



harvard university

FINANCIAL REPORT

FISCAL YEAR 2007





Former President Derek Bok and President Drew Gilpin Faust await the June 2007 Commencement Day Alumni Parade on the steps of Widener Library.

“ I look forward to our future adventures together with immense anticipation. I can imagine no higher calling than doing all I can to serve this great university—and helping it, in turn, to serve the world. And I feel singularly fortunate to have the opportunity to do so in concert with all of you—the faculty, students, staff, and others without whom there could be no Harvard.

Each of us brings something different, and something significant, to our shared enterprise. We teach, we study, we discover, we create, we make sure the lights go on and the bills get paid. We are individual members of a collective whose opportunity to contribute to the future of learning, and the improvement of the human condition, knows few equals and few bounds. That opportunity is ours to make the most of—by aiming relentlessly high, by challenging each other and ourselves, by bridging our differences, and by drawing strength but never self-satisfaction from the past on which we are privileged to build. ”

—Drew Gilpin Faust, July 2, 2007

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Message from the President

I am pleased to present Harvard University's financial report for fiscal 2007. Although I did not assume the presidency until July 1st, I am privileged to convey results that were outstanding across the board. Under the leadership of Mohamed A. El-Erian, we achieved endowment returns of 23.0%, yielding a market value of \$34.9 billion and support from the endowment of a third (over \$1.0 billion) of the University's operating budget. In addition, our alumni and friends contributed \$615.0 million during fiscal 2007, the second highest level of fund-raising receipts in the University's history, and we finished our eighth straight year with operating surpluses.

We are very fortunate to have these resources with which to fund our extraordinarily ambitious academic agenda. Planning for Allston is moving forward on a variety of fronts, from transportation and infrastructure to academic programming across a range of fields. The design of the first science building in Allston is well underway, and we expect to break ground during this academic year. In the past few months, we have announced the appointment of three new deans—in the Faculty of Arts and Sciences, the Medical School and the Design School—all of whom promise to bring energy and creativity to their respective Schools and Faculties, as well as to the increasingly important collaborations across the University. As we welcome new and returning students this fall, we will continue to explore ways to enhance the undergraduate experience in all of its dimensions and to provide appropriate support for the work of our faculty and graduate students.

Looking ahead, it will be more important than ever to make sound decisions about how we invest our resources, how we can direct endowment returns to priority areas within the Schools and the University as a whole, and how we can most effectively make the case to Harvard's generous community of alumni and friends about the importance of continued investment in the University's work. To these ends, I have launched a comprehensive academic planning effort, involving all of the Deans, as well as faculty leadership in a variety of cross-cutting areas, to provide a framework for systematic, but flexible, decision making that will allow us to define our goals with greater precision and to align financial and physical resources with identified priorities.

Success in all of these areas will depend on the continued efforts and engagement of the entire University community. I look forward to our shared endeavors in the years to come.

Sincerely,



Drew Gilpin Faust
president

September 30, 2007

Financial highlights

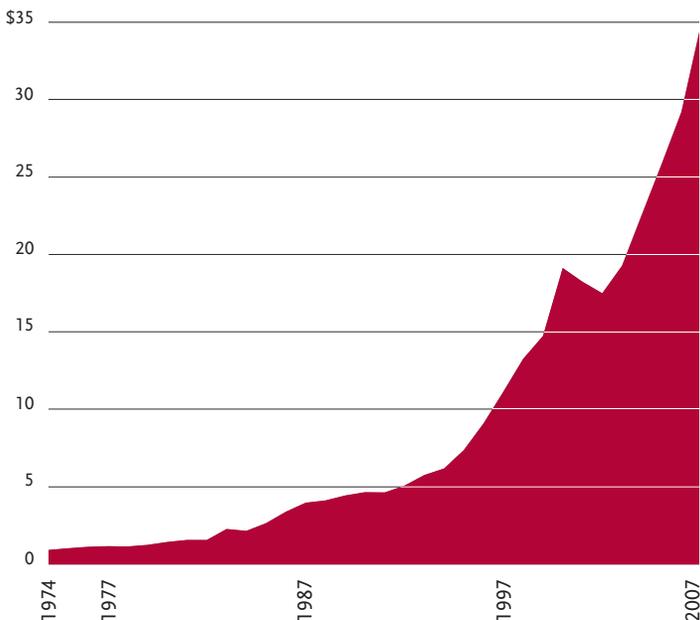
Fiscal 2007's financial results were among the best Harvard has attained, with significant endowment growth, strong giving from alumni and friends, as well as a healthy operating surplus. This financial success provided the underpinning for progress on many programmatic fronts: continued planning for the Allston campus; formation of the Harvard University Science and Engineering Committee (husec), charged with providing guidance on and governance of the University's efforts in inter-departmental and inter-School science and engineering; the transformation of the Division of Engineering and Applied Sciences within the Faculty of Arts and Sciences (fas) into the School of Engineering and Applied Sciences; significant growth in international programs; and approval of a new undergraduate general education curriculum.

While celebrating the fiscal and programmatic achievements of the past year, it is important to recognize several elements of uncertainty that could impact Harvard's long-term financial stability. Total federal sponsored funding declined in fiscal 2007, reflecting the impact of federal research budget cuts following

many years of solid growth. Recent volatility in the worldwide credit and investment markets may also negatively impact future endowment returns. The University's ability to manage and mitigate these and other risks will be crucial in ensuring its continued financial strength.

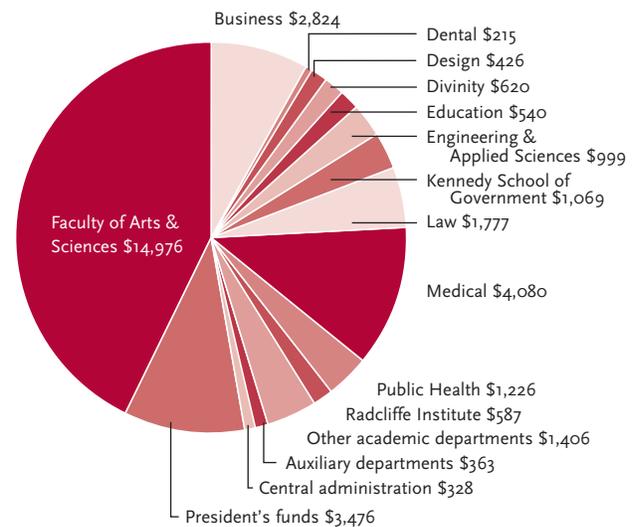
endowment growth

In billions of dollars



market value of endowment funds as of June 30, 2007

In millions of dollars



total market value \$34,912

endowment performance

Generous donors and expert investment management propelled the University's endowment to a record market value of \$34.9 billion as of June 30, 2007. Harvard Management Company (HMC) is responsible for managing the investments that comprise the endowment. The endowment's total return for fiscal 2007 was 23.0%, exceeding the annual performance benchmark by 5.8% and resulting in a five-year annualized return of 18.4%.¹ The unaudited *Annual Report of the Harvard*

Management Company, beginning on page 8, discusses HMC's investment philosophy and further analyzes the endowment's fiscal 2007 performance.

Mohamed A. El-Erian recently announced his resignation as president and chief executive officer of HMC, effective at the end of calendar year 2007. The search for his successor began immediately and is a top priority for for fiscal 2008.

summary of financial results

<i>In millions of dollars</i>	2007	2006	2005	2004	2003
Total revenue	\$ 3,210.5	\$ 2,999.6	\$ 2,800.9	\$ 2,597.7	\$ 2,472.7
Total expenses	3,170.7	2,999.5	2,757.4	2,560.9	2,432.9
Total gifts	615.0	595.8	590.7*	549.6*	562.4
Fixed assets, net	4,524.2	4,078.5	3,797.8	3,468.9	3,168.4
Total investments	41,832.9	34,249.6	29,938.2*	26,211.0*	22,093.9*
Bonds and notes payable	3,847.0	2,922.2	2,849.1	2,604.7	2,246.9
Net assets—General Operating Account	6,438.6	5,116.1	4,197.6	3,935.5	3,439.4
Net assets—endowment funds	34,912.1	29,219.4	25,853.0	22,587.3	19,294.7
Total return on general investments**	23.0%	16.7%	19.2%	21.1%	12.5%

* These numbers have been recast to conform with fiscal 2006 presentation.

** Total return on general investments is net of all fees and expenses, and includes the impact of revenue-sharing agreements with certain fund managers.

operating results

The University's fiscal 2007 operating surplus of \$39.9 million comprised a \$2.5 million unrestricted deficit and a \$42.4 million surplus in restricted funds. Revenue rose 7% to \$3.2 billion due to steady growth in most revenue categories, and operating expenses totaled \$3.2 billion, a 6% increase over the prior year. The University continues to pursue cost savings across all expense categories.

Student income

Student income increased 7%, totaling \$657.6 million in fiscal 2007. Revenue from undergraduate and graduate tuition rose 6% and 7%, respectively, slightly higher than the changes in tuition rates. Total student room and board income grew 6%, primarily due to the annual increase in the undergraduate room and board rate. Continuing and executive education revenue rose 14%, largely a result of higher enrollment in programs

at Harvard Business School (HBS) and the Extension School, as well as new programs at HBS and the Graduate School of Education (GSE).

Sponsored research support

Total sponsored revenue increased 1% to \$641.9 million in fiscal 2007. The University received 80% of its sponsored research funding from the federal government, 12% from foundations and 8% from other sources, including corporations; foreign, state and local governments; as well as research institutes.

Total federal funding decreased 1% to \$514.8 million. Various agencies of the Department of Health and Human Services (DHHS), including most notably the National Institutes of Health (NIH), funded \$412.0 million or 80% of the University's federal sponsored research in fiscal 2007. While total DHHS funding

¹ These returns are calculated on a time-weighted basis, net of all fees and expenses, and include the impact of revenue-sharing agreements with certain fund managers.

increased 2% in fiscal 2007, NIH funding fell 5%, reflecting a continued reduction in NIH funding that was first observed in fiscal 2006. In addition, funding from the National Science Foundation and the Department of Defense declined 6% and 16%, respectively. Cutbacks in federal funding pose challenges for the continued growth of the University's research activities, particularly for those Schools that are most reliant on federal funding. These decreases were offset in part by funding increases in support of the President's Emergency Plan for AIDS Relief (PEPFAR) project in Africa. In fiscal 2007, the Harvard School of Public Health (HSPH) entered the fourth year of this five-year award. Total PEPFAR funding was \$48.5 million in fiscal 2007, increasing 128% from \$21.3 million in fiscal 2006.

Non-federal funding grew 9% to \$127.2 million. Corporate funding was responsible for much of this gain, increasing 71% to \$15.6 million. Foundation support declined 2% to \$72.9 million.

Gifts for current use

Gifts from alumni and friends provide vital funding for the University's ongoing operations and strategic priorities, such as faculty development and financial aid. Current use gifts rose 6% in fiscal 2007, totaling \$214.0 million.

Investment income

Total investment income increased 11% to \$1.2 billion. The largest component of investment income, endowment income distributed for operations, climbed 12% to \$1.0 billion. This increase resulted from planned growth of up to 11% in endowment distributions as well as the impact of new gifts and other additions to the endowment. The Corporation-approved per unit distribution rate as a percentage of endowment market value was 4.3%. The Corporation also approves certain endowment decapitalizations to support strategic, mission-critical activities. For example, a \$100.0 million decapitalization was approved for the FAS in fiscal 2007, primarily to fund construction and other facilities costs. The aggregate spending rate, including both endowment distributions as well as approved decapitalizations of endowment principal, was 4.6%, within the University's historically targeted spending rate range of 4.5% to 5.0%.

The University's endowment operating distribution comprises a base payout as well as a strategic payout. Implemented in fiscal 2006, the strategic payout component of the operating distribution has been an

important source of funding for the Schools' key programs and objectives. The University has undertaken a systematic planning process to ensure that important strategic goals continue to benefit from the endowment's wealth. As a result, and in an effort to accelerate progress on priority initiatives, the University recently increased its targeted aggregate spending rate range to between 5.0% and 5.5% of the endowment's market value annually.

Endowment income distributed for operations remained Harvard's largest source of income in fiscal 2007, representing 33% of total operating income compared with 21% ten years ago. This growth has resulted from the generous support of our alumni and friends as well as the endowment's continued strong performance.

Other income

Other income rose 8% to \$488.6 million in fiscal 2007, largely due to incremental rental and publications income.

