PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

To the Board of Trustees
University of Rochester:

In our opinion, the accompanying consolidated balance sheet and the related consolidated statement of activities and of cash flows present fairly, in all material respects, the financial position of the University of Rochester and related entities (the "University") at June 30, 2005, and the results of their changes in net assets and their 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. 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. The financial statements of the University as of June 30, 2004 and for the year then ended were audited by other auditors whose report dated September 22, 2004 expressed an unqualified opinion on those statements.

PricewaterhouseCoopers LLP

October 24, 2005

UNIVERSITY OF ROCHESTER AND RELATED ENTITIES

Consolidated Financial Statements

June 30, 2005 and 2004

UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES

Consolidated Balance Sheets

As of June 30
(dollars in thousands)

Assets	**2005**	**2004**
Cash and cash equivalents	$ 175,019	$ 124,086
Operating investments	110,468	88,746
Accounts receivable, net	222,778	229,561
Inventories, prepaid expenses and deferred charges	48,411	39,296
Contributions receivable, net	35,074	40,922
Notes receivable, net	20,066	21,297
Other assets	12,855	17,917
Investments held for long-term purposes	1,540,386	1,408,688
Property, plant and equipment, net	1,009,331	934,421
Interest in net assets of foundation	16,382	16,920
Investments in perpetual trusts held by others	52,451	50,622
Total assets	$ 3,243,221	$ 2,972,476
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	$ 203,550	$ 173,534
Advance receipt of sponsored research revenues	34,644	31,141
Deferred revenue	45,897	40,520
Third-party settlements payable, net	76,730	59,360
Accrued pension, post-retirement, and post-employment obligations	135,423	116,816
Long-term debt	535,430	504,240
Refundable U.S. Government grants for student loans	15,660	15,848
Total liabilities	1,047,334	941,459
Net Assets:		
Unrestricted	1,726,153	1,587,176
Temporarily restricted	220,361	207,447
Permanently restricted	249,373	236,394
Total net assets	2,195,887	2,031,017
Total liabilities and net assets	$ 3,243,221	$ 2,972,476

See accompanying notes to consolidated financial statements.

UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES

Consolidated Statement of Activities

Year ended June 30, 2005
(dollars in thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating revenues:				
Tuition and fees	$ 203,738	-	$ -	$ 203,738
Less: scholarships and fellowships	(83,563)	-	-	(83,563)
Net tuition and fees	120,175	-	-	120,175
State and local appropriations	1,800	-	-	1,800
Gifts and pledges	23,111	16,042	11,874	51,027
Grants and contracts	365,017	-	-	365,017
Hospital and faculty practice patient care activities	1,233,468	-	-	1,233,468
Auxiliary enterprises	40,257	-	-	40,257
Interest income on cash equivalents	3,886	295	-	4,181
Educational activities	24,887	-	-	24,887
Royalty income	37,643	-	-	37,643
Other sources	4,740	-	-	4,740
Long-term investment income and gains allocated to operations	74,312	-	-	74,312
Net assets released from restrictions	24,794	(24,794)	-	-
Total operating revenues	1,954,090	(8,457)	11,874	1,957,507
Operating expenses:				
Salaries and wages	916,861	-	-	916,861
Fringe benefits	238,023	-	-	238,023
Total compensation	1,154,884	-	-	1,154,884
Supplies	248,220	-	-	248,220
Business and professional	152,579	-	-	152,579
Utilities	22,126	-	-	22,126
Maintenance and facilities costs	74,117	-	-	74,117
Depreciation expense	119,976	-	-	119,976
Interest expense	22,609	-	-	22,609
Other	84,183	-	-	84,183
Total operating expenses	1,878,694	-	-	1,878,694
Change in net assets from operating activities	75,396	(8,457)	11,874	78,813
Non-operating activities:				
Long-term investment activities:				
Investment income	27,698	1,469	(66)	29,101
Net appreciation	113,060	18,380	1,097	132,537
Total long-term investment activities	140,758	19,849	1,031 `	161,638
Long-term investment income and gains allocated for operations	(74,312)	-	-	(74,312)
Loss on extinguishment of debt	(1,264)	-	-	(1,264)
Other changes, net	(1,601)	-	-	(1,601)
Change in valuation of annuities	-	1,522	74	1,596
Change in net assets from non-operating activities	63,581	21,371	1,105	86,057
Change in net assets	138,977	12,914	12,979	164,870
Beginning net assets	1,587,176	207,447	236,394	2,031,017
Ending net assets	$ 1,726,153	$ 220,361	$ 249,373	$ 2,195,887

See accompanying notes to consolidated financial statements.

UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES

Consolidated Statement of Activities

Year ended June 30, 2004
(dollars in thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Operating revenues:				
Tuition and fees	$ 198,901	$ -	$ -	$ 198,901
Less: scholarships and fellowships	(81,422)	-	-	(81,422)
Net tuition and fees	117,479	-	-	117,479
State and local appropriations	1,942	-	-	1,942
Gifts and pledges	22,740	12,889	14,092	49,721
Grants and contracts	310,460	-	-	310,460
Hospital and faculty practice patient care activities	1,149,961	-	-	1,149,961
Auxiliary enterprises	38,090	-	-	38,090
Interest income on cash equivalents	2,368	627	-	2,995
Educational activities	26,880	-	-	26,880
Royalty income	31,846	-	-	31,846
Other sources	3,790	-	-	3,790
Long-term investment income and gains allocated to operations	73,798	-	-	73,798
Net assets released from restrictions	22,934	(22,934)	-	-
Total operating revenues	1,802,288	(9,418)	14,092	1,806,962
Operating expenses:				
Salaries and wages	867,555	-	-	867,555
Fringe benefits	221,046	-	-	221,046
Total compensation	1,088,601	-	-	1,088,601
Supplies	230,384	-	-	230,384
Business and professional	167,850	-	-	167,850
Utilities	20,125	-	-	20,125
Maintenance and facilities costs	69,573	-	-	69,573
Depreciation expense	109,437	-	-	109,437
Interest expense	23,811	-	-	23,811
Other	64,839	-	-	64,839
Total operating expenses	1,774,620	-	-	1,774,620
Change in net assets from operating activities	27,668	(9,418)	14,092	32,342
Non-operating activities:				
Long-term investment activities:				
Investment income	20,346	1,634	-	21,980
Net appreciation	125,013	31,469	3,560	160,042
Total long-term investment activities	145,359	33,103	3,560	182,022
Long-term investment income and gains allocated for operations	(73,798)	-	-	(73,798)
Loss on extinguishment of debt	(4,746)	-	-	(4,746)
Other changes, net	7,418	-	-	7,418
Change in valuation of annuities	-	(1,337)	-	(1,337)
Change in net assets from non-operating activities	74,233	31,766	3,560	109,559
Change in net assets	101,901	22,348	17,652	141,901
Beginning net assets	1,485,275	185,099	218,742	1,889,116
Ending net assets	$ 1,587,176	$ 207,447	$ 236,394	$ 2,031,017

See accompanying notes to consolidated financial statements.

UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES

Consolidated Statement of Cash Flows

Years ended June 30, 2005 and 2004

(dollars in thousands)

	2005	2004
Cash flows from operating activities:		
Change in net assets	$ 164,870	$ 141,901
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization expense	116,538	102,256
Net unrealized appreciation of investments	(137,016)	(158,044)
Gifts of property, plant and equipment	(9,049)	(144)
(Appreciation)/depreciation in interest in net assets of foundation	538	(1,348)
Appreciation of investments in perpetual trusts held by others	(1,829)	(4,276)
Bond premium amortization	613	60
Loss on the extinguishment of debt	1,264	4,746
Loss on disposals of property, plant and equipment	3,469	7,181
(Increases)/decreases in:		
Operating investments	(21,722)	(27,626)
Accounts receivable	6,783	(18,902)
Inventories, prepaid expenses and deferred charges	(10,186)	18,936
Contributions receivable	5,848	(3,312)
Other assets	4,394	(3,517)
Increases/(decreases) in:		
Accounts payable and accrued expenses	30,016	23,950
Advance receipt of sponsored research revenues	3,503	4,306
Deferred revenues	5,377	2,315
Third-party settlements, net	17,370	9,986
Accrued post-employment and post-retirement benefits	18,607	18,030
Contributions for long-term investment, net	(19,005)	(10,559)
Investment income restricted for long-term purposes	(206)	365
Net cash provided by operating activities	180,177	106,304
Cash flows from investing activities:		
Purchases of property, plant and equipment, net	(184,932)	(145,075)
Purchases of investments	(1,148,659)	(977,028)
Proceeds from the sale and maturity of investments	1,153,516	982,150
Increase/(decrease) in notes receivable, net of activities and other reductions	1,231	(263)
Net cash used in investing activities	(178,844)	(140,216)
Cash flows from financing activities:		
Principal repayments of indebtedness	(31,164)	(30,409)
Proceeds from issuance of long-term debt	61,741	89,062
Increase in investments held in perpetuity by others	-	(3,188)
Increase in refundable U.S. Government grants for student loans	(188)	(928)
Contributions for long-term investment, net	19,005	10,559
Investment income restricted for long-term purposes	206	(365)
Net cash provided by financing activities	49,600	64,731
Net increase in cash and cash equivalents	50,933	30,819
Cash and cash equivalents - beginning of year	124,086	93,267
Cash and cash equivalents - end of year	$ 175,019	$ 124,086
Supplemental disclosure of cash flow information - Cash paid during the year for interest on long-term debt	$ 24,147	$ 24,528

