Part I

Financial Statements

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
One International Place
Boston MA 02110
Telephone (617) 530 5000
Facsimile (617) 530 5001

Report of Independent Auditors

To the Board of Overseers of Harvard College

In our opinion, the accompanying balance sheet and the related statements of changes in net assets with general operating account detail, changes in net assets of the endowment, and cash flows present fairly, in all material respects, the financial position of Harvard University as of June 30, 2004, and the changes in the net assets of its general operating account and endowment funds and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's fiscal 2003 financial statements, and in our report dated September 25, 2003, 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 and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, which 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.

In accordance with *Government Auditing Standards,* we have also issued our report dated October 1, 2004, on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters for the year ended June 30, 2004. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

October 1, 2004

Balance sheets

with summarized financial information for the year ended June 30, 2003

In thousands of dollars	June 30 2004	June 30 2003
ASSETS:		
Cash and cash equivalents *(Notes 3 and 4)*	$ 1,404,626	$ 1,746,843
Working capital investments, at market *(Notes 3 and 4)*	1,866,964	882,375
Receivables *(Note 5)*	146,246	199,456
Prepayments and deferred charges	64,686	66,260
Notes receivable:		
Students *(Note 6)*	128,611	136,726
Faculty and staff	108,994	102,952
Other	19,556	19,260
Total notes receivable	257,161	258,938
Pledges receivable *(Note 7)*	721,803	732,715
Fixed assets, net of accumulated depreciation *(Note 8)*	3,468,897	3,168,426
Interests in perpetual trusts held by others *(Note 9)*	245,277	215,317
Investment portfolio, at market *(Notes 3 and 4)*	24,472,444	20,035,262
Market value of securities pledged to counterparties *(Notes 3 and 4)*	27,401,077	35,714,633
TOTAL ASSETS	60,049,181	63,020,225
LIABILITIES:		
Accounts payable	424,482	414,881
Deposits and other liabilities	293,753	257,148
Securities lending and other liabilities associated with the investment portfolio *(Notes 3 and 4)*	28,897,526	36,251,907
Liabilities due under life income fund agreements *(Note 10)*	492,138	419,415
Bonds and notes payable *(Note 11)*	2,604,714	2,246,910
Pension and other accrued retirement obligations *(Note 12)*	343,282	278,253
Government loan advances *(Note 6)*	56,045	55,455
TOTAL LIABILITIES	33,111,940	39,923,969
NET ASSETS	$ 26,937,241	$ 23,096,256

	Unrestricted	Temporarily restricted	Permanently restricted	June 30 2004	June 30 2003
NET ASSETS:					
General Operating Account *(Note 13)*	$ 2,824,375	$ 1,030,947	$ 80,152	$ 3,935,474	$ 3,439,377
Endowment *(Note 9)*	3,374,635	15,456,102	3,756,568	22,587,305	19,294,735
Life income funds *(Note 10)*	0	140,248	274,214	414,462	362,144
TOTAL NET ASSETS	$ 6,199,010	$ 16,627,297	$ 4,110,934	$ 26,937,241	$ 23,096,256

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

Statements of changes in net assets with General Operating Account detail

with summarized financial information for the year ended June 30, 2003

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2004	2003
REVENUE:					
Student income:					
Undergraduate program	$ 190,619			$ 190,619	$ 179,689
Graduate programs	287,102			287,102	266,785
Board and lodging	106,736			106,736	99,008
Continuing education and executive programs	145,281			145,281	137,754
Scholarships applied to student income *(Note 6)*	(173,437)			(173,437)	(158,350)
Total student income	556,301	0	0	556,301	524,886
Sponsored research support *(Note 14)*:					
Federal government—direct costs	342,026			342,026	302,432
Federal government—indirect costs	131,474			131,474	113,723
Non-federal sponsors—direct costs	27,588	79,033		106,621	121,180
Non-federal sponsors—indirect costs	5,295	3,753		9,048	11,542
Total sponsored research support	506,383	82,786	0	589,169	548,877
Gifts for current use *(Note 15)*	61,795	91,723		153,518	151,941
Investment income:					
Endowment income distributed for operations *(Note 9)*	126,398	681,247		807,645	770,670
Income on working capital investments distributed for operations	97,763	14,070		111,833	133,274
Interest received on student, faculty, and staff loans	6,544			6,544	7,744
Total investment income	230,705	695,317	0	926,022	911,688
Other operating income *(Note 16)*	372,696			372,696	335,300
Net assets released from restrictions *(Note 2)*	821,352	(821,352)		0	0
TOTAL REVENUE	2,549,232	48,474	0	2,597,706	2,472,692
EXPENSES:					
Salaries and wages	1,036,028			1,036,028	986,196
Employee benefits *(Note 12)*	304,281			304,281	274,187
Scholarships and other student awards *(Note 6)*	89,414			89,414	79,510
Supplies and equipment	198,310			198,310	199,112
Space and occupancy	262,633			262,633	241,162
Depreciation *(Note 8)*	182,138			182,138	168,072
Other expenses *(Note 17)*	488,115			488,115	484,705
TOTAL EXPENSES	2,560,919	0	0	2,560,919	2,432,944
NET REVENUE/(DEFICIT)	(11,687)	48,474	0	36,787	39,748
OTHER PROVISIONS AND CREDITS:					
Change in appreciation, net of operating distribution	437,861	11,838		449,699	21,083
Change in undistributed general investment income	(23,686)	(43,162)		(66,848)	(150,520)
Other changes *(Note 2)*				0	9,885
TOTAL OTHER PROVISIONS AND CREDITS	414,175	(31,324)	0	382,851	(119,552)
CAPITAL CHANGES:					
Net change in pledge balances *(Note 7)*		(10,098)		(10,098)	(3,065)
Capital gifts for loan funds and facilities *(Note 15)*		28,485	1,305	29,790	28,867
Transfers between General Operating Account and endowment	66,473	(12,301)	(3,037)	51,135	72,175
Transfers between General Operating Account and life income funds *(Note 10)*		5,249	383	5,632	1,339
Non-operating net assets released from restrictions *(Note 2)*	41,155	(44,488)	3,333	0	0
TOTAL CAPITAL CHANGES	107,628	(33,153)	1,984	76,459	99,316
GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR	510,116	(16,003)	1,984	496,097	19,512
Endowment net change during the year	490,302	2,530,918	271,350	3,292,570	1,776,714
Life income funds net change during the year *(Note 10)*		28,969	23,349	52,318	23,632
NET CHANGE DURING THE YEAR	1,000,418	2,543,884	296,683	3,840,985	1,819,858
Balance, beginning of year	5,198,592	14,083,413	3,814,251	23,096,256	21,276,398
BALANCE, end of year	$ 6,199,010	$ 16,627,297	$ 4,110,934	$ 26,937,241	$ 23,096,256

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

Statements of changes in net assets of the endowment

with summarized financial information for the year ended June 30, 2003

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2004	2003
Gifts for capital *(Note 15)*	$ 14,774	$ 39,376	$ 203,617	$ **257,767**	$ 262,368
Investment return *(Notes 3 and 9)*:					
Endowment income from general investments	29,852	162,991		**192,843**	252,524
Change in realized and unrealized appreciation during year	558,996	3,048,681		**3,607,677**	1,807,171
Total investment return	588,848	3,211,672	0	**3,800,520**	2,059,695
Endowment income distributed for operations	(126,398)	(681,247)		**(807,645)**	(770,670)
Change in undistributed general investment income	9,543	50,138		**59,681**	126,475
Net investment return after distributions	471,993	2,580,563	0	**3,052,556**	1,415,500
Transfers between endowment and General Operating Account:					
Unexpended income capitalized/(decapitalized)	(1,581)	12,150	4,416	**14,985**	(968)
Gifts capitalized	1,036	1,518	1,145	**3,699**	3,812
Other	(65,928)	(1,367)	(2,524)	**(69,819)**	(75,019)
Total transfers	(66,473)	12,301	3,037	**(51,135)**	(72,175)
Capitalization of life income funds *(Note 10)*		1,985	7,487	**9,472**	20,796
Net change in endowment pledge balances *(Note 7)*		(16,601)	15,013	**(1,588)**	96,980
Net change in interests in perpetual trusts held by others *(Note 9)*			29,960	**29,960**	(7,184)
Other changes	(26)	(1,930)	(2,506)	**(4,462)**	60,429
Net assets released from restrictions *(Note 2)*	70,034	(84,776)	14,742	**0**	0
NET CHANGE DURING THE YEAR	**490,302**	**2,530,918**	**271,350**	**3,292,570**	**1,776,714**
Balance, beginning of year	2,884,333	12,925,184	3,485,218	**19,294,735**	17,518,021
BALANCE, end of year	**$ 3,374,635**	**$ 15,456,102**	**$ 3,756,568**	**$ 22,587,305**	**$ 19,294,735**