Compensation

Compensation and benefits costs represented 49% of the University's total expenses in fiscal 2007. These costs totaled \$1.5 billion in fiscal 2007, an increase of 5% over fiscal 2006. This increase included 7% growth in total salary and wage costs and a 2% decrease in benefits expenses. The lower benefits expenses resulted primarily from a reduction in costs associated with the employee vacation liability, partly offset by higher health and pension costs.

Rising health costs continue to be a concern, prompting the University to develop a multi-year strategy that addresses cost containment in this area. In calendar year 2007, the University introduced greater cost sharing with employees through increases in health plan copayments. The next step in this cost containment strategy is negotiation of a new pharmacy vendor agreement, expected to generate cost savings of approximately \$6.0 million over the next three years.

Financial aid

Enhancing the financial aid programs for both undergraduate and graduate students continues to be one of the University's top priorities. Scholarships and student awards, including amounts applied against student income, rose 11% to \$339.2 million in fiscal 2007. In addition, the University spent \$61.2 million on student employment, loaned \$30.6 million to students and

acted as agent on behalf of specific student recipients for \$12.9 million in aid from outside sponsors. Approximately 65% of scholarships and student awards was funded through gifts, endowment income and sponsored support, with the remaining 35% provided by other University operating funds.

Supplies and equipment

Supplies and equipment expenses increased 8% to \$216.5 million. Increased purchases of drugs and lab supplies in support of sponsored activity for the PEPFAR project represented \$7.7 million of this increase. University-wide contracts with vendor partners together with cost-conscious purchasing practices contained further expense growth.

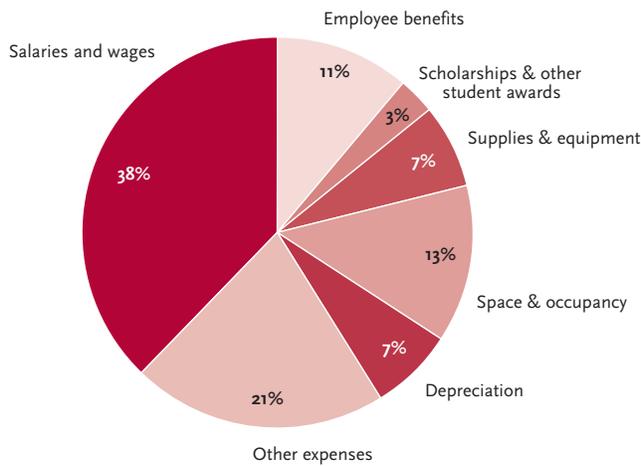
Space and occupancy

Space and occupancy costs totaled \$405.2 million in fiscal 2007, a 13% increase over the prior year. Interest on bonds and notes payable related to capital projects rose 19% due to new debt issuances and higher interest rates on variable-rate debt. Space improvement, repair and maintenance expenses increased 24% as a result of establishing reserves for future environmental remediation and conditional asset retirement obligations. Utility costs remained flat thanks to the implementation of electricity and natural gas purchasing strategies to help mitigate the effects of volatility in the energy markets as well as lower usage, partly resulting from energy conservation efforts.

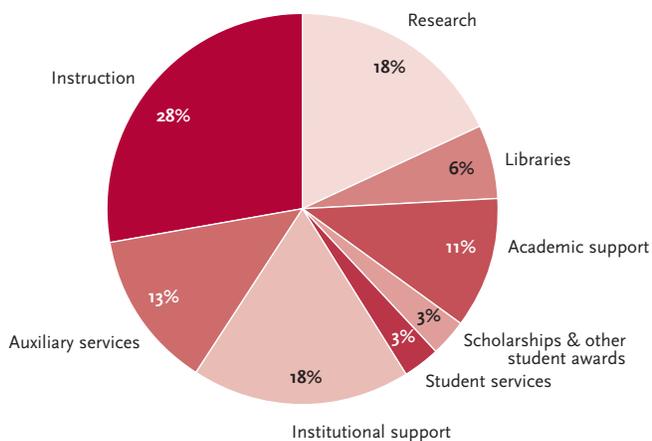
Other expenses

Other expenses grew 4% to \$680.9 million, largely due to higher interest on working capital debt and losses on building sales and demolition. In addition, international travel costs climbed 19%, as the University's global presence expanded.

fiscal 2007 operating expenses



fiscal 2007 functional expenses



capital activities

The University invested \$594.7 million in 388 active capital projects and acquisitions in fiscal 2007. Total capital expenditures included 57% new construction and acquisitions as well as 43% investment in the existing physical plant. The University's largest acquisition was the "Harvard at Trilogy" development in the Fenway area of Boston, which provides 171 apartments for graduate students and affiliates.

Within Harvard's existing campus locations, site preparation for the Harvard Law School Northwest Corner development moved forward, and construction progressed on the North Precinct Chilled Water Plant and Electrical Substation. Major FAS science building projects continued at the Northwest Science Building and the Laboratory for Integrated Science and Engineering. The first of two graduate housing complexes in the Riverside area of Cambridge was completed in July 2007. As a related community benefit, the University completed construction on 33 affordable condominium units in the renovated Switch House on Blackstone Street, which the City of Cambridge will be selling to qualified Cambridge residents. Renovations were completed at University Operations Services' Blackstone office facility, earning a Platinum Leadership in Energy and Environmental Design (LEED) rating,

Annual Report of the Harvard Management Company

Harvard Management Company (hmc) is a wholly owned subsidiary of Harvard University that is governed by a Board of Directors (the “Board”) appointed by the President and Fellows of Harvard College (the “Corporation”). Established in 1974, hmc is charged with management of the University’s endowment, pension assets, working capital, and deferred-giving balances. As of June 30, 2007, hmc managed a total of \$42.8 billion, \$40.8 billion of which consisted of the General Investment Account (gia). The gia is a pooled fund consisting primarily of endowment assets. The information presented in this unaudited report relates to the gia.

performance of the general investment account

The GIA experienced another strong year of absolute and relative performance in fiscal 2007. Accordingly, HMC was able to meet its objective of preserving and enhancing the real value of the GIA after taking into account distributions to support the University’s mission of excellence in teaching and research. HMC also outperformed its “Policy Portfolio,” the long-term neutral asset mix deemed likely to meet the University’s return goals given the appropriate risk specification.

The total investment return amounted to 23.0%, calculated on a time-weighted basis, net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers. After including gifts, distributions, and other changes, the total value of the GIA increased from \$33.5 billion as of June 30, 2006 to \$40.8 billion as of June 30, 2007. The endowment, the largest component of the GIA, grew from \$29.2 billion to \$34.9 billion.

Consistent with global developments, the main drivers of the GIA’s absolute return in the fiscal year ended June 30, 2007 included exposures to emerging markets, international, and domestic equities (through both public and private vehicles). Emerging markets bonds also did well, benefiting from both capital appreciation and carry. The absolute return/special situations and real estate categories had a good twelve months, while also offering some diversification during periods of market volatility.

Notwithstanding the fact that HMC is still in a transition phase, the fiscal 2007 investment return is consistent with Harvard’s history of superior investment performance. Indeed, as illustrated on the following page, the fiscal 2007 return of 23.0% exceeds various historical averages. Relative to the major U.S. indices, the endowment outpaced the 20.6% return registered by the S&P in fiscal 2007 and the 6.1% return registered by the Lehman Aggregate (a broad measure of the bond market).

Within the overall investment return, HMC’s efforts to add value contributed 5.8% (23.0% versus the Policy Portfolio benchmark return of 17.2%) for fiscal 2007. This translates into \$1.9 billion of additional value for the GIA. In the process, HMC maintained its record of delivering long-term value added across the eleven (non-cash) asset classes in which it invests.

Traditionally, HMC has measured itself against the TUCS median (Trust Universe Comparison Service compiled by Wilshire Associates) for peer comparison. On the basis of this measure, which incorporates available data on 151 large institutional investors, the GIA’s performance exceeded the median return of 17.7%, as well as the 20.9% return that marks the top five percentile for this sample.

HMC’s value-added efforts benefited from bottom-up internal and external portfolio management capabilities, as well as top-down adjustments in overall positioning.

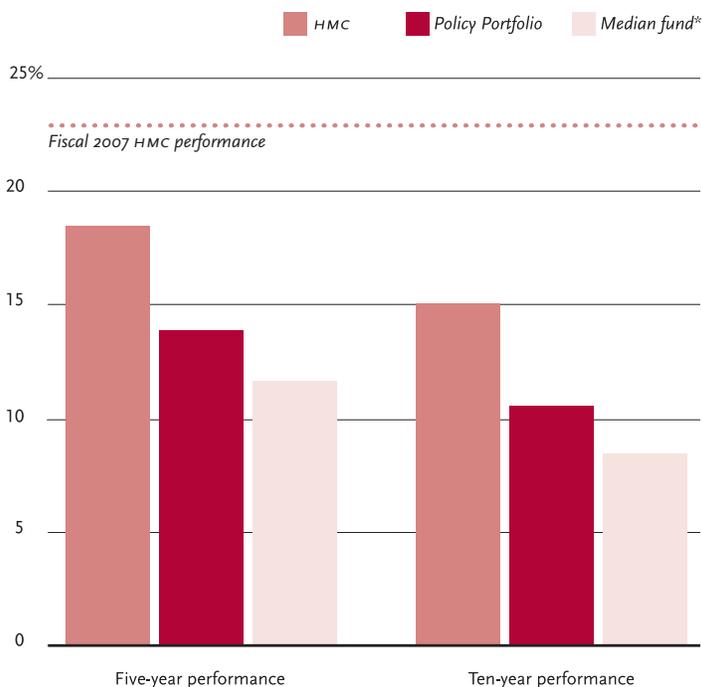
Specifically, the GIA's value was enhanced by:

- The outperformance of the internal portfolio management group,
- The strong results delivered by some long-standing external managers,
- Returns generated by recent additions to the stable of external managers, and
- Asset allocation adjustments driven by intra-year risk mitigation considerations.

HMC is also excited about some of the new approaches that its portfolio managers pursued in fiscal 2007. While the specific opportunities are relatively small at this point—in absolute terms and relative to more traditional strategies—they have the ability and potential to grow over time. They involve looking at under-exploited market segments that speak directly to HMC's secular themes, helping to develop new investment vehicles by drawing on modern portfolio tools and techniques, and seeking incremental value through a deeper and broader set of institutional relationships.

five- and ten-year annualized average returns

Fiscal 2007 HMC performance is consistent with HMC's history of superior investment returns



the historical context

The annualized five- and ten-year performance for the GIA, after incorporating the fiscal 2007 results, are summarized in the graph below. Three historical factors are worth noting:

- First, by significantly outperforming the University's long-term real return target over time, the GIA has taken advantage of the opportunities present in the market to build an important margin for the future;
- Second, by having access to a mix of both internal and external investment management capabilities, the long-term outperformance margin relative to the Policy Portfolio is solidly ahead of the 1.0% level that has historically been deemed a realistic long-term objective; and
- Third, relative to the long-term average for institutional funds, the GIA has maintained an outperformance margin that continues to exceed the target of 1.5%.