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) General

The University of Rochester (the University) is a private, nonprofit institution of higher education based in Rochester, New York. The University provides education and training services, primarily for students at the undergraduate, graduate and postdoctoral levels. It also performs research, training and other services under grants, contracts and similar agreements with sponsoring organizations, primarily departments and agencies of the United States Government; and provides health care services through Strong Memorial Hospital (Hospital), Strong Home Care Group and the various entities included in Strong Partners Health System, Inc. (SPHS).

(b) Basis of Presentation

The accompanying consolidated financial statements include all of the integrated divisions of the University – The College, Margaret Warner Graduate School of Education and Human Development, William E. Simon Graduate School of Business Administration, Eastman School of Music, Memorial Art Gallery, School of Medicine and Dentistry, Strong Memorial Hospital, School of Nursing, Eastman Dental Center, Health Affairs and the University of Rochester Medical Faculty Group (URMFG). Included also are Strong Partners Health System, Inc. (and its affiliates), Eastman Dental Center Foundation, Inc., Strong Home Care Group (and its subsidiaries), the Research Foundation of the University of Rochester, Excell Partners, Inc. and Excell Technology Center, Inc. All significant interorganizational balances and transactions have been eliminated.

The University is the sole member of SPHS, which is the sole member of Highland Hospital of Rochester (including its subsidiaries Highland Foundation, Inc., Highland Facilities Development Corp. and the Medical Administrative Associates, Inc.); The Highlands Living Center, Inc.; Highland Community Development Corporation; and The Meadows at Westfall, Inc. Highland Hospital and its subsidiaries have debt outstanding which has been included in the University's consolidated financial statements; however, under the terms of the affiliation agreement with SPHS, the University has no legal obligation for the debt of Highland Hospital and affiliates.

The Eastman Dental Center Foundation (the Foundation) was formed to hold and manage the investment assets of the former Eastman Dental Center, which was merged into the University during 1998. Income and assets of the Foundation are used to support oral health, education and research projects at the University.

The University is the sole corporate member of Strong Home Care Group, which is the sole member of Visiting Nurse Service of Rochester and Monroe County, Inc. and Community Care of Rochester.

The University is the sole corporate member of the Research Foundation of the University of Rochester. The Research Foundation was formed to manage certain intellectual property created by the University of Rochester and investments based on such intellectual property. It has ceased operations and as of June 30, 2005 had no assets or liabilities.

The University, through SPHS, Strong Memorial Hospital and URMFG, formed a Managed Care Organization (MCO) in October 1997 together with two community physician organizations: the Highland Physician Organization and the Rochester Community Physician Organization. The MCO has ceased operations related to member contracting activities and is in the process of winding down its activities.

The University is the sole corporate member of Excell Partners, Inc., which was formed to support early stage commercial development utilizing technologies created at the University of Rochester and other regional colleges and universities.

The University is the sole corporate member of Excell Technology Center, Inc., which was formed to support the development of new businesses utilizing technologies created at the University of Rochester and other regional colleges and universities, through the operation of incubator/research facilities in Monroe County, New York.

(c) Basis of Accounting

The consolidated financial statements of the University are prepared on the accrual basis of accounting and in conformity with generally accepted accounting principles in the United States of America.

Certain amounts as of and for the year ended June 30, 2004 have been reclassified for comparative purposes.

Classification of Net Assets

The University reports its net assets and changes therein according to three classifications: unrestricted, temporarily restricted and permanently restricted, based upon the existence or absence of donor-imposed restrictions.

Permanently restricted – Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, the University may use the income and gains derived from the donated assets, restricted only by the donors' stipulations.

Temporarily restricted – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the University and/or the passage of time. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Unrestricted – Net assets that are not subject to donor-imposed stipulations and that are generally available for support of the University's activities, with certain limitations, as follows:

- Uses of certain unrestricted net assets are committed through contractual agreements. Such amounts primarily consist of required trusteed balances under long-term debt agreements and matching funds under student loan programs of the Federal Government. In addition, grants and contracts for the performances of certain services or functions are reported in the unrestricted net asset category.

- Many of the funds, which are unrestricted for accounting purposes, carry internal designations to specific divisions of the University, and therefore are not treated operationally as unrestricted funds.

- Certain accumulated net investment gains earned on permanently restricted net assets are included within unrestricted net assets. In accordance with New York State law, the appropriation and spending of such gains, absent donor directives, is subject to a standard of prudence, as more fully discussed under the accounting policy note on investments, note 1(i).

- The Board of Trustees, through voluntary resolutions, has set aside portions of the University's unrestricted net assets to function as endowment, for property, plant and equipment purposes and for other specific operating purposes.

Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Contributions are reported as increases in the appropriate category of net assets, except those contributions whose imposed restrictions are met in the same fiscal year they are received, are included in unrestricted revenues.

Investment income and gains and losses on investments are reported as increases or decreases in the unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. When such restrictions exist, investment income, gains or losses are reported as temporarily or permanently restricted, except when the restrictions are met in the same fiscal year in which the income or gains are earned, in which case the income and gains are reported within the unrestricted category.

Expenses are reported as decreases in unrestricted net assets. Expiration of temporary restrictions recognized on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) that do not occur within the same period as revenue recognition are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period in which the assets are acquired or placed in service.

(d) Income Taxes

The University is a not-for-profit organization as described in section 501(c)(3) of the Internal Revenue Code and is generally exempt from income taxes on related income pursuant to Section 501(a) of the Code.

(e) Operations

The statements of activities present the changes in net assets of the University from operating activities and from non-operating activities. Operating revenues and expenses relate primarily to educational and training programs, research activities and hospital and patient care activities provided by the University and its related entities.

(Continued)

Utilization of investment income and gains on long-term investments held for endowment and similar purposes under the University's total return spending policy, as discussed in note 1(i), is considered operating revenue.

Non-operating activities consist primarily of investment income and appreciation from long-term investments in excess of amounts utilized for operations.

(f) Cash Equivalents and Operating Investments

Cash equivalents include amounts on deposit with financial institutions, short-term investments with maturities of three months or less at the time of purchase and other highly liquid investments, primarily cash management funds.

Operating investments include all other current investments with original maturities greater than three months. These current investments include obligations of the US Treasury, US Government and other government agencies and corporate & foreign bonds. These items are reported at fair value.

(g) Inventories

Inventories, primarily medical supplies, are valued at the lower of cost, which is determined by the first-in, first-out method, or market.

(h) Contributions

Contributions, including unconditional promises, or pledges, are recognized as revenues in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Contributions to be received after one year are discounted, at a range of 2% to 6%, to their present value. Amortization of the discount is recorded as additional contribution revenue and used in accordance with donor-imposed restrictions, if any, on the contributions. Allowance is made for uncollectible contributions based upon management's judgement and analysis of the creditworthiness of the donors, past collection experience and other relevant factors.

(i) Investments

The University's investments are comprised of the assets of the University's endowment and other investments held for general operating purposes. The University reports those investments at fair value. The fair value of debt and equity securities is based on quoted market prices of public securities markets. Fair value for certain venture investments is based on transactions involving similar issues or on quoted prices of registered securities, although the University's holdings are restricted with respect to disposition in the ordinary manner.

New York State law generally allows the spending of income and gains on investments of permanently restricted net assets, absent explicit donor stipulations that all or a portion of such gains be maintained in perpetuity. State law allows the University to appropriate and spend such income and gains as is prudent, considering such factors as the University's long- and short-term needs, present and anticipated financial requirements, expected total return on investments, price level trends and general economic conditions.

