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The Radcliffe Institute for Advanced Studies celebrated the sixtieth anniversary of the Arthur and Elizabeth Schlesinger Library on the History of Women in America. During this landmark year, renovations took place at the library, restoring and updating the building while preserving its holdings for future research. The Schlesinger Library collects manuscripts, books, and other materials essential for understanding women's lives and activities, including the papers of many famous women such as Dorothy West and Amelia Earhart, the records of groups like the National Organization for Women, a world-renowned collection of over 15,000 culinary books, and the Radcliffe College Archives.



To the Members and Friends of the Harvard Community:

I am pleased to present Harvard University's financial report for fiscal 2005. It was a strong year financially. The University realized an operating surplus, a reflection of the efforts across Harvard to budget and spend with care. The market value of the endowment rose to a record \$25.9 billion as of June 30, 2005, primarily as a result of the impressive investment returns achieved by Harvard Management Company. Fundraising receipts were the second highest in the University's history, thanks to the generosity of alumni and friends. All of this has contributed to the current vitality of our academic programs and our capacity to realize our ambitious aspirations for the years ahead.

The 2004-05 academic year featured continuing progress in the comprehensive review of the undergraduate academic experience, as well as major steps forward in both growing the faculty and ensuring strong financial aid programs for our students. A new generation of intriguing interdisciplinary science initiatives is taking shape, and we are also pursuing important opportunities to broaden and deepen our enduring institutional commitment to the humanities and the arts. We have benefited from the intensive work of two faculty task forces that have brought forth a series of strong recommendations on how we can enhance opportunities for women and minorities in the sciences and in academic life generally. And we have taken significant strides in planning for the eventual use of our properties in Allston, which represent a historic opportunity not only to expand our campus, but also to enhance our academic enterprise and the quality of life at the University for decades to come.

In short, thanks to the hard work and support of people across the Harvard community, we have the benefit of strong foundations on which to build. I look forward to a productive year ahead, one full of energy and collaborative effort, as we work together to secure the future excellence of an institution whose traditions and innovations continue to engage and inspire us all.

Sincerely,

Lawrence H. Summers

James H. Summers

President

October 11, 2005

To the Board of Overseers of Harvard College:

Fiscal 2005 has been a financially successful year for Harvard University. The University's third straight year of outstanding positive investment results boosted the endowment to a record \$25.9 billion. This endowment growth will help support several important priorities in the coming years, including the development of an Allston campus, exciting new interdisciplinary scientific endeavors, continued expansion of the faculty, and increased support of students through financial aid and graduate student housing.

The past year has also been one of change. Jack Meyer, President and CEO of Harvard Management Company (HMC) since 1990, and several of his colleagues departed on October 1, 2005 to establish their own hedge fund. Mohamed A. El-Erian, currently a Managing Director at Pacific Investment Management Company (PIMCO), has been appointed President and Chief Executive Officer of HMC, commencing early in 2006. Peter Nadosy, a member of the HMC Board and former President of Morgan Stanley Asset Management, is serving as Interim Chief Investment Officer until Mr. El-Erian assumes his post.

FINANCIAL HIGHLIGHTS

- The University ended the year with an operating surplus of \$44 million on \$2.8 billion of expenses. This surplus included a \$9 million unrestricted surplus and a \$35 million surplus in restricted funds (funds whose use is limited to the purposes designated by the donors or sponsors).
- * Harvard Management Company achieved a 19.2% total return for fiscal 2005, resulting in a five-year annualized return of 9.5%. The total market value of the endowment rose from \$22.6 billion to \$25.9 billion, and total net assets grew from \$26.9 billion to \$30.6 billion.

