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CASE WESTERN RESERVE UNIVERSITY



**CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006**

Case Western Reserve University
Financial Statements for the Year Ending June 30, 2006

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Report of Independent Auditors

To the Board of Trustees
Case Western Reserve University:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of Case Western Reserve University (the "University") as of June 30, 2006, and the changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's 2005 financial statements, and in our report dated October 12, 2005, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

October 20, 2006

CASE WESTERN RESERVE UNIVERSITY
Consolidated Balance Sheet
June 30, 2006 and 2005
(in thousands)

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Assets		
Cash and temporary investments	\$ 111,907	\$ 61,954
Accounts and loans receivable, net	130,229	127,340
Securities pledged under lending agreements	91,812	50,578
Pledges receivable, net	67,272	63,237
Prepaid expenses and other assets	15,116	15,948
Intangible pension assets	2,028	2,493
Investments	1,395,630	1,419,948
Property, plant, equipment and books, net	822,029	770,906
Funds held in trust by others	295,404	281,778
Total assets	<u><u>\$ 2,931,427</u></u>	<u><u>\$ 2,794,182</u></u>
Liabilities		
Accounts payable and accrued expenses	\$ 55,788	\$ 67,467
Deferred income and other liabilities	27,825	26,718
Payable under securities lending agreements	93,874	52,530
Annuities payable	51,685	49,995
Refundable advances	8,423	7,785
Minimum pension liability	7,509	24,811
Notes and bonds payable	619,263	594,234
Refundable federal student loans	17,271	18,395
Total liabilities	<u><u>881,638</u></u>	<u><u>841,935</u></u>
Net Assets		
Unrestricted	1,202,264	1,127,435
Temporarily restricted	46,921	40,284
Permanently restricted	800,604	784,528
Total net assets	<u><u>2,049,789</u></u>	<u><u>1,952,247</u></u>
Total liabilities and net assets	<u><u>\$ 2,931,427</u></u>	<u><u>\$ 2,794,182</u></u>

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

CASE WESTERN RESERVE UNIVERSITY
Consolidated Statement of Activities
For the Year Ended June 30, 2006
with summarized financial information for the year ended June 30, 2005
(in thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Year Ended June 30, 2006</u>	<u>Year Ended June 30, 2005</u>
Operating revenues					
Student tuition and fees	\$ 228,752			\$ 228,752	\$ 203,062
Less: Student aid	(89,661)			(89,661)	(77,066)
	<u>139,091</u>			<u>139,091</u>	<u>125,996</u>
Endowment income	74,874		\$ 335	75,209	81,070
Grants and contracts	253,769			253,769	253,438
CCLCM grants and contracts	86,075			86,075	68,382
Gifts and pledges	21,473	\$ 18,508	2,927	42,908	55,373
State of Ohio appropriation	3,900			3,900	3,962
Facilities and administrative cost recovery	67,045			67,045	66,612
Organized activities	9,019			9,019	8,677
Other sources	30,853		414	31,267	13,296
Auxiliary services	31,554			31,554	25,884
Net assets released from restrictions	12,142	(11,871)	(271)	-	-
Total operating revenues	<u>729,795</u>	<u>6,637</u>	<u>3,405</u>	<u>739,837</u>	<u>702,690</u>
Operating expenses					
Instructional	242,435			242,435	208,740
Sponsored research and training	232,730			232,730	226,766
Other sponsored projects	33,651			33,651	42,102
CCLCM research and training	86,075			86,075	68,382
Libraries	20,708			20,708	19,796
Student services	20,719			20,719	20,695
University services	84,975			84,975	94,100
Auxiliary enterprises - students	32,878			32,878	23,947
Auxiliary enterprises - others	25,864			25,864	15,403
Total operating expenses	<u>780,035</u>	<u>-</u>	<u>-</u>	<u>780,035</u>	<u>719,931</u>
Net operating (deficit) revenues	<u>(50,240)</u>	<u>6,637</u>	<u>3,405</u>	<u>(40,198)</u>	<u>(17,241)</u>
Non-operating revenues and expenses					
Investment and other income	113,296		12,248	125,544	37,964
Net appreciation in the fair market value of investments	3,420		710	4,130	52,500
Actuarial adjustment to annuity payable			(287)	(287)	1,492
(Loss) gain on disposal of plant assets	(797)			(797)	778
Disposal of interest in subsidiary				-	(398)
Adjustment for minimum pension liability	16,837			16,837	(14,739)
Non-operating revenues, net	<u>132,756</u>	<u>-</u>	<u>12,671</u>	<u>145,427</u>	<u>77,597</u>
Increase in net assets before effect of accounting change	82,516	6,637	16,076	105,229	60,356
Cumulative effect of change in accounting principle	(7,687)			(7,687)	-
Increase in net assets	74,829	6,637	16,076	97,542	60,356
Beginning net assets	1,127,435	40,284	784,528	1,952,247	1,891,891
Ending net assets	<u>\$ 1,202,264</u>	<u>\$ 46,921</u>	<u>\$ 800,604</u>	<u>\$ 2,049,789</u>	<u>\$ 1,952,247</u>

