

**William Marsh Rice
University**

**Consolidated Financial Statements
June 30, 2007 and 2006**

William Marsh Rice University

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June 30, 2007 and 2006

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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 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, 2007, 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 2006 financial statements, and in our report dated October 27, 2006, we expressed an unqualified opinion on those financial statements. Our report on the 2006 financial statements included an explanatory paragraph regarding the University's change in accounting policy relating to asset retirement obligations. 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.

PricewaterhouseCoopers LLP

October 15, 2007

William Marsh Rice University
Consolidated Statements of Financial Position
As of June 30, 2007 and 2006

(in thousands of dollars)

	<u>2007</u>	<u>2006</u>
Assets		
Cash and cash equivalents	\$ 8,242	\$ 12,305
Accounts receivable and other assets	48,828	43,629
Pledges receivable, net	121,588	94,039
Investments	5,212,879	4,282,956
Property and equipment, net	669,501	588,889
Total assets	<u>\$ 6,061,038</u>	<u>\$ 5,021,818</u>
Liabilities		
Accounts payable and other liabilities	61,654	50,217
Notes and bonds payable	492,170	222,568
Actuarial liability for annuities payable	113,164	101,884
Government refundable loan programs	6,808	6,906
Total liabilities	<u>673,796</u>	<u>381,575</u>
Net assets		
Unrestricted net assets	4,168,571	3,532,627
Temporarily restricted net assets	344,532	273,708
Permanently restricted net assets	874,139	833,908
Total net assets	<u>5,387,242</u>	<u>4,640,243</u>
Total liabilities and net assets	<u>\$ 6,061,038</u>	<u>\$ 5,021,818</u>

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, 2007
With Summarized Financial Information for the Year Ended June 30, 2006

<i>(in thousands of dollars)</i>	2007			2006	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Operating revenues					
Investment returns distributed for operations	\$ 172,459	\$ 11,005	\$ -	\$ 183,464	\$ 175,606
Student tuition and fees, net	75,148	-		75,148	71,354
Grants and contracts	80,149	-		80,149	73,363
Gifts and pledges	24,890	7,456		32,346	41,713
Gifts and trusts released from restrictions	13,549	(13,549)		-	-
Auxiliary enterprises	25,838	-		25,838	24,653
Other revenues	18,797	-		18,797	13,437
Total operating revenues	410,830	4,912	-	415,742	400,126
Operating expenses					
Educational and general activities	362,764			362,764	337,863
Auxiliary enterprise expenditures	33,335			33,335	33,475
Total operating expenses	396,099	-	-	396,099	371,338
Net operating income	14,731	4,912	-	19,643	28,788
Nonoperating changes					
Gifts and pledges for property and endowment	-	27,361	31,115	58,476	56,990
Investment returns, reduced by operating distribution above	611,984	53,298	18,482	683,764	348,767
Releases and other changes in restrictions on net assets	11,593	(11,797)	204	-	-
Change in liabilities due under life-income agreements	-	(2,950)	(9,711)	(12,661)	(7,516)
Other nonoperating changes	(2,364)	-	141	(2,223)	(4,736)
Net nonoperating changes	621,213	65,912	40,231	727,356	393,505
Change in net assets before cumulative effect of change in accounting principle	635,944	70,824	40,231	746,999	422,293
Cumulative effect of change in accounting principle	-	-	-	-	(7,007)
Net increase in net assets	635,944	70,824	40,231	746,999	415,286
Net assets					
Beginning of year	3,532,627	273,708	833,908	4,640,243	4,224,957
End of year	\$ 4,168,571	\$ 344,532	\$ 874,139	\$ 5,387,242	\$ 4,640,243