- ❖ Total revenue rose 8%, due to substantial increases in current use gifts and other income, as well as steady growth in other revenue categories.
- Student income, net of scholarships applied to tuition and fees, rose 5%, while total scholarships and other student awards grew 8%, outpacing tuition growth for the seventh consecutive year. This relatively higher percentage increase underscores the continued focus on financial aid as one of the University's highest priorities.
- Sponsored funding for research and training increased 6%, primarily due to growth in federal funding of 8%. The increase in federal sponsored research support included 14% greater funding from the NIH as well as additional research support from other federal sponsors, including other Department of Health and Human Services agencies and the Department of Defense.
- Thanks to the generosity of alumni and friends, gifts totaled an impressive \$639 million, an 8% increase over fiscal 2004. Endowment gifts totaled \$286 million, current use gifts were \$188 million, and grants for non-federal research as well as gifts for loans, facilities, and life income funds comprised the remaining \$165 million.
- ❖ Endowment income distributed for operations increased 6% to \$855 million, the result of a 4% increase in the distribution rate as well as distributions on additions to the endowment. The fiscal 2005 spending rate was 4.5%, within the targeted range of 4.5% to 5.0%.
- Endowment income distributed for operations remained the University's largest source of income in fiscal 2005, representing 31% of total operating income compared with 21% ten years ago. This growth reflects both the generous support of our alumni and friends as well as the continued strong performance of the Harvard Management Company.
- Total expenses increased 8%, primarily driven by significant growth in space and occupancy costs as new buildings came on line and energy costs increased nationwide.

The University spent \$1.4 billion on compensation, an increase of 5% over fiscal 2004. Compensation growth included an increase in total salary and wage costs of

6%, and of 3% in benefits expenses after several years of more significant increases.

❖ Space and occupancy expenses increased 11%, primarily due to higher maintenance,

interest, and utilities costs. In addition, the University spent a total of \$470 million

on physical renewal, new facilities, and acquisitions. Significant expenditures were

incurred for construction of the Center for Government and International Studies.

the Biology Research Infrastructure building, the Northwest Science Building, the

Oxford Street garage, and the Laboratory for Integrated Science and Engineering, as

well as for renovations at Baker Library, Aldrich Hall, Dumbarton Oaks, and the

Biological Laboratories.

♦ Other expenses increased 12%, largely due to higher purchased services costs. These

services were primarily associated with Allston development planning as well as with

certain legal settlement costs.

Looking forward, we must understand that realizing the University's objectives will

require continued fiscal prudence and significant new resources. The past few years

of financial strength will enable the University to actively pursue its goals. Faculty,

staff, alumni, friends, and students each hold an important role in helping to build

on this financial success and sustain the University's future.

Ann E. Berman

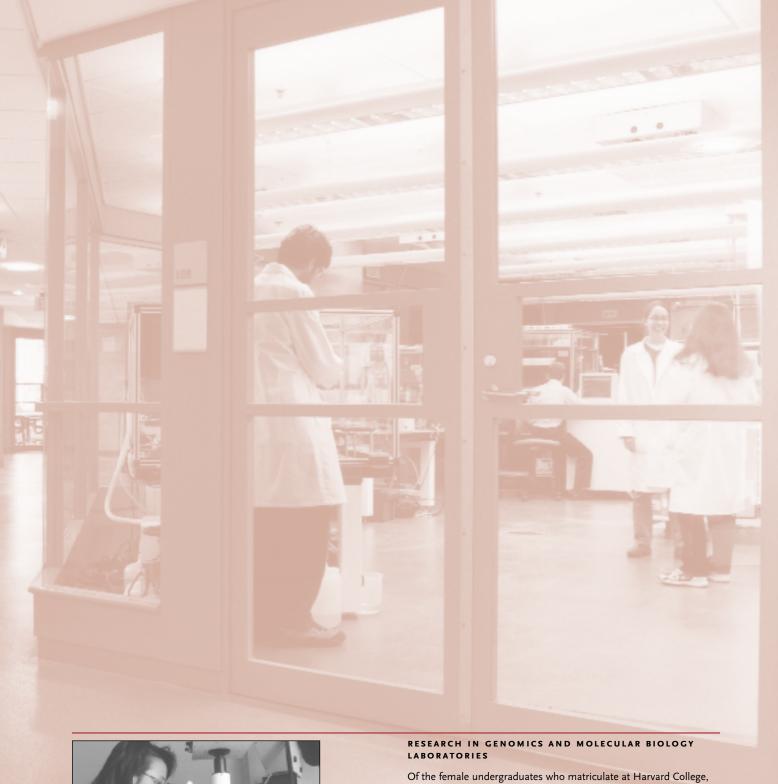
VICE PRESIDENT FOR FINANCE

James F. Rothenberg

James & Rother

TREASURER

October 11, 2005





Of the female undergraduates who matriculate at Harvard College, over 50% declare an interest in concentrating in the sciences; only 42% of this group actually does so. Two task forces recently issued reports on women in the sciences and faculty diversity. The University has committed \$50 million over the next ten years towards implementing the recommendations of the task forces, including ways of encouraging female students in their pursuits of scientific study and research.