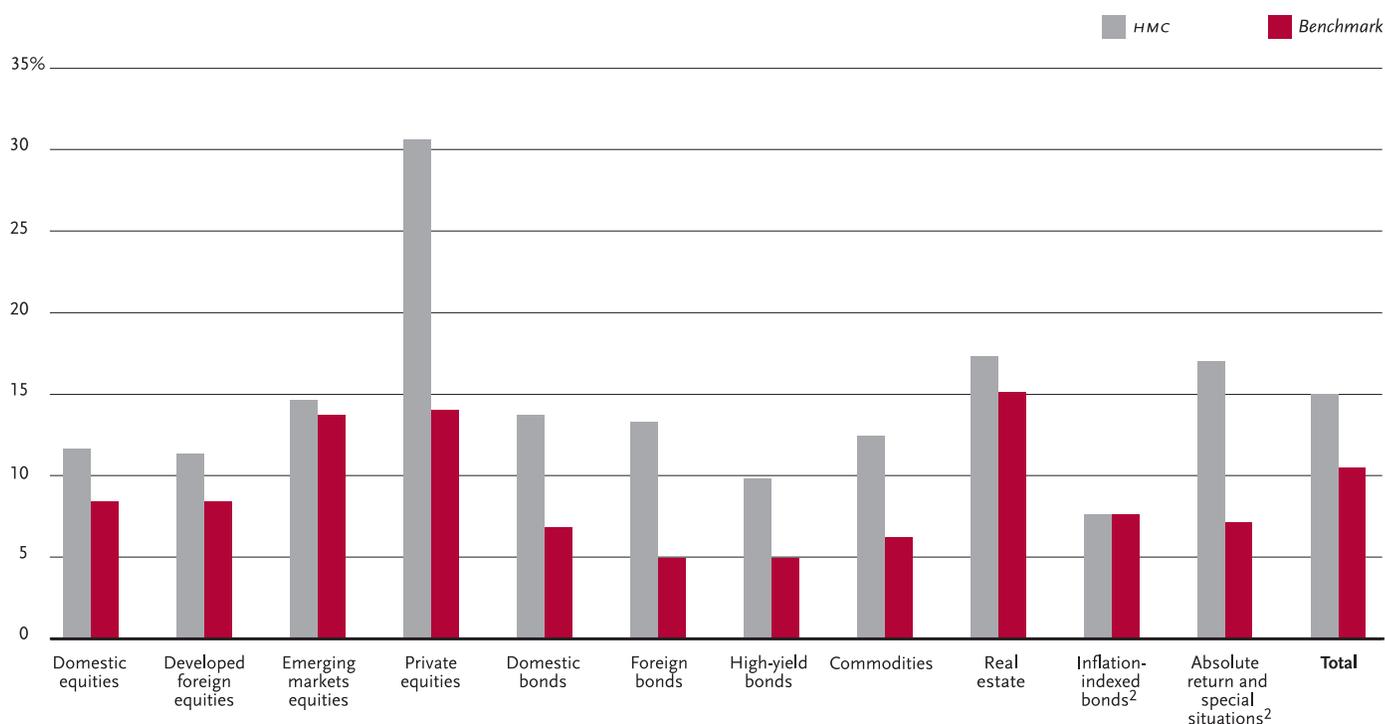
average annualized percentage returns for the periods ended June 30, 2007

	Total return*	Policy Portfolio benchmark	Value added
1 year	23.0%	17.2%	5.8%
5 years	18.4	13.8	4.6
10 years	15.0	10.5	4.5
15 years	16.2	12.2	4.0
20 years	14.0	11.5	2.5
25 years	15.7	13.9	1.8
30 years	14.3	12.6	1.7
Since inception	13.3	11.9	1.4

* Total return is net of all fees and expenses, and includes the impact of revenue-sharing agreements with certain fund managers.

* As measured by the median of 151 institutional funds with assets of over \$1.0 billion, based on information compiled by the Trust Universe Comparison Service (TUCS).

annualized ten-year performance by asset class¹



¹ Returns are calculated on a time-weighted basis with the exception of private equities, real estate, and commodities, which are calculated on a dollar-weighted basis. Returns are net of all fees and expenses, and include the impact of revenue-sharing agreements with certain fund managers. Individual benchmarks are representative of each asset class and are approved by the Board.

² Inflation-indexed bonds, and absolute return and special situations, have been held for less than ten years. For these asset classes, the HMC return and the benchmark reflect annualized performance of 8.00 years and 8.75 years, respectively.

Similar to what occurred in fiscal 2007, the historical outperformance of the GIA has been accompanied by consistently solid results at the individual asset class level, as illustrated above.

investment management philosophy and process

HMC's results were achieved within the context of an investment philosophy and approach that has served the GIA well over the years. The investment philosophy has been anchored by a disciplined approach that draws lessons from experience and monitors changing global economic and financial conditions. HMC tries to blend the best of two worlds by leveraging the University's intrinsic attributes—large, patient pool of single-source capital, AAA credit rating, world-class reputation—to take the long view with direct investments in the capital markets, while also accessing some of the best external investment management available in the marketplace.

The breakdown of the GIA by asset category as of June 30, 2007 and 2006 was (in millions of dollars):

	2007	2006
Equities:		
Domestic equities	\$ 7,266	\$ 5,730
Developed foreign equities	5,932	5,189
Emerging markets equities	4,595	2,722
Private equities	4,156	2,968
Total equities	21,949	16,609
Fixed-income:		
Domestic bonds	2,694	3,299
Foreign bonds	1,351	1,276
High-yield bonds	641	1,724
Total fixed-income	4,686	6,299
Real assets:		
Commodities	5,725	2,887
Real estate	2,722	2,518
Inflation-indexed bonds	2,679	1,535
Total real assets	11,126	6,940
Absolute return and special situations	5,063	4,917
Cash	(2,071)	(1,293)
TOTAL	\$ 40,753	\$ 33,472

HMC seeks to add value in every element of the investment stream, starting at the asset allocation level. Each year, HMC's Board of Directors and management team determine an appropriate "neutral" allocation of Harvard's capital across various markets given the University's desired return target and risk tolerance. Currently, capital is allocated across eleven (non-cash) asset classes. While significant changes are not generally made on an annual basis, Harvard's investment mix has evolved substantially over time.

Once the neutral allocation guidelines are determined, HMC's management is charged with the selection of appropriate implementation vehicles. Both internal and external vehicles are used to optimally deploy capital across all asset classes. This active use of specific investment strategies is aimed at delivering value over and above what can be realized by investing in a passive portfolio.

HMC uses a variety of alpha generators to add value. Examples include absolute return strategies, including equity and fixed-income arbitrage, enhanced cash management, structural alpha trades, and tactical adjustments to the asset allocation. All of these alpha generators help HMC focus on delivering a superior, risk-adjusted return across all of its asset classes (after all fees required to generate that return). The result is a diversified investment portfolio, managed in a responsive manner, and backed by effective risk management.

risk management

Appropriate controls and procedures are integral to mitigating risks and effectively managing the GIA. Accordingly, HMC maintains an approach aimed at monitoring and managing the factors pertaining to credit, liquidity, market and operational risks. (A summary description of these risk factors may be found below.) Since no single indicator can reasonably be expected to capture the host of risk factors that affect the GIA, HMC utilizes a matrix approach that is subject to regular reviews both by the Board and management of HMC.

HMC's risk mitigating measures include the use of risk limits as they pertain to investment strategies, single names, and managers; assessment of correlations across investment strategies, managers and asset classes; counterparty credit evaluations; etc. By necessity, this is a dynamic process that takes into account general market developments, the proliferation of new instruments, and the changing nature of linkages across asset classes. This process is supported by consistent efforts to ensure that HMC has the required information inputs and management system, the appropriate analytical tools, and a robust set of checks and balances.

The effectiveness of HMC's risk management is highly dependent on manager transparency and the quality of the data inputs, particularly in terms of completeness and timeliness. In this context, and as HMC deepens and widens its relationships with external managers, an effort is being made to counteract the existing market tendency towards a lower level of information transparency.

components of risk

market risk is defined as the sensitivity of income and capital to variations in interest rates, foreign exchange rates, equity prices, commodity prices, and other market-driven rates and prices. Market risk also considers the correlation risk among investments and the liquidity of the underlying positions. Market risk is measured as the potential gain or loss resulting from a price change at a given probability over a specific time period; this is also described as value at risk. Value

at risk is monitored and reviewed frequently by the Board of Directors and senior management to ensure that exposures are consistent with approved limits and guidelines. Stress and scenario tests are also conducted to determine how potential changes in market conditions could impact the market value of the portfolio.

credit risk is defined as the risk of loss arising from a counterparty's failure or inability to meet payment or

performance terms of a contract. HMC manages credit risk by establishing strict credit policies, setting concentration limits and approval procedures, and monitoring exposure continuously. HMC enters into arrangements with counterparties believed to be credit-worthy and requires collateral to the maximum extent possible. Limits are established for each counterparty based on their creditworthiness.

(Continued on next page)

Finally, and in recognition of the increasing fluidity of the global economy, HMC has placed particular emphasis on potential cross-asset class correlations and market contagion.

salient organizational developments

Fiscal 2007 saw important institutional changes as HMC completes its transition phase. Efforts in this area have been aimed at establishing conditions for sustaining superior investment returns for Harvard University over time, including the development of deep organizational and institutional roots.

Of note are several initiatives that, in the context of ongoing changes in the global financial landscape, target the appropriate balance between continuity and change:

- During the course of the year, HMC essentially completed the process of reconstructing the internal portfolio management platform. It now consists of teams covering five market segments: advanced country equities, emerging markets equities, domestic fixed income, international fixed income, and foreign exchange. In the process, HMC hired top talent from the industry that complements existing staff.
- HMC restructured the allocations to its external managers within the confines of various investment lockups. In addition to emphasizing bottom-up manager-related issues, this process was influenced by the secular themes guiding HMC's overall investment approach.

- Risk management activities benefited from updates in analytics, scenario formulation, guidelines, and monitoring mechanisms.

- Progress in these areas was facilitated by ongoing efforts to retool key support functions in compliance, risk, operations and information technology. While these are less visible to the outside world, they are nonetheless important for the sustainability of superior, risk-adjusted investment returns.

- Further steps were taken to enhance HMC's corporate governance. The Board committee structure was expanded and strengthened, and the self-evaluation procedures were revised.

- Finally, HMC starts fiscal 2008 with a new organizational task: selecting a new CEO for HMC. The Board of Directors has launched an immediate search for my successor.

the road ahead

HMC continues to take a multi-faceted approach to asset allocation. First, as has periodically been the case, the composition of the Policy Portfolio has been slightly altered for fiscal 2008, consistent with an updated analysis of the risk/return prospects for individual asset classes and their likely correlations. In addition to this annual review, HMC has layered elements that reflect its secular themes, including the realignment in key components of global growth, the structural weakening of global disinflationary pressures, the gradual

components of risk, *continued*

Liquidity risk considers the risk of loss arising from the inability to meet funding commitments. The objective of liquidity risk management is to ensure the ability to meet the endowment's financial obligations. Effective management of liquidity risk requires the ability to project and understand all cash flows and potential future commitments. It also involves the identification and prioritization of sources of liquidity. Cash is actively managed by a centralized staff

responsible for understanding funding requirements and evaluating sources of liquidity. Liquidity measures are employed to ensure that the University maintains adequate liquidity and is prepared for periods of stress.

operational risk is the risk of loss resulting from inadequate or failed internal processes or systems, errors by employees, or external events. The management of these risks is primarily the responsibility of the business line

managers in each functional area. HMC manages operational risk by identifying areas of risk, monitoring compliance, promoting best practices, and implementing internal controls and robust systems. The results of these activities are reviewed frequently by senior management.

historical evolution of the policy portfolio (selected years)

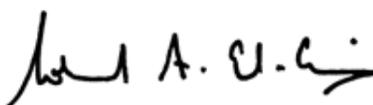
	1980	1991	1996	2000	2007	2008
Equities:						
Domestic equities	66%	40%	36%	22%	12%	12%
Developed foreign equities		18	15	15	11	12
Emerging markets equities			9	9	8	10
Private equities		12	15	15	13	11
Total equities	66	70	75	61	44	45
Fixed-income:						
Domestic bonds	27	15	13	10	7	5
Foreign bonds	8	5	5	4	3	3
High-yield bonds		2	2	3	3	1
Total fixed-income	35	22	20	17	13	9
Real assets:						
Commodities		6	3	6	16	17
Real estate		7	7	7	10	9
Inflation-indexed bonds				7	5	7
Total real assets	0	13	10	20	31	33
Absolute return and special situations				5	17	18
Cash	(1)	(5)	(5)	(3)	(5)	(5)
TOTAL	100%	100%	100%	100%	100%	100%

redeployment of windfall reserve gains by emerging economies, the institutionalization of alternative investments, and the broader application of risk transfer technology to balance sheets within and beyond the banking system.

In addition to understanding the key characteristics influencing the long-term evolution of the global financial landscape, HMC's future success will depend on its ability to navigate the journey—particularly the extent to which it can discern and respond to an increasingly fluid and volatile economic, financial and geopolitical landscape.

The global system is in the midst of important structural changes that offer new opportunities as well as a different configuration of risks. Ever larger pools of private and public investment capital are looking to mimic the “endowment approach.” And while imitation may be the highest form of flattery, such migration of capital will inevitably dilute the potency of the approach and complicate its implementation. This comes at a time when global payments imbalances remain large, correlations among asset classes and managers are rising, the market robustness of certain new derivative products is yet to be tested sufficiently, and a certain amount of hubris seems to influence some market participants who have confidently moved to a “just-in-time” risk management paradigm.