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

CASE WESTERN RESERVE UNIVERSITY
Consolidated Statement of Cash Flows
For the Years Ended June 30, 2006 and 2005
(in thousands)

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 97,542	\$ 60,356
<i>Adjustments to reconcile change in net assets to net cash provided by (used for) operating activities:</i>		
Cumulative effect - change in accounting principle	7,687	-
Depreciation	55,984	40,675
Net unrealized appreciation in the fair market value of investments	(4,130)	(52,500)
Realized gains on investments	(79,932)	(36,368)
Increase (decrease) to annuities payable resulting from actuarial adjustments	287	(1,492)
Gifts of property and equipment	(40)	(516)
Loss (gain) on disposal of plant assets	797	(778)
Contributions restricted for long-term investment	(8,277)	(24,763)
Increase in accounts and notes receivable, net	(4,120)	(4,017)
(Increase) decrease in contributions receivable, net	(4,035)	1,965
Decrease (increase) in prepaid expenses and other assets	832	(2,633)
Decrease in intangible pension assets	465	467
Increase in funds held in trust by others	(13,626)	(9,146)
(Decrease) increase in accounts payable and accrued expenses	(11,679)	10,174
(Decrease) increase in deferred income and other liabilities	(5,071)	3,159
Increase (decrease) in refundable advances	638	(2,106)
(Decrease) increase in minimum pension liability	(17,302)	14,272
Net cash provided by (used for) operating activities	<u>16,020</u>	<u>(3,251)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Student loans collected	8,509	6,568
Student loans issued	(7,278)	(8,282)
Proceeds from the sale of investments	2,561,991	2,185,394
Purchase of investments	(2,453,611)	(2,116,463)
Proceeds from the sale of buildings and land	4,809	6,890
Purchase of property, plant, equipment and books	(114,182)	(153,583)
Net cash provided by (used for) investing activities	<u>238</u>	<u>(79,476)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Decrease in federal advances for student loans	(1,124)	(904)
(Increase) decrease in securities pledged under lending agreements	(41,234)	21,341
Increase (decrease) in payables under securities lending agreements	41,344	(21,509)
Contributions restricted for long-term investment	8,277	24,763
Proceeds from bond issues and long-term debt	68,176	30,000
Repayment of debt	(43,147)	(5,683)
Withdrawals from (payments on) annuities payable	782	(3,269)
Increase to annuities payable resulting from new gifts	621	27,319
Net cash provided by financing activities	<u>33,695</u>	<u>72,058</u>
Net increase (decrease) in cash and cash equivalents	49,953	(10,669)
Cash and cash equivalents, beginning of year	61,954	72,623
Cash and cash equivalents, end of year	<u>\$ 111,907</u>	<u>\$ 61,954</u>
SUPPLEMENTAL SCHEDULE OF NON-CASH ACTIVITIES		
Construction in progress payments included in accounts payable	\$ 3,553	\$ 186
Effect of FIN 47 included in deferred income and other liabilities	8,600	-
Effect of FIN 47 included in purchases of property, plant and equipment	2,062	-

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

Part 2 – Summary of Significant Accounting Policies and Terms

This part explains the accounting practices the University uses in its consolidated financial statements.