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, 2007 and 2006

(in thousands of dollars)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Increase in net assets	\$ 746,999	\$ 415,286
Adjustments to reconcile increase in net assets to net cash used in operating activities		
Depreciation	39,200	38,754
Loss on disposal of property and equipment	1,638	175
Net realized and unrealized investment gains	(801,304)	(455,602)
Equipment gifts in kind	(634)	(1,005)
Contributions restricted for long term purposes	(72,875)	(67,213)
Actuarial decrease in life-income agreements	12,661	7,516
Change in fair value of interest rate swap	577	(4,451)
Cumulative effect of change in accounting principle	-	7,007
Change in		
Accounts receivable and other assets	(1,430)	(439)
Pledges receivable for current purposes	(2,798)	(18,744)
Accounts payable and accrued liabilities	8,844	1,870
Net cash used in operating activities	<u>(69,122)</u>	<u>(76,846)</u>
Cash flows from investing activities		
Proceeds from sales and maturities of investments	921,369	985,014
Purchases of investments	(1,026,400)	(881,540)
Purchases of property and equipment	(120,624)	(53,347)
Net cash provided (used) by investing activities	<u>(225,655)</u>	<u>50,127</u>
Cash flows from financing activities		
Contributions restricted for long term purposes		
Endowment	13,653	11,029
Trusts and other	4,597	4,462
Property	2,960	3,003
Tax-exempt debt activity		
Proceeds from issuance of tax-exempt debt	314,632	147,180
Advance refunding of tax-exempt debt	-	(120,000)
Commercial paper activity		
Proceeds from issuance of commercial paper	15,000	11,000
Payment of outstanding commercial paper	(61,100)	(21,500)
Taxable Line of Credit	1,070	488
Change in refundable advances	(98)	(104)
Net cash provided by financing activities	<u>290,714</u>	<u>35,558</u>
Net increase (decrease) in cash and cash equivalents	(4,063)	8,839
Cash and cash equivalents		
Beginning of year	12,305	3,466
End of year	<u>\$ 8,242</u>	<u>\$ 12,305</u>

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

William Marsh Rice University
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

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, 2007, 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, 2006, from which the summarized information was derived. Certain reclassifications of 2006 information have been made to conform to the 2007 presentation.

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 and other sponsored program 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.

William Marsh Rice University
Notes to Consolidated Financial Statements
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- 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 using a rate based on U.S. government obligations of similar duration. 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, endowment and term 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

William Marsh Rice University
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

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.

Asset Retirement Obligations

The University recognizes 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. The University measures conditional AROs at estimated fair value using a probability-weighted, discounted cash flow model with multiple scenarios, if applicable. The present value of weighted, discounted cash flows is calculated annually using credit-adjusted, risk-free rates applicable to the University in order to determine the estimated fair value of the conditional AROs.

Life-Income Agreements

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.

Government refundable loan programs

The University participates in the Perkins revolving loan program, which is funded principally with advances from the federal government. These advances are refundable to the federal government if the program is terminated or if the University ceases to participate in the program.

William Marsh Rice University
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

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, 2007 and 2006, were as follows:

(in thousands of dollars)

	<u>2007</u>	<u>2006</u>
Unsettled investment sales	\$ 7,570	\$ 3,224
Investment income receivable	4,347	4,891
Student loans receivable, net of allowance of \$1,241 in 2007 and \$1,068 in 2006	8,006	8,254
Interest rate swap agreements	3,874	4,451
Inventory, prepaid expenses and other assets	7,914	3,765
Sponsored agreements receivable	10,510	13,311
Other accounts receivable	<u>6,607</u>	<u>5,733</u>
Total accounts receivable and other assets	<u>\$ 48,828</u>	<u>\$ 43,629</u>

3. Pledges Receivable

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, 2007 and 2006, are expected to be realized in the following periods:

(in thousands of dollars)

	<u>2007</u>	<u>2006</u>
In one year or less	\$ 10,294	\$ 26,711
Between one year and five years	98,078	55,542
More than five years	59,660	48,797
Less: Discount to net present value	(39,723)	(31,769)
Less: Allowance for uncollectible pledges	<u>(6,721)</u>	<u>(5,242)</u>
	<u>\$ 121,588</u>	<u>\$ 94,039</u>

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June 30, 2007 and 2006

Pledges receivable at June 30, 2007 and 2006, had the following restrictions:

