2006–2007 Financial Statements

University of Rochester
and Related Entities

2006–2007 Financial Statements

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University of Rochester
and Related Entities

Message from the CFO

December 10, 2007

To: The President and the Board of Trustees

I am pleased to present the 2006–07 Financial Statements for the University of Rochester including its affiliated entities. The picture presented in these statements and related analytical material is one of continuing strong performance and a sound base of financial resources.

During the 2006–07 fiscal year, the University's total net assets increased by $320 million, reflecting both favorable results from operations and positive returns on the University's investment portfolio. This increase continues the trend of steady increase in the University's net assets over the past five years.

Once again, the outstanding performance of the University's hospitals played a dominant role in the fiscal year operating outcome. Many other positives underlie the University's financial results. These include a banner year for undergraduate admissions in the College, progress in building Advancement capabilities along with substantial improvement in fundraising results, and a record year for royalty income from intellectual property developed by members of the University's faculty. I urge you to review the Financial Statement Highlights section on page 5 of this book for a detailed analysis of the significant factors relating to the University's financial position and performance.

The 2006–07 fiscal year saw significant progress on a number of fronts that will help ensure the University's strength in the future. The hiring of Provost and Executive Vice President Ralph Kuncl and Dean Douglas Lowry of the Eastman School of Music completed President Seligman's senior leadership team. Substantial progress was made toward the completion of an integrated university-wide Strategic Plan under the aegis of the Trustees' Strategic Planning Advisory Committee. The Campus Master Plan, covering all of the University's campuses and facilities, also moved into its final phases. Both of these plans, along with accompanying operating and capital financial plans, will be presented for Board approval during the 2007–08 fiscal year.

I hope that you find the materials in this publication informative. University Controller Doug Wylie and I would be glad to answer any questions you might have regarding the financial report. Our contact information as well as other financial materials can be found on the University's Administration and Finance Web site at www.rochester.edu/adminfinance.

Ronald J. Paprocki
Senior Vice President for Administration
and Finance and Chief Financial Officer

Financial Statements Highlights

Summary

Fiscal year 2007 marked another year of record financial performance by the University of Rochester and its related entities (the University). We review financial performance highlights in conjunction with a number of key operating measures. One such measure is the change in net assets, which is comprised of two primary components: operating and non-operating activities. The University's change in net assets from operating activities was $118.3 million. Operating results were driven primarily by the combined operating margins of our hospitals and other health-related entities of $87.3 million and increased royalty income of $17.2 million. The change in net assets from non-operating activities was $201.9 million driven by the return on the University's endowment portfolio and inclusive also of the cumulative effect on net assets for adoption of SFAS No. 158. The total change in net assets was $320.2 million or $102.5 million over last year's change in net assets of $217.7 million.

On the balance sheet, the University's consolidated cash position continued on its positive trend line and improved to over $417 million at June 30, 2007. Investments held for long-term purposes (including $19.3 million of securities pledged) grew by 21% over last year to almost $2 billion. This was the result primarily of the return on the University's endowment portfolio of 19.4% and unspent bond proceeds held by bond trustee. Series 2007 bonds were issued by the University in the spring of 2007 and are included in the net increase to long-term debt of approximately $167.2 million.

Selected Financial Trends

($'s in millions)

	FY07	FY06	FY05
Consolidated operating revenues	$ 2,295.4	$ 2,139.8	$ 1,977.1
Consolidated operating expenses	$ 2,177.1	$ 2,038.9	$ 1,895.2
Consolidated investments	$ 1,989.8	$ 1,632.2	$ 1,514.6
Return on endowment	19.4%	14.0%	12.7%
Consolidated changes in net assets:			
From operating activities	$ 118.3	$ 100.9	$ 81.9
From all other non-operating activities	201.9	116.8	83.0
Total increase/(decrease) to net assets	**$ 320.2**	**$ 217.7**	**$ 164.9**
Consolidated total net assets	**$ 2,733.9**	**$ 2,413.6**	**$ 2,195.9**

Results of Operations

A review of the consolidated financial results over the last three years reveals continued growth in certain key financial statement indicators:

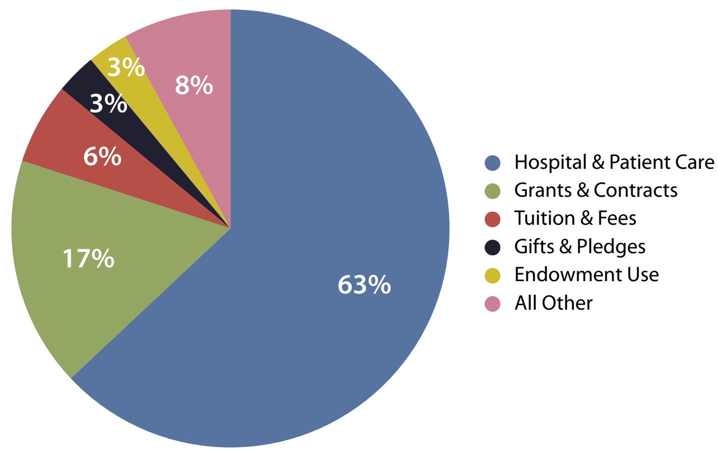
Revenues

Consolidated operating revenues recorded for FY 2007 totaled \$2.3 billion, an increase of 7.3% over the prior year. Tuition and fee revenues (gross) were \$22.8 million, 10.4% higher than last year reflecting increased enrollments and tuition rates in the College, increases in the Simon Business School summer graduate programs, and increased enrollments in expanded programs offered by the School of Nursing. Composite financial aid rates were 40.5% and 41.2% for fiscal years 2007 and 2006, respectively. Annual grants and contracts revenue has increased dramatically over the last five years. However, like other research institutions, the University has been feeling the impact of the flattening of federal government research budgets. Grants and contracts revenues for FY 2007 were \$362.2 million compared to \$359.1 million in FY 2006, approximately 1% over last year. The University seeks to obtain a market share increase by attracting talented (and well-funded) faculty researchers. The mix of sponsored programs has remained relatively unchanged from the prior year. Government sponsored grants and contracts account for about 80% of the total of \$362.2 million shown on the Statement of Activities. Revenues from the Department of Health and Human Services along with the Department of Energy and New York State comprised 87% of all government grants and contracts revenues. Aggregate research expenditures dipped slightly from last year by less than 2% for the River Campus while grant expenditure activity at the Medical Center increased by 2%.