Basis of Accounting Presentation	<p>The consolidated financial statements use the accrual basis of accounting. These statements include the accounts of the University, Triangle Residential LP and Triangle Residential LLC.</p> <p>Triangle Residential LP is a limited partnership formed in 2005 that owns and operates two apartment buildings, a parking garage and a commercial structure located in the Ford-Euclid-Mayfield Road area. The University is the sole limited partner. The general partner is Triangle Residential LLC, a wholly owned subsidiary of the University, also formed in 2005. The University, through Triangle Residential LP, plans to operate the properties pending finalization of plans to develop a university arts and retail district in the area.</p>
Net Asset Categories	<p>The consolidated financial statements present information about the University's financial position and activities using three categories of net assets:</p> <ul style="list-style-type: none">• Unrestricted net assets have no donor-imposed restrictions. They are available for any purpose consistent with the University's mission.• Temporarily restricted net assets are subject to specific donor-imposed restrictions that must be met by University actions or through the passage of time.• Permanently restricted net assets are subject to donor-imposed restrictions that the University must honor in perpetuity. Usually, donors allow part or all of the income to be used for a designated purpose.
Cash and Temporary Investments	<p>Investments with a maturity of three months or less when purchased are reported as temporary investments (i.e., cash equivalents) unless they are part of long-term investment pools.</p>
Investments	<p>Investments are stated at fair value. The fair value of all debt and equity securities with readily determinable fair value are based on quotations obtained from national securities exchanges. The alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers. The University reviews and evaluates the values provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these securities existed. Realized gains and losses on investments are included in investment income. Average cost is generally used to determine gains or losses on securities sold. Unrealized changes in the fair market value of investments are shown as net unrealized appreciation or depreciation.</p>

Contributions	Contributions (including unconditional pledges) are recognized as either temporarily restricted or permanently restricted net assets when donors' commitments are received. Conditional pledges become revenue when the conditions are substantially met. Gifts whose restrictions are met in the same fiscal year in which they are received are reported with unrestricted contribution revenues.
Grants and Contracts (Government and Private)	Revenues from government and private grants and contracts are recognized as earned in accordance with the terms of the contract. Any government revenue received before it is expended is recorded as a refundable advance. Expenses incurred for government grants before revenue is received are recorded as receivables.
Collections	The University's collections of historically significant artifacts, scientific specimens, and art objects are held for education, research, scientific inquiry, and public exhibition. Therefore, their value is not reflected in the University's financial statements.
Funds Held in Trust by Others	Funds held in trust by others are assets held and administered by outside trustees from which the University derives income or residual interest. Funds held in trust by others are reported at their market value as of June 30, 2006, which approximates the present value of the future income flows from these funds.
Allocation of Certain Expenses	The statement of activities presents expenses by function. Some expenses — such as depreciation, amortization, and expenses related to the operation of the physical plant — are allocated by square footage. Interest expense is allocated to the functions that derive the greatest benefit from the facilities financed.
Use of Estimates	Financial statements using accounting principles generally accepted in the United States of America rely on estimates. At June 30, management makes certain estimates and assumptions, which affect assets and liabilities, disclosures of contingent assets and liabilities, and reported revenues and expenses during the period. Actual results may differ from these estimates.
Comparative Information	The statement of activities includes prior year summarized comparative information in total, but not by net asset category. Such information does not include enough detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the University's financial statements for the year ending June 30, 2005, from which it was derived. Certain reclassifications have been made to the summarized financial information for comparative purposes.
Income Taxes	The University is generally exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes is made in the financial statements.