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

Statements of cash flows

In thousands of dollars	For the year ended June 30 2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ 3,840,985	$ 1,819,858
Adjustments to reconcile change in net assets to net cash provided by/(used by) operating activities:		
Provision for depreciation	182,138	168,072
Change in pension and retirement obligations	65,029	37,995
Change in interests in perpetual trusts held by others	(29,960)	7,184
Change in liabilities due under life income fund agreements	72,723	(8,092)
Net gain on sale of investments	(2,157,674)	(1,100,000)
Net unrealized appreciation on investments	(2,069,157)	(945,748)
Gifts restricted for capital purposes	(352,870)	(311,092)
Changes in operating assets and liabilities:		
Working capital investments	(984,589)	685,694
Receivables	53,210	128,735
Prepayments and deferred charges	1,574	(9,985)
Pledges receivable	10,912	(93,917)
Accounts payable	9,601	27,659
Deposits and other liabilities	36,605	9,822
NET CASH PROVIDED BY/(USED BY) OPERATING ACTIVITIES	(1,321,473)	416,185
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans made to students, faculty, and staff	(51,425)	(53,243)
Payments received on student, faculty, and staff loans	53,498	62,233
Change in other notes receivable	(296)	17,211
Proceeds from sale of investments	33,928,651	23,057,775
Purchase of investments	(26,116,555)	(38,987,889)
Net additions to fixed assets	(482,609)	(562,090)
NET CASH PROVIDED BY/(USED BY) INVESTING ACTIVITIES	7,331,264	(16,466,003)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of debt	371,913	421,030
Debt repayment	(14,109)	(13,630)
Gifts restricted for capital purposes	352,870	311,092
Advances under security lending agreements	15,708,183	26,992,825
Payments under security lending agreements	(22,771,455)	(10,683,883)
Change in government loan advances	590	167
NET CASH PROVIDED BY/(USED BY) FINANCING ACTIVITIES	(6,352,008)	17,027,601
NET CHANGE IN CASH AND CASH EQUIVALENTS	(342,217)	977,783
Cash and cash equivalents, beginning of year	1,746,843	769,060
CASH AND CASH EQUIVALENTS, end of year	$ 1,404,626	$ 1,746,843

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

1. University organization

Harvard University is a private, not-for-profit institution of higher education with approximately 7,000 undergraduate and 12,650 graduate students. Established in 1636, the University includes the Faculty of Arts and Sciences, ten graduate schools, the Radcliffe Institute for Advanced Study, the Division of Continuing Education, a variety of research museums and institutes, and an extensive library system to support the teaching, learning, and research activities of the Harvard community. The President and Fellows of Harvard College (the Corporation), a governing board of the University, has oversight responsibility for all of the University's financial affairs. The Corporation delegates substantial authority to the schools and departments for the management of their individual resources and operations.

2. Summary of significant accounting policies

The financial statements include the activities of Harvard University as a whole, including all significant affiliated organizations.

On July 1, 2002, the Rowland Institute for Science (the Rowland Institute) became part of Harvard University. The Rowland Institute is an interdisciplinary research institute focused on experimental rather than theoretical science. The addition of the Rowland Institute's investment in plant and equipment, as well as its operating balances, are included in the "Other changes" line of the fiscal 2003 *Statement of Changes in Net Assets with General Operating Account Detail.* The addition of the Rowland Institute's endowment is included in the "Other changes" line of the fiscal 2003 *Statement of Changes in Net Assets of the Endowment.*

For the purposes of financial reporting, the University classifies resources into three net asset categories pursuant to any donor-imposed restrictions and applicable law. Accordingly, the net assets of the University are classified and defined in the accompanying financial statements in the categories that follow.

Permanently restricted net assets are subject to donor-imposed stipulations that they be invested to provide a perpetual source of income to the University. Generally, donors of these assets require the University to maintain and invest the original contribution in perpetuity, but permit the use of some or all investment earnings for general or specific purposes.

Temporarily restricted net assets are subject to legal or donor-imposed stipulations that will be satisfied either by actions of the University, the passage of time, or both. These net assets include gifts donated for a particular purpose, amounts subject to time restrictions such as funds pledged for future payment, or amounts subject to legal restrictions such as portions of otherwise unrestricted capital appreciation, which must be reported as temporarily restricted in accordance with Massachusetts law.

Unrestricted net assets are not subject to donor-imposed restrictions. Funds invested in fixed assets and funds functioning as endowment comprise 74% of unrestricted net assets. In addition, this category includes unrestricted gifts and endowment income balances, University-designated loan funds, and other unrestricted designated and undesignated current funds (see *Notes 9* and *13*).

Revenues received, expenses incurred, and income distributed for operations for the purpose of conducting the programs and services of the University are presented as "Net revenue/(deficit)" in the *Statements of Changes in Net Assets with General Operating Account Detail.* Net revenue/(deficit) is the measure of operating activity of the University.

Revenue from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Income earned by restricted fund and gift accounts is initially classified as temporarily restricted and reclassified as unrestricted when expenses are incurred for the intended purpose.

Unconditional pledges are reported as increases in the appropriate category of net assets in accordance with donor restrictions (see *Note 7*). Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. Funds transferred to the University on behalf of a specific beneficiary are reported as agency transactions and are not included in the *Statements of Changes in Net Assets.*

The *Balance Sheets* display both the assets and corresponding liabilities generated by securities lending transactions. These are transactions executed to support the investment activities of the Harvard Management Company. The University has also separately reported the fair value of assets for which the counterparty has the right to pledge or exchange the collateral it has received; assets of the investment portfolio that are unencumbered are reported as "Investment portfolio, at market" in the *Balance Sheets.*

The University's vast array of museums and libraries houses priceless works of art, literary works, historical treasures, and artifacts. These collections are protected and preserved for public exhibition, education, research, and the furtherance of public service. They are neither disposed of for financial gain nor encumbered in any manner. Accordingly, such collections are not recorded or capitalized for financial statement purposes.

The University is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates. The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2003, from which the summarized information was derived. Certain prior year amounts have been reclassified to conform to current year presentation.

3. Investment Holdings

The University's investment holdings as of June 30, 2004 and 2003 are summarized in the following tables (in thousands of dollars):

	2004			2003
	Pooled general investments	Other investments	Total	Total
Short-term investments*	$ 2,871,952	$ 399,638	**$ 3,271,590**	$ 2,629,218
Investment portfolio	24,032,158	440,286	**24,472,444**	20,035,262
Securities pledged to counterparties	27,401,077	0	**27,401,077**	35,714,633
Securities lending and other liabilities associated with the investment portfolio	(28,897,526)	0	**(28,897,526)**	(36,251,907)
TOTAL INVESTMENT HOLDINGS	**$ 25,407,661**	**$ 839,924**	**$ 26,247,585**	**$ 22,127,206**

Investment holdings are comprised of:

	2004			2003
	Pooled general investments	Other investments	Total	Total
Short-term investments*	$ 2,871,952	$ 399,638	**$ 3,271,590**	$ 2,629,218
Endowment investments	21,849,253	49,119	**21,898,372**	18,634,174
Life income fund investments	482,044	424,556	**906,600**	781,559
Pension investments	26,772	0	**26,772**	27,876
Postretirement health investments	97,913	0	**97,913**	73,029
Miscellaneous investments	79,727	(33,389)	**46,338**	(18,650)
TOTAL INVESTMENT HOLDINGS	**$ 25,407,661**	**$ 839,924**	**$ 26,247,585**	**$ 22,127,206**

**Short-term investments include working capital investments and cash and cash equivalents. Cash and cash equivalents consist principally of funds deposited in cash management accounts with maturities when purchased of fewer than 90 days.*

The University employs a unit method of accounting for pooled general investments. Each participating fund enters and withdraws from the pooled investment account based on monthly unit market values. Changes in the market value of investments are distributed proportionately to each fund that participates in the investment pool. Net general investment income distributed during the year is allocated on a per unit basis to each participating fund (see *Note 4*).