In view of these factors, HMC is resisting the temptation to extrapolate the recent strong investment performance. Instead, it is more prudent to view it as involving a “windfall gain” component. Indeed, the question is not whether there will be market pullbacks, but rather their likely depth, breadth, and duration. This consideration assumes added importance given the gradual decline in the traditional risk-mitigating characteristics of a diversified asset allocation, thus further emphasizing the importance of HMC's hedging and risk management strategies. Indeed, as HMC enters fiscal 2008, it has been reminded of how these strategies can help the GIA navigate well a challenging combination of sudden market disruptions, significant liquidity dislocations, and severe difficulties for an external manager. HMC's Board of Directors is committed to continuing the current investment management approach and strategies.



Mohamed A. El-Erian
president and ceo

September 30, 2007

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 (the "University") as of June 30, 2007, and the changes in its net assets of the 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 2006 financial statements, and in our report dated October 6, 2006, 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.

As discussed in Note 2 to the financial statements, the University changed the manner in which it accounts for defined benefit and other postretirement plans and limited partnerships held for investment in 2007 and began recognizing conditional asset retirement obligations in 2006.

PricewaterhouseCoopers LLP

September 30, 2007

balance sheets

with summarized financial information as of June 30, 2006

In thousands of dollars	June 30	
	2007	2006
ASSETS:		
Cash	\$ 39,800	\$ 43,594
Receivables, net (Note 4)	207,999	222,793
Prepayments and deferred charges	98,718	82,698
Notes receivable, net (Note 5)	307,643	286,297
Pledges receivable, net (Note 6)	524,972	540,623
Fixed assets, net (Note 7)	4,524,162	4,078,536
Net retirement assets (Note 11)	303,282	0
Interests in trusts held by others (Notes 8 and 12)	358,294	320,990
Investment portfolio, at market (Note 3)	46,616,888	37,085,236
Market value of securities pledged to counterparties (Note 3)	5,341,587	2,905,867
TOTAL ASSETS	58,323,345	45,566,634
LIABILITIES:		
Accounts payable (Note 19)	370,496	327,697
Deposits and other liabilities (Note 7)	478,471	409,775
Securities lending and other liabilities associated with the investment portfolio (Note 3)	10,125,587	5,741,473
Liabilities due under split interest agreements (Note 9)	906,581	693,383
Bonds and notes payable (Note 10)	3,846,978	2,922,247
Accrued retirement obligations (Note 11)	545,698	476,600
Government loan advances (Note 5)	57,146	56,960
TOTAL LIABILITIES	16,330,957	10,628,135
NET ASSETS	\$ 41,992,388	\$ 34,938,499

	Unrestricted	Temporarily restricted	Permanently restricted	June 30	
				2007	2006
NET ASSETS:					
General Operating Account (Note 12)	\$ 5,201,951	\$ 1,150,504	\$ 86,156	\$ 6,438,611	\$ 5,116,072
Endowment (Note 8)	5,796,425	24,779,301	4,336,342	34,912,068	29,219,430
Split interest agreements (Note 9)	0	196,021	445,688	641,709	602,997
TOTAL NET ASSETS	\$ 10,998,376	\$ 26,125,826	\$ 4,868,186	\$ 41,992,388	\$ 34,938,499

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, 2006

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30	
				2007	2006
REVENUE:					
Student income:					
Undergraduate program	\$ 225,690			\$ 225,690	\$ 212,473
Graduate programs	345,443			345,443	323,157
Board and lodging	123,892			123,892	116,485
Continuing education and executive programs	193,164			193,164	169,963
Scholarships applied to student income (Note 13)	(230,562)			(230,562)	(205,957)
Total student income	657,627	0	0	657,627	616,121
Sponsored research support (Notes 14 and 15):					
Federal government - direct costs	376,415			376,415	378,466
Federal government - indirect costs	138,355			138,355	139,526
Non-federal sponsors - direct costs	37,493	\$ 76,784		114,277	104,942
Non-federal sponsors - indirect costs	7,779	5,108		12,887	11,296
Total sponsored research support	560,042	81,892	0	641,934	634,230
Gifts for current use (Note 15)	83,128	130,866		213,994	201,946
Investment income:					
Endowment income distributed for operations (Note 8)	174,423	869,332		1,043,755	933,337
Income on working capital investments distributed for operations	132,672	24,989		157,661	154,009
Interest received on student, faculty and staff loans	6,962			6,962	6,075
Total investment income	314,057	894,321	0	1,208,378	1,093,421
Other operating income (Note 16)	488,573			488,573	453,865
Net assets released from restrictions	1,064,727	(1,064,727)		0	0
TOTAL REVENUE	3,168,154	42,352	0	3,210,506	2,999,583
EXPENSES:					
Salaries and wages	1,203,209			1,203,209	1,126,322
Employee benefits (Note 11)	341,962			341,962	350,575
Scholarships and other student awards (Note 13)	108,588			108,588	99,574
Supplies and equipment	216,549			216,549	199,779
Space and occupancy	405,156			405,156	360,054
Depreciation (Note 7)	214,318			214,318	210,964
Other expenses (Note 17)	680,868			680,868	652,235
TOTAL EXPENSES	3,170,650	0	0	3,170,650	2,999,503
NET REVENUE/(DEFICIT)	(2,496)	42,352	0	39,856	80
OTHER PROVISIONS AND CREDITS:					
Increase in appreciation, net of operating distribution (Note 10)	880,089	4,315		884,404	868,832
Change in undistributed general investment income	(4,884)	(17,976)		(22,860)	115,977
Other changes (Note 10)				0	(11,316)
TOTAL OTHER PROVISIONS AND CREDITS	875,205	(13,661)	0	861,544	973,493
CAPITAL CHANGES:					
Change in pledge balances (Note 6)		11,536		11,536	(29,020)
Increase in interests in trusts held by others (Note 12)		8,856		8,856	21,174
Capital gifts for loan funds and facilities (Note 15)		5,062	\$ 534	5,596	16,150
Transfers between the General Operating Account and endowment	38,745	38,547	(959)	76,333	(34,993)
Transfers from split interest agreements (Note 9)		6,970	506	7,476	4,917
Non-operating net assets released from restrictions	99,717	(101,538)	1,821	0	0
TOTAL CAPITAL CHANGES	138,462	(30,567)	1,902	109,797	(21,772)
GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR	1,011,171	(1,876)	1,902	1,011,197	951,801
Endowment net change during the year	1,088,095	4,382,032	222,511	5,692,638	3,366,382
Split interest agreements net change during the year (Note 9)		8,383	30,329	38,712	95,218
NET CHANGE BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGES	2,099,266	4,388,539	254,742	6,742,547	4,413,401
Cumulative effect of accounting changes (Notes 2, 7 and 11)	311,342			311,342	(33,323)
NET CHANGE DURING THE YEAR	2,410,608	4,388,539	254,742	7,053,889	4,380,078
Net assets, beginning of year	8,587,768	21,737,287	4,613,444	34,938,499	30,558,421
NET ASSETS, end of year	\$ 10,998,376	\$ 26,125,826	\$ 4,868,186	\$ 41,992,388	\$ 34,938,499

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, 2006

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30	
				2007	2006
Gifts for capital (Note 15)	\$ 25,751	\$ 43,918	\$ 207,957	\$ 277,626	\$ 273,381
Investment return (Notes 3 and 8):					
Income from general investments	75,745	374,433		450,178	474,558
Increase in realized and unrealized appreciation	1,046,442	5,002,933		6,049,375	3,639,196
Total investment return	1,122,187	5,377,366	0	6,499,553	4,113,754
Endowment income distributed for operations	(174,423)	(869,332)		(1,043,755)	(933,337)
Change in undistributed general investment income	2,397	21,983		24,380	(102,662)
Net investment return after distributions	950,161	4,530,017	0	5,480,178	3,077,755
Transfers between endowment and the General Operating Account:					
Net transfers to/(from) unexpended endowment income	5,003	(70,201)	9,013	(56,185)	37,818
Gifts capitalized	257	3,127	901	4,285	5,818
Other transfers	(44,005)	28,527	(8,955)	(24,433)	(8,643)
Total transfers between endowment and the General Operating Account	(38,745)	(38,547)	959	(76,333)	34,993
Capitalization of split interest agreements (Note 9)		3,265	15,348	18,613	6,897
Change in pledge balances (Note 6)		4,083	(30,645)	(26,562)	(75,603)
Increase in interests in trusts held by others (Note 8)		9,449	18,999	28,448	47,899
Other changes	2,858	(7,700)	(4,490)	(9,332)	1,060
Net assets released from restrictions	148,070	(162,453)	14,383	0	0
NET CHANGE DURING THE YEAR	1,088,095	4,382,032	222,511	5,692,638	3,366,382
Net assets of the endowment, beginning of year	4,708,330	20,397,269	4,113,831	29,219,430	25,853,048
NET ASSETS OF THE ENDOWMENT, end of year	\$ 5,796,425	\$ 24,779,301	\$ 4,336,342	\$ 34,912,068	\$ 29,219,430

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

statements of cash flows

<i>In thousands of dollars</i>	For the year ended	
	June 30	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 7,053,889	\$ 4,380,078
Adjustments to reconcile change in net assets to net cash provided by/(used in) operating activities:		
Cumulative effect of accounting changes	(311,342)	33,323
Depreciation	214,318	210,964
Increase in fair value of interest rate exchange agreements	(4,651)	(442,888)
Increase in interests in trusts held by others	(37,304)	(69,073)
Increase in liabilities due under split interest agreements	213,198	125,271
Increase in accrued retirement obligations	77,158	80,201
Gain on investments, net	(7,286,777)	(4,298,785)
Gifts restricted for capital purposes	(292,645)	(302,164)
Changes in operating assets and liabilities:		
Receivables, net	14,794	(51,177)
Prepayments and deferred charges	(16,020)	(4,888)
Pledges receivable, net	15,651	104,220
Accounts payable	47,053	(105,582)
Deposits and other liabilities	68,696	20,196
NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES	(243,982)	(320,304)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans made to students, faculty and staff	(56,338)	(55,325)
Payments received on student, faculty and staff loans	34,681	45,203
Change in other notes receivable	311	(6,631)
Proceeds from the sales and maturities of investments	41,386,657	38,883,059
Purchase of investments	(43,400,260)	(22,814,630)
Additions to fixed assets	(635,727)	(466,858)
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	(2,670,676)	15,584,818
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in overdrafts included in accounts payable	(28,471)	7,426
Proceeds from the issuance of debt	1,122,628	921,596
Debt repayments	(197,897)	(848,478)
Gifts restricted for capital purposes	292,645	302,164
Change associated with securities lending agreements	1,721,773	(15,638,182)
Increase in government loan advances	186	104
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	2,910,864	(15,255,370)
NET CHANGE IN CASH	(3,794)	9,144
Cash, beginning of year	43,594	34,450
CASH, end of year	\$ 39,800	\$ 43,594
Supplemental disclosure of cash flow information:		
Change in investments as well as other liabilities associated with the investment portfolio related to the implementation of EITF 04-5	\$ 537,544	\$ 0
Change in accounts payable related to fixed asset additions	24,217	24,804
Cash paid for interest	158,881	119,526

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

1. university organization

Harvard University (the “University”) is a private, not-for-profit institution of higher education with approximately 7,100 undergraduate and 12,940 graduate students. Established in 1636, the University includes the Faculty of Arts and Sciences, the School of Engineering and Applied Sciences, the Division of Continuing Education, ten graduate and professional Schools, the Radcliffe Institute for Advanced Study, a variety of research museums and institutes, and an extensive library system to support the teaching 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.

The University includes Harvard Management Company (HMC), a wholly owned subsidiary founded in 1974 to manage the University’s investment assets. HMC is governed by a Board of Directors that is appointed by the Corporation.

2. summary of significant accounting policies

Basis of presentation

The consolidated financial statements present the activities of Harvard University as a whole, including significant affiliated organizations controlled by the University.

The financial statements include certain prior year summarized comparative information in total, not by net asset classification. This information is not presented in sufficient detail to conform 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, 2006, from which the summarized information was derived. Certain prior year amounts have been reclassified to conform to current year presentation.

Funds transferred to the University on behalf of specific beneficiaries (agency funds) are recorded as assets and liabilities in the *Balance Sheets* and are not included in the *Statements of Changes in Net Assets*.

Net asset classifications

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 in the accompanying financial statements in the categories that follow:

unrestricted net assets are not subject to donor-imposed restrictions. Funds invested in fixed assets and unrestricted funds functioning as endowment comprise 65% of the University’s unrestricted net assets as of June 30, 2007. In addition, this category includes unrestricted gifts and endowment income balances, University-designated loan funds and other unrestricted current funds.

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 net assets in accordance with Massachusetts law.

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.

Revenues 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 net assets and is reclassified as unrestricted net assets when expenses are incurred for their intended purpose.