Analysis of financial results

Fiscal 2005 was a financially successful year for the University, with an operating surplus, strong endowment growth, and total net assets of \$30.6 billion.

OVERVIEW

The University realized unrestricted and restricted operating surpluses in fiscal 2005, the first time in three years that both the unrestricted and restricted operating results were positive. The unrestricted operating surplus was \$8.7 million, rebounding from an \$11.7 million unrestricted operating deficit in fiscal 2004. The restricted operating surplus was

\$34.9 million, compared with \$48.5 million in fiscal 2004. At year-end, the University's total assets were \$55.5 billion, and total liabilities were \$25.0 billion. Net assets of \$30.6 billion included \$25.9 billion of endowment funds.

FINANCIAL RESULTS

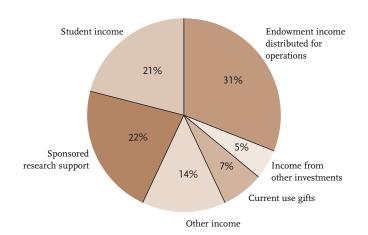
This section of the report analyzes revenue and expenses for fiscal 2005.

REVENUE The University's operating revenue totaled \$2.8 billion in fiscal 2005, an 8% increase over the prior year. Most revenue categories experienced steady growth, with substantial increases in gifts for current use and other income.

Harvard University's many achievements over the past fiscal year extended from the areas of teaching and research to administration and public service. The highlights that follow provide a sampling of the accomplishments of each School and of the University as a whole.

Frudent Income Student income increased 5% from fiscal 2004, totaling \$586.5 million in fiscal 2005. Revenue from undergraduate tuition rose 5%, consistent with the change in the College's tuition rate. Graduate tuition revenue increased 7%, reflecting 6% average graduate tuition rate growth and additional graduate students in certain programs. Total student room and board income grew 6%, primarily due to a 4% increase in the undergraduate room and board rate as well as additional housing of graduate students at One Western Avenue, 29 Garden Street, and Peabody Terrace. Continuing and executive education revenue rose 7%, largely

FISCAL YEAR 2005 OPERATING REVENUE



a result of increased enrollment in programs at the Business School and the Graduate School of Education (GSE), as well as new programs at the Kennedy School of Government (KSG) and the Medical School (HMS). Scholarships applied to student income continued to outpace tuition growth, with a 9% increase in fiscal 2005 following a 10% increase in fiscal 2004.

Sponsored research grew 6% in fiscal 2005 to \$626.4 million, primarily due to an 8% increase in federal support. Total non-federal sponsored support remained flat in fiscal 2005. The University received 82% of its sponsored research funding from the federal government, 12% from foundations, and 6% from other sources, including corporations, foreign, state, and local governments, as well as research institutes.

Various agencies of the Department of Health and Human Services, including most notably the National Institutes of Health, funded \$401.2 million or 79% of the University's federal sponsored research in fiscal 2005, growing from \$367.9 million or 78% of federal funding in fiscal 2004. The National Science Foundation supplied 7% of fiscal 2005 federal support, with the remainder awarded by other federal entities including the Departments of Defense, Energy, and Education, as well as the National Aeronautics and Space



FACULTY OF ARTS AND SCIENCES

In the past year, the Faculty of Arts and Sciences has been intensely focused on creating a new undergraduate curriculum. The Faculty will soon review the products of two years' work and approve a new range of curricular requirements. Some innovation in this area has already

occurred: increasing numbers of students are engaged in study, research, or work abroad; a new foundational life sciences course began this fall; and the freshman seminar program continues to expand.

New building for the sciences is underway, with the Laboratory for Integrated Science and Engineering, the Northwest Science Building, and the Biology Research Infrastructure building all under construction. Beyond the sciences, the Center for Government and International Studies opened in September 2005.

The faculty now

numbers 700, with approximately 100 new faculty members added in the past ten years. This growth will fuel the new undergraduate curriculum and fortify both FAS's and the University's interdisciplinary efforts in the sciences.