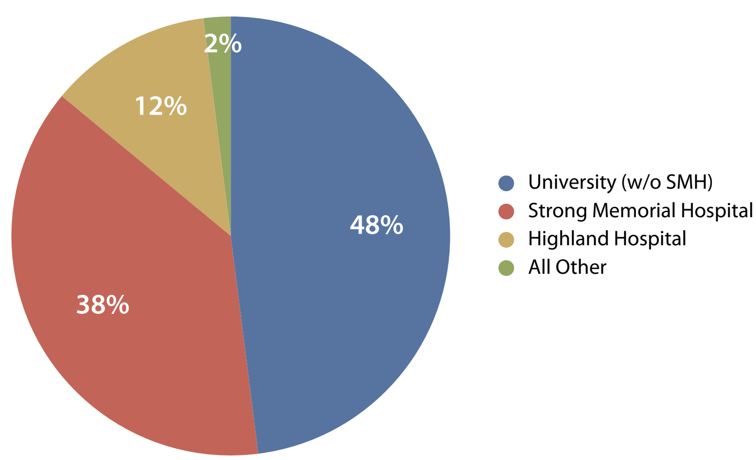
At approximately 63% of total revenues, the University's health-related activities are integral to the financial success of the organization. The operating revenues of the Strong Memorial Hospital (SMH) and the Highland Hospital (HH), the University of Rochester Medical Faculty Group (URMFG) practices, and nursing home and related care activities (combined in the financial statement category of hospital and faculty practice patient care revenues) increased 7.5% to \$1.4 billion. On the hospital side, revenues increases were 6.9% for SMH and 7.9% at HH. They were driven by increases in patient days, rates, and case mix indices. The aggregate URMFG group practices generated an increase in revenue of almost 10% over FY 2006 to \$292.7 million. This increase was attributed to increased patient volume particularly in radiology, surgery, and surgery-related specialties. The operating margin of SMH was 8% on revenues of \$880.8 million. The operating margin of HH was 7.3% on revenues of \$235.9 million.

FY 2007 was another banner year in terms of royalty/license fee income. This year provided the largest revenue total ever at \$61.4 million, or almost 40% higher than last year. This growth has been tied to two University licensed technologies; both are marketed and sold in vaccine therapies.

Operating Revenues by Source



Operating Revenues by Entity



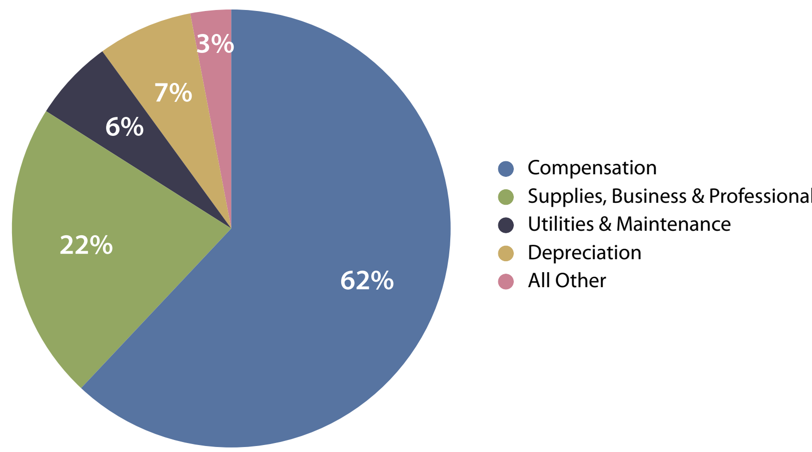
Expenses

Consolidated operating expenses increased by 6.8% to approximately $2.2 billion for the year ended June 30, 2007. Compensation expenses (salaries, wages, and fringe benefits) comprise 61% of total expenses and increased by 7% over last year. Contributing to this increase were the University's wage and salary program increase of 3% (slightly higher for faculty and the Medical Center), volume increases in the patient care areas, and continued increases in health care benefits to employees (inclusive of post-retirement and post-employment fringe benefit programs). Supplies expense increases continued in the health care delivery segment entities related not only to continued pricing increases but also to the growth in surgical support services and in pharmaceutical supplies usage. Business and professional expenses totaled $192 million and were about 5% over last year. The increase was primarily attributable to the increase in royalty revenues and associated payout formulae to the faculty inventors. Utilities expense increased by approximately 26% due to increased rates and consumption. Interest expense increased due to the Series 2007 bonds issued this past spring.

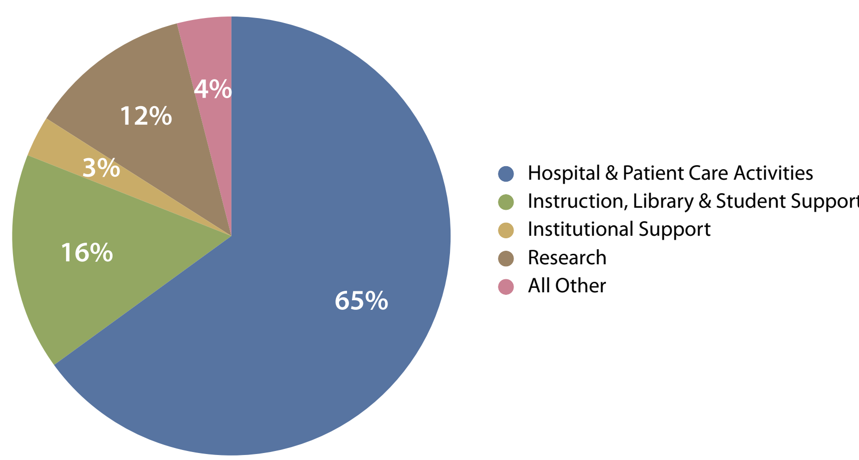
Related entities and affiliates

The operating activities of the related and affiliated entities represent 13.6% of total consolidated operating revenues. For the fiscal year ended June 30, 2007, this group provided about $20.7 million of the increase to total consolidated net assets of $320.3 million. Within the affiliated group, Highland Hospital (and subsidiaries) generated operating revenues of $270.0 million followed by Visiting Nurse Service, Inc. with $43.0 million. Over the past several years, the financial performance of these organizations has improved significantly. The University's Strong Health System continues to manage carefully its program operations and patient flow among the University's hospitals and nursing homes.