Unconditional pledges are reported as increases in the appropriate categories of net assets in accordance with donor restrictions. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or by law. Expirations of temporary restrictions on net assets are reported as reclassifications from temporarily restricted to unrestricted net assets and appear as “Net assets released from restrictions” and “Non-operating net assets released from restrictions” in the *Statements of Changes in Net Assets*.

Net revenue/(deficit)

Revenues earned, expenses incurred and income distributed for operations for the purpose of conducting research and 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 the University’s operating result.

Securities lending transactions

The *Balance Sheets* display both the assets and corresponding liabilities generated by securities lending transactions. These transactions are executed to support the investment activities of HMC. The University also separately reports the fair value of assets for which counterparties have the right to pledge or exchange the collateral they have received; assets of the investment portfolio that are unencumbered are reported as “Investment portfolio, at market” in the *Balance Sheets*.

Collections

The University’s vast array of museums and libraries houses priceless works of art, historical treasures, literary works 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.

Insurance programs

The University, together with the Harvard-affiliated teaching hospitals, has formed a captive insurance company, Controlled Risk Insurance Company (CRICO), to provide limited professional liability, general liability and medical malpractice insurance for its shareholders. The University self insures a portion of its professional liability and general liability programs and maintains a reserve for liability claims. CRICO provides medical malpractice coverage with no deductible for Harvard University Health Services, the Harvard School of Dental Medicine and the Harvard School of Public Health. The University also maintains self-insurance programs and reserves for claims for automobile liability, property and workers’ compensation; these programs are supplemented with commercial excess insurance above the University’s self-insured limit. In addition, the University is self insured for unemployment, the primary senior health plan and all health and dental plans for active employees. The University’s claims liabilities are recognized as incurred, including claims that have been incurred but not reported, and are included in operating expenses.

Tax-exempt status

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

Use of estimates

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.

New accounting pronouncements

The University implemented the requirements of Financial Accounting Standard 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158) as of June 30, 2007. Under FAS 158, the funded status of each pension and other postretirement benefit plan as of June 30 is required to be reported as an asset (for overfunded plans) or a liability (for underfunded plans). FAS 158 requires disclosure of the incremental effect of adopting the standard on certain individual line items of the *Balance Sheet*. In addition, the initial implementation of this standard is recognized as a cumulative effect of a change in an accounting principle in the fiscal 2007 *Statement of Changes in Net Assets with General Operating Account Detail*. The effect of FAS 158’s adoption is discussed in *Note 11*.

Effective July 1, 2006, the University implemented Emerging Issues Task Force Issue 04-5, *Investor’s Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights* (EITF 04-5). Under EITF 04-5, a general partner is required to consolidate any partnership that it controls, including those interests in the partnerships in which it does not have ownership rights. A general partner is presumed to control a partnership unless the limited partners have certain rights to remove the general partner or other substantive rights to participate in partnership operations.

In accordance with EITF 04-5, the University has consolidated assets held in partnerships controlled by HMC. These assets are included in “Investment portfolio, at market” in the *Balance Sheets*. Liabilities of the consolidated entities and the minority interest related to the assets not owned by the University are included in “Securities lending and other liabilities associated with the investment portfolio” in the *Balance Sheets*. The effect of adopting EITF 04-5 is discussed in *Note 3*.

In fiscal 2006, the University adopted Financial Accounting Standards Board (FASB) Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). FIN 47 requires the initial application of the interpretation to be recognized as a cumulative effect of a change in an accounting principle. Specifically, FIN 47 requires the recognition of a liability, a cumulative effect, the cumulative accretion and

accumulated depreciation for the period from the date the liability was incurred to the date of adoption of this interpretation. The liability is presumed to be incurred on the date that the legal requirement to perform the asset retirement activity was enacted. The effect of FIN 47's adoption is discussed in *Note 7*.

3. investments

The significant accounting policies of the University related to investments are as follows:

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 primarily valued using 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 primarily valued using models with externally verifiable inputs, or by using independent broker quotes. Private equities, real assets, and absolute return and special situations 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 private equity and real asset investments are valued using discounted cash flow and other industry standard methodologies. Where applicable, independent appraisers and engineers assist in the valuation. These values are determined under the direction of, and subject to approval by, the Valuation Committee of the HMC Board of Directors.

B) The preparation of financial statements requires management to make estimates and assumptions about the effects of matters that are inherently uncertain. The accounting policies considered potentially significant in this respect are the valuation of derivative instruments, absolute return and special situations, private equities and certain real assets. 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.

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

E) The collateral advanced under security borrowing agreements is in the form of cash. 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 majority of the University's investments are managed in the General Investment Account (GIA), a pooled fund that consists primarily of endowment assets.

Other investments are managed separately from the GIA. 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 split interest agreements.

The University's investments as of June 30, 2007 and 2006 are summarized in the following table (in thousands of dollars):

	2007	2006
Investment portfolio, at market:		
Pooled general investment assets ¹	\$ 45,536,634	\$ 36,308,104
Other investments ²	1,093,529	795,058
Fair value of interest rate exchange agreements	(13,275)	(17,926)
Total investment portfolio, at market	46,616,888	37,085,236
Market value of securities pledged to counterparties	5,341,587	2,905,867
Securities lending and other liabilities associated with the investment portfolio	(10,125,587)	(5,741,473)
TOTAL INVESTMENTS³	\$ 41,832,888	\$ 34,249,630

Investments as of June 30, 2007 and 2006 comprised the following (in thousands of dollars):

	2007	2006
Pooled general investment net assets:		
General Operating Account	\$ 5,264,544	\$ 3,904,716
Endowment	34,251,729	28,589,702
Split interest agreements	986,906	779,902
Other internally designated funds	249,455	198,178
Total pooled general investment net assets	40,752,634	33,472,498
Other investments ²	1,093,529	795,058
Fair value of interest rate exchange agreements	(13,275)	(17,926)
TOTAL INVESTMENTS³	\$ 41,832,888	\$ 34,249,630

¹ Excludes securities pledged to counterparties.

² Includes split interest agreement assets of \$561,384 and \$516,478 as of June 30, 2007 and 2006, respectively.

³ Includes cash equivalents that consist principally of funds that have maturities of 90 days or less. Cash equivalents classified as investments were \$2,627,760 and \$1,859,259 as of June 30, 2007 and 2006, respectively.

A summary of the University's total return on investments for fiscal 2007 and 2006 is presented below (in thousands of dollars):

	2007	2006
Return on pooled general investments:		
Realized and unrealized gains, net	\$ 7,135,715	\$ 4,290,895
Investment income	535,902	558,322
Total return on pooled general investments*	7,671,617	4,849,217
Return on other investments:		
Realized and unrealized gains, net	151,062	7,890
Investment income	35,644	23,941
Total return on other investments	186,706	31,831
Unrealized gain on interest rate exchange agreements	4,651	442,888
TOTAL RETURN ON INVESTMENTS	\$ 7,862,974	\$ 5,323,936

* Net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers.

The University employs a unit method of accounting for pooled general investments. Each participating fund enters into 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 in the investment pool. Net general investment income distributed during the year is allocated on a per unit basis.

The changes in the market value and income of participating units for the years ended June 30, 2007 and 2006 were as follows:

	2007	2006
Unit market value, end of year	\$ 1,982.64	\$ 1,635.04
Unit market value, beginning of year	1,635.04	1,425.68
Increase in unit market value due to realized and unrealized appreciation	347.60	209.36
Income earned per unit on general investments	26.12	27.27
TOTAL UNIT RETURN OF POOLED GENERAL INVESTMENTS*	\$ 373.72	\$ 236.63
TOTAL UNIT RETURN PERCENTAGE USING MONTHLY COMPOUNDING*	23.0%	16.7%

* Net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers.

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, real estate, commodities and private equity markets. A core investment portfolio is structured to mirror the market exposures defined by the Policy Portfolio and is considered to be "unhedged" as represented by "Total investments" in the table on page 24. The Policy Portfolio is the long-term asset mix that is most likely to meet the University's long-term return goals with the appropriate level of risk. It serves as the benchmark against which the performance of the pooled general investments is measured. 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 in the asset or liability sections of the table on page 24.

The table on page 24 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, 2007 was \$747.0 million and as of June 30, 2006 was \$906.9 million. The fair value of collateral accepted by the University as of June 30, 2007 was \$2,822.6 million and as of June 30, 2006 was \$2,096.8 million. The portion of this collateral that was sold or repledged as of June 30, 2007 was \$1,046.2 million and as of June 30, 2006 was \$1,633.3 million. The cost of the net investments (the sum of

total investments, total financial instruments purchased under hedge transactions and total financial instruments sold, not yet purchased, under hedge transactions) was \$34,872.9 million as of June 30, 2007 and \$27,411.0 million as of June 30, 2006.

As discussed in Note 2, the University consolidated assets and liabilities held in partnerships controlled by HMC in fiscal 2007, in accordance with EITF 04-5. The consolidation of these entities increased both the pooled general investment assets and liabilities shown in the table on page 24. Real asset investments increased by \$401.5 million; other assets, consisting of cash, receivables and fixed assets, increased by \$136.0 million; and other liabilities, consisting of accruals, payables, debt and minority interests, increased by \$537.5 million.

The pooled general investment assets and liabilities as of June 30, 2007 and 2006 are summarized as follows (in thousands of dollars):

	2007		2006	
POOLED GENERAL INVESTMENT ASSETS:				
Investments:				
Domestic equity and convertible securities	\$ 6,757,501		\$ 5,957,302	
Securities pledged to counterparties	437,237	\$ 7,194,738	295,341	\$ 6,252,643
Developed foreign equity and convertible securities	4,162,410		5,427,138	
Securities pledged to counterparties		4,162,410	525,970	5,953,108
Domestic fixed-income securities	1,399,694		1,691,594	
Securities pledged to counterparties	1,734,036	3,133,730	801,097	2,492,691
Foreign fixed-income securities	12,428		21,220	
Securities pledged to counterparties	1,236,639	1,249,067	594,072	615,292
Emerging markets equity, debt and options	2,326,864		2,062,680	
Securities pledged to counterparties	1,045,380	3,372,244	396,684	2,459,364
High-yield securities	2,000,304		1,237,422	
Securities pledged to counterparties		2,000,304	43,494	1,280,916
Absolute return funds and special situations	5,487,554		4,431,298	
Securities pledged to counterparties		5,487,554	25,827	4,457,125
Real assets ¹	9,724,325		5,839,778	
Securities pledged to counterparties	279,466	10,003,791	112,951	5,952,729
Private equities		4,178,397		3,072,182
Total investments		40,782,235		32,536,050
Financial instruments purchased under hedge transactions:				
Equity and convertible securities	1,095,684		1,394,026	
Securities pledged to counterparties	27,113	1,122,797	45,672	1,439,698
Fixed-income securities	1,772,670		768,074	
Securities pledged to counterparties	563,070	2,335,740	64,759	832,833
Real assets ¹	16,030		20,110	
Securities pledged to counterparties	18,646	34,676		20,110
Options		353,192		38,478
Total financial instruments purchased under hedge transactions		3,846,405		2,331,119
Collateral advanced under security borrowing agreements ²		2,450,224		1,724,361
Cash and short-term investments		2,523,657		1,741,657
Other assets ³		1,275,700		880,784
TOTAL POOLED GENERAL INVESTMENT ASSETS		50,878,221		39,213,971
POOLED GENERAL INVESTMENT LIABILITIES:				
Financial instruments sold, not yet purchased, under hedge transactions:				
Equity and convertible securities		1,044,560		1,416,443
Fixed-income securities		1,714,450		410,547
Options		300,968		8,819
Total financial instruments sold, not yet purchased, under hedge transactions		3,059,978		1,835,809
Cash collateral held under security lending agreements ⁴		5,128,807		2,681,172
Other liabilities ⁵		1,936,802		1,224,492
TOTAL POOLED GENERAL INVESTMENT LIABILITIES		10,125,587		5,741,473
TOTAL POOLED GENERAL INVESTMENT NET ASSETS		\$ 40,752,634		\$ 33,472,498

¹ Real assets include investments in commodities, real estate and inflation-indexed bonds.

² The collateral advanced under security borrowing agreements is in the form of cash.

³ As of June 30, 2007, other assets consisted primarily of accounts receivable for the sale of securities of \$1,103,913, of which gross receivables related to off-balance sheet instruments were \$294,374. As of June 30, 2006, other assets consisted primarily of accounts receivable for the sale of securities of \$817,568, of which gross receivables related to off-balance sheet instruments were \$68,946.

