

**UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES**

Consolidated Financial Statements

June 30, 2006 and 2005

UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES

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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 (the "University") at June 30, 2006 and 2005, the changes of their net assets and their cash flows for the year 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 audits provide a reasonable basis for our opinion.

As further discussed in Note 18 to the financial statements, the University changed its method of accounting for conditional asset retirement obligations.

PricewaterhouseCoopers LLP

September 29, 2006

**UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES**

Consolidated Balance Sheets

As of June 30
(dollars in thousands)

Assets	2006	2005
Cash and cash equivalents	\$ 199,805	\$ 175,019
Operating investments	147,793	147,086
Accounts receivable, net	231,258	222,778
Inventories, prepaid expense and deferred charges	49,143	48,411
Contributions receivable, net	29,044	35,074
Notes receivable, net	18,583	20,066
Other assets	4,710	2,019
Investments held for long-term purposes	1,633,507	1,514,604
Property, plant and equipment, net	1,103,891	1,009,331
Interest in net assets of foundation	16,920	16,382
Investments in perpetual trusts held by others	54,533	52,451
Total assets	\$ 3,489,187	\$ 3,243,221
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 205,734	\$ 203,550
Advanced receipt of sponsored research revenues	31,132	34,644
Deferred revenue	48,700	45,897
Third-party settlements payable, net	75,860	76,730
Accrued pension, post-retirement, and post-employment	140,356	135,423
Long-term debt	541,305	535,430
Asset retirement obligation	16,763	-
Refundable U.S. Government grants for student loans	15,719	15,660
Total liabilities	1,075,569	1,047,334
Net Assets:		
Unrestricted	1,944,990	1,726,153
Temporarily Restricted	211,969	220,361
Permanently Restricted	256,659	249,373
	2,413,618	2,195,887
Total liabilities and net assets	\$ 3,489,187	\$ 3,243,221

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF ROCHESTER
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Consolidated Statement of Activities

Year ended June 30, 2006

(dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Operating revenues:				
Tuition and fees	\$ 219,288	\$ -	\$ -	\$ 219,288
Less: scholarships and fellowships	(87,433)	-	-	(87,433)
Net tuition and fees	131,855	-	-	131,855
State and local appropriations	1,812	-	-	1,812
Grants and contracts	359,097	-	-	359,097
Gifts and pledges	45,885	16,935	6,147	68,967
Hospital and faculty practice patient care activities	1,344,612	-	-	1,344,612
Auxiliary enterprises	60,907	-	-	60,907
Interest income on cash and operating investments	13,975	-	-	13,975
Educational activities	27,270	-	-	27,270
Royalty income	44,278	-	-	44,278
Other sources	9,769	-	-	9,769
Long-term investment income and gains allocated to operations	80,120	-	-	80,120
Net assets released from restrictions	35,130	(35,130)	-	-
Total operating revenues	<u>2,154,710</u>	<u>(18,195)</u>	<u>6,147</u>	<u>2,142,662</u>
Operating expenses:				
Salaries and wages	992,517	-	-	992,517
Fringe benefits	250,901	-	-	250,901
Total compensation	1,243,418	-	-	1,243,418
Supplies	276,869	-	-	276,869
Business and professional	182,538	-	-	182,538
Utilities	42,614	-	-	42,614
Maintenance and facilities costs	77,045	-	-	77,045
Depreciation expense	113,592	-	-	113,592
Interest expense	24,732	-	-	24,732
Other	80,975	-	-	80,975
Total operating expenses	<u>2,041,783</u>	<u>-</u>	<u>-</u>	<u>2,041,783</u>
Change in net assets from operating activities	<u>112,927</u>	<u>(18,195)</u>	<u>6,147</u>	<u>100,879</u>
Non-operating activities:				
Long-term investment activities:				
Investment income	20,795	3,302	49	24,146
Net appreciation	148,781	31,894	3,895	184,570
Total long-term investment activities	169,576	35,196	3,944	208,716
Long-term investment income and gains allocated for operations	(80,120)	-	-	(80,120)
Loss on extinguishment of debt	(2,638)	-	-	(2,638)
Reclass of net assets	26,404	(24,395)	(2,009)	-
Other changes, net	9,451	90	(804)	8,737
Change in valuation of annuities	-	(1,088)	8	(1,080)
Change in net assets from non-operating activities	<u>122,673</u>	<u>9,803</u>	<u>1,139</u>	<u>133,615</u>
Change in net assets before cumulative effect of change in accounting principle	235,600	(8,392)	7,286	234,494
Cumulative effect of change in accounting principle	(16,763)	-	-	(16,763)
Change in net assets	<u>218,837</u>	<u>(8,392)</u>	<u>7,286</u>	<u>217,731</u>
Beginning net assets	1,726,153	220,361	249,373	2,195,887
Ending net assets	<u>\$ 1,944,990</u>	<u>\$ 211,969</u>	<u>\$ 256,659</u>	<u>\$ 2,413,618</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF ROCHESTER
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Consolidated Statement of Activities