The changes in the market value and income of participating units for the years ended June 30, 2004 and 2003 were as follows:

	2004	2003
Unit value at end of year	**$ 1,215.68**	$ 1,013.51
Unit value at beginning of year	**1,013.51**	914.78
Change in realized and unrealized appreciation	**202.17**	98.73
Net income earned on general investments	**10.79**	13.88
TOTAL UNIT RETURN ON POOLED GENERAL INVESTMENTS	**$ 212.96**	$ 112.61
TOTAL UNIT RETURN PERCENTAGE USING MONTHLY COMPOUNDING	**21.1%**	12.5%

Other investments are managed separately from the pooled general investment account. These investments consist primarily of fixed-income securities, principally government securities and certificates of deposit held for the University's working capital needs, and various managed bond and equity portfolios associated with life income funds. Those investments that are not readily marketable are carried either at cost or a nominal value. Income on other investments is recorded and distributed when received.

4. Pooled General Investments

The following are the significant accounting policies of the University related to pooled general investments:

A) Investments are presented at fair market value based on trade date positions as of June 30. Instruments listed or traded on a securities exchange are valued at the last sale price on the primary exchange where the security is traded. Investments in publicly traded securities that are subject to restrictions limiting their salability are discounted from the current public market price to levels that reflect the estimated cost of those restrictions. Non-exchange traded debt instruments are valued by independent pricing services or by broker/dealers who actively make markets in these securities. Options contracts, forward contracts, interest rate exchange agreements, and interest rate cap and floor agreements are valued using validated models with externally verifiable model inputs, or by using independent broker quotes. Private equity, real estate, commodities, and absolute return funds consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are valued utilizing the most current information provided by the general partner. Direct investments are valued utilizing discounted cash flow and other industry standard methodologies. Where applicable, independent appraisers and engineers are utilized to assist in the valuation. These values are determined under the direction of, and subject to approval by, the Valuation Committee of the Harvard Management Company Board of Directors.

B) The preparation of consolidated financial statements requires management to make estimates and assumptions about the effect of matters that are inherently uncertain. The accounting policies considered potentially significant in this respect are the valuation of derivative instruments, private equities, real estate, and certain commodities. Values for these instruments are often estimated using techniques such as discounted cash flow analysis and comparisons to similar instruments. Estimates developed using these methods are subjective and require judgment regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Estimates, by their nature, are based on judgment and available information. Changes in assumptions could have a significant effect on the fair value of these instruments. Actual results could differ from these estimates and could have a material impact on the financial statements.

C) The University amortizes bond premiums and accretes bond discounts where such expense or income is significant.

D) The University utilizes a number of subsidiary entities to support the investment activities of the endowment. The consolidated financial statements include all assets and liabilities associated with these entities.

The University's investment strategy incorporates a diversified asset allocation approach and maintains, within defined limits, exposure to the movements of the world equity, fixed-income, commodities, real estate, and private equity markets. The core investment portfolio is structured to mirror the market exposures defined by the Policy Portfolio and is considered to be "unhedged." (The Policy Portfolio is described in the unaudited *Annual Report of the Harvard Management Company*, which begins on page 22.) In addition, the University seeks to enhance the returns of certain asset classes through strategies designed to capture mispricings in specific financial instruments without changing the fundamental risk profile of the core investment account. These strategies generally involve several distinct but highly correlated financial instruments that are weighted to neutralize market risk. Depending on the characteristics of the financial instruments, the specific positions within a given strategy may be recorded on the asset or liability sections of the following table.

The following table delineates securities pledged to counterparties, where the counterparty has the right, by contract or custom, to sell or repledge the securities. The fair value of collateral pledged to counterparties that cannot be sold or repledged as of June 30, 2004 was $688.5 million and as of June 30, 2003 was $922.9 million. The fair value of collateral accepted by the University as of June 30, 2004 was $3,757.1 million and as of June 30, 2003 was $2,157.6 million. The portion of this collateral that was sold or repledged as of June 30, 2004 was $1,020.8 million and as of June 30, 2003 was $1,307.1 million.

The summarization of pooled general investment assets and liabilities as of June 30, 2004 and 2003 is as follows (in thousands of dollars):

	2004		2003	
ASSETS:				
Investments:				
Domestic equity and convertible securities	$ 4,462,050		$ 3,681,700	
Securities pledged to counterparties	169,540	**4,631,590**	241,682	3,923,382
Foreign equity and convertible securities	2,892,546		2,572,538	
Securities pledged to counterparties	590,064	**3,482,610**	236,505	2,809,043
Domestic fixed-income securities	75,442		59,118	
Securities pledged to counterparties	2,349,446	**2,424,888**	2,660,202	2,719,320
Foreign fixed-income securities	12,155		36,411	
Securities pledged to counterparties	137,547	**149,702**	81,511	117,922
Emerging markets equity and debt	1,636,487		1,318,407	
Securities pledged to counterparties	17,449	**1,653,936**	0	1,318,407
High-yield securities	814,259		1,045,628	
Securities pledged to counterparties	361,971	**1,176,230**	278,713	1,324,341
Absolute return funds		**2,630,057**		1,991,165
Private equities		**1,980,619**		1,886,163
Real estate		**1,457,203**		1,161,096
Commodities		**2,197,088**		1,190,322
Inflation-indexed bonds	353,654		385,602	
Securities pledged to counterparties	973,030	**1,326,684**	997,243	1,382,845
Total investments		**23,110,607**		19,824,006
Financial instruments purchased under hedge transactions:				
Equity and convertible securities	1,393,766		1,431,261	
Securities pledged to counterparties	59,617	**1,453,383**	30,472	1,461,733
Fixed-income securities	1,263,807		2,146,749	
Securities pledged to counterparties	22,733,300	**23,997,107**	31,174,723	33,321,472
Options		**2,268,210**		2,076,990
Commodities		**336,965**		11,867
Total financial instruments purchased under hedge transactions		**28,055,665**		36,872,062
Collateral advanced under security borrowing agreements[1]		**1,195,850**		1,013,020
Cash and short-term investments	1,085,357		1,160,971	
Securities pledged to counterparties	9,113	**1,094,470**	13,582	1,174,553
Accounts receivable/(payable), net[2]		**848,595**		(1,712,198)
POOLED GENERAL INVESTMENT ASSETS		**54,305,187**		57,171,443
LIABILITIES:				
Financial instruments sold, not yet purchased, under hedge transactions:				
Equity and convertible securities		**697,407**		892,819
Fixed-income securities		**424,267**		629,852
Options		**746,820**		636,932
Total financial instruments sold, not yet purchased, under hedge transactions		**1,868,494**		2,159,603
Cash collateral held under security lending agreements[3]		**27,029,032**		34,092,304
POOLED GENERAL INVESTMENT LIABILITIES		**28,897,526**		36,251,907
POOLED GENERAL INVESTMENT NET ASSETS		**$ 25,407,661**		$ 20,919,536

[1] *The collateral advanced under security borrowing agreements is in the form of cash or publicly traded equity securities.*

[2] *As of June 30, 2004, accounts receivable and payable relating to undistributed income and purchases and sales of securities were $1,547,256 and $698,661, respectively. The amounts at June 30, 2003 were $660,846 and $2,373,044, respectively. As of June 30, 2004, of the $1,547,256 of accounts receivable, gross receivables relating to off-balance sheet instruments were $787,463, and of the $698,661 of accounts payable, gross payables relating to off-balance sheets instruments were $220,529. As of June 30, 2003, of the $660,846 of accounts receivable, gross receivables relating to off-balance sheet instruments were $148,924, and of the $2,373,044 of accounts payable, gross payables relating to off-balance sheet instruments were $1,964,598.*