⁴ 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.

⁵ As of June 30, 2007, other liabilities consisted primarily of accounts payable for undistributed income and the purchase of securities of \$1,363,483, of which gross payables related to off-balance sheet instruments were \$117,001. As of June 30, 2006, other liabilities consisted primarily of accounts payable for undistributed income and the purchase of securities of \$1,161,276, of which gross payables related to off-balance sheet instruments were \$26,466.

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 used in both the core portfolio to gain exposure to a given asset class (displayed as “unhedged” market exposure in the following tables) and in the arbitrage strategies with the goal of enhancing the returns of certain asset classes without increasing the market risk to the underlying asset class (displayed as “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 in the *Balance Sheets*. The University manages exposure to 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.

The following table summarizes the market exposure (expressed in delta-weighted notional amounts), net ending fair value, net average fair value (an average of the five quarters ending June 30, 2007) and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2007 (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 instruments:							
Equity futures	\$ 1,314,137		\$ (301,633)	\$ 25,788	\$ (96)	\$ 5,760	\$ 52,305
Equity options	20,244	\$ 7,587	(191,730)	3,861	13,256	29,462	2,859
Equity exchange agreements	4,133,959	164	(110,003)	61,896	(2,397)	23,391	7,616
Total equity instruments	5,468,340	7,751	(603,366)	91,545	10,763	58,613	62,780
Fixed-income instruments:							
Fixed-income futures		1,854,864	(1,164,495)		970	5,578	21,233
Fixed-income options		10,222,863	(12,701,397)		1,645	(13,533)	44,628
Interest rate exchange agreements	537,119	1,939,938	(1,441,566)	(2,881)	11,194	(7,671)	618
Interest rate caps and floors		9,883,207	(12,929,576)		55,024	20,228	16,605
Total fixed-income instruments	537,119	23,900,872	(28,237,034)	(2,881)	68,833	4,602	83,084
Commodity instruments:							
Commodity futures							3,968
Commodity options			(10,280)		(10,280)	(3,042)	
Commodity exchange agreements	3,293,716						32,492
Total commodity instruments	3,293,716	0	(10,280)	0	(10,280)	(3,042)	36,460
Currency forwards	1,305,209	12,195,924	(13,537,807)	2,334	(39,008)	(26,258)	22,717
Currency options		259,923	(48,594)		(19,330)	(4,180)	13,961
TOTAL	\$ 10,604,384	\$ 36,364,470	\$ (42,437,081)	\$ 90,998	\$ 10,978	\$ 29,735	\$ 219,002

* Credit exposure represents cash or securities advanced by the University to meet legal margin requirements in connection with future, forward and option contracts, as well as exposure to counterparties where gains on financial instruments with off-balance sheet risk exceeds collateral held by the University.

The following table summarizes the market exposure (expressed in delta-weighted notional amounts), net ending fair value, net average fair value (an average of the five

quarters ending June 30, 2006) and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2006 (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 instruments:							
Equity futures	\$ 469,645		\$ (677,883)		\$ 1,611	\$ 1,098	\$ 49,118
Equity options	1,861	\$ 11,031	(233,370)	\$ 1,861	31,763	44,627	18,657
Equity exchange agreements	607,916	18,702	(438,633)	(10,591)	28,737	6,326	2,814
Total equity instruments	1,079,422	29,733	(1,349,886)	(8,730)	62,111	52,051	70,589
Fixed-income instruments:							
Fixed-income futures	1,091,435	176,929	(26,829)	70		78	9,029
Fixed-income options	14,070	140,557	(157,873)	(483)	(7,298)	206,871	9,249
Interest rate exchange agreements	154,842	222,504	(254,960)	(1,573)	(1,977)	(252,746)	
Interest rate caps and floors		89,903	(30)		5,341	48,670	2,512
Total fixed-income instruments	1,260,347	629,893	(439,692)	(1,986)	(3,934)	2,873	20,790
Commodity instruments:							
Commodity futures			(46,378)				2,115
Commodity options		10	(10)			24	
Commodity exchange agreements	1,549,575					205,518	
Total commodity instruments	1,549,575	10	(46,388)	0	0	205,542	2,115
Currency forwards	907,316	778,730	(1,682,154)	5,949	(2,058)	(11,049)	2,569
Currency options		77,218	(37,623)		13,805	147,390	416
TOTAL	\$ 4,796,660	\$ 1,515,584	\$ (3,555,743)	\$ (4,767)	\$ 69,924	\$ 396,807	\$ 96,479

* Credit exposure represents cash or securities advanced by the University to meet legal margin requirements in connection with future, forward and option contracts, as well as exposure to counterparties where gains on financial instruments with off-balance sheet risk exceeds collateral held by the University.

Financial instruments with off-balance sheet risk are recorded in the table on page 24 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 market exposure represents the notional value of the off-balance sheet instrument adjusted for its correlation to its underlying index or asset. Market exposure for the "hedged" positions is most meaningful when related to the corresponding positions recorded in the *Balance Sheets*. 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.

Financial instruments with off-balance sheet risk 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 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 counterparties based on their individual credit ratings. 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 also entered into agreements with private equity and real estate partnerships and external investment managers, which require periodic cash contributions totaling approximately \$8,170.6 million through fiscal 2017.

4. receivables

The major components of receivables, net of reserves for doubtful accounts of \$3.7 million and \$4.1 million as of June 30, 2007 and 2006, respectively, were as follows (in thousands of dollars):

	2007	2006
Investment income	\$ 37,724	\$ 64,195
U.S. Government, principally related to research	41,072	36,799
Non-federal sponsored research	5,677	6,019
Tuition and fees	10,246	11,282
Publications	23,086	23,162
Rent	9,844	17,397
Gift receipts	15,246	8,834
Executive education	21,615	6,396
Other	43,489	48,709
TOTAL RECEIVABLES, NET	\$ 207,999	\$ 222,793

5. notes receivable

Notes receivable, net of reserves for doubtful accounts of \$7.5 million and \$7.0 million as of June 30, 2007 and 2006, respectively, were as follows (in thousands of dollars):

	2007	2006
Student:		
Government revolving loans	\$ 63,391	\$ 60,115
Institutional loans	67,557	61,829
Federally guaranteed loans	3,085	4,564
Total student	134,033	126,508
Faculty and staff	145,129	130,997
Other	28,481	28,792
TOTAL NOTES RECEIVABLE, NET	\$ 307,643	\$ 286,297

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled \$57.1 million and \$57.0 million as of June 30, 2007 and 2006, respectively, and are classified as liabilities in the *Balance Sheets*. 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.

In addition to administering institutional loan programs, the University participates in various federal loan programs. 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.

Faculty and staff notes receivable primarily contain mortgages and educational loans. Mortgages include shared appreciation loans and loans that bear interest at the applicable federal rate. In addition, certain mortgages bear interest at the current market rate, which may be subsidized for an initial period. The educational loans are primarily zero-interest loans.

Notes receivable are presented at fair value with the exception of those under federally guaranteed student loan programs. These notes are subject to significant restrictions, and accordingly, it is not practicable to determine their fair value.

6. pledges receivable

Unconditional promises to donate to the University in the future are recorded as pledges receivable in the years promised at the present value of expected cash flows, net of an allowance for uncollectible pledges. Pledges receivable included in the financial statements as of June 30, 2007 and 2006 are expected to be realized as follows (in thousands of dollars):

	2007	2006
Within one year	\$ 86,999	\$ 86,104
Between one and five years	348,000	344,412
More than five years	172,337	180,677
Less: discount and allowance for uncollectible pledges	(82,364)	(70,570)
TOTAL PLEDGES RECEIVABLE, NET	\$ 524,972	\$ 540,623

Discounts of \$48.1 million and \$42.4 million for the years ended June 30, 2007 and 2006, respectively, were calculated using discount factors based on the appropriate U.S. Treasury Note rates.

Pledges receivable as of June 30, 2007 and 2006 have been designated for the following purposes (in thousands of dollars):

	2007	2006
General Operating Account balances:		
Gifts for current use	\$ 119,965	\$ 123,074
Non-federal sponsored gifts	112,533	102,532
Loan funds and facilities	15,312	11,293
Total General Operating Account balances	247,810	236,899
Endowment	277,162	303,724
TOTAL PLEDGES RECEIVABLE, NET	\$ 524,972	\$ 540,623

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

7. fixed assets

Fixed assets are reported 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, 2007 and 2006 are summarized as follows (in thousands of dollars):

	2007	2006	Estimated useful life (in years)
Research facilities	\$ 1,480,450	\$ 1,323,422	*
Classrooms and offices	1,065,829	1,025,588	35
Housing facilities	933,052	844,643	35
Libraries	374,231	367,700	35
Museums and assembly facilities	254,977	223,637	35
Athletic facilities	129,157	127,840	35
Service facilities	304,753	294,550	35
Other facilities	360,989	374,627	35
Land	591,932	558,555	N/A
Construction in progress	585,250	361,056	N/A
Equipment	544,314	471,911	**
Total fixed assets, at cost	6,624,934	5,973,529	
Less: accumulated depreciation	(2,100,772)	(1,894,993)	
TOTAL FIXED ASSETS, NET	\$ 4,524,162	\$ 4,078,536	

* Estimated useful lives of components range from 10 to 45 years.

** Estimated useful lives of equipment range from 3 to 8 years.

The costs of each research facility are separated into the shell, roof, finishes, fixed equipment and services. These components are depreciated separately.

Equipment fixed assets include general and scientific equipment, computers, software, furniture and vehicles.

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

Upon adoption of FIN 47 on June 30, 2006, the University recognized a conditional asset retirement obligation of \$33.3 million that is reported as a "Cumulative effect of accounting changes" in the fiscal 2006 *Statement of Changes in Net Assets with General Operating Account Detail*, and as a liability included in "Deposits and other liabilities" in the *Balance Sheets*. The liability is associated with buildings that are fully depreciated, therefore no adjustment was made to the cost of the assets. During fiscal 2007, this obligation was reevaluated, resulting in a \$5.2 million increase in the liability.

8. endowment funds

The University's endowment consists of approximately 11,100 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 unrestricted, temporarily restricted or permanently restricted net assets in accordance with donor specifications. Net unrealized 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, decisions to spend their principal require the approval of the Corporation. All but a small fraction of the endowment is invested in the GIA (Note 3).

The University is also the beneficiary of certain irrevocable 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 increases in net assets when the required trust documentation is provided to the University.

Endowment funds as of June 30, 2007 and 2006 are summarized below (in thousands of dollars):

	2007			Total	2006
	Unrestricted	Temporarily restricted	Permanently restricted		Total
Endowment funds		\$ 21,663,975	\$ 3,815,240	\$ 25,479,215	\$ 21,369,630
Funds functioning as endowment	\$ 5,796,425	3,031,002		8,827,427	7,246,260
Pledge balances		57,199	219,963	277,162	303,724
Interests in trusts held by others		27,125	301,139	328,264	299,816
TOTAL ENDOWMENT FUNDS	\$ 5,796,425	\$ 24,779,301	\$ 4,336,342	\$ 34,912,068	\$ 29,219,430

The University's endowment 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. Each fall, the Corporation approves the endowment distribution rate (the "endowment distribution"), stated in dollars per unit, for the following fiscal year. The endowment distribution is not based on a specific formula, nor is it directly tied to current investment returns. Rather, it reflects expectations about long-term returns, inflation rates and the University's ongoing spending needs. For fiscal 2007, the per unit endowment distribution approved by the Corporation (prior to decapitalizations described below) was equal to 4.3% of market value as of the beginning of the fiscal year.

In addition to the endowment distribution, the Corporation approves certain decapitalizations from the endowment to support strategic, mission-critical activities or objectives that are typically one-time or time-limited. During fiscal 2007, these additional decapitalizations, in combination with the endowment distribution, resulted in an aggregate spending rate of 4.6%. The following table displays for each of the past five years the total return on endowment, the endowment distribution rate per unit and as a percentage of market value as of the beginning of each fiscal year, and the aggregate spending rate (inclusive of decapitalizations).

Endowment investments are managed to achieve the maximum long-term total return. As a result of this emphasis on total return, the proportion of endowment distributions 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 2007 and 2006 distributions totaled \$709.7 million and \$685.0 million, respectively.