Natural Expenses



Functional Expenses



Financial Condition

Consolidated total assets grew to over $4 billion (or 16.3% over last year) with the more significant increases in cash (cash and cash equivalents and operating investments), long-term investments, and property, plant, and equipment. Importantly, total net assets (or net worth) increased to $2.73 billion or 13% over last year. The University's consolidated cash position increased by over $70 million to $417.7 million as of June 30, 2007. The endowment investment portfolio reached a market value of about $1.73 billion at June 30, 2007. The rate of return was 19.4% for FY 2007 compared to 14.0% for the prior year, which placed the University in the middle of its peer group and substantially above the 8% assumption contained in the University's financial plans. Rochester's five-year average annual return through June 30, 2007, was 13.4% versus 11.7% for its benchmark.

Net property, plant, and equipment increased to over $1.2 billion by the end of FY 2007. Consolidated capital spending of $216.1 million was incurred by the University and included $21.8 million for the Omega EP Laser project, $21.4 million for the James P. Wilmot Cancer Center, $9.8 million for the Robert B. Goergen Hall for Biomedical Engineering and Optics, $8.1 million for our new patient billing/information system, and $7.7 million for the Cardiovascular Research Institute. Another $54.9 million was expended on major moveable equipment.

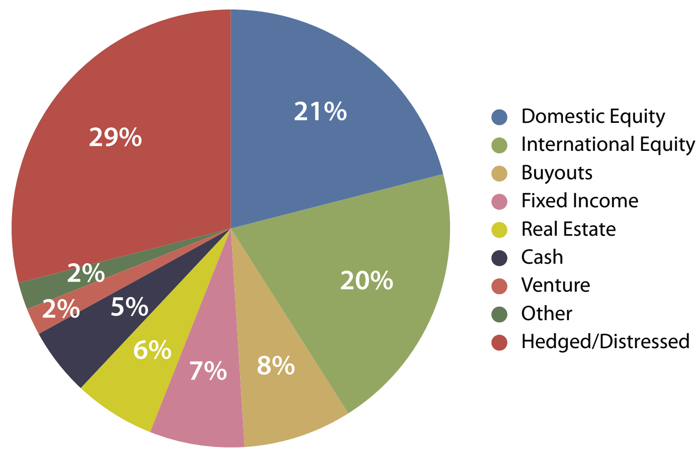
Total liabilities were slightly over $1.3 billion or an increase over last year by 23%. The more significant increases were noted in accrued pension, post-retirement, post-employment balances and in long-term debt. The University adopted the provisions of Financial Accounting Standards Board SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Post-retirement Plans.* As explained in the footnotes to the consolidated financials, SFAS No. 158 requires employers to recognize the over- or under-funded status of defined benefit pension and post-retirement in its financial statements and is comprised primarily of health/medical benefits for our retirees. For the consolidated group, the aggregate adjustment was reflected as a decrease to net assets of $34.1 million.

Long-term debt increased by $167.2 million. During FY 2007, the University issued Series 2007 bonds to provide new money for capital projects and to refund existing bonds in order to achieve aggregate savings. Credit ratings assigned by Moody's and Standard & Poor's (S&P) were A1, A+. The outlook under Moody's rating was changed to positive while that of S&P remained at stable.

Fiscal 2007 was another strong year for the University of Rochester. Positive operating results and growth in net assets through the success of the health care operations and favorable investment results continue to dominate financial statement performance of the institution.

Douglas W. Wylie
University Controller

Endowment Asset Allocation



Report of Independent Auditors

To the Board of Trustees
University of Rochester and Related Entities

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements 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, 2007 and 2006, and the changes in their net assets and their cash flows for the years 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 audits. We conducted our audits 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 discussed in Notes 1 and 9, respectively to the consolidated financial statements, the University changed the manner in which it accounts for conditional asset retirement obligations in 2006 and the manner in which it accounts for its postretirement benefit liability in 2007.

PricewaterhouseCoopers LLP

October 8, 2007

Consolidated Balance Sheet

As of June 30, 2007 ($'s in thousands)

ASSETS	2007	2006
Cash and cash equivalents	$ 200,690	$ 199,805
Operating investments, at market	217,077	147,793
Accounts receivable, net	251,784	231,258
Inventories, prepaid expense, and deferred charges	56,429	49,143
Contributions receivable, net	33,645	29,044
Notes receivable, net	18,556	18,583
Other assets	9,227	6,034
Investments held for long-term purposes	1,970,610	1,632,183
Market value of securities pledged	19,265	-
Property, plant, and equipment, net	1,203,203	1,103,891
Interest in net assets of foundation	18,553	16,920
Investments in perpetual trusts held by others	57,823	54,533
Total assets	$ 4,056,862	$ 3,489,187

LIABILITIES	2007	2006
Accounts payable and accrued expenses	$ 233,122	$ 205,734
Advanced receipt of sponsored research revenues	29,636	31,132
Deferred revenue	50,757	48,700
Third-party settlements payable, net	68,459	75,860
Securities lending liabilities	19,863	-
Accrued pension, post-retirement, and post-employment	179,427	140,356
Long-term debt	708,542	541,305
Asset retirement obligation	17,349	16,763
Refundable U.S. Government grants for student loans	15,818	15,719
Total liabilities	1,322,973	1,075,569

NET ASSETS	2007	2006
Unrestricted	2,209,715	1,944,990
Temporarily Restricted	247,420	211,969
Permanently Restricted	276,754	256,659
Total net assets	2,733,889	2,413,618
Total liabilities and net assets	$ 4,056,862	$ 3,489,187

See accompanying notes to consolidated financial statements.