Year ended June 30, 2005

(dollars in thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
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
Grants and contracts	365,017	-	-	365,017
Gifts and pledges	23,111	16,042	11,874	51,027
Hospital and faculty practice patient care activities	1,232,087	-	-	1,232,087
Auxiliary enterprises	56,787	-	-	56,787
Interest income on cash and operating investments	6,367	295	-	6,662
Educational activities	24,887	-	-	24,887
Royalty income	37,643	-	-	37,643
Other sources	6,695	-	-	6,695
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	<u>1,973,675</u>	<u>(8,457)</u>	<u>11,874</u>	<u>1,977,092</u>
Operating expenses:				
Salaries and wages	916,861	-	-	916,861
Fringe benefits	238,023	-	-	238,023
Total compensation	1,154,884	-	-	1,154,884
Supplies	255,538	-	-	255,538
Business and professional	163,865	-	-	163,865
Utilities	32,547	-	-	32,547
Maintenance and facilities costs	75,325	-	-	75,325
Depreciation expense	119,976	-	-	119,976
Interest expense	22,609	-	-	22,609
Other	70,480	-	-	70,480
Total operating expenses	<u>1,895,224</u>	<u>-</u>	<u>-</u>	<u>1,895,224</u>
Change in net assets from operating activities	<u>78,451</u>	<u>(8,457)</u>	<u>11,874</u>	<u>81,868</u>
Non-operating activities:				
Long-term investment activities:				
Investment income	24,615	1,469	(66)	26,018
Net appreciation	113,088	18,380	1,097	132,565
Total long-term investment activities	137,703	19,849	1,031	158,583
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	<u>60,526</u>	<u>21,371</u>	<u>1,105</u>	<u>83,002</u>
Change in net assets	138,977	12,914	12,979	164,870
Beginning net assets	<u>1,587,176</u>	<u>207,447</u>	<u>236,394</u>	<u>2,031,017</u>
Ending net assets	<u>\$ 1,726,153</u>	<u>\$ 220,361</u>	<u>\$ 249,373</u>	<u>\$ 2,195,887</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF ROCHESTER
AND RELATED ENTITIES**

Consolidated Statement of Cash Flows

Years Ended June 30

(dollars in thousands)

	2006	2005
Cash flows from operating activities:		
Change in net assets	\$ 217,731	\$ 164,870
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization expense	111,920	116,538
Net appreciation of investments	(176,948)	(134,198)
Gifts of property, plant and equipment	(1,373)	(9,049)
(Appreciation)/depreciation of interest in net assets of foundation	(538)	538
Appreciation of investments in perpetual trusts held by others	(2,082)	(1,829)
Bond premium amortization	205	613
Loss on the extinguishment of debt	2,638	1,264
Loss on disposals of property plant and equipment	1,744	3,469
Cumulative effect of change in accounting principle	16,763	-
(Increases)/decreases in:		
Operating investments	(707)	(34,005)
Accounts receivable	(8,480)	6,783
Inventories, prepaid expenses and deferred charges	(1,342)	(8,177)
Contributions receivable	6,030	5,848
Other assets	(3,300)	4,495
Increases/(decreases) in:		
Accounts payable and accrued expenses	(1,877)	27,544
Advanced receipt of sponsored research revenues	(3,512)	3,503
Deferred revenues	2,803	5,377
Third-party settlements, net	(870)	17,370
Accrued post-employment and post-retirement benefits	4,933	18,607
Contributions for long-term investment, net	(13,518)	(19,005)
Investment income restricted for long-term purposes	2,550	(206)
Net cash provided by operating activities	152,770	170,350
Cash flows from investing activities:		
Purchases of property, plant and equipment, net	(187,054)	(181,456)
Purchases of investments	(1,139,880)	(1,148,659)
Proceeds from the sale and maturity of investments	1,196,722	1,162,880
Increase in notes receivable, net of activities and other reductions	1,483	1,231
Net cash used in investing activities	(128,729)	(166,004)
Cash flows from financing activities:		
Principal repayments of indebtedness	(120,177)	(58,206)
Proceeds from issuance of long-term debt	111,180	87,779
Deferred financing costs	(1,285)	(2,009)
Increase in refundable U.S. Government grants for student loans	59	(188)
Contributions for long-term investment, net	13,518	19,005
Investment income restricted for long-term purposes	(2,550)	206
Net cash provided by financing activities	745	46,587
Increase in cash and cash equivalents during year	24,786	50,933
Cash and cash equivalents, beginning of year	175,019	124,086
Cash and cash equivalents, end of year	\$ 199,805	\$ 175,019
Supplemental disclosure of cash flow information -		
Cash paid during year for interest on long-term debt	\$ 22,593	\$ 24,147
Non-cash investing and financing activities:		
Change in construction related payables	4,061	2,472
Property, plant and equipment financed with capital leases	14,667	1,004
Net non-cash investing and financing activities	\$ 18,728	\$ 3,476

