319
Investment returns, reduced by operating distribution above	304,374	22,601	21,792	348,767	289,481
Releases and other changes in restrictions on net assets	6,971	3,612	(10,583)	-	-
Change in liabilities due under life-income agreements	-	(2,332)	(5,184)	(7,516)	(7,688)
Other nonoperating changes	(4,855)	-	119	(4,736)	1,495
Net nonoperating changes	306,490	31,029	55,986	393,505	302,607
Change in net assets before cumulative effect of change in accounting principle	315,971	50,336	55,986	422,293	315,798
Cumulative effect of change in accounting principle	(7,007)	-	-	(7,007)	-
Net increase in net assets	308,964	50,336	55,986	415,286	315,798
Net assets					
Beginning of year	3,223,663	223,372	777,922	4,224,957	3,909,159
End of year	$3,532,627	$ 273,708	$ 833,908	$4,640,243	$4,224,957

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

William Marsh Rice University
Consolidated Statements of Cash Flows
For the Years Ended June 30, 2006 and 2005

(in thousands of dollars)	2006	2005
Cash flows from operating activities		
Increase in net assets	$ 415,286	$ 315,798
Adjustments to reconcile increase in net assets to net cash used in operating activities		
Depreciation	38,754	36,179
Loss on disposal of property and equipment	175	1,577
Net realized and unrealized investment gains	(455,602)	(393,025)
Equipment gifts in kind	(1,005)	(292)
Contributions restricted for long term purposes	(67,213)	(30,782)
Actuarial decrease in life-income agreements	7,516	7,688
Change in fair value of interest rate swap	(4,451)	-
Cumulative effect of change in accounting principle	7,007	-
Change in		
Accounts receivable and other assets	(439)	(2,330)
Pledges receivable for current purposes	(18,744)	1,578
Accounts payable and accrued liabilities	1,870	(455)
Net cash used in operating activities	(76,846)	(64,064)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	985,014	1,420,410
Purchases of investments	(881,540)	(1,337,814)
Purchases of property and equipment	(53,347)	(29,340)
Net cash provided by investing activities	50,127	53,256
Cash flows from financing activities		
Contributions restricted for long term purposes		
Endowment	11,029	11,368
Trusts and other	4,462	2,269
Property	3,003	2,682
Tax-exempt debt activity		
Proceeds from issuance of tax-exempt debt	147,180	-
Advance refunding of tax-exempt debt	(120,000)	-
Commercial paper activity		
Proceeds from issuance of commercial paper	11,000	-
Payment of outstanding commercial paper	(21,500)	(4,600)
Taxable Line of Credit	488	-
Net change in amounts held for others	(104)	(141)
Net cash provided by financing activities	35,558	11,578
Net increase in cash and cash equivalents	8,839	770
Cash and cash equivalents		
Beginning of year	3,466	2,696
End of year	$ 12,305	$ 3,466

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

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

William Marsh Rice University (the University) is a Texas not-for-profit corporation that operates a private research university in Houston, Texas. The University is exempt from federal income tax to the extent provided under Section 501(c)(3) of the Internal Revenue Code. The consolidated financial statements of the University as of June 30, 2006, and for the year then ended, have been prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, the accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and all wholly-owned subsidiaries. All material transactions between the University and its subsidiaries have been eliminated.

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the organization's financial statements for the year ended June 30, 2005, from which the summarized information was derived.

Net Asset Categories

Standards for external financial reporting by not-for-profit organizations require that resources be classified for reporting purposes into three net asset categories according to donor-imposed restrictions. A description of the University's three net asset categories follows:

(a) Unrestricted net assets and related activity include the following:

(1) All revenues traditionally classified as unrestricted resources of the University, including tuition and fees, unrestricted gifts and income on unrestricted endowments, recovery of facility and administrative costs from grants and contracts, and auxiliary enterprise revenues.

(2) Revenues related to sponsored research agreements, which are considered exchange transactions.

(3) Gifts and endowment income with donor-imposed restrictions, if the restriction is anticipated to be met within the current fiscal year of the University.

(4) Investments in plant assets stated at cost or fair value at the date of gift, less accumulated depreciation computed on a straight-line basis over the estimated useful lives of the assets. Equipment is removed from the records at the time of disposal.

(5) All expenses of the University.