Consolidated Statement of Activities

Year Ended June 30, 2007 ($'s in thousands)

OPERATING REVENUES	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
Tuition and fees	$ 242,121	$ -	$ -	$ 242,121
Less: scholarships and fellowships	(97,948)	-	-	(97,948)
Net tuition and fees	144,173	-	-	144,173
State and local appropriations	1,954	-	-	1,954
Grants and contracts	362,156	-	-	362,156
Gifts and pledges	42,443	18,640	14,411	75,494
Hospital and faculty practice patient care activities	1,445,795	-	-	1,445,795
Auxiliary enterprises	65,030	-	-	65,030
Interest income on cash & operating investments	23,731	-	-	23,731
Educational activities	25,749	-	-	25,749
Royalty income	61,429	-	-	61,429
Other sources	10,223	-	-	10,223
Long-term investment income and gains allocated to operations	79,672	-	-	79,672
Net assets released from restrictions	31,208	(28,808)	(2,400)	-
Total operating revenues	2,293,563	(10,168)	12,011	2,295,406
OPERATING EXPENSES				
Salaries and wages	1,058,157	-	-	1,058,157
Fringe benefits	280,837	-	-	280,837
Total compensation	1,338,994	-	-	1,338,994
Supplies	291,986	-	-	291,986
Business and professional	191,989	-	-	191,989
Utilities	53,668	-	-	53,668
Maintenance and facilities costs	81,710	-	-	81,710
Depreciation expense	118,810	-	-	118,810
Interest expense	29,888	-	-	29,888
Other	70,035	-	-	70,035
Total operating expenses	2,177,080	-	-	2,177,080
Change in net assets from operating activities	**116,483**	**(10,168)**	**12,011**	**118,326**
NON-OPERATING ACTIVITIES				
Long-term investment activities				
Investment income	23,745	3,213	39	26,997
Net appreciation	234,103	48,180	10,257	292,540
Total long-term investment activities	257,848	51,393	10,296	319,537
Long-term investment income and gains allocated for operations	(79,672)	-	-	(79,672)
Loss on extinguishment of debt	(1,018)	-	-	(1,018)
Reclass of net assets	5,191	(3,711)	(1,480)	-
Other changes, net	(55)	-	(747)	(802)
Change in valuation of annuities	-	(2,063)	15	(2,048)
Change in net assets from non-operating activities	**182,294**	**45,619**	**8,084**	**235,997**
Change in net assets before cumulative effect of change in accounting principle	298,777	35,451	20,095	354,323
Cumulative effect of change in accounting principle	(34,052)	-	-	(34,052)
Change in net assets	**264,725**	**35,451**	**20,095**	**320,271**
Beginning net assets	1,944,990	211,969	256,659	2,413,618
Ending net assets	$2,209,715	$247,420	$276,754	$2,733,889

See accompanying notes to consolidated financial statements.

Consolidated Statement of Activities

Year Ended June 30, 2006 ($'s in thousands)

OPERATING REVENUES	UNRESTRICTED	TEMPORARILY RESTRICTED	PERMANENTLY RESTRICTED	TOTAL
Tuition and fees	$ 219,288	$ -	$ -	$ 219,288
Less: scholarships and fellowships	(90,313)	-	-	(90,313)
Net tuition and fees	128,975	-	-	128,975
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 & 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	2,151,830	(18,195)	6,147	2,139,782
OPERATING EXPENSES				
Salaries and wages	993,178	-	-	993,178
Fringe benefits	259,091	-	-	259,091
Total compensation	1,252,269	-	-	1,252,269
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	114,091	-	-	114,091
Interest expense	24,732	-	-	24,732
Other	68,745	-	-	68,745
Total operating expenses	2,038,903	-	-	2,038,903
Change in net assets from operating activities	**112,927**	**(18,195)**	**6,147**	**100,879**
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	**122,673**	**9,803**	**1,139**	**133,615**
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	**218,837**	**(8,392)**	**7,286**	**217,731**
Beginning net assets	1,726,153	220,361	249,373	2,195,887
Ending net assets	$1,944,990	$211,969	$256,659	$2,413,618

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended June 30 ($'s in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	2007	2006
Change in net assets	$ 320,271	$ 217,731
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization expense	114,796	112,419
Net appreciation of investments	(270,540)	(175,624)
Gifts of property, plant, and equipment	(1,176)	(1,373)
(Appreciation) / depreciation of interest in net assets of foundation	(1,633)	(538)
Appreciation of investments in perpetual trusts held by others	(5,486)	(2,082)
Bond (discount) / premium amortization	(158)	205
Loss on the extinguishment of debt	1,018	2,638
Loss on disposals of property, plant, and equipment	4,049	1,744
Cumulative effect of change in accounting principle	34,052	16,763
(Increases) / decreases in:		
Operating investments	(69,284)	(707)
Accounts receivable	(20,526)	(8,480)
Inventories, prepaid expenses, and deferred charges	(4,050)	258
Contributions receivable	(4,601)	6,030
Other assets	(3,817)	(4,624)
Increases / (decreases) in:		
Accounts payable and accrued expenses	16,432	(1,877)
Advanced receipt of sponsored research revenues	(1,496)	(3,512)
Deferred revenues	2,057	2,803
Third-party settlements, net	(7,401)	(870)
Accrued post-employment and post-retirement benefits	5,019	4,933
Contributions for long-term investment, net	(18,001)	(13,518)
Investment income restricted for long-term purposes	4,022	2,550
Net cash provided by operating activities	93,547	154,869
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant, and equipment, net	(195,589)	(187,054)
Purchases of investments	(2,040,226)	(1,139,880)
Proceeds from the sale and maturity of investments	1,952,622	1,196,722
Decrease in investments held in perpetuity by others	2,196	-
Decrease in notes receivable, net of activities, and other reductions	27	1,483
Net cash used in investing activities	(280,970)	(128,729)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal repayments of indebtedness	(89,757)	(120,177)
Proceeds from issuance of long-term debt	248,769	111,180
Deferred financing costs	(4,645)	(3,384)
Changes associated with security lending agreement	19,863	-
Increase in refundable U.S. Government grants for student loans	99	59
Contributions for long-term investment, net	18,001	13,518
Investment income restricted for long-term purposes	(4,022)	(2,550)
Net cash provided by financing activities	188,308	(1,354)
Net increase in cash and cash equivalents	**885**	**24,786**
Cash and cash equivalents, beginning of year	**199,805**	**175,019**
Cash and cash equivalents, end of year	**$200,690**	**$199,805**
Supplemental disclosure of cash flow information		
Cash paid during the period for interest on long-term debt	$26,148	$22,593
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Change in construction related payables	$10,919	$4,061
Property, plant, and equipment financed with capital leases	8,383	14,667

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(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.

(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 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, which 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 placed in service.

The University reviewed specific donor restrictions for its temporarily and permanently restricted contributions and determined that reclasses of net assets of approximately $5.2 million and $26.4 million to unrestricted net assets for the years ended June 30, 2007 and 2006, were required.

(d) Income Taxes

The University and its affiliates are not-for-profit organizations as described in section 501(c)(3) of the Internal Revenue Code and are 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 U.S. Treasury, U.S. Government, and other government agencies and corporate and 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 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 fair 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 2007 and 2006, University Trustees authorized the use of total return (income and appreciation) from its endowment resources at a rate of 6.6% and 6.7%, respectively, of the average fair 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 and dividends, 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 and dividends, 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.