See accompanying notes to consolidated financial statements.

UNIVERSITY OF ROCHESTER AND RELATED ENTITIES

Notes to Consolidated Financial Statements

June 30, 2006 and 2005
(dollars in thousands)

(1) Summary of Significant Accounting Policies

(a) General

The University of Rochester (the University) is a private nonprofit institute 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 Systems, Inc. (and its affiliates), Eastman Dental Center Foundation, Inc., Strong Home Care Group (and its subsidiaries), 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, 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.

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(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.

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 asset, 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 trustee 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.

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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 placed in service.

During fiscal year 2006, the University reviewed specific donor restrictions for its temporarily and permanently restricted contributions and determined that a reclass of net assets of \$26.4 million to unrestricted net assets was required.

(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.

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, except that such instruments purchased with endowment and annuity and life income assets on deposit with trustees are classified as investments.

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

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management's judgment 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 2006 and 2005, University Trustees authorized the use of total return (income and appreciation) from its endowment resources at a rate of 6.7% 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:

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	<u>Years</u>
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) Benefit Plans

The University provides certain health care and life insurance benefits to retired employees and spouses

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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, 2002.

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 the 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 17%, respectively, of the Hospital's net patient revenue for the year ended June 30, 2006 and 32% and 15%, respectively, for the year ended June 30, 2005. Laws and regulation governing the Medicare and Medicaid programs are extremely complex and

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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 2006 and 2005, the Hospital recognized approximately \$15,700 and \$13,800 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 State 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 University. In the year ending June 30, 2006, 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 800,348 outpatient visits in their offices, mostly on University owned or leased premises; and covered 38,378 hospital admissions, as well as participated in the coverage of the emergency department handling over 91,925 visits. Payments for these services are derived primarily from third party insurers including Managed Care companies (40.0%), Medicare (25.2%), Blue Shield (10.8%), Medicaid (8.1%), Commercial (6.3%), Other (6.1%) and Self-pay (3.5%).

In addition to providing clinical outpatient care, the faculty group's mission is met by providing education and teaching. Our faculty supervise and instruct 410 University medical students and 642 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.

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(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 variable rate bond issues and interest rate swap agreements to obtain fixed rate financing at the lowest available cost at the time of the transactions. The University is exposed to credit loss in the event of nonperformance by the counterparty to its long-term rate swaps. The interest rate swaps do not qualify for cash flow hedge accounting.

(2) Net Assets

Unrestricted net assets consist of the following at June 30:

	2006	2005
Designated:		
For long-term purposes to support scholarships and other programs:		
Funds functioning as endowment	\$ 869,694	\$ 799,061
Accumulated appreciation resulting from investment of permanently restricted net assets	265,406	228,540
For property, plant and equipment purposes and debt service reserves held by trustees under debt agreements	42,940	14,856
For student loan programs, including required matching funds under Federal Government loan programs	3,385	3,658
For other specific operating purposes	53,534	51,749
For Highland Hospital and affiliates	67,142	58,364
For Eastman Dental Center Foundation	47,567	43,444
For other related entities	(20,769)	(19,072)
Total designated	1,328,899	1,180,600
Net investment in property, plant and equipment	514,755	490,639
Undesignated	101,336	54,914
Total unrestricted net assets	\$ 1,944,990	\$ 1,726,153

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

	2006	2005
Accumulated appreciation on permanently restricted net assets subject to purpose restrictions:		
Scholarships and grants	\$ 28,024	\$ 24,946
Instruction	66,572	62,560
Other	17,082	23,879
Subtotal	111,678	111,385
Interest in net assets of foundation	16,920	16,382
Related entities	5,719	3,458
Other gifts and income subject to:		
Purpose restrictions	21,856	20,461
Time restrictions:		
Contributions receivable	22,770	30,136
Split-interest agreements	33,026	38,539
Total temporarily restricted net assets	\$ 211,969	\$ 220,361