[3] *The minimum collateral the University requires by contract on each stock loan and repurchase agreement is 100% of the market value of the security loaned. Collateral is moved as is required by fluctuations in the market value of the security loaned.*

The University uses a variety of financial instruments with off-balance sheet risk involving contractual or optional commitments for future settlement. These include futures, options, interest rate exchange agreements, interest rate cap and floor agreements, and forward purchase and sale agreements, which are exchange traded or executed over-the-counter. These instruments are primarily used in the arbitrage strategies that enhance the returns of certain asset classes without increasing the market risk to the underlying asset class (see "hedged" market exposure in the following tables). The market risk of a strategy is influenced by the relationship between the financial instruments with off-balance sheet risk and the offsetting positions recorded on the balance sheet. (For a detailed analysis of the market exposure of the portfolio as of June 30, 2004, see the supplemental information on *Pooled General Investments* beginning on page 54.) The University controls market risk through the use of industry standard analytical tools that measure the market exposure of each position within a strategy. The strategies are monitored daily and positions are frequently adjusted in response to changes in the financial markets. Financial instruments with off-balance sheet risk are also used by the University to adjust the market exposure of a given asset class without disturbing the underlying instruments in the core investment portfolio (see "unhedged" market exposure in the following tables).

The following table summarizes the market exposure (expressed in cash market equivalents as discussed below), net ending fair value, net average fair value, and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2004 (in thousands of dollars):

	Market exposure			Net ending fair value of off-balance sheet positions		Net average fair value	Credit exposure*
	Long unhedged	Long hedged	Short hedged	Unhedged	Hedged		
Equity futures	$ 228,150	$ 7,610	$ (848,357)	$ 0	$ (188)	$ 3,164	$ 52,963
Equity options	11,857	87,014	(38,055)	11,857	26,524	43,943	1,026
Equity exchange agreements	333,440	31,492	(268,753)	(15,521)	17,544	8,954	377
Total equity instruments	573,447	126,116	(1,155,165)	(3,664)	43,880	56,061	54,366
Fixed-income futures	29,411	114,356	(320,653)	0	20	(416)	1,800
Fixed-income options	531	1,828,160	(5,809,972)	2,023	712,500	676,278	2,651
Fixed-income forwards	0	0	0	0	0	0	0
Interest exchange agreements	314,976	7,074,374	(33,870,004)	968	571,309	(628,713)	805
Interest rate caps and floors	7,894	17,843,634	(1,558,156)	20,684	328,015	481,597	3,301
Total fixed-income instruments	352,812	26,860,524	(41,558,785)	23,675	1,611,844	528,746	8,557
Commodity futures	0	0	(86,369)	0	0	0	1,661
Commodity options	0	122,694	(273,490)	0	84,818	29,206	13
Commodity exchange agreements	880,000	547,438	(490,189)	0	92,133	200	4,988
Total commodity instruments	880,000	670,132	(850,048)	0	176,951	29,406	6,662
Currency forwards	1,071,187	2,075,857	(3,127,351)	7,121	12,572	5,905	73
Currency options	0	5,210,907	(1,860,145)	0	448,477	580,751	1,071
Private put agreements related to real estate investments	5,000	0	0	0	0	0	0
TOTAL	**$ 2,882,446**	**$ 34,943,536**	**$ (48,551,494)**	**$ 27,132**	**$ 2,293,724**	**$ 1,200,869**	**$ 70,729**

* *Credit exposures primarily represent cash or securities advanced by the University to meet legal margin requirements in connection with future, forward, and option contracts.*

The following table summarizes the market exposure (expressed in cash market equivalents as discussed below), net ending fair value, net average fair value, and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2003 (in thousands of dollars):

	Market exposure			Net ending fair value of off-balance sheet positions		Net average fair value	Credit exposure*
	Long unhedged	Long hedged	Short hedged	Unhedged	Hedged		
Equity futures	$ 24,943	$ 4,474	$ (591,960)	$ 3,939	$ 3,342	$ 22,704	$ 54,976
Equity options	0	14,483	(40,746)	0	5,379	51,474	2,803
Equity exchange agreements	163,171	162,364	(450,776)	8,707	(11,984)	(4,765)	42
Total equity instruments	188,114	181,321	(1,083,482)	12,646	(3,263)	69,413	57,821
Fixed-income futures	47,763	100,837	(179,139)	0	0	1,406	3,570
Fixed-income options	22,933	2,339,293	(7,695,028)	2,085	558,498	409,213	11,587
Fixed-income forwards	0	0	0	0	0	(3,512)	0
Interest exchange agreements	300,902	8,835,423	(43,380,781)	10,677	(2,082,796)	(960,200)	2,106
Interest rate caps and floors	529,801	15,312,692	(955,161)	24,475	464,035	308,522	14,219
Total fixed-income instruments	901,399	26,588,245	(52,210,109)	37,237	(1,060,263)	(244,571)	31,482
Commodity futures	0	0	0	0	0	0	0
Commodity options	0	89,819	(59,017)	0	(10,137)	(4,259)	511
Commodity exchange agreements	800,000	307,272	(307,150)	0	122	9,465	4,577
Total commodity instruments	800,000	397,091	(366,167)	0	(10,015)	5,206	5,088
Currency forwards	952,707	3,878,253	(4,796,735)	(14,898)	49,123	2,885	12,645
Currency options	0	6,013,832	(2,175,485)	0	628,433	461,882	7,050
Private put agreements related to real estate investments	5,000	0	0	0	0	0	0
TOTAL	$ 2,847,220	$ 37,058,742	$ (60,631,978)	$ 34,985	$ (395,985)	$ 294,815	$ 114,086

* *Credit exposures primarily represent cash or securities advanced by the University to meet legal margin requirements in connection with future, forward, and option contracts.*

Financial instruments with off-balance sheet risk are recorded on the balance sheet at fair value. Fair value is a function of the characteristics of the individual financial instruments and their relationship to current market conditions, as well as the length of time each instrument has been held. For example, domestic futures contracts, which expire periodically, are subject to daily cash settlements, and as such, the end of day fair value of these contracts is zero. In contrast, interest rate exchange agreements may be held for the life of a strategy and may reflect significant unrealized gains and losses depending on the change in value since the inception of the contract. The cash market equivalent of exposure represents the notional value of the off-balance sheet instrument adjusted for its correlation to its underlying index or asset.

Market exposure is only meaningful when related to the corresponding positions recorded on the balance sheet. Fair value and market exposure do not accurately measure risk. A more appropriate indicator of market risk is the net exposure of all positions (on and off-balance sheet) expressed in market risk equivalents, or value at risk. (For a more comprehensive discussion of market risk of the portfolio, see the unaudited *Annual Report of the Harvard Management Company*, which begins on page 22.)

Financial instruments with off-balance sheet risk necessarily involve counterparty credit exposure. The policy of the University is to require collateral to the maximum extent possible under normal trading practices. Collateral is moved on a daily basis as is required by fluctuations in

the market. The collateral is generally in the form of debt obligations issued by the U.S. Treasury. In the event of counterparty default, the University has the right to use the collateral to offset the loss associated with the replacements of the agreements. The University enters into arrangements only with counterparties believed to be creditworthy. Specific credit limits are established for each counterparty, based on their individual credit rating. Credit limits are monitored daily and are adjusted according to policy.

The asset allocation of the University's portfolio involves exposure to a diverse set of markets. The investments within these markets involve various risks such as interest rate, market, sovereign, and credit risks. The University anticipates that the value of its investments may, from time to time, fluctuate substantially as a result of these risks.

The University has entered into debt service put agreements in connection with its real estate investments. Under specific circumstances, these put agreements grant those who lend to certain investments held in these portfolios the right to sell senior secured loans to the University at a designated price. These put agreements have been valued by the University under policies previously described. The University has also entered into agreements, primarily with private equity partnerships, that require periodic cash contributions totaling approximately $3,457.6 million through 2014.