Part 3 – Notes

These notes clarify and amplify data in the financial statements. Unless otherwise indicated, all dollar values are listed in thousands as of June 30.

NOTE A
Accounts and
Loans
Receivable

Accounts and loans receivable are as follows:

	<u>2006</u>	<u>2005</u>
Accounts receivable, net:		
Grants, contracts and others	\$ 80,132	\$ 75,513
Students	7,464	7,962
Student loans, net	42,633	43,865
	<u>\$ 130,229</u>	<u>\$ 127,340</u>
Allowances for doubtful accounts:		
Accounts receivable	\$ 10,867	\$ 5,881
Loans receivable	\$ 1,938	\$ 1,745

NOTE B
Pledges
Receivable

Unconditional pledges are expected to be realized in the following periods:

	<u>2006</u>	<u>2005</u>
In one year or less	\$ 31,363	\$ 24,298
Between one year and five years	32,566	36,341
More than five years	15,532	15,120
	<u>79,461</u>	<u>75,759</u>
Less: Discount	(5,459)	(6,127)
Less: Allowance	(6,730)	(6,395)
	<u>\$ 67,272</u>	<u>\$ 63,237</u>

Pledges receivable have been made for the following purposes:

	<u>2006</u>	<u>2005</u>
Department programs and activities	\$ 26,346	\$ 20,096
Endowments for scholarships and department programs and activities	18,386	18,442
Building construction	22,540	24,699
	<u>\$ 67,272</u>	<u>\$ 63,237</u>

Uncollectible pledges totaling \$2,728 (2006) and \$11,951 (2005) are included in University Services expense.

NOTE C
Investments

Investments (except funds held in trust by others) are as follows:

	2006	
	Fair Market	
	Value	Cost
Short-term investments	\$ 61,591	\$ 61,591
Domestic stocks	182,199	146,590
International securities	226,383	175,284
Bonds		
• U.S. Government	54,445	55,064
• Corporate	140,195	142,536
Mutual funds	118,435	112,077
Limited partnerships and other	574,548	485,396
Equity real estate	37,834	35,042
Total	<u>\$ 1,395,630</u>	<u>\$ 1,213,580</u>
	2005	
	Fair Market	
	Value	Cost
Short-term investments	\$ 57,575	\$ 57,575
Domestic stocks	219,983	166,749
International securities	225,977	179,668
Bonds		
• U.S. Government	124,085	125,297
• Corporate	126,722	123,847
Mutual funds	124,673	114,854
Limited partnerships and other	503,220	439,286
Equity real estate	37,713	34,750
Total	<u>\$ 1,419,948</u>	<u>\$ 1,242,026</u>

Included in the University's cash and investments are **unexpended bond proceeds**. These funds are temporarily held by trustees under the bond indenture for future capital expenditures. The proceeds are invested in cash, U.S. government and corporate bonds and mutual funds. The fair value of these assets totaled \$96,410 (2006) and \$144,530 (2005).

The University's **spending policy** determines the amount of endowment income to be used as operating revenue and distributed for spending during the year. Distributions in excess or deficit of amounts actually earned are transferred to or from the endowment pool, honoring any donor restrictions. The fiscal 2006 endowment and similar funds distribution of \$2.00 per unit totaled \$59,271, of which \$46,022 was accumulated realized gains. For fiscal 2005, the distribution of \$1.98 per unit totaled \$57,682, of which \$44,248 was accumulated realized gains.

NOTE C
Investments
(continued)

Certain endowment and similar fund assets are pooled for efficient investment purposes. The unit market value for each pool is used to account for **pooled transactions**. The unit market values are \$41.41 (2006) and \$39.80 (2005).

As a result of **market declines**, the fair market values of certain donor-restricted endowments fell below the level required by donor stipulations or law by \$374 (2006) and \$322 (2005). These unrealized losses have been recorded as reductions in unrestricted net assets. Future market gains will be used to restore this deficiency.