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

	2006	2005
Perpetual endowment funds:		
Restricted income purposes:		
Scholarships and grants	\$ 12,288	\$ 12,118
Instruction	37,483	38,284
Other	8,926	9,061
Unrestricted income purposes	133,191	124,782
Subtotal	191,888	184,245
Interests in perpetual trusts held by others:		
Restricted income purposes:		
Instruction	36,582	35,060
Student loans	1,458	1,440
Other	1,693	1,652
Unrestricted income purposes	14,800	14,299
Subtotal	54,533	52,451
Related entities	3,057	3,124
Split-interest agreements	801	715
Perpetual loan funds	3,674	3,900
Contributions receivable	2,706	4,938
Total permanently restricted net assets	\$ 256,659	\$ 249,373

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(3) Accounts Receivable

Accounts receivable at June 30 consist of the following:

	2006	2005
Patient care and related activities, net of allowances for doubtful accounts of \$24,014 and \$22,646	\$ 138,382	\$ 137,632
Federal, state and local governments, foundations and companies, net of allowances for doubtful accounts of \$183 and \$200	40,590	42,890
Student receivables, net of allowances for doubtful accounts of \$1,838 and \$2,687	6,326	6,137
Royalties and other	45,960	36,119
Total accounts receivable	\$ 231,258	\$ 222,778

(4) Contributions

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

	2006	2005
Unconditional promises expected to be collected in:		
Less than one year	\$ 11,083	\$ 13,036
One year to five years	21,033	24,817
Over five years	1,593	1,654
Subtotal	33,709	39,507
Less unamortized discount and allowance for uncollectible amounts	(4,665)	(4,433)
Total contributions receivable, net	\$ 29,044	\$ 35,074

At June 30, 2006, 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 \$13,431 and \$16,842, for University relations and development for the years ended June 30, 2006 and 2005, respectively.

(5) Notes Receivable

Student loans receivable at June 30, 2006 and 2005 are reported net of allowances for doubtful loans of \$1,372 and \$1,328, 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.

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(6) Investments Held for Long-Term Purposes

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

	<u>2006</u>	<u>2005</u>
Endowment and similar purposes	\$ 1,494,605	\$ 1,375,176
Property, plant and equipment purposes:		
Debt service reserve held by trustees under debt agreements	38,429	18,866
Other	<u>12,607</u>	<u>51,683</u>
Total property, plant and equipment purposes	51,036	70,549
Other purposes	<u>87,866</u>	<u>68,879</u>
Total investments held for long-term purposes	<u>\$ 1,633,507</u>	<u>\$ 1,514,604</u>

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

	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$ 116,790	\$ 104,141
Debt securities	124,427	189,383
Common and preferred stocks	748,506	535,696
Limited partnerships and similar interests	604,790	631,549
Oil royalties	-	16,000
Other investments-affiliates	<u>38,994</u>	<u>37,835</u>
Total market value	<u>\$ 1,633,507</u>	<u>\$ 1,514,604</u>

Included in the investments held for long-term purposes above are \$374,100 and \$376,097 of

international investments at June 30, 2006 and 2005, 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, 2006 and 2005, respectively, the University had commitments of \$282,565 and \$186,934 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:

	<u>2006</u>		
	<u>Market</u>	<u>Cost</u>	<u>Net Gains</u>
End of year	\$ 1,494,605	\$ 1,217,786	\$ 276,819
Beginning of year	\$ 1,375,176	\$ 1,100,264	<u>\$ 274,912</u>
Unrealized appreciation			1,907
Realized net gains for year			<u>156,071</u>
Net increase for year			<u>\$ 157,978</u>

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	2005		Net Gains
	Market	Cost	
End of year	\$ 1,375,176	\$ 1,100,264	\$ 274,912
Beginning of year	\$ 1,262,838	\$ 1,054,033	\$ 208,805
Unrealized appreciation			66,107
Realized net gains for year			65,530
Net increase for year			<u>\$ 131,637</u>

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, 2006 and 2005, at a notational amount of \$3,520 and \$6,475, 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 \$114 at June 30, 2006 and \$1,111 at June 30, 2005.

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 were \$24,586 and \$22,180 for the years ended June 30, 2006 and 2005, respectively.