(b) Temporarily restricted net assets include income from restricted endowments and gifts for which donor-imposed restrictions have not been met. The category also includes pledges receivable and life-income gifts for which the ultimate purpose of the proceeds is not permanently restricted.

(c) Permanently restricted net assets include gifts, trusts and pledges on which donors have imposed the restriction that the corpus be maintained in perpetuity and only the investment return be made available for program operations. Those gifts specified by donors to provide loans to students are also included in permanently restricted net assets.

Expirations of temporary restrictions on net assets are reported as reclassifications between the applicable classes of net assets. Donor required matching from university funds and subsequent donor release or clarification of restrictions are also included in this category.

Contributions
Contributions, including unconditional promises to give and irrevocable trusts held by others under which the University is the beneficiary, are recognized as revenues in the period received or promised. Contributions restricted for the acquisition of land, buildings and equipment are reported as temporarily restricted revenues. These contributions are reclassified to unrestricted net assets when the assets are placed in service. Promises to give that are subject to donor-imposed stipulations that the corpus be maintained in perpetuity are recognized as increases in permanently restricted net assets.

Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are reported at their estimated fair value at the date of gift. Contributions scheduled to be received after one year are discounted at a rate commensurate with the risk. Amortization of the discount is recorded as contribution revenue.

Operating and Nonoperating Activities
The consolidated statement of activities reports the change in net assets from the University's operating and nonoperating activities. Operating activities exclude (a) gifts and pledges for property and endowment (including annuity and life-income trusts), (b) release from restrictions of contributions restricted for the acquisition of property and equipment, (c) donor release of restrictions from permanently restricted net assets, (d) endowment return net of the University's operating needs as defined by University spending policy (Note 4) and (e) actuarial adjustments of annuities payable.

Cash and Cash Equivalents
The University considers all highly liquid financial instruments with an original maturity of 90 days or less to be cash and cash equivalents, except those amounts assigned to its investment managers and unspent commercial paper proceeds, which are classified as investments.

Investments
Investments are made within guidelines authorized by the University's Board of Trustees. Investments are initially recorded at cost at date of acquisition or fair value at date of donation in the case of gifts. Ownership of marketable securities is recognized as of the trade date. Marketable securities transactions that have not settled are recognized as accounts receivable or accounts payable until the settlement date. Endowment return is calculated net of investment management expenses.

Investments are stated at fair value. The estimated fair value of investments is based on quoted market prices, except for alternative investments for which quoted market prices are not available.

The estimated fair value of certain alternative investments, such as private equity and other limited partnership interests, is based on valuations provided by the general partners or partnership valuation committees. Such valuations consider variables such as financial performance of investments, recent sale prices of similar investments and other pertinent information. The University believes the carrying amount of these investments is a reasonable estimate of fair value. Because alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. These differences could be material.

The fair value of real estate, timber, oil and gas and other investments is estimated by professional appraisers or university management.

The terms of certain gifts of real property made by the founder of the University provided that all returns realized from these properties were to be invested to generate income to be used for University purposes. Changes in the market value of these specific properties are recorded as permanently restricted as required by the donor.

Property and Equipment
Educational property is stated at cost for purchased assets and fair market value at the date of donation in the case of gifts. The University depreciates its educational property assets (excluding works of art) using the straight-line method over their estimated useful lives. Repairs and maintenance of property and equipment are expensed as incurred.

Life-Income Agreements and Agency Arrangements
Life-income agreements include charitable remainder trusts and gift annuities. Charitable remainder trusts hold donated assets for which the University's subsidiary acts as trustee and periodically pays specified amounts to the designated beneficiaries. Generally, beneficiary payments are a fixed amount for annuity trusts and a fixed percentage of the fair market value of the trust assets or based on income earned for other charitable remainder trusts. At a date specified in each gift instrument, usually the beneficiary's date of death, ownership of the trust assets will transfer to the University and the beneficiary payments will cease. The University also enters into gift annuity agreements, which require that the University take ownership of the assets at the date of gift with an obligation to periodically pay specified amounts to designated beneficiaries for their lifetimes. Assets held in life-income trusts and those assets associated with gift annuities are included in investments. Contribution revenues are recognized at the date the trusts or gift annuities are established. Liabilities are recorded at the same time in accordance with actuarial tables established by the Internal Revenue Service and discounted according to the risk-free rate at the time of the gift. The liability represents the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted annually for changes in the value of the assets and actuarial changes, which impact the estimates of future payments.