<i>(in thousands of dollars)</i>	<u>2007</u>	<u>2006</u>
Permanently invested	\$ 77,833	\$ 60,573
Buildings	28,383	13,957
Support of University programs and activities	61,816	56,520
Less: Discount to net present value	(39,723)	(31,769)
Less: Allowance for uncollectible pledges	<u>(6,721)</u>	<u>(5,242)</u>
	<u>\$ 121,588</u>	<u>\$ 94,039</u>

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

The University received a conditional pledge of up to \$30,000,000 to establish an unrestricted fund that will function as a term endowment, provided that a building is constructed as specified in the pledge document.

4. Investments

Investments at June 30, 2007 and 2006, were as follows:

<i>(in thousands of dollars)</i>	<u>2007</u>	<u>2006</u>
Repurchase agreements	\$ 236,070	\$ -
Fixed income securities	489,968	385,879
Equity securities	2,409,155	2,238,574
Limited partnerships	1,753,450	1,334,395
Other investments	<u>324,236</u>	<u>324,108</u>
	<u>\$ 5,212,879</u>	<u>\$ 4,282,956</u>

The table above includes annuity and life-income fund assets of \$176,081,000 and \$156,801,000 as of June 30, 2007 and 2006, respectively. The repurchase agreements included in the above table represent unspent bond proceeds that will be drawn down as project expenditures are incurred (Note 7).

William Marsh Rice University
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

The following table summarizes investment income and net gain for the years ended June 30, 2007 and 2006, by net asset classification:

<i>(in thousands of dollars)</i>	2007			2006	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Investment earnings	\$ 57,590	\$ 2,320	\$ 6,014	\$ 65,924	\$ 68,771
Net gains on investments	726,853	61,983	12,468	801,304	455,602
Total investment gains and earnings	784,443	64,303	18,482	867,228	524,373
Less: Investment returns distributed for operations	(172,459)	(11,005)	-	(183,464)	(175,606)
Investment returns, reduced by operating distribution	\$ 611,984	\$ 53,298	\$ 18,482	\$ 683,764	\$ 348,767

Investment earnings are presented net of internal and external investment management expenses of \$33,085,000 and \$26,302,000 in fiscal 2007 and 2006, 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.

William Marsh Rice University
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

5. Property and Equipment

Property and equipment of educational plant at June 30, 2007 and 2006, were as follows:

<i>(in thousands of dollars)</i>	Estimated Useful Lives (Years)	2007	2006
Land	–	\$ 23,768	\$ 18,105
Buildings and improvements	20 – 50	617,576	584,771
Equipment, furniture and library books	2 – 20	290,211	284,111
Construction in progress	–	78,729	21,662
Less: Accumulated depreciation	–	<u>(340,783)</u>	<u>(319,760)</u>
		<u>\$ 669,501</u>	<u>\$ 588,889</u>

6. Accounts Payable and Other Liabilities

Accounts payable and other liabilities of the University at June 30, 2007 and 2006, were as follows:

<i>(in thousands of dollars)</i>	2007	2006
Unsettled investment purchases	\$ 3,253	\$ 660
Vendor accounts payable	19,569	13,769
Accrued payroll and employee benefits	12,000	12,190
Sponsored agreements unearned income	10,300	9,931
Conditional asset retirement obligations	7,455	8,346
Conditional pledge advances	4,725	-
Other liabilities	<u>4,352</u>	<u>5,321</u>
Total accounts payable and accrued liabilities	<u>\$ 61,654</u>	<u>\$ 50,217</u>

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Notes to Consolidated Financial Statements
June 30, 2007 and 2006

7. Notes and Bonds Payable

Notes and bonds payable of the University at June 30, 2007 and 2006, were as follows:

(in thousands of dollars)