(7) Property, Plant and Equipment

As of June 30, 2006 and 2005, the University's investment in property, plant and equipment is as follows:

	2006	2005
Buildings and improvements	\$ 1,315,450	\$ 1,268,228
Land improvements	33,271	30,642
Completed projects under leasehold agreements	46,454	46,331
Equipment owned	651,691	598,569
Library books	102,829	96,210
Subtotal	<u>2,149,695</u>	<u>2,039,980</u>
Less accumulated depreciation	1,237,530	1,136,934
Subtotal	912,165	903,046
Land	7,053	7,053
Museum collections	27,136	26,627
Construction in progress	<u>157,537</u>	<u>72,605</u>
Total property, plant and equipment, net	<u>\$ 1,103,891</u>	<u>\$ 1,009,331</u>

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(8) Long-Term Debt

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

	<u>2006</u>	<u>2005</u>
Obligations under capital leases, 0% to 9.164%, (a)	\$ 18,989	\$ 8,661
Urban Development Corporation loan, (b)	2,499	2,667
Term note payable, LIBOR rate plus 0.40%, (c)	-	3,000
Term note payable, LIBOR rate plus 0.75% (d)	601	945
Settlement note payable, 6.00% (e)	-	51
Direct Note Obligation, Series 2003, 5.40% to 5.75% (net of unamortized discount of \$30 in 2006 and \$32 in 2005), (f)	8,570	8,568
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), (h)	-	1,201
Bonds payable – DASNY Series 1994, 7.625%, (i)	8,930	9,124
Bonds payable – DASNY Series 1994B, 5.50% (j)	11,125	11,445
Bonds payable – DASNY Series 1996, 3.85% to 5.30% (net of unamortized discount of \$5 in 2005), (k)	-	2,625
Bonds payable – DASNY Series 1997A, 3.75% to 5.00% (net of unamortized premium of \$679 in 2006 and \$774 in 2005), (l)	24,799	38,704
Bonds payable – DASNY Series 1998A, 3.50% to 5.00% (net of unamortized discount of \$149 in 2006 and \$279 in 2005), (m)	82,565	103,766
Bonds payable – DASNY Series 1999A, 5.00% (net of unamortized discount of \$124 in 2005), (n)	-	17,341
Bonds payable – DASNY Series 1999B, 3.70% to 5.72% (net of unamortized discount of \$86 in 2006 and \$234 in 2005), (o)	5,989	22,046
Bonds payable – DASNY Series 2000A, 4.50% to 6.05% (p)	7,036	39,139
Bonds payable – DASNY Series 2001A, 2.90% to 5.00% (net of unamortized discount of \$108 in 2006 and \$117 in 2005), (q)	21,512	21,903
Bonds payable – DASNY Series 2003 A, B and C, 3.97%, (r)	150,050	156,100
Bonds payable – DASNY Series 2004A, 3.00 to 5.13% (net of unamortized premium of \$570 in 2006 and \$587 in 2005), (s)	44,545	45,122
Bonds payable – COMIDA, 3.125% to 5.450% (net of unamortized premium of \$1,161 in 2006 and \$1,269 in 2005), (t)	42,217	42,324
Bonds payable – DASNY Series 2006 A-1 and B-1, 3.919%, (u)	111,180	-
Total long-term debt	<u>\$ 541,305</u>	<u>\$ 535,430</u>

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.

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(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 collateralized 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 was 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 was 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

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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 are a 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 year 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 remaining outstanding Series 1994A bonds matured on June 30, 2006. The bondholders received final payment on July 1, 2006.

The obligation of the University is collateralized 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 collateralized by an irrevocable direct pay letter that is held by the trustee, JPMorgan Chase Bank. The Series 1994B Revenue Bonds are collateralized 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.

The outstanding Series 1996 bonds matured on June 30, 2006. The bondholders received final payment on July 1, 2006.

(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

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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.

During fiscal year 2006, a portion of the Series 1997A bonds were refinanced as a result of the issuance of Series 2006A-1.

The bonds are collateralized 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 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.

During fiscal year 2006, a portion of the Series 1998A bonds were refinanced as a result of the issuance of Series 2006A-1

The bonds are collateralized 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.

(n) 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.

During fiscal year 2006, all of the outstanding Series 1999A bonds were refinanced as a result of the issuance of Series 2006A-1.

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(o) 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.

During fiscal year 2006, a portion of the Series 1999B bonds were refinanced as a result of the issuance of Series 2006B-1.

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 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.

During fiscal year 2006, a portion of the Series 2000A bonds were refinanced as a result of the issuance of Series 2006A-1.