The University began securities lending activities during fiscal year 2007. Investments that have been loaned to another institution are reported as pledged assets on the consolidated balance sheet. Cash received as collateral on the securities lending transactions is included in cash and cash equivalents on the consolidated balance sheet. Because the collateral must be returned in the future, a corresponding liability is reported on the consolidated balance sheet.

(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:

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 temporarily 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.

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

(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 held for long-term purposes and investments in perpetual trusts held by others. For fiscal years 2007 and 2006, the fair values are $62,045 and $56,080, respectively. 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 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, 2003.

- **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 March 31, 2008. 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 16%, respectively, of the Hospital's net patient revenue for the year ended June 30, 2007, and 32% and 17%, respectively, for the year ended June 30, 2006. 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 that 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 2007 and 2006, the Hospital recognized approximately $20,400 and $15,700 of net patient service revenue as a result of changes in estimates related to third-party settlements. In addition, the Hospital recognized additional third-party payables of approximately $8,100 and $14,300 related to fiscal years 2007 and 2006, respectively.

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, 2007, 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 806,692 outpatient visits in their offices, mostly on University owned or leased premises, and covered 38,039 hospital admissions as well as participated in the coverage of the emergency department, handling over 91,697 visits. Payments for these services are derived primarily from third-party insurers, including Managed Care companies (38.7%), Medicare (26.0%), Blue Shield (12.0%), Medicaid (7.8%), Commercial (6.3%), Other (6.0%), and Self-pay (3.2%).

In addition to providing clinical outpatient care, the faculty group's mission is met by providing education and teaching. The faculty supervise and instruct 377 University medical students and 653 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) Asset Retirement Obligations

The University accounts for asset retirement obligations in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations,* and FAS Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligations—An Interpretation of FASB Statement No. 143*. This standard primarily affects the way the University accounts for asbestos-related removal costs. The University accrues for asset retirement obligations in the period in which they are incurred if sufficient information is available to reasonably estimate the fair value of the obligation. Over time, the liability is accreted to its settlement value. Upon settlement of the liability, the University will recognize a gain or loss for any difference between the settlement amount and liability recorded.

Upon adoption of FIN 47 on June 30, 2006, the University recognized $16,763 as the cumulative effect of a change in accounting principle in the statement of activities.

(t) Derivative Instruments and Hedging Activities

Derivative instruments related to the University's long-term debt are included in accounts payable and accrued expenses or in accounts receivable on the consolidated balance sheets. 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:

	2007	2006
Designated:		
For long-term purposes to support scholarships and other programs:		
Funds functioning as endowment	$ 1,007,879	$ 869,694
Accumulated appreciation resulting from investment of permanently restricted net assets	317,151	265,406
For property, plant, and equipment purposes and debt service reserves held by trustees under debt agreements	71,057	42,940
For student loan programs, including required matching funds under Federal Government loan programs	3,210	3,385
For other specific operating purposes	60,010	53,534
For Highland Hospital and affiliates	78,212	67,142
For Eastman Dental Center Foundation	49,304	47,567
For other related entities	(11,396)	(20,769)
Total designated	1,575,427	1,328,899
Net investment in property, plant, and equipment	532,371	514,755
Undesignated	101,917	101,336
Total unrestricted net assets	$ 2,209,715	$ 1,944,990

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

	2007	2006
Accumulated appreciation on permanently restricted net assets subject to purpose restrictions:		
Scholarships and grants	$ 33,119	$ 28,024
Instruction	80,305	66,572
Other	26,978	17,082
Subtotal	140,402	111,678
Interest in net assets of foundation	18,553	16,920
Related entities	5,793	5,719
Other gifts and income subject to:		
Purpose restrictions	20,447	21,856
Time restrictions:		
Contributions receivable	25,020	22,770
Split-interest agreements	37,205	33,026
Total temporarily restricted net assets	$ 247,420	$ 211,969

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

	2007	2006
Perpetual endowment funds:		
Restricted income purposes:		
Scholarships and grants	$ 12,932	$ 12,288
Instruction	40,429	37,483
Other	8,185	8,926
Unrestricted income purposes	143,437	133,191
Subtotal	204,983	191,888
Interests in perpetual trusts held by others:		
Restricted income purposes:		
Instruction	37,853	36,582
Student loans	1,547	1,458
Other	1,897	1,693
Unrestricted income purposes	16,526	14,800
Subtotal	57,823	54,533
Related entities	3,299	3,057
Split-interest agreements	895	801
Perpetual loan funds	3,660	3,674
Contributions receivable	6,094	2,706
Total permanently restricted net assets	$ 276,754	$ 256,659

(3) Accounts Receivable

Accounts receivable at June 30 consist of the following:

	2007	2006
Patient care and related activities, net of allowances for doubtful accounts of $24,970 and $24,014	$ 149,079	$ 138,382
Federal, state, and local governments; foundations and companies, net of allowances for doubtful accounts of $489 and $183	45,606	40,590
Student receivables, net of allowances for doubtful accounts of $1,845 and $1,838	6,933	6,326
Royalties and other	50,166	45,960
Total accounts receivable	$ 251,784	$ 231,258

(4) Contributions

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

	2007	2006
Unconditional promises expected to be collected in:		
Less than one year	$ 17,085	$ 11,083
One year to five years	18,572	21,033
Over five years	1,450	1,593
Subtotal	37,107	33,709
Less unamortized discount and allowance for uncollectible amounts	(3,462)	(4,665)
Total contributions receivable, net	$ 33,645	$ 29,044

At June 30, 2007, the University had also received $12,220 in bequest intentions 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 $18,022 and $13,431, for University relations and development for the years ended June 30, 2007 and 2006, respectively.