The University has also received certain agency funds for which the University serves as custodian. Agency funds are recorded as investments with a corresponding liability (amounts held in trust for others) in the accompanying consolidated financial statements.

Asset Retirement Obligations

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47 "Accounting for Conditional Asset Retirement Obligations" (FIN 47). FIN 47 was issued to clarify Statement of Financial Accounting Standard No. 143 and requires the University to recognize asset retirement obligations (AROs) that are conditional on a future event, such as the legal obligation to safely dispose of asbestos when a building is remodeled or demolished. Upon adoption of FIN 47, the most significant conditional AROs identified by the University involved asbestos abatement and disposal. Asbestos abatement and disposal are appropriately managed by the University in accordance with current laws and regulations.

The ability to reasonably estimate conditional AROs was a matter of management judgment, based upon management's ability to estimate when these costs might be incurred (a settlement date or range of settlement dates), a method or potential method of settlement and probabilities associated with the potential dates and methods of settlement of it's conditional AROs. In determining whether the conditional AROs could be reasonably estimated, management considered past practices, industry practices, management's intent and the estimated economic lives of assets. The management of the University determined that sufficient information was available to reasonably estimate the fair value of known retirement obligations.

The University was required to measure conditional AROs at fair value using the methodology prescribed by FIN 47. The transition provisions of FIN 47 required the University to apply this measurement back to the historical periods in which the conditional AROs were incurred, resulting in a re-measurement of these obligations at the latter of the date that the related assets were placed into service or acquired or the date that the applicable law or environmental regulation became effective. The fair values of the conditional AROs were then estimated using a probability-weighted, discounted cash flow model with multiple scenarios, if applicable. The present value of future estimated cash flows was calculated using credit-adjusted, risk-free rates applicable to the University in order to determine the fair value of the conditional AROs at the time of adoption of FIN 47.

Use of Estimates

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

2. Accounts Receivable and Other Assets

Accounts receivable and other assets of the University at June 30, 2006 and 2005, were as follows:

(in thousands of dollars)	2006	2005
Unsettled investment sales	$ 3,224	$ 3,871
Investment income receivable	4,891	4,336
Student loans receivable, net of allowance of $1,068 in 2006 and $940 in 2005	8,254	8,113
Interest rate swap agreements	4,451	-
Other accounts receivable	5,733	4,245
Inventory, prepaid expenses and other assets	3,765	5,773
Sponsored programs receivable	13,311	13,048
Total accounts receivable and other assets	$ 43,629	$ 39,386

3. Pledges

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and revenue of the appropriate net asset category. Multi-year pledges are recorded after discounting to the present value of expected future cash flows. Unconditional promises to give at June 30, 2006 and 2005, are expected to be realized in the following periods:

(in thousands of dollars)	2006	2005
In one year or less	$ 26,711	$ 20,248
Between one year and five years	55,542	32,899
More than five years	48,797	15,141
Less: Discount to net present value	(31,769)	(5,205)
Less: Allowance for uncollectible pledges	(5,242)	(2,433)
	$ 94,039	$ 60,650

Pledges receivable at June 30, 2006 and 2005, had the following restrictions:

(in thousands of dollars)	2006	2005
Permanently invested	$ 60,573	$ 17,543
Buildings	13,957	16,005
Support of University programs and activities	56,520	34,740
Less: Discount to net present value	(31,769)	(5,205)
Less: Allowance for uncollectible pledges	(5,242)	(2,433)
	$ 94,039	$ 60,650

A discount rate of 5 percent was used to discount pledges made on or after July 1, 2005, a discount rate of 3 percent was used to discount pledges made between July 1, 2001, and June 30, 2005, and a discount rate of 6 percent was used to discount all pledges made prior to July 1, 2001. A reserve rate of 4 percent was used for allowance for uncollectible pledges. The reserve rate is reviewed periodically to ensure adequate provision for uncollectible amounts.

4. Investments

Investments at June 30, 2006 and 2005, were as follows:

(in thousands of dollars)	2006	2005
Fixed income securities	$ 385,879	$ 559,306
Equity securities	2,238,574	1,976,859
Limited partnerships	1,334,395	1,096,969
Other investments	324,108	265,371
	$ 4,282,956	$ 3,898,505

The table above includes annuity and life income fund assets of $156,801,000 and $143,871,000 as of June 30, 2006 and 2005, respectively.