For the year ended June 30, 2004, the total return on the pooled general investments was 21.1%, or $4,391.7 million, net of all expenses and fees, and including the impact of revenue-sharing agreements with certain fund managers. This compares with 12.5%, or $2,312.4 million for fiscal 2003. The investment return is a result of the performance of the core investment portfolio, adjusted for the net results of the internal value-added strategies. The fiscal 2004 investment results by asset class are described in detail in the unaudited *Annual Report of the Harvard Management Company*.

5. Receivables

The major components of receivables, net of reserves for doubtful accounts of $2.5 million and $1.5 million, as of June 30, 2004 and 2003, respectively, were as follows (in thousands of dollars):

	2004	2003
Investment income	$ 0	$ 53,260
U.S. Government, principally related to research	36,080	36,440
Non-federal sponsored research	5,044	6,364
Students	9,102	6,290
Other	96,020	97,102
TOTAL RECEIVABLES	**$ 146,246**	**$ 199,456**

6. Student Financial Aid

Financial aid granted to students totaled $353.1 million in fiscal 2004: $262.9 million of scholarships and other student awards, $25.3 million of loans, $51.9 million of student employment, and $13.0 million of aid from sponsors for which the University acts as an agent for the recipient. Of the $262.9 million of scholarships and other student awards, $89.4 million represents stipends and other payments made directly to students, and $173.5 million represents financial aid applied to student income. Approximately 70% of this financial aid is funded by gifts, endowment income, and sponsored support.

In addition to administering institutional loan programs, the University participates in various federal loan programs. Notes receivable from students as of June 30, 2004 and 2003 were as follows (in thousands of dollars):

	2004	2003
Federally insured loans	$ 13,149	$ 21,245
Government revolving loans	63,211	62,045
Institutional loans	52,251	53,436
TOTAL STUDENT NOTES RECEIVABLE	**$ 128,611**	**$ 136,726**

Federally insured loans are generally repaid over a ten-year period and earn interest at an adjustable rate that approximates the 90-day U.S. Treasury Bill rate plus 3.0%. Principal and interest payments on these loans are insured by the American Student Assistance Corporation and are reinsured by the federal government.

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled $56.0 million and $55.5 million as of June 30, 2004 and 2003, respectively, and are classified as liabilities. Interest earned on the revolving and institutional loan programs is reinvested to support additional loans. The repayment and interest rate terms of the institutional loans vary considerably.

Notes receivable under federally guaranteed student loan programs are subject to significant restrictions. Accordingly, it is not practicable to determine the fair value of such amounts.

7. Pledges Receivable

Unconditional promises to donate to the University in the future are recorded as pledges receivable in the year promised at the present value of expected cash flows, net of an allowance for unfulfilled pledges. Pledges receivable included in the financial statements as of June 30, 2004 and 2003 are expected to be realized as follows (in thousands of dollars):

	2004	2003
Within one year	$ 106,797	$ 105,699
Between one and five years	427,187	422,797
More than five years	275,599	280,174
Less: discount and allowance for unfulfilled pledges	(87,780)	(75,955)
PLEDGES RECEIVABLE	**$ 721,803**	**$ 732,715**

A discount of $42.4 million and $52.9 million for the years ended June 30, 2004 and 2003, respectively, was calculated using a discount factor based on the appropriate U.S. Treasury Note rate.

Pledges receivable have been designated for the following purposes (in thousands of dollars):

	2004	2003
Gifts for current use	$ 134,723	$ 97,748
Non-federal sponsored research	108,154	136,516
Loan funds and facilities	35,270	53,207
General Operating Account balances	278,147	287,471
Endowment	443,656	445,244
PLEDGES RECEIVABLE	**$ 721,803**	**$ 732,715**

Because of uncertainties with regard to their realizability and valuation, bequest intentions and other conditional promises are not estimated by management and are recognized as assets if and when the specified conditions are met.

8. Fixed assets

Fixed assets are shown at cost or at fair value as of the date of the gift, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

The major categories of fixed assets as of June 30, 2004 and 2003 are summarized as follows (in thousands of dollars):

	2004	2003	Estimated useful life (in years)
Housing	$ 798,881	$ 678,866	35
Research facilities	1,198,698	894,953	*
Classrooms and offices	751,653	682,251	35
Libraries	242,057	222,769	35
Museums and assembly facilities	205,579	200,103	35
Athletic facilities	106,274	104,899	35
Service facilities	200,593	141,773	35
Other facilities and land	795,677	765,691	**
Construction in progress	328,749	526,970	-
Equipment	334,999	268,973	***
SUBTOTAL AT COST	4,963,160	4,487,248	
Less: accumulated depreciation	(1,494,263)	(1,318,822)	
FIXED ASSETS, net	$ 3,468,897	$ 3,168,426	

* *Estimated useful lives of components used for calculating depreciation range from 10 to 45 years.*
** *The estimated useful life of other facilities is 35 years.*
*** *Estimated useful lives of equipment range from 3 to 8 years.*

Fixed assets include both facilities and equipment. Equipment includes general and scientific equipment, computers, software, furniture, and vehicles.

The costs of research facilities are separated into the shell, roof, finishes, fixed equipment, and services. These components are separately depreciated. The average useful life for research facilities is 19 years.

Certain University facilities are subject to restrictions as to use, structural modifications, and ownership transfer.

9. Endowment funds

Harvard's endowment consists of approximately 10,700 separate funds established over many years for a wide variety of purposes. Endowment fund balances, including funds functioning as endowment, are classified and reported as either permanently restricted, temporarily restricted, or unrestricted, in accordance with donor specifications. Net losses on permanently restricted endowment funds are classified as a reduction to unrestricted net assets until such time as the market value equals or exceeds book value. Although funds functioning as endowment are not subject to permanent donor restrictions, the decision to spend their principal requires the approval of the Corporation. All but a small fraction of the endowment is invested in the pooled general investment account (see *Notes 3* and *4*).

The University is also the beneficiary of certain perpetual trusts held and administered by others. The estimated fair values of trust assets, which approximate the present values of expected future cash flows from the trusts, are recognized as assets and revenue when the trusts are established.

Endowment funds as of June 30, 2004 and 2003 are summarized below (in thousands of dollars):

	2004				2003
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Endowment funds	$ 0	$ 13,441,532	$ 3,151,772	**$ 16,593,304**	$ 14,094,860
Funds functioning as endowment:					
Departmental funds	2,521,874	1,878,787	0	**4,400,661**	3,767,414
University funds	852,761	51,646	0	**904,407**	771,900
Pledge balances	0	84,137	359,519	**443,656**	445,244
Interests in perpetual trusts held by others	0	0	245,277	**245,277**	215,317
TOTAL	**$ 3,374,635**	**$ 15,456,102**	**$ 3,756,568**	**$ 22,587,305**	**$ 19,294,735**

The University's endowment income distribution policies are designed to preserve the value of the endowment in real terms (after inflation) and to generate a predictable stream of spendable income. Endowment investments are managed to achieve the maximum long-term total return. As a result of this emphasis on total return, the proportion of the annual income distribution funded by dividend and interest income or by capital gains may vary significantly from year to year. Amounts withdrawn from endowment capital gains to fund the fiscal 2004 and 2003 distributions totaled $644.9 million and $471.7 million, respectively.

The portion of investment returns earned on endowment and distributed each year is based on a rate (stated in dollars per unit) that is approved by the Corporation. This rate is not set based on a specific formula, nor is it directly tied to current investment returns. Rather, it reflects expectations about long-term returns and inflation rates and seeks to maintain the distribution rate at between 4.5% and 5.0% of the market value of the endowment. The table below shows the total return on endowment for the past five fiscal years, as well as the distribution rate for the following fiscal years.

Endowment income capitalized to endowment principal is available to meet future spending needs, subject to the approval of the Corporation.