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

Fiscal year	Endowment total return % ¹	Distribution rate ²		Aggregate spending rate ³
		Per unit	As a % of market value	As a % of market value
2007	23.0%	\$ 69.73	4.3%	4.6%
2006	16.7	60.99	4.3	4.2
2005	19.2	54.17	4.5	4.5
2004	21.1	49.70	4.9	4.9
2003	12.5	47.11	5.1	5.2

¹ The endowment total return % is calculated in relation to pooled general investments, is net of all expenses and fees, and includes the impact of revenue-sharing agreements with certain fund managers.

² This data is based upon the per unit distribution rate established by the Corporation for each fiscal year.

³ Aggregate spending rate percentages are based upon actual endowment distributions in combination with approved decapitalizations of endowment principal made during the fiscal year.

9. split interest agreements

Under split interest agreements, donors enter into trust arrangements with the University in which the University receives benefits that are shared with other beneficiaries and institutions. Split interest agreement investment assets are recorded at fair value, and liabilities are recorded at the present value of estimated future payments due to beneficiaries and other institutions.

The changes in split interest agreement net assets for fiscal 2007 and 2006 were as follows (in thousands of dollars):

	2007			2006
	Temporarily restricted	Permanently restricted	Total	Total
Gifts for capital (Note 15)*	\$ 9,190	\$ 25,984	\$ 35,174	\$ 23,562
Investment return:				
Investment income	9,713	20,791	30,504	28,496
Increase in realized and unrealized appreciation	78,269	167,535	245,804	119,698
Total investment return	87,982	188,326	276,308	148,194
Payments to annuitants	(24,988)	(53,487)	(78,475)	(56,760)
Transfers to endowment	(3,265)	(15,348)	(18,613)	(6,897)
Transfers to the General Operating Account	(6,970)	(506)	(7,476)	(4,917)
Increase in liabilities and other adjustments	(53,566)	(114,640)	(168,206)	(7,964)**
NET INCREASE DURING THE YEAR	8,383	30,329	38,712	95,218
Total split interest agreement net assets, beginning of year	187,638	415,359	602,997	507,779
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	\$ 196,021	\$ 445,688	\$ 641,709	\$ 602,997

* Shown at net present value. The undiscounted value of these gifts was \$89,928 and \$61,854 for the years ended June 30, 2007 and 2006, respectively.

** Includes the effect of recording charitable lead trusts previously included in pledges.

Split interest agreement net assets as of June 30, 2007 and 2006 consisted of the following (in thousands of dollars):

	2007	2006
Split interest agreement investments (Note 3):		
Charitable remainder trusts	\$ 926,741	\$ 792,381
Charitable lead trusts	118,949	84,082
Charitable gift annuities	385,885	313,302
Pooled income funds	116,715	106,615
Total split interest agreement investments	1,548,290	1,296,380
Liabilities due under split interest agreements:		
Amounts due to beneficiaries	(785,032)	(581,804)
Amounts due to other institutions	(121,549)	(111,579)
Total liabilities due under split interest agreements	(906,581)	(693,383)
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS	\$ 641,709	\$ 602,997

10. bonds and notes payable

Bonds and notes payable as of June 30, 2007 and 2006 were as follows (in thousands of dollars):

	Fiscal year of issue	Remaining years to maturity	One-year effective interest rate	Outstanding principal	
				2007	2006
Tax-exempt bonds and notes payable:					
Variable-rate bonds and notes payable:					
Series L - weekly	1990	17	4.8%	\$ 71,140	\$ 71,140
Series R - daily	2000-2006	42	3.5	131,200	131,200
Series Y - weekly	2000	28	5.1	117,905	117,905
Series BB - weekly	2001	27	3.6	196,700	196,700
Series HH - weekly	2004	26	4.8	92,235	92,235
Series GG1 - weekly	2005	22	4.4	205,935	205,935
Series 2006B1 - daily	2007	29	3.3	112,900	
Series 2006B2 - weekly	2007	29	3.4	112,900	
Commercial paper	Various	Various**	3.6	546,895	189,162
Total variable-rate bonds and notes payable			3.9	1,587,810	1,004,277
Fixed-rate bonds:					
Series N	1992	13	6.3	79,002*	78,925
Series P	1995	N/A	5.0		1,335
Series Z	2001	9	5.1	85,413*	93,838
Series AA	2001	2	5.5	10,213*	15,171
Series DD	2002	28	5.0	134,949*	134,917
Series FF	2003	30	5.1	275,984*	275,979
Series 2005A	2005	29	5.0	93,877*	94,041
Series 2005B	2006	25	5.0	105,234*	105,422
Series 2005C	2006	28	5.0	130,155*	130,312
Total fixed-rate bonds			5.2	914,827	929,940
Total tax-exempt bonds and notes payable			4.4	2,502,637	1,934,217
Taxable bonds and notes payable:					
Commercial paper	Various	Various**	5.7	807,079	329,224
Fixed-rate bonds	1992	N/A	8.1		115,000
Series GG2	2005	6	4.5	45,745	52,250
Series 2006A	2006	30	6.3	401,350*	401,329
Total taxable bonds and notes payable			6.0	1,254,174	897,803
Other notes payable	Various	3-15	Various	90,167	90,227
TOTAL BONDS AND NOTES PAYABLE			4.9%	\$ 3,846,978	\$ 2,922,247

* Series N, DD, FF and 2006A principal are net of \$1.0 million, \$0.9 million, \$0.2 million and \$0.7 million of discounts, respectively. Series Z, AA, 2005A, 2005B and 2005C principal include premiums of \$1.4 million, \$0.4 million, \$4.8 million, \$4.7 million and \$4.2 million, respectively.

** All commercial paper will mature in fiscal 2008.

Interest expense, recorded in both the "Space and occupancy" and "Other expenses" lines of the *Statements of Changes in Net Assets with General Operating Account Detail*, was \$162.8 million and \$124.9 million for fiscal 2007 and 2006, respectively. Excluding maturity of commercial paper and other notes payable, as well as unamortized discounts and premiums, scheduled principal payments are (in thousands of dollars):

Fiscal year	Principal payments
2008	\$ 19,570
2009	20,345
2010	16,140
2011	16,900
2012	17,765
Thereafter	2,299,460
TOTAL PRINCIPAL PAYMENTS	\$ 2,390,180

In fiscal 2007, the University reauthorized and increased the capacity of its taxable commercial paper program to \$1.0 billion from \$650.0 million. In July 2007, the University paid down \$238.0 million of taxable commercial paper. As of July 31, 2007, the balance outstanding was \$571.3 million. Also in fiscal 2007, the University issued \$225.8 million of tax-exempt daily and weekly variable-rate reset Series 2006B bonds to finance graduate housing.

In fiscal 2006, the University issued \$105.6 million of Series 2005B bonds. The Series 2005B bonds refunded \$102.1 million of Series P bonds and will mature in 2032. Also in fiscal 2006, the University issued \$130.5 million of tax-exempt fixed-rate Series 2005C bonds and \$401.3 million of taxable fixed-rate Series 2006A bonds, which were used in part to redeem the University's outstanding Series CC bonds.

An \$11.3 million loss resulting from the fiscal 2006 refunding of Series P bonds and the refinancing of Series CC bonds is reflected in the "Other changes" line of the *Statements of Changes in Net Assets with General Operating Account Detail*.

In fiscal 2006, the seventh tranche of Series R current refunding bonds was issued. This tranche totaled \$14.0 million and brought the total amount outstanding under this series to \$131.2 million. These bonds, which are in a daily variable-rate reset mode, represent a current refunding of tax-exempt principal payments made throughout the calendar year. Also in fiscal 2006, the University reauthorized its existing tax-exempt commercial paper program. With this action, the authorized limit on the program was raised from \$650.0 million to \$1.0 billion.

Based on quoted market prices, the estimated fair value of the University's outstanding bonds and notes payable, including accrued interest, was \$3,813.3 million and \$2,887.1 million as of June 30, 2007 and 2006, respectively.

In the event that the University receives notice of any optional tender on its variable-rate bonds, or if the bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a general obligation to purchase the bonds tendered.

Interest rate exchange agreements

The University has entered into various interest rate exchange agreements (interest rate swaps) 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 3*. 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 \$3,533.9 million and \$(13.3) million, respectively, as of June 30, 2007 and \$3,542.6 million and \$(17.9) million, respectively, as of June 30, 2006.

The fair value of these agreements is included in the "Investment portfolio, at market" line in the *Balance Sheets*. The loss realized from the monthly settling of these agreements was \$7.9 million and \$18.5 million for fiscal 2007 and 2006, respectively. All unrealized and realized gains and losses from interest rate exchange agreements are included in the "Increase in appreciation, net of operating distribution" line in the *Statements of Changes in Net Assets with General Operating Account Detail*.

11. employee benefits

The University offers current employees a choice of health plans, a dental plan, 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.

In accordance with ERISA requirements, the University has established a trust to hold plan assets for its defined benefit pension plans. The market values of the trust's assets were

\$897.0 million and \$776.4 million as of June 30, 2007 and 2006, respectively. In addition, the University had internally designated and invested \$36.7 million and \$35.1 million as of June 30, 2007 and 2006, respectively, for its defined benefit pension plans. The University recorded expenses for its defined contribution plans of \$87.4 million and \$79.3 million for fiscal 2007 and 2006, 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, 2007, the University had internally designated and invested \$206.7 million to fund the postretirement health benefit accrued liability of \$545.7 million. As of June 30, 2006, the University had internally designated and invested \$157.9 million to fund an accrued liability of \$441.5 million.

The following table provides a reconciliation of the benefit obligation for the University for fiscal 2007 and 2006 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2007	2006	2007	2006
Reconciliation of benefit obligation:				
Benefit obligation, beginning of year	\$ 583,501	\$ 632,362	\$ 505,104	\$ 520,746
Service cost	12,819	14,580	23,353	27,724
Interest cost	37,399	33,135	31,822	29,039
Plan participants' contributions	n/a	N/A	1,819	1,593
Federal subsidy on benefits paid	n/a	N/A	1,231	N/A
Gross benefits paid	(39,298)	(38,849)	(17,829)	(14,332)
Actuarial (gain)/loss	(739)	(57,727)	198	(59,666)
BENEFIT OBLIGATION, end of year	\$ 593,682	\$ 583,501	\$ 545,698	\$ 505,104
Accumulated benefit obligation	\$ 511,923	\$ 507,476	n/a	N/A
Weighted-average assumptions used to determine benefit obligation at end of year:				
Discount rate	6.25%	6.25%	6.25%	6.25%
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%
Health care cost trend rate:				
– Initial rate	n/a	N/A	9.00%	8.00%
– Ultimate rate	n/a	N/A	5.00%	5.00%
– Years to ultimate rate	n/a	N/A	4	3
Effect of one-percentage-point change in assumed health care cost trend rate on postretirement benefit obligation:				
– Increase	n/a	N/A	\$ 95,593	\$ 95,979
– Decrease	n/a	N/A	\$ (76,066)	\$ (75,385)

The following table provides a reconciliation of the fair value of plan assets for the University as of June 30, 2007 and 2006 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2007	2006	2007	2006
Reconciliation of fair value of plan assets:				
Fair value of plan assets, beginning of year	\$ 776,442	\$ 709,639	\$ 0	\$ 0
Actual return on plan assets	159,820	105,652		
Gross benefits paid	(39,298)	(38,849)		
FAIR VALUE OF PLAN ASSETS, end of year	\$ 896,964	\$ 776,442	\$ 0	\$ 0

The actual asset allocation of the investment portfolio for the pension plan for fiscal 2007 and 2006, along with target allocations for fiscal 2008, are as follows:

	2008 Target	2007 Actual	2006 Actual
Asset allocation by category for pension plan:			
Equity securities	44.0%	48.1%	53.3%
Debt securities	18.0	21.1	20.4
Real estate	10.0	6.9	9.6
Other	28.0	23.9	16.7
TOTAL OF 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 that is in line with the long-term 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.