	<u>2007</u>	<u>2006</u>
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, 2007, of 3.75% (3.94% at June 30, 2006) per annum payable monthly	\$ 147,180	\$ 147,180
Tax-exempt revenue bonds, Series 2007A & 2007B, maturing 2010 through 2047, with an average coupon of 4.75% per annum payable semiannually	314,632	-
Tax-exempt commercial paper notes, Series A, with interest ranging from 3.65% to 3.69% at June 30, 2007 (3.33% to 3.75% at June 30, 2006) per annum payable upon maturity	28,800	74,900
Taxable line of credit from commercial bank with interest payable at the end of each interest period at LIBOR plus .15%	1,558	488
	<u>\$ 492,170</u>	<u>\$ 222,568</u>

The University incurred interest expense of approximately \$8,512,000 and \$8,832,000 in 2007 and 2006, respectively, and made interest payments of approximately \$9,446,000 in 2007 and \$8,771,000 in 2006. Interest expense of \$7,856,000 and \$8,732,000 was charged to operations in 2007 and 2006, respectively.

Tax-Exempt Revenue Bonds

On June 12, 2007, the University issued Series 2007A and 2007B revenue bonds through the City of Houston Higher Education Finance Corporation (CHHEFC). The Series 2007A bonds were issued with a \$5,832,000 original issue premium and the Series 2007B bonds were issued net of a \$365,000 original issue discount. The original issue premium and discount and additional issuance costs of \$2,494,000 were capitalized by the University and are being amortized over the term of the bond issue. Interest payments on the bonds are payable semiannually. Principal payments for Series 2007A commence on May 15, 2010 and will be required annually until the scheduled maturity date of May 15, 2047. Principal payments for Series 2007B begin November 15, 2030 and continue annually until their maturity in November 2037.

A portion of the proceeds of the Series 2007A and Series 2007B bonds were used to legally defease \$5,000,000 and \$42,400,000, respectively, of commercial paper. The obligation for this commercial paper has been removed from the financial statements.

Unspent bond proceeds of \$236,069,000 at June 30, 2007 were invested in a flexible repurchase agreement. The financial institution that provided the investment contract has deposited securities equal to at least 102% of the value of the repurchase agreements as collateral with a custodian. These securities are limited to obligations of the United State of America or its agencies.

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The estimated fair value of the CHHEFC Series 2007A bonds is equal to \$206,538,000 at June 30, 2007. The estimated fair value of the CHHEFC Series 2007B bonds is equal to \$93,348,000 at June 30, 2007.

In March 2006, the University issued CHHEFC Series 2006A and 2006B revenue refunding bonds in the amount of \$147,180,000. Proceeds from these bonds were used to advance refund the Series 1999A debt service obligation by irrevocably placing assets with a trustee to pay principal, interest and call premium on the obligations as they become due and to current refund \$20,000,000 of the commercial paper program. An accounting loss of \$9,000,000 for the refunding was included as a nonoperating item for fiscal 2006 in the Consolidated Statement of Activities. Series 2006A and 2006B are floating rate bonds with an average interest rate of 3.75% and 3.94% at June 30, 2007 and 2006, respectively. Interest is paid monthly and the maturity date is November 15, 2029. No collateral is pledged on these bonds.

The estimated fair value of the CHHEFC Series 2006A and 2006B bonds is equal to the face value at June 30, 2007 and 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 matches the term of the Series 2006A and 2006B 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 \$3,874,000 as of June 30, 2007 and \$4,451,000 as of June 30, 2006. These amounts are included in the Consolidated Statements of Financial Position as an asset and the change in value is reported in other nonoperating changes on the Consolidated Statement of Activities.

Excluding maturity of commercial paper and other notes payable, as well as unamortized discounts and premiums, scheduled principal payments are:

<i>(in thousands of dollars)</i>	<u>Principal Payments</u>
2008	\$ -
2009	-
2010	2,055
2011	2,135
2012	2,220
Thereafter	449,935
	<u>\$ 456,345</u>

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, not to exceed 270 days. The outstanding balance under the facility was \$28,800,000 and \$74,900,000 with an average interest rate of 3.61% and 3.62% and an average maturity of 67 days and 74 days as of June 30,

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2007 and 2006, respectively. Subsequent to June 30, 2007, the University issued an additional \$10,000,000 of commercial paper under this facility.