In accordance with accounting requirements, realized and unrealized gains and losses, as well as gains and losses on temporarily restricted and unrestricted net assets, are reported as temporarily restricted or unrestricted, based upon the presence or absence of donor stipulations as to their use. The University's policy regarding spending of gains thus classified, however, is to spend no more than a stated percentage of market value of its investment portfolio over time, as described in the following paragraph.

Investment of the University's net assets held for endowment and similar purposes is based upon a total return policy, and the utilization of its endowment resources for current operating and capital needs is related to this policy. Accordingly, during 2005 and 2004, University Trustees authorized the use of total return (income and appreciation) from its endowment resources at a rate of 6.5% and 6.5%, respectively, of the average market value of its consolidated investment portfolio for the most recent five years. To the extent that the total return requirement for the current year is not fulfilled by interest, dividends and royalties, the University utilizes the appreciation of its endowment and similar net assets for operating purposes. To the extent that the total return requirement for the current year is exceeded by interest, dividends and royalties, the University reinvests the excess in its net assets held for endowment and similar purposes.

Investment securities are exposed to various risks, such as interest rates, market, economic conditions, world affairs and credit risks. Due to the level of risk associated with certain investment securities, it is possible that changes in their value could occur in the near term and such changes could materially affect the amounts reported in the investments and investment activity of the University.

(j) Property, Plant and Equipment

Property, plant and equipment are stated at cost or at estimated fair value if acquired by gift, less accumulated depreciation and amortization. Buildings used for research activities are componentized as site improvements, buildings, building services and fixed equipment. Depreciation of the building components is recorded using the straight-line method over the useful lives of the components ranging from five to fifty years. Depreciation of non-research buildings, equipment and library books and amortization of leasehold and land improvements are computed using the straight-line method over the estimated useful lives of the assets. Land and museum collections are not subject to depreciation. Estimated useful lives for non-research assets are as follows:

	Years
Building	40
Building and leasehold improvements	20
Land improvements	20
Equipment	4 to 15
Library books	10

The University reports gifts of property, plant and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the University reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

(k) Collections

The University capitalizes its collections. If purchased, collection items are capitalized at cost, and if donated, at their appraised or fair value on the accession date (the date on which the item is accepted by the Board of Trustees). There is no depreciation recorded on collection items.

(l) Split Interest Agreements and Perpetual Trusts

The University's split interest agreements with donors consist primarily of gift annuities, unitrusts, lead trusts, charitable remainder annuity trusts and life income agreements. Assets held under these agreements are included in investments. Generally, contribution revenues are recognized at the dates the agreements are established after recording liabilities for the present value of the estimated future payments to be made to the beneficiaries. The liabilities are adjusted during the term of the trusts for changes in the value of the assets, accretion of the discount and other changes in the estimates of future benefits. The University is also the beneficiary of certain perpetual trusts held and administered by others. The present values of the estimated future cash receipts, which are measured by the fair value of the assets contributed to the trust, are recognized as assets and contribution revenues at the dates the trusts are established. Distributions from the trusts are recorded as contributions and the carrying value of the assets is adjusted for changes in the fair value of the trust assets.

(m) Refundable U.S. Government Grants for Student Loans

Funds provided by the United States Government under the Federal Perkins, Nursing and Health Professions Student Loan programs are loaned to qualified students and may be reloaned after cash collections. These funds are ultimately refundable to the government and are recognized as a liability in the accompanying consolidated balance sheets.

(n) Grants and Contracts

Revenue from grants and contracts, primarily for research and training programs, is generally recognized as earned, that is, as the related costs are incurred under the grant or contract agreements. Amounts received in advance are reported as advance receipt of sponsored research revenues.

Grants and contracts awarded to the University are subject to audit by the various sponsoring agencies. Indirect costs recovered on grants and contracts are recorded at rates established by the University with the Federal Government, or predetermined by the non-Federal sponsor. Indirect cost rates for government grants and contracts are subject to audit, and subsequent final settlements are recorded as current period adjustments. Management believes the impact of any future settlements to be immaterial to the consolidated financial statements.

(o) Benefits Plans

The University provides certain health care and life insurance benefits to retired employees and spouses under a defined benefit plan. Benefits include basic medical and major medical coverage. Certain categories of retirees receive dental coverage and group life insurance. Such post-retirement benefits are accounted for as a form of deferred compensation over the estimated service lives of employees.

Post-employment benefits include benefits provided to former or inactive employees after employment but before retirement. For the University, such benefits include workers' compensation benefits, short-term disability benefits and benefits provided under various other programs.

(p) Hospital and Faculty Practice Patient Care Activities

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare

Under the Medicare program, the Hospital receives reimbursement under a prospective payment system (PPS) for inpatient services. Under the hospital inpatient PPS, fixed payment amounts per inpatient discharge are established based on the patient's assigned diagnosis related group (DRG). When the estimated cost of treatment for certain patients is higher than the average, providers typically will receive additional "outlier" payments. The Hospital also receives reimbursement under a prospective payment system for certain medical outpatient services, based on service groups, called ambulatory payment classifications (APCs). Other outpatient services are based upon a fee schedule and/or actual costs. The Hospital's Medicare cost reports are subject to audit by the fiscal intermediary. Such audits have been done through December 31, 2001.

Medicaid and Other Third-Party Payors

The New York Health Care Reform Act of 1996 (HCRA), as amended, governs payments to hospitals in New York State through June 30, 2007. Under the Act, Medicaid, workers compensation and no-fault payors pay rates promulgated by the New York State Department of Health. Fixed payment amounts per inpatient discharge are established based on the patient's assigned case mix intensity similar to a Medicare DRG. All other third-party payors, principally Blue Cross, other private insurance companies, Health Maintenance Organizations (HMOs), Preferred Provider Organizations (PPOs) and other managed care plans, negotiate payment rates directly with hospitals. Such arrangements vary from DRG-based payment systems, to per diems, case rates and percentage of billed charges. If such rates are not negotiated, then the payors are billed at the Hospital's established charges.

In addition, under HCRA, all non-Medicare payors are required to make surcharge payments for the subsidization of indigent care and other health care initiatives. The percentage amounts of the surcharge vary by payor and apply to a broader array of health care services. Also, certain payors are required to fund a pool for graduate medical education expenses through surcharges on payments to hospitals for inpatient services or through voluntary election to pay a covered lives assessment directly to the Department of Health.

Revenue from Medicare and Medicaid programs accounted for approximately 32% and 15%, respectively, of the Hospital's net patient revenue for the year ended June 30, 2005 and 33% and 15%, respectively, for the year ended June 30, 2004. Laws and regulation governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the near term. The Hospital believes that it is in compliance, in all material respects, with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation. Non-compliance with such laws and regulations could result in repayments of amounts improperly reimbursed, substantial monetary fines, civil and criminal penalties and exclusion from the Medicare and Medicaid programs.

Both Federal and New York State regulations provide for certain adjustments to current and prior years' payment rates and indigent care pool distributions based on industry-wide and hospital-specific data. The Hospital has established estimates based on information presently available of the amounts due to or from Medicare, Medicaid, workers compensation and no-fault payors and amounts due from the indigent care pool for such adjustments. Those adjustments which can be reasonably estimated have been provided for in the accompanying financial statements. The Hospital has estimated the potential impact of such adjustments based on the most recent information available. However, those which are either (a) without current specific regulations to implement such adjustments, or (b) are dependent upon certain future events, cannot be reasonably estimated and have not been provided for in the accompanying financial statements. Management believes the amounts recorded in the accompanying financial statements will not be materially affected upon the implementation of such adjustments. During 2005 and 2004, the Hospital recognized approximately $13,800 and $7,000 of net patient service revenue as a result of changes in estimates related to third party settlements.

There are various other proposals at the Federal and New York Sate levels relating to Medicare and Medicaid, that could, among other things, reduce reimbursement rates, modify reimbursement methods or increase managed care penetration. The ultimate outcome of these proposals and other market changes cannot presently be determined.

The University of Rochester Medical Faculty Group (URMFG) is an operating division of the Medical Center. In the year ending June 30, 2005, over 850 full-time faculty in 17 clinical departments and 2 clinical centers participated in patient care at the University of Rochester Medical Center. These full-time faculty physicians handled 700,000 outpatient visits in the their offices, mostly on University owned or leased premises; and covered 38,000 hospital admissions, as well as participated in the coverage of the emergency department handling over 90,000 visits. Payments for these services are derived primarily from third party insurers including Managed Care companies (39.1%), Medicare (25.1%), Blue Shield (10.7%), Medicaid (8.9%), Commercial (6.3%), Other (6.2%) and Self-pay (3.7%).