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 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.

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(r) Bonds Payable – DASNY Series 2003A, 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 counterparty pays the University a variable

interest rate equal to 61.5% of one-month LIBOR plus 56 basis points. The University will pay the counterparty 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, 2006, the fair value of the interest rate swap was a liability of \$1,135, 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.

(s) 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.

(t) 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

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debt. These Refunding Bonds are collateralized 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 collateralized 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 collateralized by amounts in a Debt Service Reserved Fund.

(u) Bonds Payable –DASNY Series 2006A-1 and B-1

Pursuant to an agreement between the University and DASNY dated March 16, 2006, DASNY issued and sold \$111,180 of bonds known as the University of Rochester Revenue Bonds, Series 2006, consisting of \$94,130 Series 2006A-1 bonds and \$17,050 Series 2006B-1 bonds. The Series 2006A-1 bonds were issued to refinance the University of Rochester Series 1999A bonds and portions of the University of Rochester Series 1997A bonds, the University of Rochester Series 1998A bonds and the University of Rochester Series 2000A bonds. The Series 2006B-1 bonds were issued to refinance portions of the University of Rochester Series 1999B bonds.

On March 16, 2006 the University executed \$111,180 of interest rate swaps with a third party. The University entered into an interest rate swap agreement to exchange variable rate debt for the fixed rate obligation without the exchange of the underlying principal amount. Under this agreement, the counterparty will pay the University a variable interest rate based on the Bond Market Association (BMA) Municipal Swap Index. The University will pay the counterparty a fixed interest rate of 3.92%. Net payments or receipts under the swap agreement are recorded as an adjustment to interest expense.

As of June 30, 2006, the fair value of the interest rate swap was a liability of \$3,216, 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, 2027.

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

(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, 2011 and thereafter are as follows:

<u>Maturity</u>	<u>Principal portions of lease payments</u>	<u>Principal payments of debt</u>	<u>Total principal payments</u>
2007	\$ 3,719	\$ 24,573	\$ 28,292
2008	2,917	25,029	27,946
2009	1,409	25,464	26,873
2010	635	16,739	17,374
2011	427	20,386	20,813
Thereafter	<u>9,882</u>	<u>410,125</u>	<u>420,007</u>
Total	<u>\$ 18,989</u>	<u>\$ 522,316</u>	<u>\$ 541,305</u>

The University expended \$24,732 and \$22,609 for interest for the years ended June 30, 2006 and 2005, respectively, net of interest capitalization of \$1,422 and \$1,599 for the years ended June 30, 2006 and 2005, respectively.

(9) Benefits Plans

Self-insurance Plans – University

The University is self-insured for workers' compensation and medical benefits. Liabilities for

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asserted and unasserted claims under the workers' compensation program at June 30, 2006 were discounted by 4.75% and amounted to \$24,338 (4.50% and \$23,472 in 2005). The University has a \$25.5 million standby letter of credit with JPMorgan Chase Bank to cover potential liabilities under the University's self-insured workers' compensation program.

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.

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 \$10,402 as of June 30, 2006 (\$9,311 in 2005). 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 \$51,840 in 2006 (\$47,833 in 2005), 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 \$13,139 and \$13,140 for the years ended June 30, 2006 and 2005, respectively, that is recorded in fringe benefits expense on the Consolidated Statement of Activities.

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Benefit expense for this plan for the years ended June 30, 2006 and 2005 includes the following components:

	<u>2006</u>	<u>2005</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 109,420	\$ 124,266
Service cost	1,936	1,832
Interest cost	6,097	6,203
Estimated plan participants' contributions	1,373	1,497
Actuarial (gain)/loss	(2,517)	(15,891)
Benefits paid	(8,130)	(8,487)
Amendments	1,744	-
	<u>109,923</u>	<u>109,420</u>
Benefit obligation at end of year	\$ <u>109,923</u>	\$ <u>109,420</u>
Change in plan:		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contributions	6,757	6,990
Participant contributions	1,373	1,497
Benefits paid	(8,130)	(8,487)
	<u>-</u>	<u>-</u>
Fair value of plan assets at end of year	\$ <u>-</u>	\$ <u>-</u>
Components of accrued benefit:		
Funded status	\$ (109,924)	\$ (109,420)
Unrecognized net actuarial loss	4,345	6,861
Unrecognized prior service cost	34,245	37,606
	<u>(71,334)</u>	<u>(64,953)</u>
Accrued benefits	\$ <u>(71,334)</u>	\$ <u>(64,953)</u>
Amounts recognized in the balance sheet consist of:		
Accrued post-retirement benefit cost	\$ (64,953)	\$ (58,803)
Net post-retirement benefit expense	(13,138)	(13,140)
Net benefits paid	6,757	6,990
	<u>(71,334)</u>	<u>(64,953)</u>
Accrued benefits paid at end of year	\$ <u>(71,334)</u>	\$ <u>(64,953)</u>
Components of net periodic benefit cost:		
Service cost	\$ 1,936	\$ 1,832
Interest cost	6,098	6,203
Amortization of prior service cost	5,105	5,105
	<u>13,139</u>	<u>13,140</u>
Net periodic benefit cost	\$ <u>13,139</u>	\$ <u>13,140</u>
Estimated future contribution and benefit payments net of estimated 28% prescription subsidy payments:		
2007	\$ 6,247	
2008	6,455	
2009	6,747	
2010	6,969	
2011	7,140	
2012 to 2016	39,165	
	<u>72,723</u>	
Total estimated future payments	\$ <u>72,723</u>	