	Endowment investment returns (dollar amounts in thousands)				Distribution rate[1,3]	
Fiscal year	Interest and dividends	Net appreciation	Total return[2]	Total return %[3]	Per unit	As a % of market value
2004	$ 192,843	$ 3,607,677	$ 3,800,520	21.1%	$ 54.17	4.5%
2003	252,524	1,807,171	2,059,695	12.5	49.70	4.9
2002	378,999	(474,416)	(95,417)	(0.5)	47.11	5.1
2001	354,368	(844,638)	(490,270)	(2.7)	45.32	4.8
2000	268,797	4,192,691	4,461,488	32.2	32.92	3.3
FIVE-YEAR TOTAL	**$ 1,447,531**	**$ 8,288,485**	**$ 9,736,016**			

[1] *Since current year interest and dividends are used to fund the following year's distribution, these represent distribution rates for the following fiscal year.*
[2] *Total return is net of all expenses and fees, and includes the impact of revenue-sharing agreements with certain fund managers.*
[3] *Total return % and distribution rate per unit and as a % of market value amounts relate to pooled general investments.*

10. Life income funds

As of June 30, 2004, the University held life income funds—pooled funds, gift annuities, and charitable remainder trusts—for approximately 2,000 donors. These funds are held in trust for one or more beneficiaries, and generally pay lifetime income to those beneficiaries, after which the principal is made available to the University in accordance with donor intentions. When a trust is established, life income fund net assets are recorded at fair market value, net of related liabilities for the present value of estimated future payments due to beneficiaries and net of obligations under charitable remainder trusts due to other institutions. As of June 30, 2004, life income fund assets totaled $906.6 million, with corresponding liabilities for amounts due to beneficiaries of $420.1 million and amounts due to institutions of $72.0 million, respectively. Gifts for capital to life income funds are presented at full value. The discounted present value of these gifts is $23.1 million and $9.0 million for fiscal 2004 and 2003, respectively. The changes in life income fund net assets for fiscal 2004 and 2003 were as follows (in thousands of dollars):

	2004			2003
	Temporarily restricted	Permanently restricted	Total	Total
Gifts for capital *(Note 15)*	$ 36,614	$ 28,699	**$ 65,313**	$ 19,857
Investment return:				
Investment income	6,222	13,407	**19,629**	17,607
Change in realized and unrealized appreciation	31,306	67,465	**98,771**	41,979
Total investment return	37,528	80,872	**118,400**	59,586
Payments to annuitants	(13,809)	(29,759)	**(43,568)**	(41,768)
Life income funds capitalized to endowment	(1,985)	(7,487)	**(9,472)**	(20,796)
Life income funds transferred to General Operating Account	(5,249)	(383)	**(5,632)**	(1,339)
Change in liabilities due under life income agreements	(24,130)	(48,593)	**(72,723)**	8,092
NET INCREASE DURING THE YEAR	**28,969**	**23,349**	**52,318**	**23,632**
Balance, beginning of year	111,279	250,865	**362,144**	338,512
BALANCE, end of year	**$ 140,248**	**$ 274,214**	**$ 414,462**	**$ 362,144**

11. Bonds and Notes Payable

Bonds and notes payable as of June 30, 2004 and 2003 are summarized as follows (in thousands of dollars):

	Fiscal year of issue	Remaining years to maturity	One-year effective interest rate	Outstanding principal 2004	Outstanding principal 2003
TAX-EXEMPT BONDS AND NOTES PAYABLE:					
Variable-rate bonds and notes:					
Series L - Weekly	1990	20	4.5%	$ 71,140	$ 71,140
Series R - Weekly	2000-2004	45	0.9	103,670	90,765
Series Y - Weekly	2000	31	5.3	117,905	117,905
Series BB - Weekly	2001	30	0.9	196,700	196,700
Series HH - Weekly	2004	30	5.7	92,235	0
Commercial Paper (Series EE)	Various	29	1.0	519,434	212,298
Total variable-rate bonds and notes			2.0	1,101,084	688,808
Fixed-rate bonds:					
Series N	1992	16	6.3	78,771 *	78,679
Series P	1995	28	5.5	104,730	105,830
Series Z	2001	12	5.1	110,194 *	118,174
Series AA	2001	5	5.5	24,769 *	29,403
Series DD	2002	31	5.0	134,852 *	134,819
Series FF	2003	33	5.1	275,968 *	275,962
Radcliffe College Series 1997	1998	2	4.7	575	1,100
Total fixed-rate bonds			5.3	729,859	743,967
TOTAL TAX-EXEMPT BONDS AND NOTES PAYABLE			3.3	1,830,943	1,432,775
TAXABLE BONDS AND NOTES PAYABLE:					
Commercial paper	Various		5.1	336,977	377,386
Fixed-rate bonds	1992	3	8.1	115,000	115,000
Series CC	2001	27	7.0	247,000	247,000
TOTAL TAXABLE BONDS AND NOTES PAYABLE			6.3	698,977	739,386
OTHER NOTES PAYABLE	Various	38		74,794	74,749
TOTAL BONDS AND NOTES PAYABLE			4.1%	$ 2,604,714	$ 2,246,910

* *Series N ,DD and FF principal are net of $1.2 million, $1.0 million and $0.2 million of discounts, respectively. Series Z and AA principal include premiums of $1.8 million and $0.9 million, respectively.*

Interest payments on a cash basis totaled $77.1 million and $70.8 million for fiscal 2004 and 2003, respectively. Interest expense was $76.8 million for both fiscal 2004 and 2003. Excluding maturity of commercial paper and other notes payable, scheduled principal payments are (in thousands of dollars):

Fiscal year	Principal payments
2005	$ 14,380
2006	13,960
2007	129,395
2008	14,175
2009	14,725
Thereafter	1,486,625
TOTAL	$ 1,673,260

The University initiated its affiliate housing bond program in fiscal 2004 with the issuance of $92.2 million of Series HH tax-exempt weekly variable-rate bonds. Also in fiscal 2004, the University reauthorized its existing tax-exempt commercial paper program (Series EE). With this action, the authorized limit on the program was raised from $300 million to $650 million. The series had $519.4 million in outstanding notes as of June 30, 2004.

In fiscal 2003, the University issued $276.2 million in fixed-rate Series FF bonds to finance a variety of capital facilities and equipment projects. The University also initiated a tax-exempt commercial paper program to finance construction period spending for large capital projects (Series EE). Also during fiscal 2003, the University recorded

an obligation to purchase certain property with payments that extend over 20 years. The present value of this obligation was $6.4 million as of June 30, 2004.

Based on quoted market prices, the estimated fair value, including accrued interest, of Harvard's bonds and notes payable issued in the capital market as of June 30, 2004 and 2003 was $2,582.7 million and $2,277.1 million, respectively.

In July 2004, the University issued $205.9 million in tax-exempt weekly variable-rate Series GG-1 bonds and $58.5 million in taxable weekly variable-rate Series GG-2 bonds to finance a new research facility. The Series GG-1 and Series GG-2 bonds mature in July 2029 and 2013, respectively.

INTEREST RATE EXCHANGE AGREEMENTS The University has entered into various interest rate exchange agreements in order to convert variable-rate borrowings to a fixed rate, thereby managing the interest cost and risk associated with its outstanding debt. The interest rate exchange agreements were not entered into for trading or speculative purposes. Under the terms of these agreements, the University pays a fixed rate, determined at inception, and receives a variable rate on the respective notional principal amounts. Each of these exchanges is collateralized, as described in *Note 4*. The interest rates in the preceding schedule reflect any applicable exchange agreements.

The fair value of interest rate exchange agreements is the estimated amount that the University would have received or (paid), including accrued interest, to terminate the agreements on the dates of the *Balance Sheets*, taking into account the creditworthiness of the underlying counterparties. The notional amount and fair value of interest rate exchange agreements were $1,376.6 million and $(58.4) million, respectively, as of June 30, 2004 and $720.5 million and $(120.0) million, respectively, as of June 30, 2003. The fair value of these agreements is included in "Investment portfolio, at market" in the *Balance Sheets*. The change in unrealized depreciation that was recognized for the interest rate exchange agreements was approximately $61.7 million and $78.6 million for fiscal 2004 and 2003, respectively. The loss realized from the monthly settling of these agreements was $28.7 million and $25.8 million for fiscal 2004 and 2003, respectively. All unrealized and realized gains and losses from interest rate exchange agreements are included in the "Change in appreciation, net of operating distribution" line in the *Statements of Changes in Net Assets with General Operating Account Detail*.