Investments in stocks, bonds, mutual funds, and other investments are exposed to a variety of uncertainties, including interest rate, market fluctuation, and credit risks. Due to the **level of risk** associated with certain investments, the value of these investments could change. Such changes could materially affect the amounts reported in the financial statements.

Investment strategies employed by outside managers incorporate the use of financial instruments with off-balance sheet risk. These financial instruments include international investment funds with underlying equity interests as well as forward and futures contracts that are subject to foreign currency translation gains and losses. Management does not anticipate that losses, if any, resulting from its market or credit risks would materially affect the financial position of the University; however, there can be no assurances.

The University is obligated under certain limited partnerships and similar agreements to provide future funding for further investment. The University had **unfunded commitments** of approximately \$218,629 (2006) and \$196,787 (2005) that are likely to be called in the future.

The University has a **securities lending** agency agreement for the purpose of lending securities held or beneficially owned by the University. Under this agreement, the University's agent receives collateral in the form of cash or U.S. government securities in exchange for loaning securities to approved borrowers. The agent invests these funds on behalf of the University until the securities are returned. The amount of collateral required for securities traded principally in the United States is equal to 102% of the market value of the securities borrowed. For securities traded principally outside the United States, the amount of collateral required is 105%. The fair value of securities on loan is \$91,812 (2006) and \$50,578 (2005). The fair value of collateral received is \$93,874 (2006) and \$52,530 (2005). Cash collateral is reflected in the cash and temporary investments balance.

**NOTE D
 Property,
 Plant,
 Equipment,
 and Books**

Property, plant, equipment, and library books are stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful life of 28 years for buildings, 5 to 12 years for equipment, and 10 years for books.

Components of property, plant, equipment, and books are as follows:

	2006	2005
Land and land improvements	\$ 38,838	\$ 36,539
Building and building improvements	963,362	766,646
Equipment and software	192,673	141,421
Library books	29,770	29,688
Construction-in-progress	60,093	207,289
	<u>1,284,736</u>	<u>1,181,583</u>
Less: accumulated depreciation	(462,707)	(410,677)
	<u>\$ 822,029</u>	<u>\$ 770,906</u>

The above assets include \$429,525 leased from the Ohio Higher Education Facility Commission (OHEFC). The University may purchase each of the leased assets for a nominal amount at the end of the lease period. Therefore, these assets have been capitalized and are included in the above listing. Also included in the University's financial statements is the obligation for related bonds issued by the OHEFC.

NOTE E
Bonds and
Notes Payable

Bonds and notes payable are as follows:

	Interest	Maturity	2006	2005
Ohio Higher Education Facilities Commission revenue bonds and notes:				
Series 1988	7.85 - 7.90%	2009-2013	\$ 21,464	\$ 19,868
Series 1990	6.50 - 7.15%	2006-2020	12,066	12,128
Series 1994	6.00 - 6.25%	2014-2018	20,000	20,000
Series 1997	4.70 - 6.00%	2006-2018	10,120	12,795
Series 1997	5.00 - 5.50%	2006-2017	17,700	20,030
Series 1997	4.90 - 6.25%	2009-2014	8,920	8,920
Series 2001	Variable	2006-2022	17,520	18,755
Series 2002	Variable	2023-2031	64,875	64,875
Series 2002	5.00 - 5.50%	2019-2022	35,125	35,125
Series 2004	2.00 - 5.00%	2006-2034	105,960	107,950
Series 2004	Variable	2008-2044	177,826	177,825
United States government housing bonds:				
Series 1966	3.00 - 3.50%	2006-2016	1,275	1,415
Series 1971	3.00%	2006-2016	1,235	1,335
Ohio Board of Regents note	-n/a-	2006	-	213
Ohio Higher Education Facilities Commission commercial paper	-Various-	-Various-	63,000	63,000
National City Bank commercial note	LIBOR + .25%		13,417	-
Key Bank line of credit	LIBOR + .30%	2007	30,000	30,000
Compass Group USA note	-n/a-	2006-2014	1,200	-
Department of Housing and Urban Development mortgages:				
HUD - Part A	4.96%	2006-2041	13,079	-
HUD - Part B	5.33%	2006-2041	4,481	-
			<u>\$619,263</u>	<u>\$594,234</u>

The housing bonds are collateralized by securities and pledges of net revenues from the University's student housing and dining facilities.