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

	<u>2006</u>	<u>2005</u>
Discount rate for obligation	6.00%	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	10.00%	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:

	<u>One percentage point increase</u>	<u>One percentage point decrease</u>
Effect on total of service and interest cost components	\$ 551	\$ (484)
Effect on post- retirement benefit obligation	\$ 4,712	\$ (4,442)

The Medicare Prescription Drug Improvement and Modernization Act of 2003 provides for a direct government subsidy for employers who continue to offer a retiree drug program that is deemed to be actuarially equivalent in the government plan. The University qualified for the Medicare Part D prescription drug federal subsidy. In accordance with FASB Staff Position 106-2, *Accounting and Disclosure Requirements 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 post-retirement 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 post-retirement benefit cost for fiscal year 2005 is \$1,387 at the University level.

In September 2006, the Financial Accounting Standards Board issued SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Post-retirement Plans* which is an amendment of SFAS No.'s 87, 88, 106, and 132(R). SFAS No. 158 requires employers to recognize the over-funded or under-funded status of defined benefit pension and post-retirement plans as assets or liabilities in its consolidated balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. This statement also requires an employer to measure the funded status of the plan as of the consolidated balance sheet date. The University has not completed all of the analyses to determine the impact of the adoption of this new pronouncement.

Post-employment Benefits – University

Accrued post-employment benefits of the University amounted to \$45,185 and \$43,443 at June 30, 2006 and 2005, 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.

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Retirement plan expense of \$4,573 and \$3,851 was incurred for the years ended December 31, 2005 and 2004, respectively, and is recorded in fringe benefits expense in the consolidated statement of activities. In addition, in 2005, a reduction in minimum pension liability of \$406 was recorded. An increase in minimum pension liability of \$1,503 was recorded in 2004. 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, 2005 and 2004 (the most recent data available) includes the following components (in thousands):

	<u>2005</u>	<u>2004</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 67,648	\$ 58,682
Service cost	3,109	2,592
Interest cost	3,842	3,479
Actuarial loss	4,455	4,492
Benefits paid	<u>(1,940)</u>	<u>(1,597)</u>
Benefit obligation at end of year	<u>\$ 77,114</u>	<u>\$ 67,648</u>
Change in plan assets:		
Fair value of assets at beginning of year	\$ 39,395	\$ 34,563
Actual return on plan assets	6,995	4,516
Employer contribution	6,744	2,220
Benefits paid	(1,940)	(1,597)
Administrative expenses paid	<u>(356)</u>	<u>(307)</u>
Fair value of assets at end of year	<u>\$ 50,838</u>	<u>\$ 39,395</u>

	<u>2005</u>	<u>2004</u>
Components of accrued pension liability:		
Funded status	\$ (26,276)	\$ (28,253)
Unrecognized net actuarial loss	17,781	17,902
Unrecognized net asset in transition	(16)	(330)
Accumulated comprehensive pension expense	(9,633)	(10,039)
Intangible asset	-	-
Accrued pension liability	<u>\$ (18,144)</u>	<u>\$ (20,720)</u>

Amounts recognized in the balance sheet consist of:		
Accrued benefits cost	<u>\$ (18,144)</u>	<u>\$ (20,720)</u>
Projected benefit obligation	77,114	67,648
Accumulated benefit obligation	68,982	60,115
Fair value of plan assets	50,838	39,395