The following table summarizes investment income and net gain for the years ended June 30, 2006 and 2005, by net asset classification:

	2006				2005
(in thousands of dollars)	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Investment earnings	$ 59,364	$ 2,157	$ 7,250	$ 68,771	$ 63,950
Net gains on investments	409,910	31,150	14,542	455,602	393,025
Total investment gains and earnings	469,274	33,307	21,792	524,373	456,975
Less: Investment returns distributed for operations	(164,900)	(10,706)	-	(175,606)	(167,494)
Investment returns, reduced by operating distribution	$ 304,374	$ 22,601	$ 21,792	$348,767	$ 289,481

Investment earnings are presented net of internal and external investment management expenses of $42,580,000 and $25,716,000 in fiscal 2006 and 2005, respectively.

The University has adopted an endowment earnings distribution policy based on total investment returns, as permitted by the Texas Uniform Management of Institutional Funds Act. Under this policy, the Board of Trustees approves an endowment earnings distribution, which is based on the earnings distribution of the preceding year and the market value of endowment assets. Sources of this distribution for each restricted endowment, in the order utilized, are (a) earned income as traditionally defined (interest, dividends and rents), (b) reinvested earned income from prior years and (c) capital gains where not prohibited by the gift document. Sources of this distribution for the unrestricted general endowment, in the order utilized, are (a) earned income as traditionally defined (interest, dividends and rents) and (b) capital gains. Endowment return, net of operating distributions, is reinvested under the University's endowment earnings distribution policy in the investment pool as net assets functioning as endowment.

5. Educational Plant

Property and equipment of educational plant at June 30, 2006 and 2005, were as follows:

(in thousands of dollars)	Estimated Useful Lives (Years)	2006	2005
Land	–	$ 18,105	$ 17,597
Buildings and improvements	20 – 50	584,771	571,504
Equipment, furniture and library books	2 – 20	284,111	258,319
Construction in progress	–	21,662	6,149
Less: Accumulated depreciation	–	(319,760)	(281,588)
		$ 588,889	$ 571,981

6. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities of the University at June 30, 2006 and 2005, were as follows:

(in thousands of dollars)	2006	2005
Unsettled investment purchases	$ 660	$ 2,524
Vendor accounts payable	13,769	11,384
Accrued payroll and employee benefits	12,723	15,458
Sponsored agreements unearned income	9,931	8,341
Conditional asset retirement obligations	8,346	-
Other accrued liabilities	4,788	4,160
Total accounts payable and accrued liabilities	$ 50,217	$ 41,867

7. Notes and Bonds Payable

Notes and bonds payable of the University at June 30, 2006 and 2005, were as follows:

(in thousands of dollars)	2006	2005
City of Houston Higher Education Finance Corporation (CHHEFC)		
Tax-exempt revenue refunding bonds, Series 2006A & 2006B, maturing 2023 through 2029, with a floating average rate of interest at June 30, 2006, of 3.94% per annum payable monthly	$ 147,180	$ -
Tax-exempt revenue bonds, Series 1999A, maturing 2023 through 2029, with fixed interest at 5.375% per annum payable semiannually	-	120,000
Tax-exempt commercial paper notes, Series A, with interest ranging from 3.33% to 3.75% at June 30, 2006 (2.44% to 2.67% at June 30, 2005) per annum payable upon maturity	74,900	85,400
Taxable line of credit from commercial bank with interest payable at the end of each interest period at LIBOR plus .15%	488	-
	$ 222,568	$ 205,400

The University incurred interest expense of approximately $8,832,000 and $7,936,000 in 2006 and 2005, respectively, and paid interest expense of approximately $8,771,000 in 2006 and $8,002,000 in 2005. Interest expense of $8,732,000 and $7,915,000 was charged to operations in 2006 and 2005, respectively.

Tax-Exempt Revenue Bonds

In March 2006, the University issued Series 2006 A & B revenue refunding bonds in the amount of $147,180,000. Proceeds from these bonds were used to advance refund the Series 1999A obligation by irrevocably placing assets with a trustee to pay principal and interest on the obligations as they become due, and to current refund $20 million of the commercial paper program. An accounting loss of $9 million for the refunding was included as a nonoperating item for fiscal 2006 in the Consolidated Statements of Activities. Series 2006 A & B are floating rate bonds with an average annual interest rate of 3.94% at June 30, 2006. Interest is paid monthly. The bonds mature between November 15, 2023 and November 15, 2029. No collateral is pledged on these bonds.