Faculty, staff, and student diversity

continue to be areas of major effort, intensified by the reports of the University's task forces on diversity and women in the sciences. Student financial aid, both for graduate students and undergraduates, remains an important challenge and continuing investment.

Administration. Approximately 95% of fiscal 2005 federal sponsored funding was received by three Schools: HMS, 40%; the School of Public Health (HSPH), 30%; and the Faculty of Arts and Sciences (FAS), 25%.

In fiscal 2005, HSPH received the largest award ever granted to one of the University's individual principal investigators: \$94.4 million for the care and treatment of people living with HIV-AIDS in Nigeria, Tanzania, and Botswana. This five-year federal award, of which \$17.4 million was received in fiscal 2005, is funded by the President's Emerging Plan for AIDS Relief (PEPFAR). The project team aspires to train Nigerian, Tanzanian, and Botswanan

doctors, nurses, and other health care providers to treat 75,000 patients over the next five years, with the ultimate goal of empowering these African countries with capacity for self-sustenance after the project's end.

The indirect costs of sponsored programs include facilities operations and maintenance, depreciation, debt service, library use, and administrative expenses. These costs are allocated as overhead to the direct costs of sponsored projects, enabling their partial recovery from sponsors. Other University resources finance the unrecovered overhead costs associated with sponsored programs.

SUMMARY OF FINANCIAL RESULTS

Dollar	· amounts	in	million	ιs
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	2005	2004	2003	2002	2001
Total revenue	\$ 2,800.9	\$ 2,597.7	\$ 2,472.7	\$ 2,349.0 ¹	\$ 2,228.2
Total expenses	2,757.4	2,560.9	2,432.9	2,261.6 ¹	2,063.3
Total gifts	639.0	591.8	562.4	477.5	707.1
Student notes receivable	128.6	128.6	136.7	151.3	159.0
Fixed assets, net	3,797.8	3,468.9	3,168.4	2,774.4	2,382.8
Bonds and notes payable	2,849.1	2,604.7	2,246.9	1,839.5	1,622.2
Net assets–General Operating Account	4,197.6	3,935.5	3,439.4	3,419.9	3,279.9
Net assets-endowment	25,853.0	22,587.3	19,294.7	17,518.0	18,259.2
Total return on general investments	19.2%	21.1%	12.5%	(0.5%)	(2.7%)
Degree student enrollment	19,731	19,638	19,536	19,539	18,847

¹These numbers are restated to conform with fiscal 2003 presentation.



BUSINESS SCHOOL

HBS completed an \$85 million renovation of Baker Library, restoring its historic reading room, lobby, and north facade, creating a southfacing entrance that further opens the campus to Boston's Allston-Brighton neighborhood, and designing spaces to bring together faculty,

students, and other academics. Renovations to Aldrich Hall were also completed. Technology plays a central role in both buildings, providing students and faculty with state-of-the-art research tools as well as enhanced classroom interactivity.

The MBA Class of 2007 comprises 914 students, 33% of whom are international, 22% minorities, and 38% women.

The India Research
Center opened in Mumbai, joining centers in
Asia, Latin America,
Europe, and California.
These centers facilitate
faculty research and
foster ties with academic
and business communities around the world.



SCHOOL OF DENTAL MEDICINE

In December 2004, the new HSDM Research and Education Building hosted its opening reception. The 67,000-square-foot building, whose design has received much recognition, houses state-of-the-art laboratories, classrooms, an auditorium, and common areas. The new building

devotes half of its space to education, technology, and faculty offices, with the remainder housing basic science laboratories. In fiscal 2005, indirect cost reimbursements totaled \$155.6 million. Federal indirect cost recovery rose 9% to \$143.5 million, representing 28% of total federal support. Predetermined federal indirect cost recovery rates have been established across the University through fiscal 2006. The subsequent federal indirect cost rates will be proposed and negotiated in the coming year for use with grants and contracts beginning in fiscal 2007.

Among non-federal sponsors, indirect cost recovery rates are agreed upon independently with each sponsor, are typically much lower than federal rates, and can vary widely from 0% to over 60%. Non-federal indirect cost recovery increased \$3.1 million to \$12.2 million, with non-federal sponsored direct support declining 3%. Individual non-federal projects can substantially impact non-federal sponsored revenue and related indirect cost recovery trends for the University in any given year.