(5) Notes Receivable

Student loans receivable at June 30, 2007 and 2006, are reported net of allowances for doubtful loans of $1,320 and $1,372, 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:

	2007	2006
Endowment and similar purposes	$ 1,732,437	$ 1,494,515
Property, plant, and equipment purposes:		
Debt service reserve held by trustees under debt agreements	48,023	37,195
Other	124,822	12,607
Total property, plant, and equipment purposes	172,845	49,802
Other purposes	84,593	87,866
Total fair value	1,989,875	1,632,183
Securities pledged	(19,265)	-
Total investments held for long-term purposes	$ 1,970,610	$ 1,632,183

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

	2007	2006
Cash and cash equivalents	$ 87,473	$ 122,471
Debt securities	319,731	153,923
Common and preferred stocks	778,850	772,702
Hedge / Distressed	492,616	394,908
Real assets	123,007	79,892
Venture capital	39,381	28,587
Buyouts / Private equity	137,661	68,985
Other investments	11,156	10,715
Total fair value	$ 1,989,875	$ 1,632,183

Included in the investments held for long-term purposes above are $639,675 and $374,100 of international investments at June 30, 2007 and 2006, 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, 2007 and 2006, respectively, the University had commitments of $414,558 and $282,565 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 "fair 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 fair values of investments held for endowment and similar purposes:

2007			
	FAIR VALUE	COST	NET GAINS
End of year	$1,732,437	$ 1,299,552	$ 432,885
Beginning of year	$1,494,515	$ 1,217,696	$ 276,819
Unrealized appreciation			156,066
Realized net gains for year			117,339
Net increase for year			$ 273,405

2006			
	FAIR VALUE	COST	NET GAINS
End of year	$1,494,515	$ 1,217,696	$ 276,819
Beginning of year	$1,375,176	$ 1,100,264	$ 274,912
Unrealized appreciation			1,907
Realized net gains for year			156,071
Net increase for year			$ 157,978

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, 2007 and 2006, at a notational amount of $0 and $3,520, 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 $0 at June 30, 2007, and $114 at June 30, 2006.

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 $32,300 and $24,586 for the years ended June 30, 2007 and 2006, respectively.

During June 2007, the University began lending securities to qualified financial institutions through a program administered by a securities lending agent. All loans are callable at any time and are fully collateralized. Income is earned based on the collateral held and invested during the period of lending. The cash collateral requirement is 102% for domestic securities. The fair value of loaned securities and related cash collateral at June 30, 2007, is as follows:

	LOANED SECURITIES	COLLATERAL
Equities	$ 11,858	$ 12,321
U.S. government fixed income securities	7,407	7,542
Total	$ 19,265	$ 19,863

(7) Property, Plant, and Equipment

As of June 30, 2007 and 2006, the University's investment in property, plant, and equipment is as follows:

	2007	2006
Buildings and improvements	$ 1,370,137	$ 1,315,450
Land improvements	34,242	33,271
Completed projects under leasehold agreements	45,983	46,454
Equipment owned	658,265	651,691
Library books	109,961	102,829
Subtotal	2,218,588	2,149,695
Less accumulated depreciation	1,298,200	1,237,530
Subtotal	920,388	912,165
Land	7,168	7,053
Museum collections	29,088	27,136
Construction in progress	246,559	157,537
Total property, plant, and equipment, net	$ 1,203,203	$ 1,103,891

(8) Long-Term Debt

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

	2007	2006
Obligations under capital leases, 3.879% to 7.85% **(a)**	$ 26,984	$ 18,989
Urban Development Corporation loan **(b)**	2,333	2,499
Term note payable, LIBOR rate plus 1.25% **(c)**	258	601
Note payable, 7.60% **(d)**	84	-
Direct Note Obligation, Series 2003, 5.40% to 5.75% (net of unamortized discount of $28 in 2007 and $30 in 2006) **(e)**	8,572	8,570
Bonds Payable – COMIDA, 8.00% to 10.00% **(f)**	698	698
Bonds payable – DASNY Series 1994, 7.625% **(g)**	8,721	8,930
Bonds payable – DASNY Series 1994B, 5.50% **(h)**	10,780	11,125
Bonds payable – DASNY Series 1997A, 3.75% to 5.00% (net of unamortized premium of $644 in 2007 and $679 in 2006) **(i)**	17,624	24,799
Bonds payable – DASNY Series 1998A, 3.50% to 5.25% (net of unamortized discount of $45 in 2007 and $149 in 2006) **(j)**	32,775	82,565
Bonds payable – DASNY Series 1999B, 3.70% to 5.72% (net of unamortized discount of $74 in 2007 and $86 in 2006) **(k)**	5,256	5,989
Bonds payable – DASNY Series 2000A, 4.50% to 6.05% **(l)**	7,036	7,036
Bonds payable – DASNY Series 2001A, 2.90% to 5.00% (net of unamortized discount of $100 in 2007 and $108 in 2006) **(m)**	19,975	21,512
Bonds payable – DASNY Series 2003A, B, and C, 3.97% **(n)**	143,275	150,050
Bonds payable – DASNY Series 2004A, 3.00 to 5.25% (net of unamortized premium of $414 in 2007 and $570 in 2006) **(o)**	28,879	44,545
Bonds payable – COMIDA, 3.125% to 5.450% (net of unamortized premium of $1,061 in 2007 and $1,161 in 2006) **(p)**	40,326	42,217
Bonds payable – DASNY Series 2006 A-1 and B-1, 3.919% **(q)**	111,180	111,180
Bonds payable – DASNY Series 2007A-1, A-2, B, and C, 4.00% to 5.00% (net of unamortized premium of $8,123 in 2007) **(r)**	243,786	-
Total long-term debt	$ 708,542	$ 541,305

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

(a) Obligations Under Capital Lease Agreements

The University entered into a tax-exempt capital lease program in November 2006 for $10,832. The lease is being repaid with quarterly payments of $573, including interest at 3.879% to 3.881% through November 2012. The leased equipment includes a network infrastructure upgrade and the purchase of an MRI.

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 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 collateral 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—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 1.25% on the unpaid balance through January 2008. This note is guaranteed by the University and is collateralized by the assets of the related entity.

(d) Note Payable—HSBC

Pursuant to an agreement between a University related entity and HSBC Bank, USA dated July 2007, HSBC issued a note payable of $99 for various information technology purchases.

The note is being repaid at an interest rate of 7.60% on the unpaid balance through December 2008.

(e) 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.

(f) 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.

(g) 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.

(h) 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 an interest in certain buildings and equipment.

(i) 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 multiyear 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 multiyear 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 collateralizing outstanding indebtedness of the University.

(j) 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.

A portion of the Series 1998A bonds were refinanced as a result of the issuances of Series 2006A-1 and Series 2007C during fiscal years 2006 and 2007, respectively.

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 collateralizing certain other outstanding indebtedness of the University.

(k) 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 collateralized interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(l) 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 collateralized interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(m) 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 collateralized interest in any revenues or assets of the University has been granted by the University to the Authority under the Loan Agreement.