In addition to providing clinical outpatient care, the faculty group's mission is met by providing education and teaching. Our faculty supervise and instruct 385 University medical students and 615 residents and fellows.

(q) Use of Estimates

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

(r) Investment in Net Assets of Foundation

The University follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others* in accounting for its interest in the net assets of the James P. Wilmot Foundation, Inc. ("Foundation"). SFAS No. 136 establishes standards for transactions in which a donor transfers assets to a not-for-profit organization or charitable trust, which then agrees to transfer those assets, the return on investment of those assets, or both to a beneficiary specified by the donor. Under the provisions of SFAS No. 136, the University is required to recognize the net assets and its share of the change in the net assets of the Foundation. The Foundation was established for the support of cancer research at the University's School of Medicine and Dentistry.

(s) Derivative Instruments and Hedging Activities

Derivative instruments related to the University's long-term debt are included in accounts payable and accrued expenses on the consolidated balance sheet. The change in the fair value of the derivative instruments is also included in the net appreciation in the statement of activities. The University selected the combination of a variable rate bond issue and a thirty year interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The University is exposed to credit loss in the event of nonperformance by the counterparty to its long-term rate swap. The interest rate swap does not qualify for cash flow hedge accounting.

(Continued)

(dollars in thousands)

(2) Net Assets

Unrestricted net assets consist of the following at June 30:

	2005	2004
Designated:		
For long-term purposes to support scholarships and other programs:		
Funds functioning as endowment	$ 799,061	$ 732,285
Accumulated appreciation resulting from investment of permanently restricted net assets	228,540	201,697
For property, plant and equipment purposes and debt service reserves held by trustees under debt agreements	14,856	23,058
For student loan programs, including required matching funds under Federal Government loan programs	3,658	3,693
For other specific operating purposes	51,749	46,476
For Highland Hospital and affiliates	58,364	51,641
For Eastman Dental Center Foundation	43,444	42,531
For other related entities	(19,072)	(17,531)
Total designated	1,180,600	1,083,850
Net investment in property, plant and equipment	490,639	437,919
Undesignated	54,914	65,407
Total unrestricted net assets	$ 1,726,153	$ 1,587,176

Temporarily restricted net assets consist of the following at June 30:

	2005	2004
Accumulated appreciation on permanently restricted net assets subject to purpose restrictions:		
Scholarships and grants	$ 24,946	$ 21,858
Instruction	62,560	59,926
Other	23,879	23,601
Subtotal	111,385	105,385
Interest in net assets of foundation	16,382	16,920
Related entities	3,458	2,499
Other gifts and income subject to:		
Purpose restrictions	20,461	20,369
Time restrictions:		
Contributions receivable	30,136	36,576
Split-interest agreements	38,539	25,698
Total temporarily restricted net assets	$ 220,361	$ 207,447

(dollars in thousands)

Permanently restricted net assets consist of the following at June 30:

	2005	2004
Perpetual endowment funds:		
Restricted income purposes:		
Scholarships and grants	$ 12,118	$ 11,802
Instruction	38,284	38,873
Other	9,061	14,973
Unrestricted income purposes	124,782	109,675
Subtotal	184,245	175,323
Interests in perpetual trusts held by others:		
Restricted income purposes:		
Instruction	35,060	33,575
Student loans	1,440	1,420
Other	1,652	-
Unrestricted income purposes	14,299	14,005
Subtotal	52,451	49,000
Related entities	3,124	3,001
Split-interest agreements	715	763
Perpetual loan funds	3,900	3,961
Contributions receivable	4,938	4,346
Total permanently restricted net assets	$ 249,373	$ 236,394

(3) Accounts Receivable

Accounts receivable at June 30 consist of the following:

	2005	2004
Patient care and related activities, net of allowances for doubtful accounts of $16,035 and $16,052	$ 137,632	$ 150,102
Federal, state and local governments, foundations and companies, net of allowances for doubtful accounts of $200 and $400	42,890	35,711
Student receivables, net of allowances for doubtful accounts of $2,687 and $1,839	6,137	7,362
Other	36,119	36,386
Total accounts receivable	$ 222,778	$ 229,561

(dollars in thousands)

(4) Contributions

Contributions receivable, net, are summarized as follows at June 30:

	2005	2004
Unconditional promises expected to be collected in:		
Less than one year	$ 5,334	$ 26,202
One year to five years	27,064	18,977
Over five years	4,439	1,203
Subtotal	36,837	46,382
Less unamortized discount and allowance for uncollectible amounts	(1,763)	(5,460)
Total contributions receivable, net	$ 35,074	$ 40,922

At June 30, 2005, the University had also received bequest intentions of $1,510 and certain other conditional promises to give. These intentions and conditional promises to give are not recognized as assets. If they are received, they will generally be restricted for specific purposes stipulated by the donor, primarily endowments for faculty support, scholarships or general operating support of a particular department or division of the University.

The University expended $16,842 and $17,832, for University relations and development for the years ended June 30, 2005 and 2004, respectively.

(5) Notes Receivable

Student loans receivable at June 30, 2005 and 2004 respectively are reported net of allowances for doubtful loans of $1,328 and $1,377 respectively. The allowance is intended to provide for loans, both in repayment status and not yet in repayment status (borrowers are still in school or in the grace period following graduation), that may not be collected.

(6) Investments Held for Long-Term Purposes

Investments were held for the following long-term purposes at June 30:

	2005	2004
Endowment and similar purposes	$ 1,411,813	$ 1,287,173
Property, plant and equipment purposes:		
Debt service reserve held by trustees under debt agreements	15,526	17,194
Other	54,235	48,408
Total property, plant and equipment purposes	69,761	65,602
Other purposes	58,812	55,913
Total investments held for long-term purposes	$ 1,540,386	$ 1,408,688

Investments held for long-term purposes consist of the following at June 30:

	2005	2004
Cash and cash equivalents	$ 106,580	$ 100,341
Debt securities	189,864	181,348
Common and preferred stocks	529,433	563,376
Limited partnerships and similar interests	671,510	530,809
Oil royalties	16,000	11,700
Other investments	26,999	21,114
Total market value	$ 1,540,386	$ 1,408,688

(dollars in thousands)

Included in the investments held for long-term purposes above are $376,097 and $261,313 of international investments at June 30, 2005 and 2004, respectively.

Under the terms of certain limited partnership agreements, the University is obligated to periodically advance additional funding for private-equity and real estate investments. At June 30, 2005 and 2004, respectively, the University had commitments of $186,934 and $132,383 for which capital calls had not been exercised. Such commitments generally have fixed expiration dates or other termination clauses. The University maintains sufficient liquidity in its investment portfolio to cover such calls.

For investment purposes, substantially all investments held for endowment and similar purposes participate in one of several pools, each with its own investment policy and objectives. The investment pool assets are owned by the separate funds based on shares purchased by each fund and fund addition when it entered the pool. The pooled assets are valued on a monthly basis and a "market value per share" is determined and used to calculate the number of shares applicable to funds entering or leaving the pool.

The following table summarizes changes in relationships between cost and market values of investments held for endowment and similar purposes:

	2005		
	Market	**Cost**	**Net Gains**
End of year	$ 1,411,813	$ 1,131,408	$ 280,405
Beginning of year	$ 1,287,173	$ 1,077,281	$ 209,892
Unrealized appreciation			70,513
Realized net gains for year			66,925
Net increase for year			$ 137,438

	2004		
	Market	**Cost**	**Net Gains**
End of year	$ 1,287,173	$ 1,077,281	$ 209,892
Beginning of year	$ 1,147,299	$ 1,056,672	$ 90,627
Unrealized appreciation			119,265
Realized net gains for year			36,830
Net increase for year			$ 156,095

The University permits several of its investment managers to utilize forward contracts, currency options and futures with the specific authorization of the investment committee of the Board of Trustees. These financial instruments involve, to varying degrees, elements of market risk in excess of the amounts recorded in the consolidated financial statements.

Interest rate futures contracts are held as hedges against changes in market value of fixed income securities due to market interest rate fluctuations. The University is subject to market risk associated with the changes in the value of these futures contracts. The University held long and short-term U.S. Treasury and municipal bond futures contracts at June 30, 2005 and 2004, at a notational amount of $6,475 and $1,413, respectively. These amounts, however, may differ from the University's future cash requirements as the University may close out futures positions prior to settlement and thus be subject only to the change in value of the futures contracts since the contracts are valued daily using the mark-to-market method. The margin requirements on deposits with a third party for futures contracts were $1,111 at June 30, 2005 and $368 at June 30, 2004.

(dollars in thousands)

Management does not anticipate that losses, if any, resulting from its market or credit risks would materially affect the consolidated financial position of the University.