Two research centers formed in fiscal 2004 continued to evolve in fiscal 2005: the Harvard Stem Cell Institute (HSCI) and the Eli and Edythe L. Broad Institute (the Broad Institute) joint venture with the Massachusetts Institute of Technology (MIT), the Whitehead Institute, and the Harvard-affiliated teaching hospitals. HSCI received \$10.8 million in private gifts during fiscal 2005 and in turn funded stem cell projects at the University and in the Harvard-affiliated teaching hospitals' research laboratories. The Broad Institute made steady progress in genomic

research during its first full year of operation and looks forward to occupying a new state-of-the-art building near MIT in April 2006. Both the Broad Institute and HSCI are expected to achieve major scientific advances and discoveries with additional sponsored research funding.

GIFTS FOR CURRENT USE Gifts from alumni and friends provide crucial funding for the University's ongoing operations and priorities such as undergraduate and graduate student financial aid. Current use gifts surpassed fiscal 2004 by 22%, totaling \$187.8 million in fiscal 2005. HMS and HSCI received significant incremental gifts during fiscal 2005.

Investment income increased 6% to \$984.6 million in fiscal 2005. The largest component of investment income, endowment income distributed for operations, also increased 6% to \$854.8 million. This growth was due to a 4% increase in the distribution rate as well as the impact of new gifts and other additions to the endowment. The distribution rate as a percentage of endowment market value was 4.5%, within the targeted spending rate of 4.5% to 5.0%. The University's endowment and related spending policies may be found in the section of this report beginning on page 16.



GRADUATE SCHOOL OF DESIGN

Professor Alan Altshuler became Dean of the faculty in February 2005 after seven months as Acting Dean. His initiatives have included thorough reviews of the School's research centers and the creation of advisory faculty committees on instruction, faculty norms, and external relations.

Progress was made towards the goal of increasing the size and diversity of the senior faculty. The School's financial performance also continued to improve, resulting in the second straight year with an unrestricted surplus.



DIVINITY SCHOOL

Academic year 2004-05 witnessed a record number of professorial searches at HDS, resulting in the hiring of five new faculty members. The multi-year curriculum redesign continued, with changes implemented in the Master of Divinity program and ongoing discussion on the Master of

Theological Studies curriculum, towards the goal of graduating this century's leaders in ministry and service and helping to prepare the next generation of scholars in religion.

Fiscal 2005 was a very successful year for the School's revitalized fundraising effort, with approximately \$10 million raised, including endowment of a new professorship in science and religion. Additionally, the Harvard Divinity Bulletin was successfully redesigned as a general-interest magazine covering critical concerns surrounding religion and public life, religion and the arts, and theological education.

OTHER INCOME Other income consists primarily of rental and parking fees, publication revenue, royalties, health and clinic fees, and revenue from other auxiliary enterprises whose activities are consistent with the University's mission. In fiscal 2005, other income rose 12% to \$415.7 million, largely due to incremental rental and royalty income.

EXPENSES The University's operating expenses totaled \$2.8 billion in fiscal 2005, an 8% increase over the prior year. Expense categories that rose significantly during the year included space and occupancy costs as well as other expenses. The University continues to pursue cost savings across all expense categories.

COMPENSATION As one of the foremost institutions of higher education in the world, the University strives to hire and retain outstanding faculty and staff. Accordingly, the University offers an attractive and competitive compensation and benefits package, which includes pension plans, health benefits for active and retired employees, dental plans, life insurance, tuition assistance, child and elder care resource services, mortgage and educational loan programs, tax-deferred annuity programs, and free admission to the University's museums and libraries.

Compensation costs totaled \$1.4 billion in fiscal 2005, an increase of 5% over fiscal 2004. Compensation represented 51% of the University's total expenses in fiscal 2005 and 52% in fiscal 2004.

Salaries and wages rose 6%, while benefits costs increased 3%. Salary expense growth reflects faculty hiring initiatives and additional personnel to support both the University's science initiatives and greater sponsored research activity, as well as pay increases and adjustments.