The following tables provide the funded status at the end of the year and the related amounts recognized in the *Balance Sheets* for the University for fiscal 2007 and 2006 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2007	2006	2007	2006
Funded status and amounts recognized, end of year:				
Fair value of plan assets	\$ 896,964	\$ 776,442		
Benefit obligation	(593,682)	(583,501)	\$ (545,698)	\$ (505,104)
FUNDED STATUS, end of year	303,282	192,941	(545,698)	(505,104)
Unrecognized net actuarial (gain)/loss	n/a	(204,142)	n/a	12,365
Unrecognized prior service (credit)/cost	n/a	(23,911)	n/a	8,816
Unrecognized transition (asset)/obligation	n/a		n/a	42,435
AMOUNTS RECOGNIZED, end of year	\$ 303,282	\$ (35,112)	\$ (545,698)	\$ (441,488)
Amounts recognized in the <i>Balance Sheets</i> consist of:				
Net retirement assets	\$ 303,282			
Accrued retirement obligations		\$ (35,112)	\$ (545,698)	\$ (441,488)
TOTAL AMOUNTS RECOGNIZED IN THE BALANCE SHEETS	\$ 303,282	\$ (35,112)	\$ (545,698)	\$ (441,488)
Amounts recognized in unrestricted net assets consist of:				
Net actuarial (gain)/loss	\$ (320,749)	N/A	\$ (14,521)	N/A
Prior service (credit)/cost	(19,215)	N/A	6,770	N/A
Transition (asset)/obligation		N/A	36,373	N/A
TOTAL AMOUNTS RECOGNIZED IN UNRESTRICTED NET ASSETS	\$ (339,964)	n/a	\$ 28,622	n/a

There are no expected employer contributions for fiscal 2008 to funded pension or other postretirement health benefit plans. The following table summarizes expected benefit payments and subsidies for pension and other postretirement health benefits for the University (in thousands of dollars):

Fiscal year	Expected benefit payments		Expected Medicare Part D subsidies
	Pension	Postretirement health	
2008	\$ 38,062	\$ 22,782	\$ 2,832
2009	38,780	24,796	3,089
2010	39,589	26,819	3,352
2011	40,502	28,688	3,617
2012	41,349	30,294	3,895
2013-2017	221,045	178,321	23,970

The following table summarizes the net periodic benefit (income)/cost for the University for fiscal 2007 and 2006 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2007	2006	2007	2006
Components of net periodic benefit (income)/cost:				
Service cost	\$ 12,819	\$ 14,580	\$ 23,353	\$ 27,724
Interest cost	37,399	33,135	31,822	29,039
Expected return on plan assets	(48,512)	(47,434)	(10,111)	(9,360)
Amortization of the:				
Actuarial (gain)/loss	(2,857)	1,254	(77)	4,602
Prior service (credit)/cost	(4,696)	(5,305)	2,046	2,046
Transition (asset)/obligation			6,062	6,062
Net periodic benefit (income)/cost	(5,847)	(3,770)	53,095	60,113
Additional designated funding	7,417	14,308	22,493	9,550
TOTAL NET PERIODIC BENEFIT (INCOME)/COST	\$ 1,570	\$ 10,538	\$ 75,588	\$ 69,663

Weighted-average assumptions used to determine net periodic benefit (income)/cost:

Discount rate	6.25%	5.25%	6.25%	5.25%
Expected long-term rate of return on plan assets	7.50%	8.00%	7.50%	8.00%
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%
Health care cost trend rate:				
– Initial rate	n/a	N/A	8.00%	9.00%
– Ultimate rate	n/a	N/A	5.00%	5.00%
– Years to ultimate rate	n/a	N/A	3	4

Effect of one-percentage-point change in assumed health care cost trend rate on aggregate service and interest cost:

– Increase	n/a	N/A	\$ 12,607	\$ 14,270
– Decrease	n/a	N/A	\$ (9,664)	\$ (10,758)

The expected long-term rate of return on pension plan assets is determined by utilizing HMC's capital markets model, which takes into account the expected real return, before inflation, for each of the pension portfolio's asset classes, as well as the correlation of any one asset class to every other asset class. This model calculates 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 the 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.

The estimated amounts that will be amortized from unrestricted net assets into net periodic benefit cost in fiscal 2008 are as follows (in thousands of dollars):

	Pension benefits	Postretirement health benefits
Amounts amortized:		
Actuarial (gain)/loss	\$ (4,456)	\$ (225)
Prior service (credit)/cost	(4,375)	1,796
Transition (asset)/obligation		6,062
TOTAL AMOUNTS AMORTIZED	\$ (8,831)	\$ 7,633

The University's adoption of FAS 158, discussed in Note 2, had the following incremental effect on retirement benefit-related amounts reported in the *Balance Sheet* as of June 30, 2007 (in thousands of dollars):

	Balances before adopting FAS 158	Adjustments to adopt FAS 158	Balances after adopting FAS 158
Impact of FAS 158 implementation on the <i>Balance Sheet</i> as of June 30, 2007:			
Net retirement assets	\$ 0	\$ 303,282	\$ 303,282
Accrued retirement obligations	553,758	(8,060)	545,698
Unrestricted net assets	10,687,034	311,342*	10,998,376

* The \$311.3 million change in unrestricted net assets is included in the "Cumulative effect of accounting changes" line in the fiscal 2007 Statement of Changes in Net Assets with General Operating Account Detail.

12. general operating account

The General Operating Account (GOA) consists of the general or current funds of the University as well as the assets and liabilities 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 HMC.

The major components of the GOA net asset balances as of June 30, 2007 and 2006 are summarized as follows (in thousands of dollars):

	2007			2006
	Unrestricted	Temporarily restricted	Permanently restricted	Total
Departmental balances:				Total
Unexpended endowment income	\$ 118,379	\$ 554,725		\$ 673,104
Unexpended gift balances	59,402	238,318		297,720
Pledge balances		223,469		223,469
Interests in trusts held by others		25,037		25,037
Loan funds	29,960		\$ 86,156	116,116
Funds for construction		13,171		13,171
Funds invested in fixed assets	1,360,383			1,360,383
Other departmental purposes	666,885			666,885
Total departmental balances	2,235,009	1,054,720	86,156	3,375,885
University balances*	2,966,942	95,784		3,062,726
TOTAL GOA NET ASSET BALANCES	\$ 5,201,951	\$ 1,150,504	\$ 86,156	\$ 6,438,611
				\$ 5,116,072

* Includes interests in trusts held by others of \$4,993 and \$4,131 for the years ended June 30, 2007 and 2006, respectively.

13. student financial aid

Financial aid granted to students in fiscal 2007 and 2006 is summarized as follows (in thousands of dollars):

	2007	2006
Scholarships and other student awards:		
Scholarships applied to student income	\$ 230,562	\$ 205,957
Scholarships and other student awards paid directly to students	108,588	99,574
Total scholarships and other student awards	339,150	305,531
Student employment	61,233	59,260
Student loans	30,553	30,315
Agency financial aid*	12,887	13,948
TOTAL STUDENT FINANCIAL AID	\$ 443,823	\$ 409,054

* Represents aid from sponsors for which the University acts as an agent for the recipient.

Approximately 65% of total scholarships and other student awards was funded by gifts, endowment income and sponsored support in both fiscal 2007 and 2006.

14. sponsored research

Total expenditures funded by U.S. government sponsors or by institutions that subcontract federally sponsored research to the University were \$514.8 million and \$518.0 million in fiscal 2007 and 2006, respectively. 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 awards and grants, 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 (including the School of Dental Medicine) and the School of Public Health through fiscal 2010. Funds received for federally sponsored research activity are subject to audit.

15. gifts

Gifts that are available for current purposes are classified as either "Gifts for current use" or "Non-federal sponsored research grants," as appropriate. Gifts that have been restricted by the donor or designated by the Corporation for facilities, loan funds, endowment or similar purposes are classified as "Gifts for capital." Gifts for current use, non-federal sponsored research grants and gifts for capital are classified as unrestricted, temporarily restricted or permanently restricted net assets in accordance with donor specifications.

Gifts received for the years ended June 30, 2007 and 2006 are summarized as follows (in thousands of dollars):

	2007	2006
Gifts for current use	\$ 213,994	\$ 201,946
Non-federal sponsored research grants	82,656	80,792
Gifts for capital:		
Endowment funds	277,626	273,381
Split interest agreements*	35,174	23,562
Loan funds and facilities	5,596	16,150
Total gifts for capital	318,396	313,093
TOTAL GIFTS	\$ 615,046	\$ 595,831

* Shown at net present value. The undiscounted value of these gifts was \$89,928 and \$61,854 for the years ended June 30, 2007 and 2006, respectively.

16. other operating income

The major components of other operating income for the years ended June 30, 2007 and 2006 were as follows (in thousands of dollars):

	2007	2006
Rental and parking	\$ 133,977	\$ 112,629
Publications	86,909	80,819
Royalties from patents, copyrights and trademarks	64,490	64,398
Services income	48,188	50,116
Sales income	42,148	46,147
Non-student health and clinic fees	24,340	23,981
Other student income	22,170	21,181
Other	66,351	54,594
TOTAL OTHER OPERATING INCOME	\$ 488,573	\$ 453,865

17. other expenses

The major components of other expenses for the years ended June 30, 2007 and 2006 were as follows (in thousands of dollars):

	2007	2006
Services purchased	\$ 343,160	\$ 345,780
Subcontract expenses under sponsored projects	90,304	87,390
Travel	66,640	60,315
Publishing	51,740	51,583
Advertising	28,035	26,045
Taxes and fees	21,586	21,128
Interest	21,390	10,550
Postage	14,948	13,921
Insurance	13,554	9,596
Telephone	11,408	11,032
Other	18,103	14,895
TOTAL OTHER EXPENSES	\$ 680,868	\$ 652,235

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.

Expenses by functional classification for the years ended June 30, 2007 and 2006 were as follows (in thousands of dollars):

	2007	2006
Instruction	\$ 883,010	\$ 788,715
Research	559,314	562,827
Libraries	197,939	183,611
Academic support	349,504	349,071
Scholarships and other student awards	108,588	99,574
Student services	111,976	104,857
Institutional support	562,255	552,376
Auxiliary services	398,064	358,472
TOTAL EXPENSES	\$ 3,170,650	\$ 2,999,503

19. commitments and contingencies

Sponsored support

The University receives funding from government agencies and private entities for research and other sponsored activities conducted under grants and contracts. These 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.

Lease commitments

The University is the lessee of equipment and land under operating (rental) and capital leases. Rent expense related to these leases was \$4.5 million and \$4.1 million in fiscal 2007 and 2006, respectively. Future minimum payments under these operating and capital leases are as follows (in thousands of dollars):

	Operating	Capital
2008	\$ 4,603	\$ 582
2009	3,344	582
2010	1,955	2,194
2011	1,320	461
2012	973	499
Thereafter		17,862
TOTAL FUTURE MINIMUM PAYMENTS	\$ 12,195	\$ 22,180

Joint venture

In the spring of 2004, the University together with the Harvard-affiliated teaching hospitals, the Massachusetts Institute of Technology (MIT) and the Whitehead Institute for Biomedical Research established the Eli and Edythe L. Broad Institute (the "Broad Institute"). The Broad Institute is a collaborative biomedical research institute that is jointly governed by the University, MIT and the Broad Foundation. The Broad 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 strive to jointly raise \$20.0 million per year in gifts and non-federal grants and awards to support the Broad 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 will make payments and record the corresponding expenses as these conditions are met. The University's obligation for such payments will not exceed \$32.5 million over the initial five-year term, or \$60.0 million in total if the term is extended for a second five years. The University had a commitment of \$6.5 million and \$9.0 million as of June 30, 2007 and 2006, respectively, which was recorded in "Accounts payable" in the *Balance Sheets*.

The University and MIT will equally share certain laboratory construction fit-out costs for the Broad Institute's building. The University's portion of these costs is limited to \$13.0 million. Payments to MIT under this commitment totaled \$1.2 million and \$6.8 million in fiscal 2007 and 2006, respectively. If the University's participation in the collaboration terminates under certain circumstances, the University may also be obligated to pay MIT up to \$5.0 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 \$4.0 million per year for up to ten years. Payments to MIT under this commitment totaled \$1.1 million and \$2.8 million in fiscal 2007 and 2006, respectively. Some of the University's contributions to the fit-out and ongoing capital costs have been and will continue to be reimbursed in the future through indirect cost recoveries associated with the Broad Institute's grant funding.

Future construction

The University has various commitments for capital projects related to its ongoing campus planning, academic and other initiatives.

Environmental remediation

The University is subject to laws and regulations concerning environmental remediation and has established reserves for potential obligations that management considers to be probable and for which reasonable estimates can be made. These estimates may change substantially depending on new information regarding the nature and extent of contamination, appropriate remediation technologies and regulatory approvals. Costs of future expenditures for environmental remediation have not been discounted to their net present value. Management is not aware of any existing conditions that it currently believes are likely to have a material adverse effect on the University's financial position, changes in net assets or cash flows.

General

The University is a defendant in various legal actions arising out of the normal course of its operations. While it is not possible to predict accurately or determine the eventual outcome of such actions, management believes that the outcome of these proceedings will not have a material adverse effect on the University's financial position, changes in net assets or cash flows.

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