The estimated fair value of the CHHEFC Series 2006 A & B bonds is equal to the face value at June 30, 2006.

Effective March 29, 2006, the University entered into interest rate swap agreements with a notional amount totaling $147,180,000. The University receives amounts based on 67% of the three-month London Interbank Offered Rate (LIBOR) and makes payments based on a fixed rate of 3.868%. The term of the swaps match the term of the Series 2006 A & B bonds. The University has the option to terminate the swaps starting in 2016.

The fair value of the interest rate swap agreements is the estimated amount that the University would pay or receive to terminate these contracts as of the report date. The estimated fair value of these swap arrangements was $4,451,000 as of June 30, 2006. This amount is included in the Consolidated Statement of Financial Position as an asset and in other nonoperating income on the Consolidated Statement of Activities.

Commercial Paper Notes
The University has a tax-exempt commercial paper credit facility that provides for borrowings in the form of individual notes up to an aggregate of $100,000,000. The notes bear a fixed rate of interest, established on the borrowing date, over their individual terms. The term of the notes will not exceed 270 days. The outstanding balance under the facility was $74,900,000 and $85,400,000 with an average interest rate of 3.62% and 2.57% and an average maturity of 74 days and 57 days as of June 30, 2006 and 2005, respectively.

The estimated fair value of the Series A Notes is equal to the face value at June 30, 2006.

Taxable Line of Credit
On February 24, 2006, the University signed a taxable line of credit with a limit of $600,000 from a commercial bank. The interest on the line of credit is payable at the end of each interest period with a rate equal to the LIBOR rate for that period plus 0.15%. In August, the University signed an agreement to replace this line of credit with a new line of credit in the amount of $6,000,000; other terms remain unchanged.

8. Net Assets

The University's unrestricted, temporarily restricted and permanently restricted net assets for the years ended June 30, 2006 and 2005 are summarized as follows:

	2006				2005
(in thousands of dollars)	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Internally designated for specific programs or ongoing activities	$ 85,978	$ -	$ -	$ 85,978	$ 77,827
Designated or restricted by donor, including pledges	48,379	78,792	-	127,171	108,906
Net investment in plant	348,511	1,617	-	350,128	365,127
Endowment and designated for long-term investment, including pledges	3,042,781	176,889	802,424	4,022,094	3,627,054
Life-income trusts	-	16,410	28,959	45,369	41,813
Loans	6,978	-	2,525	9,503	4,230
	$3,532,627	$ 273,708	$ 833,908	$4,640,243	$4,224,957

The Board of Trustees has designated certain unrestricted and temporarily restricted net assets for long-term investment. Most net assets designated for long-term investment and endowment assets participate in one common investment pool of marketable securities (Note 4).

9. Student Financial Aid

Gross student tuition and fees of $111,412,000 and $100,138,000 in 2006 and 2005, respectively, are presented in the consolidated financial statements net of scholarship and fellowship awards of $40,058,000 and $35,826,000, respectively. Auxiliary enterprises revenue was reduced by scholarship awards applied to room and board charges of $1,866,000 and $1,523,000 in 2006 and 2005, respectively.

10. Functional Expenses

Educational and general expenses of the University by major functional category for the year ended June 30, 2006 and 2005, were as follows:

(in thousands of dollars)	2006	2005
Instruction and department research	$ 168,359	$ 157,342
Sponsored research	60,503	58,802
Library	23,406	21,572
Scholarships and fellowships	11,178	8,764
Student services	32,813	13,989
General administration	23,575	22,088
Institutional development and other activities	18,029	15,695
Total educational and general	$ 337,863	$ 298,252

The above table includes depreciation expense of $21,131,000 and $18,201,000 and operations and maintenance expense of $30,159,000 and $27,550,000 for the years ended June 30, 2006 and 2005, respectively, which were allocated to the major functional categories based on space usage. Depreciation of library books of $7,103,000 and $6,665,000 was recognized as library expense in 2006 and 2005, respectively. In addition, depreciation expense of $10,520,000 and $11,313,000 was allocated to auxiliary enterprises in 2006 and 2005, respectively.