Benefits costs were impacted by several offsetting changes. Pension expenses increased 13% and health costs rose a modest 5%, while postretirement health costs decreased 28%. Despite continued increases in American health costs, the University was able to contain growth in this area by implementing a self-insurance program in January 2005. This program is expected to result in administrative cost savings. The decline in post-retirement health costs was largely due to the impact of anticipated future subsidies resulting from new Medicare legislation (the Medicare Prescription Drug Improvement and Modernization Act of 2003). Postretirement health costs are also affected by actuarial assumptions including interest rates, which may cause significant changes in these costs from year to year.

In addition to the standard benefits package, the Schools may offer educational and subsidized mortgage loans to their faculty members. The mortgage program helps faculty members cope with the high cost of housing in the Boston area. Total loans outstanding to faculty and staff increased 9% to \$118.8 million in fiscal 2005, reflecting new loans associated with faculty growth.



GRADUATE SCHOOL OF EDUCATION

In June 2005, Professor Kathleen McCartney, a leading expert on early childhood education, assumed the role of Acting Dean. The work to build a core curriculum continued: the initial course, Thinking Like an Educator, was expanded to include 225 students; a new course focusing on education

reform was developed; and a seminar for first-year Doctoral students was created. Progress continued in reviewing the Master's degree programs, in particular the School's Teacher Education program. Faculty have also led the creation of a unified doctoral program experience.



JOHN F. KENNEDY SCHOOL OF GOVERNMENT

During his first year as Dean, David Ellwood focused the School's activities on three central themes: partnership, excellence, and impact. KSG is collaborating across the University through several new fellowships intended to encourage students to pursue joint degrees and participate

in social entrepreneurship.

In addition, the
School recently endowed
the Center for Business
and Government, recognizing that collaboration
between business and
government is central
to the solution of public
problems. With the
assistance of a \$10
million gift, KSG has

been able to enhance its efforts towards excellence in teaching and research. This gift provides funds for hiring and retaining superb faculty, strengthening teaching programs, upgrading facilities, and enhancing the student loan repayment program.

FINANCIAL AID The University strives to enable all admitted students to attend its Schools, regardless of their financial circumstances. 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, increased 8% to \$283.1 million in fiscal 2005. In addition, the University spent \$56.7 million on student employment, loaned \$26.2 million to students, and acted as agent on behalf of specific student recipients for \$13.7 million in aid from outside sponsors. Approximately 65% of scholarships and student awards is funded through gifts from generous alumni and friends, endowment income, and sponsored support, with the remaining 35% supported by other University operating funds.

Over the past ten years, the cost of attending Harvard College has increased 51%, from \$28,150 to \$42,450 per year. During that same ten-year period, the average annual scholarship award has grown 85%, from \$14,170 to \$26,240. The College provides need-based financial aid, while admitting students on a need-blind basis. Almost 70% of undergraduate students receive financial aid, with close to 50% qualifying for need-based scholarship assistance. The average undergraduate aid package consists of grants, loans, and employment, and represents 70% of the total cost of attendance. In the past five years,

financial aid enhancements have generated a 61% decline in the median indebtedness among graduating seniors, from \$16,400 for the Class of 2000 to \$6,400 for the Class of 2005.

A major new financial aid initiative was implemented in fiscal 2005, designed to encourage talented students from families of low and moderate income to apply to and attend the College. Parents of families with annual income of less than \$40,000 are no longer expected to contribute to the cost of their child's undergraduate education. In addition, the University has reduced the contributions expected of families with income between \$40,000 and \$60,000. This initiative is the latest step in a progressive expansion of undergraduate financial aid that has led to the largest applicant pool and the most competitive admission rate (9.1%) in the history of the College. The Class of 2009 is also the College's most economically diverse to date, with a 22% increase in the number of students from lower income backgrounds as compared with the Class of 2008. This new initiative and other improvements have made Harvard College's financial aid program an exemplar among institutions of higher education.

Financial aid is also vital in attracting students to the graduate and professional Schools. Between 50% and 93% of each School's students received financial support in fiscal 2005. The University expanded financial aid for graduate and professional



Law School

HLS completed the first comprehensive renovation of Harkness Commons, the student and dining center, resulting in increased formal and informal use of the space. HLS also made significant progress in developing a student information system, which will be implemented in fiscal 2006.

The Law School introduced elective reading groups for first-year students, small informal sessions convening groups of students and faculty members to read and discuss materials on a specific topic. Over 90% of the first-year class elected to participate in nearly 50 offerings.