The Ohio Higher Education Facility Commission (OHEFC) authorized a tax-exempt commercial paper program in February 2000 to provide construction funds for several approved capital projects and to refinance earlier projects. The program authorizes the University to issue up to \$63,000 for as long as 30 years. The amount outstanding under this program as of June 30 is \$63,000, with maturities not exceeding 270 days from the issuance date. Interest rates for this program averaged 2.95% (2006) and 1.71% (2005).

In November 2004, the University opened a \$50,000 line of credit with a financial institution to finance working capital. In November 2005, the line was increased to \$100,000. The amount outstanding at June 30 totaled \$30,000 (2006) and \$30,000 (2005).

NOTE E
Bonds and
Notes Payable
(continued)

In August 2005, the University opened a \$33,000 commercial note with a financial institution to provide bridge funding for the acquisition, improvement and development of the Triangle properties until a mortgage note could be secured. In May 2006, the terms of this note were amended and restated. The balance due at June 30 was \$13,417 (2006).

In January 2006, the University borrowed \$17,637 from the Department of Housing and Urban Development (HUD). The proceeds from this loan were used to refund the portion of the commercial note used to acquire the Triangle properties. The HUD loan is in two parts. Part A is in the amount of \$13,137 at a fixed annual interest rate of 4.96%. Part B is in the amount of \$4,500 at a fixed annual interest rate of 5.33%.

Principal payment requirements for bonds, notes, and capital lease obligations for the next five years, excluding commercial paper, are approximately as follows:

2007 —	\$39,311
2008 —	\$22,717
2009 —	\$8,356
2010 —	\$6,421
2011 —	\$6,598

Interest payments for fiscal year 2006, including payments for variable rate debt, were \$20,595. Interest paid under interest rate swap agreements during fiscal 2006 totaled \$253. See Note J.

Certain borrowing agreements require the University to maintain reserves as additional collateral against its borrowings. These agreements also require that the University comply with certain covenants. The University is in compliance with these provisions.

NOTE F
Fair Value of
Investments

The University's financial instruments consist principally of cash, temporary investments, accounts and pledges receivable, loans receivable, and long-term investments, as well as obligations under bonds and notes payable. Cash and temporary investments, pledges receivable, investments and other assets are recorded at approximate fair value.

Loans receivable are amounts due from students primarily under federally sponsored programs. Since notes receivable under federal student loan programs are not saleable and can be assigned only to the U.S. government or its designee, it is not practical to determine their fair value.

The fair value of the University's bonds and notes payable is approximately \$567,784 (2006) and \$580,539 (2005). These values were estimated utilizing the discounted future cash outflows at rates for similar debt.

NOTE G
Retirement
Plans

The University has both defined benefit and defined contribution pension plans for its employees. The funded status of the University's **defined benefit plan** is as follows:

	2006	2005
Benefit obligation at June 30	\$ 83,265	\$ 91,584
Fair value of plan assets at June 30	71,399	61,291
Funded status	<u>\$ (11,866)</u>	<u>\$ (30,293)</u>
Accrued benefit expenses recognized in the balance sheet	\$ 2,988	\$ 4,896
Accumulated benefit obligation	\$ 81,896	\$ 90,999

The **weighted-average asset allocation** for the defined benefit plan is as follows:

	2006	2005
Equity securities	65.00%	67.00%
Fixed income securities	16.00%	17.00%
Real estate	17.00%	16.00%
Other	2.00%	0.00%
Total	<u>100.00%</u>	<u>100.00%</u>

The **investment objective** for the defined benefit plan is to maximize total return with tolerance for slightly above average risk. To accomplish this objective, the University has established a broadly-diversified asset allocation strategy that includes equity-oriented investments (approximately 64% weight), real estate (approximately 16%), and fixed-income investments (approximately 20%). The weightings of the investments relative to each other in the total portfolio fluctuate as market conditions vary; they are adjusted as necessary to remain within acceptable ranges.