Investment fees for the two years ended June 30, 2005 and 2004 were $7,351 and $5,742, respectively.

(7) Property, Plant and Equipment

As of June 30, 2005 and 2004, the University's investment in property, plant and equipment is as follows:

	2005	2004
Buildings and improvements	$ 1,268,228	$ 1,171,896
Land improvements	30,642	27,586
Completed projects under leasehold agreements	46,331	46,202
Equipment owned	611,478	543,448
Library books	96,210	89,581
Subtotal	2,052,889	1,878,713
Less accumulated depreciation	1,136,934	1,045,020
Subtotal	915,955	833,693
Land	7,053	5,177
Museum collections	26,627	25,717
Construction in progress	59,696	69,834
Total property, plant and equipment, net	$ 1,009,331	$ 934,421

(dollars in thousands)

(8) Long-Term Debt

The following is a summary of the University's long-term indebtedness at June 30, 2005 and 2004:

		2005		2004
Obligations under capital leases, 0% to 9.164%, (a)	$	8,661	$	11,366
Urban Development Corporation loan, (b)		2,667		2,833
Term note payable, LIBOR rate plus 0.40%, (c)		3,000		4,400
Term note payable, LIBOR rate plus 0.75% (d)		945		1,288
Settlement note payable, 6.00% (e)		51		219
Direct Note Obligation, Series 2003, 5.40% to 5.75% (net of unamortized discount of $32 in 2005 and $33 in 2004), (f)		8,568		8,567
Bonds Payable – COMIDA, 8.00% to 10.00% (g)		698		698
Bonds payable – DASNY Series 1994A, 4.50% to 6.50% (net of unamortized discount of $9 in 2005 and $18 in 2004), (h)		1,201		2,322
Bonds payable – DASNY Series 1994, 7.625%, (i)		9,124		9,303
Bonds payable – DASNY Series 1994B, 5.50% (j)		11,445		11,745
Bonds payable – DASNY Series 1996, 3.85% to 5.30% (net of unamortized discount of $5 in 2005 and $11 in 2004), (k)		2,625		5,119
Bonds payable – DASNY Series 1997A, 3.75% to 5.00% (net of unamortized premium of $774 in 2005 and $810 in 2004), (l)		38,704		46,845
Bonds payable – DASNY Series 1997A and B, 5.70% to 8.25%, (m)		-		27,320
Bonds payable – DASNY Series 1998A, 3.50% to 5.00% (net of unamortized discount of $279 in 2005 and $291 in 2004), (n)		103,766		108,569
Bonds payable – DASNY Series 1999A, 5.00% (net of unamortized discount of $124 in 2005 and $136 in 2004), (o)		17,341		17,329
Bonds payable – DASNY Series 1999B, 3.70% to 5.72% (net of unamortized discount of $234 in 2005 and $247 in 2004), (p)		22,046		22,714
Bonds payable – DASNY Series 2000A, 4.50% to 6.05% (q)		39,139		39,139
Bonds payable – DASNY Series 2001A, 2.90% to 5.00% (net of unamortized discount of $117 in 2004 and $126 in 2004), (r)		21,903		22,089
Bonds payable – DASNY Series 2003 A, B and C, 3.97%, (s)		156,100		162,375
Bonds payable – DASNY Series 2004A, 3.00 to 5.13% (net of unamortized premium of $587 in 2005), (t)		45,122		-
Bonds payable – COMIDA, 3.125% to 5.450% (net of unamortized premium of $1,269 in 2005), (u)		42,324		-
Total long-term debt	$	535,430	$	504,240

The following is a description of the University's long-term debt.

(a) Obligations Under Capital Leases

Strong Memorial Hospital entered into a tax-exempt capital equipment lease program in October 2000 for $4,719. The lease is being repaid with quarterly payments of $208, including interest at 5.50% through May 2007. The leased equipment includes CT Radio Surgery, Ultrasound and linear accelerator equipment.

In addition to the arrangement discussed above, the University and its related entities have entered into several other capital leases for equipment.

(b) Urban Development Corporation Loan

In March 1992, the New York State Urban Development Corporation (UDC) entered into an agreement with the University to partially fund the construction of the University's Center for Optoelectronics and Imaging (COI) with a loan of $5,000. The agreement requires the

University to pay an amount equal to the debt service on the $6,320 tax-exempt bond issued by which UDC financed the loan and the associated reserve funds and costs of issuance. The loan is secured by a mortgage on the property.

Pursuant to an agreement authorized by statute, the State of New York leases the COI from the University for the 30-year term of the loan, paying, as rent, an amount sufficient to cover the University's obligations to UDC. These rents have been assigned to UDC as further security for the loan. The University retains possession of the property under a sub-lease from the State at an annual rent equivalent to one-thirtieth of the sum of the loan principal and the cost of issuance of the UDC bonds.

(c) Term Note Payable – JPMorgan Chase Bank

Pursuant to an agreement between the University and JPMorgan Chase Bank dated June 30, 2000, JPMorgan Chase Bank issued a term note of $7,000 to finance the renovation of the Goergen Athletic Center. The note is being repaid at an interest rate of LIBOR plus 0.40% on the unpaid principal balance through September 2005.

(d) Term Note Payable – HSBC Bank, USA

A University related entity entered into a $1,718 term note agreement with HSBC Bank, USA. The note is currently being repaid at an interest rate of LIBOR plus 0.75% on the unpaid balance through January 2008. This note is guaranteed by the University and is collateralized by the assets of the related entity.

(e) Settlement Note Payable – HSBC AIG

Pursuant to an agreement between a University related entity and HSBC Bank, USA dated October 10, 2004, HSBC issued a term note of $455 regarding amounts due to AIG for Workers Compensation that relate to the years 2000 through 2002. The note is currently being repaid at an interest rate of 6.00% on the unpaid balance through August 2005.

(f) Direct Note Obligation – The Bank of New York

Pursuant to an agreement between the University and the Bank of New York dated November 25, 2003, the Bank of New York issued $8,600 of notes known as the University of Rochester Direct Note Obligations, Series 2003. The Series 2003 notes were issued to refinance drawings under the University's revolving line of credit with JPMorgan Chase Bank. The line of credit had been used to refinance indebtedness and certain other mortgages related to Eastman Place. Eastman Place is a facility used partly to house activities of the Eastman School of Music.

The Series 2003 notes are general, unsecured obligations of the University.

(g) Bond Payable – COMIDA

Pursuant to an agreement between the University and the County of Monroe Industrial Development Agency (COMIDA) dated January 6, 2004, COMIDA issued a replacement bond in the amount of $698. The 2004 COMIDA Replacement bond is for the purchase of property at 10 Gibbs Street, Rochester, New York which has become part of the Eastman School of Music campus.

(h) Bonds Payable – DASNY Series 1994A

Pursuant to an agreement between the University and DASNY dated October 1, 1994, DASNY issued and sold $30,575 of bonds known as University of Rochester Revenue Bonds, Series 1994A. The Series 1994A bonds were issued at a net discount of $30, resulting in proceeds of $30,545 to finance the renovation of a dormitory, two academic buildings and an administration building on the University's River Campus; the repair and improvement of the exterior and utility infrastructure of the buildings of the Eastman School of Music and the refinancing of the University's maturing $20,000 repurchase agreement with the Student Loan Marketing Association (SLMA). The bonds area general obligation of the University and require the University to pay the principal, sinking fund installments and interest on all bonds issued as such payments come due. During fiscal 2002, the Series 1994A bonds maturing on and after July 1, 2007 were refinanced as a result of the issuance of Series 2001A. The bondholders were paid on July 1, 2004.

The obligation of the University is secured by a pledge of certain revenues of the University. These pledged revenues include all tuition, room and board and mandatory fees charged to students. The pledged revenues are subordinate to the prior pledges securing certain other outstanding indebtedness of the University.

(i) Bonds Payable – DASNY Series 1994

Pursuant to an agreement with a University related entity (Highland Hospital and affiliates) and DASNY dated July 1, 1994, DASNY issued and sold $11,790 of FHA-Insured Mortgage Revenue Bonds, Series 1994. The related entity is repaying the bonds that are due December 1, 2025 at a fixed rate of 7.625%. The Series 1994 bonds are collateralized by buildings.

(j) Bonds Payable – DASNY Series 1994B

Pursuant to an agreement with a University related entity (Highland Hospital and affiliates) and DASNY, $13,000 of Series 1994B Revenue Bonds were issued and sold by DASNY. The related entity is repaying the indebtedness at a fixed rate of 5.50%, maturing July 1, 2023. The bond issue is secured by an irrevocable direct pay letter that is held by the trustee, JPMorgan Chase Bank. The Series 1994B Revenue Bonds are secured by a parity mortgage and a security interest in certain buildings and equipment.