Beginning in fiscal 2006, the student athletics event fee was eliminated and consolidated into tuition. In addition, the University determined that Intercollegiate Athletics should be treated as a student service activity rather than as an auxiliary enterprise. Had this change been effective for fiscal 2005, functional expenses for the fiscal year would have been:

(in thousands of dollars)	2006	2005 (Pro Forma)
Instruction and department research	$ 168,359	$ 157,342
Sponsored research	60,503	58,802
Library	23,406	21,572
Scholarships and fellowships	11,178	8,764
Student services	32,813	30,552
General administration	23,575	22,088
Institutional development and other activities	18,029	15,695
Total educational and general	$ 337,863	$ 314,815

The total amount moved from auxiliary enterprise expenses to student services in fiscal 2005 would have been $16,563,000, including depreciation on athletics facilities of $1,506,000. In addition, auxiliary revenues of $3,115,000 would have been reported as investment returns distributed for operations of $155,000 and other revenues of $2,960,000 in the Consolidated Statement of Activities.

11. Related Party Transactions

Members of the University's Board of Trustees and senior management may, from time to time, be associated, either directly or though interlocking board memberships, with entities doing business with the University. The University employs a conflict of interest policy that requires any such associations to be disclosed in writing on an annual basis. When such associations exist, measures are taken to mitigate any actual or perceived conflict, including recusal of the board member from any decisions involving the entity doing business with the University. The transactions with entities associated with trustees or senior management are not considered to be significant and may include investment management, common membership in investment partnerships or other investment vehicles or the purchase of goods or services.

12. Retirement Plans

Substantially all employees are eligible to participate in a defined contribution retirement plan, which is administered by an outside agency. The plan operates in accordance with Section 401(a) of the Internal Revenue Code. All University contributions are made to this plan. In addition, employees may elect to participate in plans created under Section 403(b) of the Internal Revenue Code. The contributions of the University and its employees are applied to annuity contracts. The University's contributions to the plan of $13,863,000 and $13,265,000 were recorded as expenses in the appropriate functional categories in 2006 and 2005, respectively.

13. Commitments and Contingencies

A number of suits and claims are pending against the University. While final outcomes cannot be determined at this time, management believes that uninsured liability, if any, resulting from these suits and claims will not have a material adverse effect on the University's financial position.

The University receives funding from federal government agencies for research conducted under government grants and contracts. The grants and contracts provide for reimbursement of direct and indirect costs. Indirect costs are reimbursed under a negotiated rate agreement with the federal government. For 2005 and earlier years, the negotiated rate was predetermined. For fiscal 2006 and 2007, recovery is based on a provisional rate that equals the previous rate. The costs recovered by the University in support of sponsored research are subject to audit and adjustment.

In connection with its private equity investment program (see Note 4), the University is obligated under certain limited partnership agreements to advance additional funding up to specified levels upon the request of the general partner. At June 30, 2006 and 2005, the University had unfunded commitments of $803,621,000 and $520,796,000, respectively, which are expected to be called primarily over the next five to seven years.

Additionally, the University was committed under contracts at June 30, 2006 and 2005, for capital construction and improvements and major maintenance of approximately $31,029,000 and $7,689,000, respectively, to be financed primarily from gifts and net assets designated for long-term investment, and from debt to the extent other resources are not available. Other commitments of $4,756,000 and $3,321,000 were also outstanding at June 30, 2006 and 2005, respectively.

14. Cumulative Effect of a Change in Accounting Principle

As a result of adopting FIN 47, the University recognized the following amounts within its financial statements: (1) a liability for the estimated fair value of existing conditional AROs as of June 30, 2005; (2) an asset retirement cost (ARC) capitalized as an increase to the carrying amount of the associated long-lived assets and (3) cumulative depreciation on the ARC (Note 1). The University recorded asset retirement obligations totaling $8,025,000, increased the value of its recorded assets by $2,200,000 and recorded additional accumulated depreciation of $1,182,000. The cumulative effect of the initial adoption of this interpretation was a reduction in unrestricted net assets of $7,007,000. A $321,000 increase in the estimated fair value of the ARO liability was recorded in fiscal year 2006.

The pro forma effects of retroactively applying FIN 47 (as if it had been applied during all years reported) are as follows:

(in thousands of dollars)

For the Fiscal Year Ended June 30:	**2006**	**2005**
		(Pro Forma)
Net assets	$ 4,640,243	$ 4,217,950
Unrestricted net assets	3,532,627	3,216,656
ARO liabilities	8,346	8,025