It is management's intent to give the investment managers flexibility within the overall guidelines with respect to investment decisions and their timing. However, certain investments require specific review and approval by management. Management is also informed of significant modifications of any previously approved investment or anticipated use of derivatives to execute investment strategies.

The **expected long-term rate of return** was estimated using market benchmarks for equities and bonds applied to the plan's target asset allocation. The expected return on equities was computed utilizing a valuation framework, which projected future returns based on current equity valuations rather than historical returns. Management estimated the rate by which the plan assets would outperform the market in the future based on historical experience adjusted for changes in asset allocation and expectations for overall lower future returns on equities compared to past periods.

NOTE G
Retirement
Plans
(continued)

The University is required to recognize an additional **minimum pension liability**. Net amounts recognized in the University's balance sheet are as follows:

	<u>2006</u>	<u>2005</u>
Accrued benefit liability	\$ (10,497)	\$ (29,707)
Intangible asset	2,028	2,493
Accumulated non-operating income	5,481	22,318
Net amount recognized	<u>\$ (2,988)</u>	<u>\$ (4,896)</u>

Current pension-related charges to non-operating income are as follows:

	<u>2006</u>	<u>2005</u>
Accumulated non-operating income, beginning of year	\$ 22,318	\$ 7,579
Accumulated non-operating income, end of year	<u>5,481</u>	<u>22,318</u>
Current (credit) charge to non-operating income	<u>\$ (16,837)</u>	<u>\$ 14,739</u>

The weighted-average assumptions used to determine the University's obligation under the defined benefit plan at June 30 are as follows:

	<u>2006</u>	<u>2005</u>
Discount rate	6.50%	5.25%
Rate of compensation increase	4.50%	4.50%
Census date	7/1/05	7/1/04

Estimated benefits expected to be paid under the defined benefit plan for the next five years are as follows:

2007 —	\$2,484
2008 —	\$3,369
2009 —	\$4,068
2010 —	\$3,838
2011 —	\$4,084

Amounts expected to be paid between 2012 and 2016 total \$27,321. The University's **estimated contribution** for the defined benefit plan in fiscal 2007 is \$12,063. This amount may decrease based on the results of the July 1, 2006 actuarial valuation.

NOTE G
Retirement
Plans
(continued)

Benefit plan costs for the defined benefit and defined contribution plans are as follows:

	<u>2006</u>	<u>2005</u>
Defined benefit plan		
Benefit cost	\$ 5,712	\$ 4,064
Employer contributions	7,621	10,183
Benefits paid	2,837	2,150
Defined contribution plan		
Employer contributions	19,444	18,550

The weighted-average assumptions used to determine net periodic benefit cost for the defined benefit plan are as follows:

	<u>2006</u>	<u>2005</u>
Discount rate	5.25%	6.25%
Expected return on plan assets	9.00%	8.50%
Rate of compensation increase	4.50%	4.50%

NOTE H
Commitments
and
Contingencies

In its normal operations, the University is subject to various claims and lawsuits. In management's opinion, the resolution of these contingencies will not have a significant adverse effect on the University's financial position, operations, or cash flows.

In April 2006, the Boards of University Hospitals Health System and the University approved a new affiliation agreement between the School of Medicine and University Hospitals of Cleveland (UHC). This agreement will significantly strengthen the historical relationship between the entities through the creation of the Case Medical Center, a virtual entity that will encompass certain teaching, research and clinical activities of the School of Medicine and UHC.

In May 2002, the University entered into an agreement with the Cleveland Clinic Foundation (CCF) to form a new medical education and research program, the Cleveland Clinic Lerner College of Medicine (CCLCM). Beginning in 2004, research grants from the National Institutes of Health to support work by CCF-based investigators were awarded to and administered through the University by CCLCM, which operates as an academic unit of the School of Medicine. Expenditures for research conducted under this joint agreement totaled \$86,075 (2006) and \$68,382 (2005).