(k) Bonds Payable – DASNY Series 1996

Pursuant to an agreement between the University and DASNY dated July 1, 1996, DASNY issued and sold $21,375 of bonds known as University of Rochester, Strong Memorial Hospital Revenue Bonds, Series 1996. The Series 1996 bonds were issued at a discount of $54, resulting in proceeds of $21,321 to finance (1) the implementation of an automated clinical information system; (2) the expansion and renovation of the Hospital's basement area to enlarge and consolidate the pre and post anesthesia units and (3) the purchase and installation of a nuclear cardiology gamma camera at the Hospital's ambulatory care facility.

The bonds are a general obligation of the University and require the University to pay principal, sinking fund installments and interest on all bonds issued as such payments become due. As security for its obligation under the agreement, the University has granted to the Authority a security interest in pledged revenues consisting of any moneys, income rents, or revenues received or receivable by the Hospital.

(l) Bonds Payable – DASNY Series 1997A

Pursuant to an agreement between the University and DASNY dated November 7, 1997, DASNY issued and sold $78,280 of bonds known as University of Rochester Revenue Bonds, Series 1997A. The Series 1997A bonds were issued at a premium of $1,041 resulting in proceeds of $79,321 to finance (1) interior and exterior building renewal for major buildings at the Eastman School of Music as part of a multi-year project; (2) installation of a local area network for all River Campus and Eastman School of Music residence halls to provide high speed data access to undergraduate students; (3) reconstruction of an existing pedestrian bridge connecting Hill Court Residence Complex with the River Campus and (4) major renewal and replacement projects for various buildings, structures, roadways and other facilities on the River Campus, on Mt. Hope Avenue and at the Mees Observatory in South Bristol, New York as part of a multi-year project. Series 1997A also refunded a portion of the University of Rochester Revenue Bonds, Series 1987.

The bonds are secured by the pledge and assignment of certain revenues of the University. These pledged revenues include all tuition, room and board and mandatory fees charged to students. The pledged revenues are subordinate to the prior pledges securing outstanding indebtedness of the University.

(m) Bonds Payable – DASNY Series 1997 A and B

Pursuant to an agreement with a University related entity (Highland Hospital and affiliates) and DASNY dated December 11, 1997, DASNY issued and sold $26,635 of the Series 1997A tax-exempt FHA-Insured Mortgage Hospital Revenue Bonds and $5,250 of Series 1997B taxable FHA-Insured Mortgage Hospital Revenue Bonds.

The Series 1997A and B bonds were issued at par value. The proceeds of these bond issues were used to finance (1) the expansion and modernization of selected clinical and support areas of the Highland Hospital; (2) the construction of the main parking garage and (3) to refinance the Marine Midland Bank, N.A. construction mortgage note payable. The bonds are secured by a pledge of collateral for letters of credit and cash.

During FY05, the outstanding Series 1997 A & B bonds, totaling $27,402, were refinanced with the proceeds from the sale of COMIDA bonds.

(n) Bonds Payable – DASNY Series 1998A

Pursuant to an agreement between the University and DASNY dated March 18, 1998, DASNY issued and sold $131,615 of bonds known as University of Rochester Revenue Bonds, Series 1998A. The Series 1998A bonds were issued at a discount of $370 resulting in proceeds of $131,245 to finance (1) design and construction of a new biomedical research facility of approximately 240,000 square feet; (2) construction of a new entrance to the School of Medicine and Dentistry of approximately 55,000 square feet; (3) renovations for laboratory space of approximately 65,000 square feet; (4) the acquisition of scientific equipment and furnishings for the new facility and renovated laboratory space; (5) the University-wide telecommunications system and (6) replacement of the chiller at the central utilities plant. Series 1998A also refunded a portion of the University of Rochester Revenue Bonds, Series 1987.

The bonds are secured by the pledge and assignment of certain revenues of the University. These pledged revenues include all tuition, room and board and mandatory fees charged to students. The pledged revenues are subordinate to the prior pledges securing certain other outstanding indebtedness of the University.

(o) Bonds Payable – DASNY Series 1999A

Pursuant to an agreement between the University and DASNY dated August 15, 1999, DASNY issued and sold $17,465 of bonds known as University of Rochester Revenue Bonds, Series 1999A. The Series 1999A bonds were issued at a discount of $190 resulting in proceeds of $17,275 to finance (1) the implementation of a new Human Resource information system to serve payroll and personnel functions University-wide; (2) renovations of existing space for various uses in the School of Medicine and Dentistry and (3) various projects throughout the University designed to improve the accessibility of facilities and to accomplish deferred maintenance items. The Loan Agreement and the obligation of the University to make payments under the Loan Agreement are general obligations of the University.

No security interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(p) Bonds Payable – DASNY Series 1999B

Pursuant to an agreement between the University and DASNY dated August 15, 1999, DASNY issued and sold $25,860 of bonds known as the University of Rochester, Strong Memorial Hospital Revenue Bonds, Series 1999B. The Series 1999B bonds were issued at a discount of $306 resulting in proceeds of $25,554 to finance (1) the design and construction of a new emergency room at the Hospital; (2) relocation and expansion of the cardiac catheterization laboratory and (3) expansion of existing space for the Hospital clinical laboratories.

The Loan Agreement and the obligation of the University to make payments under the Loan Agreement are general obligations of the University. No security interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(q) Bonds Payable – DASNY Series 2000A

Pursuant to an agreement between the University and DASNY dated June 1, 2000, DASNY issued and sold $45,764 of bonds known as the University of Rochester Revenue Bonds, Series 2000A. The Series 2000A bonds were issued at a discount of $2 resulting in proceeds of $45,762 to finance (1) the construction of an addition to the Medical Research Building to expand research space for core programs in the School of Medicine and Dentistry; (2) the renovation of faculty office space and the expansion of instructional facilities of the William E. Simon Graduate School of Business Administration; (3) the upgrading of chilled water supply infrastructure; (4) improvements to faculty office and laboratory space at the University's River Campus and (5) infrastructure repairs at the Eastman School of Music and other facility improvements on the River Campus including the continuation of general deferred maintenance items. Series 2000A also refinanced a portion of the University of Rochester Revenue Bond, Series 1972C.

The Loan Agreement and the obligation of the University to make payments under the Loan Agreement are general obligations of the University. No security interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(r) Bonds Payable – DASNY Series 2001A

Pursuant to an agreement between the University and DASNY dated July 10, 2001, DASNY issued and sold $22,920 of bonds known as the University of Rochester Revenue Bonds, Series 2001A. The Series 2001A bonds were issued at a discount of $152 resulting in net proceeds of $22,768 to refinance (1) all the outstanding $184 University's Dormitory (Apartment) bonds of 1962, HUD Series D and all the outstanding $840 University's Dormitory (Apartment) bonds of 1966, HUD Series E and (2) a portion of the University of Rochester Revenue Bond, Series 1994A, maturing on and after July 1, 2007. HUD Series D and E were paid on October 1, 2001. DASNY Series 1994A bondholders were paid on July 1, 2004.

The Loan Agreement and the obligation of the University to make payments under the Loan Agreement are general obligations of the University. No security interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(s) Bonds Payable – DASNY Series 2003 A, B and C

Pursuant to an agreement with the University and DASNY dated October 29, 2003, DASNY issued and sold $164,425 of Series 2003 bonds, consisting of $32,550 Series 2003A bonds, $49,650 Series 2003B bonds and $82,225 Series 2003C bonds.

Series 2003A bonds were issued to finance (1) an expansion of the Laboratory for Laser Energetics building to accommodate the construction of a federally funded laser expansion; (2) renovation of space to house a functional MRI; (3) deferred maintenance remediation in various buildings and (4) renovation and information technology upgrades in various faculty offices, laboratory space and student residential buildings. A portion of the proceeds from Series 2003A also refinanced the remaining portion of the University of Rochester Revenue Bonds, Series 1987.

Series 2003B bonds were issued to finance (1) equipment acquisitions for the Hospital; (2) the expansion of an existing garage and (3) laboratory relocations at the Hospital. Series 2003B bonds also refinanced University of Rochester Series 1993A bonds and a portion of the University of Rochester Series 1994 bonds.

Series 2003C bonds were issued to finance (1) construction of an Adult Intensive Care Unit; (2) renovations of the Cancer Center and (3) deferred maintenance, renovations and improvements to faculty offices, laboratory and clinical spaces for various departments and areas within the Hospital and School of Medicine and Dentistry. Series 2003C also refinanced a portion of the University of Rochester Series 1994 bonds.