(n) 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, 2007, the fair value of the interest rate swap was an asset of $614, and was included in accounts receivable 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.

(o) Bonds Payable—Series 2004A

Pursuant to an agreement between the University and DASNY dated August 26, 2004, DASNY 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.

A portion of the Series 2004A bonds were refinanced as a result of the issuance of Series 2007C during fiscal year 2007.

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

(p) 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 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.

(q) 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, 2007, the fair value of the interest rate swap was an asset of $1,185, and was included in accounts receivable 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.

(r) Bonds Payable—DASNY Series 2007A-1, A-2, B, and C

Pursuant to an agreement between the University and DASNY dated February 21, 2007, DASNY issued and sold $235,869 of bonds known as the University of Rochester Revenue Bonds, Series 2007, consisting of $111,210 Series 2007A-1 bonds, $20,534 Series 2007A-2 bonds, $40,290 Series 2007B bonds, and $63,835 Series 2007C bonds. The Series 2007 bonds were issued at a net premium of $8,207, resulting in proceeds of $244,076.

Series 2007A-1 bonds were issued to finance (1) the construction of the University's portion of the Cancer Center; (2) the acquisition and renovation of a new University Data Center; (3) an upgrade to the central utilities chilled water capacity and the expansion of its infrastructure; (4) the construction of a new animal facility and the renovation of existing laboratory space at the Cardiovascular Research Building; (5) the construction or renovation of a University Health Service building; and (6) various deferred maintenance projects and renovations of laboratories, office space, and student residential buildings.

Series 2007A-2 bonds were issued to finance (1) the renovation of the University Advancement and Alumni Center; and (2) the construction of a biomedical engineering and optics building.

Series 2007B bonds were issued to finance (1) the construction of Hospital's portion of the Cancer Center; (2) the renovation of the Hospital's surgical adult intensive care and intermediate care units; (3) the renovation of the Hospital's medical behavioral inpatient unit; and (4) the purchase of equipment for the Hospital.

Series 2007C bonds were issued to refinance (1) a portion of the University of Rochester Series 1998A bonds; and (2) a portion of the University of Rochester Series 2004A bonds.

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

(s) 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, 2012, and thereafter are as follows:

MATURITY	PRINCIPAL PORTIONS OF LEASE PAYMENTS	PRINCIPAL PAYMENTS OF DEBT	TOTAL PRINCIPAL PAYMENTS
2008	$ 5,534	$ 25,904	$ 31,438
2009	4,124	26,371	30,495
2010	3,133	17,650	20,783
2011	2,638	21,299	23,937
2012	1,855	22,115	23,970
Thereafter	9,700	568,219	577,919
Total	$ 26,984	$ 681,558	$ 708,542

The University expended $29,853 and $24,732 for interest for the years ended June 30, 2007 and 2006, respectively, net of interest capitalization of $1,005 and $1,422 for the years ended June 30, 2007 and 2006, respectively.

(9) Benefits Plans

Self-insurance Plans—University

The University is self-insured for workers compensation. Liabilities for asserted and unasserted claims under the workers compensation program at June 30, 2007, were discounted by 4.5% and amounted to $31,734 (4.75% and $29,930 in 2006). 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 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 $10,425 as of June 30, 2007 ($10,402 in 2006). 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 $55,374 in 2007 ($51,840 in 2006), 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 post-retirement plan expense of $13,812 and $13,139 for the years ended June 30, 2007 and 2006, respectively, that is recorded in fringe benefits expense on the Consolidated Statement of Activities.

Benefit expense for this plan for the years ended June 30, 2007 and 2006, includes the following components:

CHANGE IN BENEFIT OBLIGATION	2007	2006
Benefit obligation at beginning of year	$ 109,923	$ 109,420
Service cost	2,183	1,936
Interest cost	6,408	6,097
Estimated plan participants' contributions	1,451	1,373
Actuarial (gain)/loss	(6,102)	(2,517)
Benefits paid	(7,698)	(8,130)
Amendments	-	1,744
Benefit obligation at end of year	$ 106,165	$ 109,923
CHANGE IN PLAN		
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	6,247	6,757
Participant contributions	1,451	1,373
Benefits paid	(7,698)	(8,130)
Fair value of plan assets at end of year	$ -	$ -
COMPONENTS OF ACCRUED BENEFIT		
Funded status	$ (106,165)	$ (109,924)
Unrecognized net actuarial (gain)/loss	(1,757)	4,345
Unrecognized prior service cost	29,023	34,245
Accrued benefits	$ (78,899)	$ (71,334)
AMOUNTS RECOGNIZED IN THE CONSOLIDATED BALANCE SHEETS CONSIST OF		
Accrued post-retirement benefit cost	$ (71,334)	$ (64,953)
Net post-retirement benefit expense	(13,812)	(13,138)
Net benefits paid	6,247	6,757
Accrued benefits paid at end of year (before FAS 158)	$ (78,899)	$ (71,334)
Impact of FAS 158 changes	(27,266)	-
Net amount recognized in unrestricted net assets	$ (106,165)	$ (71,334)
COMPONENTS OF NET PERIODIC BENEFIT COST		
Service cost	$ 2,183	$ 1,936
Interest cost	6,408	6,098
Amortization of prior service cost	5,221	5,105
Net periodic benefit cost	$ 13,812	$ 13,139

Estimated future contributions, benefit payments, and 28% prescription subsidy payments are as follows:

	ESTIMATED CONTRIBUTIONS/ BENEFIT PAYMENTS	ESTMATED 28% Rx SUBSIDY PAYMENTS
2008	$ 7,346	$ 1,286
2009	7,666	1,396
2010	7,973	1,498
2011	8,208	1,575
2012	8,323	1,651
2013 to 2017	45,131	8,333

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

	2007	2006
Discount rate for obligation	6.00%	6.00%
Expected return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Health care cost trend rate—initial	9.00%	10.00%
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	$ 564	$ (498)
Effect on post-retirement benefit obligation	$ 4,840	$ (4,609)

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 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 adopted the balance sheet recognition provisions of SFAS No. 158 as of June 30, 2007. The impact of the adoption resulted in a decrease of $27,266 in unrestricted net assets, which has been recorded as a cumulative effect of a change in accounting principle.