The estimated fair value of the commercial paper notes approximates the face value in view of their maturity dates.

Taxable Line of Credit

In August 2006, the University signed a taxable line of credit with a limit of \$6,000,000 from a commercial bank. The interest on any outstanding balances under 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%.

8. Net Assets

The University's unrestricted, temporarily restricted and permanently restricted net assets for the years ended June 30, 2007 and 2006 are summarized as follows:

<i>(in thousands of dollars)</i>	2007			2006	
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>	<u>Total</u>
Internally designated for specific programs or ongoing activities	\$ 97,359	\$ -	\$ -	\$ 97,359	\$ 85,978
Designated or restricted by donor, including pledges	60,900	32,118	-	93,018	127,171
Net investment in plant	349,334	36,032	-	385,366	350,128
Endowment and designated for long-term investment, including pledges	3,654,059	223,676	842,683	4,720,418	4,022,094
Life-income trusts	-	52,706	28,829	81,535	45,369
Loans	6,919	-	2,627	9,546	9,503
	<u>\$ 4,168,571</u>	<u>\$ 344,532</u>	<u>\$ 874,139</u>	<u>\$ 5,387,242</u>	<u>\$ 4,640,243</u>

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 \$122,648,000 and \$111,412,000 in 2007 and 2006, respectively, are presented in the consolidated financial statements net of scholarship and fellowship awards of \$47,500,000 and \$40,058,000, respectively. Auxiliary enterprises revenue was reduced by scholarship awards applied to room and board charges of \$2,071,000 and \$1,866,000 in 2007 and 2006, respectively. Scholarship and fellowship awards in excess of the above amounts are reported as expense.

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10. Functional Expenses

Educational and general expenses of the University by major functional category for the years ended June 30, 2007 and 2006, were as follows:

<i>(in thousands of dollars)</i>	<u>2007</u>	<u>2006</u>
Instruction and department research	\$ 180,123	\$ 168,359
Sponsored research and other sponsored programs	64,052	60,503
Library	24,271	23,406
Scholarships and fellowships	13,192	11,178
Student services	35,480	32,813
General administration	26,699	23,575
Institutional development and other activities	18,947	18,029
Total educational and general	<u>\$ 362,764</u>	<u>\$ 337,863</u>

The above table includes depreciation expense of \$21,151,000 and \$21,131,000, and operations and maintenance expense of \$32,618,000 and \$30,159,000, for the years ended June 30, 2007 and 2006, respectively, which were allocated to the major functional categories based on space usage. Depreciation of library books of \$7,523,000 and \$7,103,000 was recognized as library expense in 2007 and 2006, respectively. In addition, depreciation expense of \$10,526,000 and \$10,520,000 was allocated to auxiliary enterprises in 2007 and 2006, respectively.

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 through 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. 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 \$14,832,000 and \$13,863,000 were recorded as expenses in the appropriate functional categories in 2007 and 2006, 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.

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The University receives funding from federal government agencies for research and other programs 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 federally sponsored programs are subject to audit and adjustment.

In connection with its private equity investment program (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, 2007 and 2006, the University had unfunded commitments of \$898,414,000 and \$803,621,000, 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, 2007 and 2006, for capital construction and improvements and major maintenance of approximately \$215,258,000 and \$31,029,000, respectively, to be financed primarily from gifts and net assets designated for long-term investments, and from debt to the extent other resources are not available. Other commitments of \$5,737,000 and \$4,756,000 were also outstanding at June 30, 2007 and 2006, respectively.

Texas enacted the Uniform Prudent Management of Institutional Funds Act with an effective date of September 1, 2007. The future impact of this change on the University's financial statements has not been determined.

14. Cumulative Effect of a Change in Accounting Principle

As a result of adopting Financial Accounting Standards Board (FASB) Interpretation No. 47 "Accounting for Conditional Asset Retirement Obligations" (FIN 47), the University recognized the following amounts within its fiscal year 2006 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. 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.