On July 31, 2003, the University executed $164,425 of interest rate swaps with third parties. The University entered into the interest rate swap agreement to exchange variable rate debt for a fixed rate obligation without the exchange of the underlying principal amount. Under this agreement the counter party pays the University a variable interest rate equal to 61.5% of one-month LIBOR plus 56 basis points. The University will pay the counter party a fixed interest rate of 3.97%. Net payments or receipts under the swap agreements are recorded as an adjustment to interest expense. As of June 30, 2005, the fair value of the interest rate swap was a liability of $9,134, and was included in accounts payable and accrued expenses on the consolidated balance sheet. The contractual relationship under this agreement will last until July 1, 2033.

The Loan Agreement and the obligation of the University to make payments under the Loan Agreement are general obligations of the University.

(t) Bonds Payable – Series 2004A

Pursuant to an agreement between the University and DASNY dated August 26, 2004, the Bank of New York issued $45,000 of bonds known as the University of Rochester Revenue Bonds, Series 2004A. The Series 2004A bonds were issued at a premium of $603, resulting in proceeds of $45,603 to finance the construction of a co-generation facility to provide supplementary heat and/or electricity to the University and will also provide an addition to the University's Central Utility plant.

The Loan Agreement and the obligation of the University to make payments under the Loan Agreement are general obligations of the University.

(dollars in thousands)

(u) Bonds Payable – COMIDA

Pursuant to an agreement with a University related entity (Highland Hospital and affiliates) and the County of Monroe Industrial Agency (COMIDA) dated June 23, 2005, COMIDA issued and sold $20,000 of fixed rate Civic Facility Revenue Refunding Bonds and $14,920 of fixed rate Civic Facility Revenue Project Bonds. The COMIDA Refunding Bonds were issued at a premium of $912 and were used to refund a portion of Series 1997A debt. These Refunding Bonds are secured by amounts in a Debt Service Reserve Fund. The COMIDA Project Bonds were issued at a premium of $362 and were issued to finance (1) the Park Ridge Oncology Project, (2) the Bariatric Surgery Project, (3) the Orthopedic Operating Room Project and (4) various renovation projects throughout Highland Hospital. These Project Bonds are secured by the construction projects noted above. In addition, Highland Hospital issued $6,135 of direct taxable notes on June 23, 2005 to refund the remaining portion of Series 1997A and all of Series 1997B debt. These notes were issued at a discount of $5 and are secured by amounts in a Debt Service Reserved Fund.

(v) Required Principal Payments

Required composite principal payments for long-term debt, net of unamortized discount, for each of the years in the five-year period ending June 30, 2010 and thereafter are as follows:

Maturity	Principal portions of lease payments	Principal payments of debt	Total principal payments
2006	$ 3,429	$ 29,489	$ 32,918
2007	2,740	24,702	27,442
2008	1,883	24,997	26,880
2009	609	25,420	26,029
2010	-	17,336	17,336
Thereafter	-	404,825	404,825
Total	$ 8,661	$ 526,769	$ 535,430

The University expended $22,609 and $23,811 for interest for the years ended June 30, 2005 and 2004, respectively, net of interest capitalization of $1,599 and $893 for the years ended June 30, 2005 and 2004, respectively.

(9) Benefits Plans

Self-insurance Plans – University

The University is self-insured for workers' compensation and medical benefits. Liabilities for asserted and unasserted claims under the workers' compensation program at June 30, 2005 were discounted by 4.50% and amounted to $23,472 (4.50% and $23,177 in 2004). The University has a $20.2 million standby letter of credit with JPMorgan Chase Bank to cover potential liabilities under the University's self-insured workers' compensation program.

The University is self-insured for health care benefits. Based on estimates provided by actuaries, the University's obligation for incurred but not reported claims was $9,311 as of June 30, 2005 ($8,631 in 2004). This amount has not been discounted.

Retirement Plan – University

Most full-time University employees participate in the retirement plans administered by TIAA-CREF, or in a defined contributions plan sponsored by the University. Under these plans, the University made contributions of $47,833 in 2005 ($43,888 in 2004), which were vested for the benefit of the participants.

Post-retirement Benefit Plan – University

The University's post-retirement benefit plan includes basic medical, major medical, dental coverage and life insurance. Benefit levels differ for current retirees, current employees eligible to retire and current employees not eligible to retire. The accumulated post-retirement benefit obligation of $70,623, created as of January 1, 1996 by the enactment of the plan, is being amortized over 16 years, the average estimated service lives of plan participants.

The University incurred retirement plan expense of $14,527 and $13,503 for the years ended June 30, 2005 and 2004, respectively, that is recorded in fringe benefits expense on the consolidated statement of activities.

The impact on retiree liabilities as a result of the conversion to a self-funded plan for health care benefits is reflected as an amendment to the change in benefit obligation.

(dollars in thousands)

Benefit expense for this plan for the years ended June 30, 2005 and 2004 includes the following components:

	2005	2004
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 124,266	$ 112,193
Service cost	1,832	1,513
Interest cost	6,203	6,806
Estimated plan participants' contributions	1,497	1,411
Actuarial (gain)/loss	(15,891)	10,336
Benefits paid	(8,487)	(7,993)
Benefit obligation at end of year	$ 109,420	$ 124,266
Change in plan:		
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	6,990	6,582
Participant contributions	1,497	1,411
Benefits paid	(8,487)	(7,993)
Fair value of plan assets at end of year	$ -	$ -
Components of accrued benefit:		
Funded status	$ (109,420)	$ (124,266)
Unrecognized net actuarial loss	6,861	22,752
Unrecognized prior service cost	37,606	42,711
Accrued benefits	$ (64,953)	$ (58,803)
Amounts recognized in the balance sheet consist of:		
Accrued post-retirement benefit cost	$ (58,803)	$ (51,881)
Net post-retirement benefit income	(13,140)	(13,504)
Net benefits paid	6,990	6,582
Accrued benefits	$ (64,953)	$ (58,803)
Components of net periodic benefit cost:		
Service cost	$ 1,832	$ 1,513
Interest cost	6,203	6,806
Amortization of prior service cost	5,105	5,105
Net loss	-	80
Net periodic benefit cost	$ 13,140	$ 13,504
Estimated future contribution and benefit payments net of estimated 28% Rx subsidy payments:		
2006	$ 6,757	
2007	6,639	
2008	6,849	
2009	7,103	
2010	7,378	
2011 to 2015	39,237	
Total estimated future payments	$ 73,963	

(dollars in thousands)

Benefits are valued based upon the projected unit cost method. The weighted average assumptions used at the measurement date, April 1, are as follows:

	2005	2004
Discount rate for obligation	5.75%	5.75%
Expected return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Health care cost trend rate – initial	12.00%	12.00%
Health care cost trend rate – final	4.00%	4.00%

The rate increase in health care costs was assumed to decrease to 4.00% in 2012 and to remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage-point change in the health care cost trend rate would have the following effects:

	One percentage point increase	One percentage point decrease
Effect on total of service and interest cost components	$ 411	$ (369)
Effect on post-retirement benefit obligation	$ 3,862	$ (3,732)

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) provides for a direct government subsidy for employers who continue to offer a retiree drug program that is deemed to be actuarially equivalent to the government plan. The University anticipates that it will qualify for the Medicare Part D prescription drug federal subsidy. In accordance with the FASB Staff position 106-2, Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvement and Modernization Act (FSP 106-2), the University recorded the impact of the Act in its June 30, 2005 financial statements. The reduction in the Accumulated Postretirement Benefit Obligation for the subsidy related to benefits attributed to past service as of July 1, 2004 is $12,899. The effect of the subsidy on the measurement of the net periodic postretirement benefit cost for fiscal year 2005 is $1,387.

Post-employment Benefits – University

Accrued post-employment benefits of the University amounted to $43,443 and $35,545 at June 30, 2005 and 2004, respectively.

Retirement Plan – Related Entity (Highland Hospital and Affiliates)

The retirement plan of a related entity covers all employees who have completed one full year of continuous employment. The benefits for this plan are based primarily on years of service and employees' pay near retirement. The related entity's funding policy is to contribute annually, an amount consistent with the requirement of the Employee Retirement Income Security Act. Plan assets consist principally of cash equivalents, common stocks and fixed income investments.

Retirement plan expense of $3,851 and $4,136 was incurred for the years ended December 31, 2004 and 2003, respectively, and is recorded in fringe benefits expense in the consolidated statement of activities. In addition, in 2004, an increase in minimum pension liability of $1,503 was recorded. A reduction in minimum pension liability of $1,730 was recorded in 2003. These amounts are included as other health care costs in the consolidated statement of activities.