SFAS No. 158 will also require employers to measure benefit plan assets and liabilities and determine the discount rate for subsequent year expense recognition as of the balance sheet date for financial reporting purposes, thus eliminating the opportunity to use a measurement date up to 90 days prior to the balance sheet date. The change in measurement date is not required until the fiscal year ending after December 15, 2008, and will be recognized by the University at that time. None of the changes prescribed by SFAS No. 158 had an impact on the University's results of operations or cash flows in fiscal year 2007.

Post-Employment Benefits—University

Accrued post-employment benefits of the University amounted to $50,237 and $45,185 at June 30, 2007 and 2006, 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 $4,321 and $4,573 was incurred for the years ended December 31, 2006 and 2005, respectively, and is recorded in benefits expense in the consolidated statement of activities. In addition, the related entity recorded a reduction in minimum pension liability of $3,874 and $406 in 2006 and 2005, respectively. These amounts are included in other changes on the 2006 and 2005 consolidated statement of operation and changes in net assets.

Pension expense for this plan for the years ended December 31, 2006 and 2005 (the most recent data available), includes the following components (in thousands):

CHANGE IN BENEFIT OBLIGATION	2006	2005
Benefit obligation at beginning of year	$ 77,114	$ 67,648
Service cost	3,345	3,109
Interest cost	4,194	3,842
Actuarial loss	(3,154)	4,455
Benefits paid	(1,845)	(1,940)
Benefit obligation at end of year	$ 79,654	$ 77,114

	2006	2005
CHANGE IN PLAN ASSETS		
Fair value of assets at beginning of year	$ 50,838	$ 39,395
Actual return on plan assets	4,036	6,995
Employer contribution	7,351	6,744
Benefits paid	(1,968)	(1,940)
Administrative expenses paid	(238)	(356)
Fair value of assets at end of year	$ 60,019	$ 50,838
COMPONENTS OF ACCRUED PENSION LIABILITY		
Funded status	$ (19,636)	$ (26,276)
Unrecognized net actuarial loss	14,155	17,781
Unrecognized net asset in transition	-	(16)
Accumulated comprehensive pension expense	(5,759)	(9,633)
Intangible asset	-	-
Accrued pension liability	$ (11,240)	$ (18,144)
AMOUNTS RECOGNIZED IN THE BALANCE SHEET CONSIST OF		
Accrued benefits cost	$ (11,240)	$ (18,144)
Projected benefit obligation	79,654	77,114
Accumulated benefit obligation	71,259	68,982
Fair value of plan assets	60,019	50,838
COMPONENTS OF NET PERIODIC BENEFIT COST		
Service cost	$ 3,345	$ 3,109
Interest cost	4,195	3,842
Expected return on plan assets	(4,364)	(3,346)
Amortization of prior service cost	-	-
Amortization of transition asset	(16)	(315)
Amortization gain/loss	1,161	1,283
Net periodic benefit cost	$ 4,321	$ 4,573
WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31		
Discount rate for obligation	5.85%	5.50%
Discount rate for pension expense	5.50%	5.75%
Investment return assumption (regular)	8.50%	8.50%
Future compensation increase rate	3.80%	3.82%

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:

	2006	2005
WEIGHTED-AVERAGE ASSUMPTIONS BY ASSET CATEGORIES		
Equity securities	56%	54%
Fixed income securities	44%	36%
Cash and other investments	-	10%
	100%	100%

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

2007	$ 1,825
2008	1,961
2009	2,110
2010	2,306
2011	2,618
2012 to 2016	20,029
Total estimated future payments	$ 30,849

Upon adoption of SFAS No. 158 in fiscal year 2007, the related entity will report amounts that have not yet been recognized as a component of benefit expense (i.e., unrecognized prior service costs or credits, net (actuarial) gain or loss, and transition obligation or asset) as part of the net benefit liability on its balance sheet with a corresponding adjustment to net assets. This pronouncement is required to be adopted for fiscal years ending after June 15, 2007. Had the related entity adopted the balance sheet recognition provisions of SFAS No. 158 as of June 30, 2007, the impact would have resulted in a decrease of $6,786 in unrestricted net assets. This amount is reflected in the consolidated financial statements for fiscal year 2007.

(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:

RESULTS OF OPERATION	2007	2006
Net earned premiums	$ 253,242	$ 234,893
Expenses	(286,019)	(266,471)
Investment income and realized gains on sales of marketable securities	42,380	40,492
Net income	$ 9,603	$ 8,914
FINANCIAL POSITION		
Total assets	$ 1,795,771	$ 1,720,223
Total liabilities	1,611,411	1,575,750
Shareholders' Equity	$ 184,360	$ 44,473

(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 $205,500 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 $27,767 and $24,025 as of June 30, 2007 and 2006, 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 Equivalents, 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.

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 long term debt, excluding capital leases, was $632,620 and $481,908 at June 30, 2007 and 2006, respectively.

(13) Lines and Letters of Credit

The University has a total of $26,649 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, $533 is for the repayment of obligations to the Urban Development Corporation, and $84 is for the Town of Henrietta.

The University has an additional $25 million committed 364 day revolving credit agreement with JPMorgan Chase Bank for emergency purposes. Of this total, $1.86 million was outstanding at June 30, 2007, and $2.1 million is outstanding as of June 30, 2006.

(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, 2007, the University has entered into construction contracts and commitments aggregating $429,877 ($428,126 at June 30, 2006) of which $320,701 ($328,511 at June 30, 2006) 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
2008	$ 16,282	$ 3,168
2009	14,531	2,787
2010	13,390	2,262
2011	11,992	1,847
2012	11,035	1,773
Thereafter	45,107	8,639
Total minimum lease payments	$ 112,337	$ 20,476

(16) Scholarships, Grants, and Fellowships

The University awarded a total of $97,948 and $90,313 in scholarships, grants, and fellowships during fiscal years 2007 and 2006, respectively. In addition, the University awarded $14,374 and $13,233, respectively, of scholarships, grants, and fellowships as compensation to the recipients. Of the total scholarships, grants, and fellowships awarded, $14,528 and $13,166, respectively, 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:

	2007	2006
Instruction	$ 277,872	$ 258,433
Research	264,597	238,165
Public service	9,371	10,609
Libraries and other academic support	48,037	41,104
Student services	37,326	36,269
Institutional support	61,637	62,464
Hospital and faculty practice patient care	1,407,494	1,323,571
Auxiliary enterprises	70,746	68,288
Total functional expenses	$2,177,080	$ 2,038,903

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as of June 30, 2007

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