12. EMPLOYEE BENEFITS

The University offers current employees a choice of health plans, dental plans, short-term and long-term disability plans, life insurance, tuition assistance, and a variety of other benefits such as subsidized passes for public transportation and for Harvard athletic facilities. In addition, the University has pension plans covering substantially all employees.

The University uses a measurement date of June 30 for its pension and postretirement health plans.

PENSION BENEFITS Faculty members and certain long service administrative officers participate in defined contribution plans that are funded on a current basis. All staff and hourly employees are covered by a retirement program that includes a defined benefit component, a defined contribution component, or a combination of the two.

Effective July 1, 2002, certain union employees do not receive further compensation credits to their cash balance accounts, and the compensation credits to their individual investment accounts are increased.

In accordance with ERISA requirements, the University has established a trust to hold plan assets for its defined benefit pension plans. The market value of the trust's assets was $640.0 million and $575.4 million as of June 30, 2004 and 2003, respectively. In addition, the University has internally funded and invested $26.8 million and $27.9 million as of June 30, 2004 and 2003, respectively, for its defined benefit pension plans. The University recorded expenses for its defined contribution plans of $61.6 million and $71.3 million as of June 30, 2004 and 2003, respectively.

POSTRETIREMENT HEALTH BENEFITS The University provides defined benefit postretirement health coverage and life insurance to substantially all of its employees. As of June 30, 2004, the University invested $97.9 million to fund the postretirement health benefit accrued liability of $316.5 million. As of June 30, 2003, the University invested $73.0 million to fund an accrued liability of $250.4 million.

In thousands of dollars	2004 Pension benefits	2003 Pension benefits	2004 Other benefits	2003 Other benefits
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at beginning of year	$ 583,588	$ 508,061	$ 491,656	$ 379,017
Service cost	14,737	11,921	23,080	15,857
Interest cost	34,796	35,368	29,949	28,063
Plan participants' contributions	0	0	2,868	2,523
Amendments	0	(14,454)	0	0
Actuarial (gain)/loss	(18,941)	76,207	(28,247)	78,809
Benefits paid	(33,723)	(33,515)	(14,341)	(12,613)
BENEFIT OBLIGATION AT END OF YEAR	$ 580,457	$ 583,588	$ 504,965	$ 491,656

The accumulated benefit obligation for pension benefits in 2004 and 2003 was $495.7 million and $518.2 million, respectively.

CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	$ 575,366	$ 585,394	$ 0	$ 0
Actual return on plan assets	98,309	23,487	0	0
Employer contribution	0	0	11,473	10,090
Plan participants' contributions	0	0	2,868	2,523
Benefits paid	(33,723)	(33,515)	(14,341)	(12,613)
FAIR VALUE OF PLAN ASSETS AT END OF YEAR	$ 639,952	$ 575,366	$ 0	$ 0
Funded status	$ 59,494	$ (8,221)	$ (504,965)	$ (491,656)
Unrecognized actuarial (gain)/loss	(51,632)	20,397	120,987	165,703
Unrecognized portion of net obligation at transition	0	0	54,560	60,622
Unrecognized prior service cost/(credit)	(34,634)	(40,052)	12,908	14,954
NET AMOUNT RECOGNIZED	$ (26,772)	$ (27,876)	$ (316,510)	$ (250,377)
AMOUNTS RECOGNIZED IN THE BALANCE SHEETS CONSIST OF:				
Prepaid benefit cost	$ 0	$ 0	$ 0	$ 0
Accrued benefit liability	(26,772)	(27,876)	(316,510)	(250,377)
NET AMOUNT RECOGNIZED	$ (26,772)	$ (27,876)	$ (316,510)	$ (250,377)
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATIONS AS OF JUNE 30:				
Discount rate as of June 30	6.25%	6.00%	6.25%	6.00%
Rate of compensation increase as of June 30	4.00%	5.00%		

For measurement purposes, a 10.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2005, decreasing gradually to a 5.0% annual rate in 2010 and all years thereafter.

In thousands of dollars	2004 Pension benefits	2003 Pension benefits	2004 Other benefits	2003 Other benefits
COMPONENTS OF NET PERIODIC BENEFIT COST				
Service cost	$ 14,737	$ 11,921	$ 23,080	$ 15,857
Interest cost	34,796	35,368	29,949	28,063
Expected return on plan assets and reserves	(48,160)	(49,776)	(6,083)	(4,509)
Amortization of:				
transition obligation/(asset)	0	0	6,062	6,062
prior service cost/(credit)	(5,418)	(5,418)	2,046	2,046
actuarial loss/(gain)	(3,127)	(6,433)	6,620	3,386
Net periodic benefit cost/(income)	(7,172)	(14,338)	61,674	50,905
Investment return on invested reserves	6,068	4,251	15,932	7,267
TOTAL PERIODIC COST/(INCOME)	$ (1,104)	$ (10,087)	$ 77,606	$ 58,172
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE THE NET PERIODIC BENEFIT COST FOR THE YEARS ENDED JUNE 30:				
Discount rate as of June 30	6.00%	7.25%	6.00%	7.25%
Expected return on plan assets for the year	7.75%	7.75%	7.75%	7.75%
Rate of compensation increase as of June 30	5.00%	5.00%	5.00%	5.00%

The expected return on plan assets is determined by utilizing Harvard Management Company's capital markets model, which takes into account the expected real return, before inflation, for each one of the pension portfolio's asset classes, as well as the correlation of any one asset class to every other asset class. This model runs the real returns and correlations and derives an expected real return for the entire portfolio, given the percentage weighting allocated to each asset class. After calculating this expected real return, an assessment is made to accommodate the expected inflation rate for the forthcoming period. The final expected return on assets is the aggregate of the expected real return plus the expected inflation rate.

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

	2004		2003	
In thousands of dollars	One percentage point decrease	One percentage point increase	One percentage point decrease	One percentage point increase
Effect on total of service cost and interest cost components	$ (9,420)	$ 12,332	$ (7,071)	$ 9,087
Effect on the postretirement benefit obligation	(70,573)	88,900	(63,055)	78,266

ASSET ALLOCATION BY CATEGORY FOR THE PENSION PORTFOLIO

	2005 Target	2004 Actual	2003 Actual
Equity securities	50.0%	49.3%	52.9%
Debt securities	20.0	20.6	22.6
Real estate	9.0	8.8	8.8
Other	21.0	21.3	15.7
TOTAL ALL ASSET CATEGORIES	**100.0%**	**100.0%**	**100.0%**

The University's investment strategy for the pension portfolio is to manage the assets across a broad and diversified range of investment categories, both domestic and international. The objective is to achieve a risk-adjusted return, which is in line with the long-dated obligations that the University has to the pension plan beneficiaries. The investment program is also managed to comply with all ERISA regulations. The "Other" asset category consists of absolute return funds, commodities, and cash.

In thousands of dollars	Pension benefits	Other benefits
EXPECTED CASH FLOWS		
Employer contributions:		
2005 expected to plan assets, net of income from invested reserves	$ (2,507)	$ 10,351
2005 expected to participants	32,951	17,065
Expected benefit payments:		
2005	32,951	17,065
2006	33,503	18,662
2007	33,664	20,181
2008	34,623	21,621
2009	35,451	23,161
2010-2014	201,919	142,273

The Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) was signed into law in December of 2003. The Act provides certain prescription drug-related benefits for retirees as well as subsidies for employers providing actuarial equivalent subsidies to their retirees. In January of 2004, the Financial Accounting Standards Board issued a Staff Position permitting companies to defer accounting for the effects of the Act. The University has elected this deferral. As such, the University's postretirement benefit obligation and net periodic postretirement benefit cost do not reflect the effects of the Act. Guidance on the accounting for the federal subsidy under the Act has been issued effective for fiscal 2005. However, specific guidance on the eligibility for and amount of any employer subsidy available under the Act has not yet been finalized. When final guidance is available, the University may modify previously reported information to reflect the subsidies and other changes resulting from the Act.