Pension expense for this plan for the years ended December 31, 2004 and 2003 (the most recent data available) includes the following components:

	2004	2003
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 58,682	$ 53,446
Service cost	2,592	2,323
Interest cost	3,479	3,294
Amendment	-	(359)
Actuarial loss	4,492	1,493
Benefits paid	(1,597)	(1,515)
Benefit obligation at end of year	$ 67,648	$ 58,682
Change in plan assets:		
Fair value of assets at beginning of year	$ 34,563	$ 28,258
Actual return on plan assets	4,516	5,454
Employer contribution	2,220	2,665
Benefits paid	(1,597)	(1,515)
Administrative expenses paid	(307)	(299)
Fair value of assets at end of year	$ 39,395	$ 34,563

(dollars in thousands)

	2004	2003
Components of accrued pension liability:		
Funded status	$ (28,253)	$ (24,119)
Unrecognized net actuarial loss	17,902	15,648
Unrecognized net asset in transition	(330)	(645)
Unrecognized prior service cost	-	66
Accumulated comprehensive pension expense	(10,039)	(8,536)
Intangible asset	-	(66)
Accrued pension liability	$ (20,720)	$ (17,652)
Amounts recognized in the balance sheet consist of:		
Accrued benefits cost	$ (20,720)	$ (17,718)
Intangible assets	-	66
Net amount recognized	$ (20,720)	$ (17,652)
Projected benefit obligation	67,648	58,682
Accumulated benefit obligation	60,115	52,216
Fair value of plan assets	39,395	34,563
Components of net periodic benefit cost:		
Service cost	$ 2,592	$ 2,323
Interest cost	3,479	3,294
Expected return on plan assets	(3,084)	(2,510)
Amortization of prior service cost	66	84
Amortization of transition asset	(315)	(315)
Amortization gain	1,113	1,260
Net periodic benefit cost	$ 3,851	$ 4,136
Weighted-average assumptions as of December 31:		
Discount rate for obligation	5.75%	6.00%
Discount rate for pension expense	6.00%	6.50%
Investment return assumption (regular)	9.00%	9.00%
Future compensation increase rate	3.00%	3.00%

The combination of declining discount rate assumptions and market trends has resulted in a decline in the plan's funded status.

The pension plan funds are allocated to two money market managers, each with a balanced portfolio. These money managers monitor financial market funds and adjust inconsistent strategy accordingly.

The weighted-average asset allocation for the pension plan as of December 31, 2004 and 2003 by asset manager categories is as follows:

	2004	2003
Weighted-average assumptions by asset categories:		
Equity securities	67%	65%
Fixed income securities	33%	34%
Cash and other investments	-	1%
	100%	100%

Estimated future contribution and benefit payments for the years ending December 31:	
2005	$ 1,477
2006	1,537
2007	1,695
2008	1,904
2009	2,079
2010 to 2014	15,000
Total estimated future payments	**$** 23,692

(10) Investment in Captive Insurance Company

The Hospital, together with other universities and teaching hospitals, has formed a captive insurance company (captive) to insure the professional liability risks of the shareholders. The Hospital's investment in the captive represents 20% of the voting rights; however, the dissolution provisions of the captive agreement indicate that the Hospital's financial participation (based on percentage of premiums paid) is approximately 8% of the financial results of the captive. Due to the Hospital's significant interest in the captive, the investment in the captive has been recorded under the equity method.

The Hospital's premiums are based on its professional liability experience and a shared risk factor with the other participants. Premiums are subject to retrospective adjustment based on, among other things, actual loss experience of the Hospital. The Hospital is entitled to cash representing retrospective premiums from the captive. These amounts are included in accounts receivable on the balance sheets.

(dollars in thousands)

The most recent audited financial information for the captive for years ended December 31 is summarized below:

		2005		2004
Results of Operation				
Net earned premiums	$	214,869	$	226,831
Expenses		(230,657)		(249,651)
Investment income and realized gains on sales of marketable securities		37,992		24,258
Net income	$	22,204	$	1,438
Financial position				
Total assets	$	1,462,852	$	1,330,090
Total liabilities		1,338,853		1,231,674
Shareholders' Equity	$	123,999	$	98,416

(11) Professional Liability Insurance

The University's coverage for professional liability insurance is provided under insurance policies obtained jointly with other universities and teaching hospitals. The primary layer of coverage, and 10% of the first layer of excess insurance, were written by MCIC Vermont, Inc. (a Risk Retention Group) formed and directed by the participating insured institutions. Multiple layers of excess insurance were purchased from several different insurance companies. The maximum coverage for the Medical Center is $207,500 per claim. The per claim coverage amount at each of the five participating institutions has been tailored to their own experience and exposures.

Based on estimates provided by the actuaries retained by MCIC Vermont, Inc., the University's obligations for incurred, but not reported claims were $17,393 and $15,957 as of June 30, 2005 and 2004, respectively.

(12) Fair Value of Financial Instruments

The method and assumptions described below were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Cash and Cash Equivalent, Accounts Receivable, Third-Party Settlements Payable and Accounts Payable and Accrued Expenses

The carrying amount approximates fair value because of the short maturities of these instruments.

Contributions Receivable

Contributions receivable are recorded at their net present value. See note 1(h) for accounting policies related to contributions receivable.

Investment

Investments are reported at fair values. See note 1(i) for accounting policies for determination of fair value of investments.

Notes Receivable

A reasonable estimate of the fair value of notes receivable from students under Federal Government financial assistance programs could not be made because the notes are not salable and can only be assigned to the Federal Government or its designees. The fair value of notes receivable from students under University loan programs approximates carrying value.

Estimated Professional Liability Costs

The carrying amount of this actuarially determined liability approximates fair value.

Long-Term Debt

The fair value of the University's long-term debt is estimated based upon the amount of future cash flows, discounted using the University's current borrowing rate for similar debt instruments of comparable maturities. The fair value of total bonds and notes payable was $556,959 and $591,900 at June 30, 2005 and 2004, respectively.

(continued)

(dollars in thousands)

(13) Lines and Letters of Credit

The University has a total of $21,228 in letters of credit. Of this total, $20,195 is for the University's self-insured workers' compensation program, $500 is for the University's Commercial General Liability Policy deductible and $533 is for the repayment of obligations to the Urban Development Corporation.

The University has an additional $25 million committed 364 day revolving credit agreement with JPMorgan Chase Bank for emergency purposes. At June 30, 2005 and 2004, there was no amount outstanding under this line of credit.

(14) Commitments and Contingencies

In the ordinary course of operations, the University is named as a defendant in various lawsuits, or events occur which could lead to litigation, claims, or assessments. Although the outcome of such matters cannot be predicted with certainty, management believes that insurance coverage is sufficient to cover current or potential claims, or that the final outcomes of such matters will not have a material adverse effect on the consolidated financial position.

At June 30, 2005, the University has entered into construction contracts and commitments aggregating $336,268 ($309,153 at June 30, 2004) of which $264,906 ($263,003 at June 30, 2004) had been incurred.

(15) Leases

Future minimum payments by year and in the aggregate, under non-cancelable operating leases, with initial or remaining terms of one year or more are as follows:

	University	Related Entity
2006	$ 15,900	$ 2,310
2007	12,393	1,949
2008	10,281	1,925
2009	8,334	1,901
2010	6,132	1,672
Thereafter	27,298	6,298
Total minimum lease payments	$ 80,338	$ 16,055

(16) Scholarships, Grants and Fellowships

The University awarded a total of $83,563 and $81,422 in scholarships, grants and fellowships during fiscal years 2005 and 2004, respectively. In addition, the University awarded $10,140 and $9,528, respectively, of scholarships, grants and fellowships as compensation to the recipients. $13,588 and $13,316, respectively, of the total scholarships, grants and fellowships awarded were specifically funded by Federal, state or private gifts or grants, or by investment income and gains earned on investments held for endowment and similar purposes and utilized under the University's total return spending policy.

(17) Functional Expenses

The University also records expenses according to major classes of programs or functions. Functional expenses for the years ended June 30 consisted of the following:

	2005	2004
Instruction	$ 243,858	$ 242,178
Research	240,575	211,734
Public Service	10,651	9,970
Libraries and other academic support	39,095	35,525
Student services	33,536	31,105
Institutional support	54,026	73,987
Hospital and faculty practice patient care	1,204,626	1,123,244
Auxiliary enterprises	52,327	46,877
Total functional expenses	$ 1,878,694	$ 1,774,620