The University is self-insured for employee and student medical coverage. Property is commercially insured with an aggregate deductible of \$700. The University also carries general liability insurance with a deductible of \$100 per occurrence. The University believes its reserves for self-insured risks and the deductible portion of insured risks are sufficient.

**NOTE I
 Related Party
 Transaction
 (Utilities)**

In 1998, the University entered into a thirty-year agreement with the Medical Center Company (a cooperative utility company formed by and serving institutions in the University Circle area) to purchase chilled water and other utilities for several University buildings. The amount purchased during fiscal 2006 was \$14,860. No obligation associated with this agreement is recorded in the accompanying financial statements.

**NOTE J
 Derivatives
 and Other
 Financial
 Instruments**

The University makes limited use of interest rate swap agreements to manage interest rate risk associated with variable rate debt. Under interest rate swap agreements, the University and its counterparty agree to exchange the difference between the fixed rate and variable rate interest amounts calculated by reference to specified notional principal amounts during the agreement period. Operations are charged the variable rate interest; the difference between the fixed and variable interest amounts under the swap agreements is recorded in non-operating revenues and expenses as investment and other income.

Information related to the long-term interest rate swap agreements to which the University is a party, including the associated OHEFC borrowing where applicable and the asset (liability) recognized in the balance sheet are as follows:

Date of Agreement	OHEFC Borrowing	Notional Amount	Effective Rate	Maturity Date	2006		2005	
February 2001	Series 2001	\$ 17,520	4.34%	2022	\$ (363)		\$ (1,745)	
May 2002	Series 2002	15,000	4.43%	2022	(744)		(2,366)	
September 2002	Series 2002	15,000	3.60%	2022	580		(871)	
October 2003	Series 2004	35,000	3.81%	2034	794		(3,577)	
March 2004	Series 2004	60,000	2.46%	2009	2,115		1,216	
March 2004	Series 2004	20,000	1.92%	2007	285		333	
March 2004	Series 2004	20,000	1.92%	2007	283		335	
June 2005	-n/a-	75,000	4.05%	2037	-		(674)	

The University selected the combination of variable rate bond issues and long-term interest rate swap agreements to obtain fixed rate financing at the lowest available cost at the time of the transaction. Changes in the fair value of derivative instruments are recorded in non-operating revenues and expenses as investment and other income.

NOTE K
Recently
Issued
Accounting
Pronounce-
ments

In 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47), which is effective for the University as of and for the year ended June 30, 2006. FIN 47 was issued to provide clarity surrounding the recognition of conditional asset retirement obligations, as referred to in FASB Statement No. 143, "Accounting for Asset Retirement Obligations." FIN 47 defines a conditional asset retirement obligation as a legal obligation to perform an asset retirement activity in which the timing or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also provides guidance with respect to the criteria to be used to determine whether sufficient information exists to reasonably estimate the fair value of an asset retirement obligation. Based on the guidance in FIN 47, management of the University determined that sufficient information was available to reasonably estimate the fair value of known asset retirement obligations.

FIN 47 requires the initial application of the interpretation to be recognized as a cumulative effect of a change in accounting principle. Specifically, FIN 47 requires the recognition, as a cumulative effect, of the cumulative accretion and accumulated depreciation for the time period from the date the liability would have been recognized had the provisions of the interpretation been in effect when the liability was incurred to the date of adoption of this Interpretation. The liability incurred date is presumed to be the date upon which the legal requirement to perform the asset retirement activity was enacted.

Upon initial application of FIN 47, the University recognized \$7,687 as the cumulative effect of a change in accounting principle in the statement of operations. As of June 30, 2006, \$8,600 of conditional asset retirement obligations is included within other liabilities in the balance sheet. Property, plant and equipment at June 30, 2006 includes asset retirement cost at inception for non-fully depreciated assets of \$2,062.