Components of net periodic benefit cost:		
Service cost	\$ 3,109	\$ 2,592
Interest cost	3,842	3,479
Expected return on plan assets	(3,346)	(3,084)
Amortization of prior service cost	-	66
Amortization of transition asset	(315)	(315)
Amortization gain/loss	<u>1,283</u>	<u>1,113</u>
Net periodic benefit cost	<u>\$ 4,573</u>	<u>\$ 3,851</u>

Weighted-average assumptions as of December 31:		
Discount rate for obligation	5.50%	5.75%
Discount rate for pension expense	5.75%	6.00%
Investment return assumption (regular)	8.50%	9.00%
Future compensation increase rate	3.82%	3.84%

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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, by asset manager categories is as follows:

Weighted-average assumptions by asset categories:	<u>2005</u>	<u>2004</u>
Equity securities	54%	67%
Fixed income securities	36%	33%
Cash and other investments	10%	-
	<u>100%</u>	<u>100%</u>

Estimated future contribution and benefit payments for the years ending December 31:

2006	\$	1,713
2007		1,801
2008		1,941
2009		2,093
2010		2,280
2011 to 2014		17,000
Total estimated future payments	\$	<u>26,828</u>

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

	<u>2006</u>	<u>2005</u>
Results of Operation		
Net earned premiums	\$ 234,893	\$ 214,869
Expenses	(266,471)	(230,657)
Investment income and realized gains on sales of marketable securities	40,492	37,992
Net income	<u>\$ 8,914</u>	<u>\$ 22,204</u>
Financial position		
Total assets	\$ 1,720,223	\$ 1,462,852
Total liabilities	<u>1,575,750</u>	<u>1,338,853</u>
Shareholders' Equity	<u>\$ 144,473</u>	<u>\$ 123,999</u>

(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 100% 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 \$204,500 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

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were \$24,025 and \$17,393 as of June 30, 2006 and 2005, respectively.

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 \$502,591 and \$556,959 at June 30, 2006 and 2005, 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.

(13) Lines and Letters of Credit

The University has a total of \$26,565 in letters of credit. Of this total, \$25,532 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. Of this total, \$2.1 million is outstanding as of June 30, 2006 and there was no amount outstanding at June 30, 2005.

(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, 2006, the University has entered into construction contracts and commitments aggregating \$428,126 (\$336,268 at June 30, 2005) of which \$328,511 (\$264,906 at June 30, 2005) had been incurred.

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(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:

	<u>University</u>	<u>Related Entity</u>
2007	\$ 15,556	\$ 2,593
2008	13,459	2,282
2009	10,771	2,084
2010	8,491	1,674
2011	7,376	1,283
Thereafter	25,102	7,079
Total minimum lease payments	<u>\$ 80,755</u>	<u>\$ 16,995</u>

	<u>2006</u>	<u>2005</u>
Instruction	\$ 261,313	\$ 243,858
Research	238,165	240,575
Public service	10,609	10,651
Libraries and other academic support	41,104	39,095
Student services	36,269	33,536
Institutional support	62,464	54,026
Hospital and faculty practice patient care	1,323,571	1,204,626
Auxiliary enterprises	68,288	68,857
Total functional expenses	<u>\$ 2,041,783</u>	<u>\$ 1,895,224</u>

(18) Asset Retirement Obligations

Financial Accounting Standards Board (FASB) Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligations (an interpretation of FASB Statement No. 143)* was issued in March 2005. This Interpretation requires recognition of a liability for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. This Interpretation requires that the fair value of a liability for a conditional asset retirement obligation be recognized in the period in which it occurred if a reasonable estimate of fair value can be made. Upon adoption of FIN 47 on June 30, 2006, the University recognized asset retirement obligations of \$16,763 which is reported as a cumulative effect of a change in accounting principle in the consolidated statement of activities, and a liability for conditional asset retirement obligations of \$16,763.

(16) Scholarships, Grants and Fellowships

The University awarded a total of \$87,433 and \$83,563 in scholarships, grants and fellowships during fiscal years 2006 and 2005, respectively. In addition, the University awarded \$11,731 and \$10,140, respectively, of scholarships, grants and fellowships as compensation to the recipients. \$13,166 and \$13,588, 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:

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The following table illustrates the effect on changes in net assets as if this Interpretation had been applied for the years ended, June 30:

	<u>2006</u>	<u>2005</u>
Change in net assets from operating activities, as reported	\$ 100,879	\$ 81,868
Less total interest accretion costs	<u>(763)</u>	<u>(742)</u>
Proforma change in net assets from operating activities	<u>\$ 100,116</u>	<u>\$ 81,126</u>