13. General Operating Account

The General Operating Account (GOA) consists of the general or current funds of the University as well as the assets, liabilities, and obligations related to student and faculty loans and facilities. The GOA accepts, manages, and pays interest on deposits made by University departments, invests surplus working capital, makes loans, and arranges external financing for major capital projects. It is used to manage, control, and execute all University financial transactions, except for those related to investment activities conducted by the Harvard Management Company.

The major components of GOA net asset balances are summarized in the following table (in thousands of dollars):

	2004				2003
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Departmental balances:					
Unexpended endowment income	$ 63,121	$ 387,388	$ 0	**$ 450,509**	$ 488,865
Unexpended gift balances	65,405	273,906	0	**339,311**	334,102
Pledge balances	0	263,313	0	**263,313**	282,818
Loan funds	30,883	0	80,152	**111,035**	112,092
Funds for construction	0	48,382	0	**48,382**	30,552
Funds invested in fixed assets	1,189,028	0	0	**1,189,028**	1,106,497
Other departmental purposes	407,743	0	0	**407,743**	486,977
Total departmental balances	1,756,180	972,989	80,152	**2,809,321**	2,841,903
University balances	1,068,195	57,958	0	**1,126,153**	597,474
TOTAL	**$ 2,824,375**	**$ 1,030,947**	**$ 80,152**	**$ 3,935,474**	**$ 3,439,377**

14. Sponsored Research

Total expenditures funded by U.S. government sponsors or by institutions that subcontract federally sponsored research to the University were $473.5 and $416.2 million in fiscal 2004 and 2003, respectively. Approximately 95% of federal research support for the year ended June 30, 2004 was received by the Medical School, the School of Public Health, and the Faculty of Arts and Sciences. The University's principal source of federal research funds is the Department of Health and Human Services. The University also has many non-federal sources of sponsored support, including corporations, foundations, state and local governments, foreign governments, and research institutes.

Research grants and contracts normally provide for the recovery of direct and indirect costs. The University recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related indirect costs is generally recorded at fixed or predetermined rates negotiated with the federal government and other sponsors. Predetermined federal indirect cost rates have been established for the University Area, the Medical School, and the School of Public Health through fiscal 2006. Funds received for federally sponsored research activity are subject to audit.

15. Gifts

Gifts that are available for current purposes are classified as "Gifts for current use." Gifts that have been restricted by the donor or designated by the Corporation for construction, loan funds, endowment, or similar purposes are classified as "Gifts for capital." Both gifts for current use and gifts for capital are classified as unrestricted, temporarily restricted, or permanently restricted in accordance with donor specifications.

Gifts for the years ended June 30, 2004 and 2003 are summarized as follows (in thousands of dollars):

	2004	2003
Gifts for current use:		
Current use gift funds	**$ 153,518**	$ 151,941
Support for non-federal projects	**85,445**	99,337
Total gifts for current use	**238,963**	**251,278**
Gifts for capital:		
Endowment funds	**257,767**	262,368
Life income funds*	**65,313**	19,857
Loan funds and facilities	**29,790**	28,867
Total gifts for capital	**352,870**	**311,092**
TOTAL GIFTS	**$ 591,833**	**$ 562,370**

** Gifts for capital to life income funds are presented at full value. The discounted present value of these gifts is $23,062 and $9,007 for fiscal 2004 and 2003, respectively.*

16. Other operating income

The major components of other operating income for the years ended June 30, 2004 and 2003 were as follows (in thousands of dollars):

	2004	2003
Publications	**$ 76,901**	$ 71,213
Rental and parking	**81,954**	63,154
Royalties from patents, copyrights, and trademarks	**50,697**	47,883
Other student income	**20,698**	13,926
Health and clinic fees	**12,313**	10,991
Other	**130,133**	128,133
TOTAL OTHER OPERATING INCOME	**$ 372,696**	**$ 335,300**

17. Other expenses

The major components of other expenses for the years ended June 30, 2004 and 2003 were as follows (in thousands of dollars):

	2004	2003
Services purchased	**$ 224,424**	$ 244,001
Subcontract expenses under sponsored projects	**79,794**	73,664
Publishing	**51,020**	53,631
Travel	**49,744**	45,799
Telephone	**11,110**	12,196
Other	**72,023**	55,414
TOTAL OTHER EXPENSES	**$ 488,115**	**$ 484,705**

18. Functional classification of expenses

Expenses are allocated functionally on a direct basis. Interest, depreciation, and operations and maintenance expenses are allocated based on square footage. Operations and maintenance costs allocated to functional categories totaled $217.5 million and $198.6 million for the years ended June 30, 2004 and 2003, respectively.

Expenses by functional classification for the years ended June 30, 2004 and 2003 were as follows (in thousands of dollars):

	2004	2003
Instruction	$ **710,870**	$ 672,960
Research	**585,623**	535,916
Libraries	**164,055**	156,265
Academic support	**211,074**	235,996
Scholarships and other student awards	**89,414**	79,510
Student services	**119,181**	100,292
Institutional support	**389,722**	343,546
Auxiliary services	**290,980**	308,459
TOTAL EXPENSES	**$ 2,560,919**	**$ 2,432,944**

19. Commitments and contingencies

The University receives funding from federal government agencies for research conducted under government grants and contracts. The grants and contracts provide for reimbursement of direct and indirect costs. The costs recovered by the University in support of sponsored research are subject to audit and adjustment.

In July of 1999, the University commenced a comprehensive investigation of the most recent years of the administration of a specific training grant funded by the National Institute on Aging. The University entered into an agreement with the government to resolve this matter during fiscal 2004.

In April of 1997, the Harvard Institute for International Development (HIID) learned of an investigation by the Inspector General's Office of the U.S. Agency for International Development (USAID). USAID had awarded amounts to HIID under two cooperative agreements to provide assistance to Russia in implementing economic and legal reforms. In September of 2000, the United States filed an eleven-count civil complaint against the University and others. The district court has since dismissed or entered judgment for the University on all counts against it, except for one count alleging breach of contract. Regarding this breach of contract count, the court issued summary judgment for the government on liability during fiscal 2004. It is not possible to predict what damages, if any, the government may receive as a result of the court's finding.

While it is not possible to predict accurately or determine the eventual outcome of the above described legal matters or various other legal proceedings involving the University, management believes that the outcome of these proceedings will not have a material adverse effect on the University's financial position, results of operations, or cash flows.

In the spring of 2004, the University together with the Massachusetts Institute of Technology (MIT) and the Whitehead Institute for Biomedical Research established the Eli and Edythe L. Broad Institute. The Broad Institute is a collaborative biomedical research institute within MIT that is jointly governed by the University, MIT, and the Broad Foundation. The Institute is focused on applying knowledge of the human genome to clinical medicine and making such knowledge widely available to the scientific community.

In connection with the founding of the Broad Institute, the University and MIT agreed to try to jointly raise $20 million per year in gifts and non-federal grants and awards to support the Institute's endeavors. In the event this fundraising goal is not reached, the University has agreed to provide MIT with a portion of the shortfall, subject to certain conditions. The University's obligation for such payments will not exceed $20 million over the initial five-year term of the Institute, or $30 million in total if the term is extended for a second five years. The University will make payments and record the corresponding expenses as these conditions are met. The University made no such payments to MIT for the Broad Institute during fiscal 2004.

The University and MIT will equally share certain laboratory construction costs for the Broad Institute's new building, which is expected to be completed in fiscal 2006. The University's portion of these costs is expected to be approximately $10 million. If the University's participation in the collaboration terminates under certain circumstances, the University may also be obligated to pay MIT up to $5 million to compensate MIT for expenses incurred in connection with the lease for the new building. In addition, the University expects to share with MIT in ongoing facilities improvement costs of approximately $4 million per year for up to ten years. Some of the University's contributions to these capital costs may be reimbursed in the future through indirect cost recoveries associated with the Institute's grant funding.