MEDICAL SCHOOL

HMS launched four new advanced degree programs in collaboration with other areas of the University. An MD-MBA program was begun with Harvard Business School, and a new MD-PhD program in social sciences and two new PhD programs, in systems biology and chemical biology, were

developed in conjunction with FAS.

Planning for extensive reform of the medical education program made major strides through pilot projects and agreement on five core areas for reform. A target date for implementation of the year-one curriculum reform has been set

for the fall of 2006.
In fiscal 2005,
HMS faculty at the
Quadrangle and the
affiliated hospitals
continued to receive
major federal grants,
including funding for
HIV vaccine research,
bioinformatics, and
biosecurity.

students during the past year, utilizing funds reallocated from cost-cutting initiatives in the University's core central administration. These funds are intended to provide \$9.0 million of incremental financial aid to eight of the graduate and professional Schools through fiscal 2007. The Schools are deploying these funds in a variety of ways, ranging from additional support for HSPH Presidential Scholars to Leadership in Education merit awards for Master's degree students at GSE and funding for KSG Presidential Public Service Fellowships.

In fiscal 2005, the University continued its partnership with a major financial institution to provide commercially funded loans to graduate and professional students through the Harvard Educational Loan Program (HELP). Graduate students rely on educational loans or other financing to cover the costs of attending the University. The HELP program is particularly important for international students, who are ineligible for federally subsidized education loans. The program assisted more than 2,100 graduate students by providing over \$39.1 million of belowmarket-rate loans in fiscal 2005. In the coming year, approximately \$42.0 million is expected to be loaned to 2,200 students.

The University also maintains its own student loan programs, which are funded through federal support, University capital resources, and donations. Outstanding loans from University funds to current and former students remained constant at \$128.6 million in fiscal 2005.

SUPPLIES AND EQUIPMENT In fiscal 2005, supplies and equipment expenses increased 10% to \$206.7 million. This growth was primarily related to general equipment purchases and upgrades.

University-wide contracts with vendor partners together with cost-conscious purchasing practices contained further expense growth. During fiscal 2005, the University completed contract renegotiations with its primary office supplies vendor, resulting in additional savings. A new contract was also negotiated with a convenience copier vendor. Other vendor partnerships continued in the areas of office furniture; scientific supplies; personal computers; watermark and recycled paper; facilities maintenance, repair, and operating supplies; and audiovisual equipment. The University will continue to evaluate additional vendor savings opportunities in the coming year, while also encouraging increased use of preferred vendors to generate and leverage further savings for the University.



SCHOOL OF PUBLIC HEALTH

HSPH received funding from the National Cancer Institute to create a professional network for reducing cancer deaths and illness in minority and underserved populations in Massachusetts. The network will develop cancer prevention programs and early detection interventions. Other research

at HSPH identified the importance of combining treatment and prevention efforts to combat the HIV epidemic in Africa; found a link between obesity and Type 2 diabetes; and determined through computer modeling that rapid vaccination could avert a future pandemic caused by bird flu.



RADCLIFFE INSTITUTE FOR ADVANCED STUDY

In fiscal 2005, the Radcliffe Institute marked five years since the 1999 merger of Radcliffe College and the University with a strong sense of progress and accomplishment. In that short time, fellowship applications have increased 280% as the Institute's reputation has spread, and support

from alumnae/alumni and friends has grown an extraordinary 103% since fiscal 2004.

The Radcliffe
Institute reopened
Schlesinger Library after
an extensive renovation
aimed at securing and
preserving its increasingly valuable collections.
The Institute finalized
preparations for the next

phase of its space plan: renovation of the Radcliffe Gym into a spacious lecture hall for fellows' presentations and other events, as well as much needed office space for Institute staff. SPACE AND OCCUPANCY Space and occupancy costs totaled \$296.1 million in fiscal 2005, an 11% increase over the prior year. Facilities improvement and maintenance costs rose 19%, largely due to non-capitalizable laboratory and other renovations at HSPH, HMS, and FAS. Interest on bonds and notes payable related to capital projects increased 18% as a result of new debt issuances and higher interest rates on variable-rate debt. Utility costs grew 10% due to higher market rates. The University is actively identifying and implementing strategies to mitigate the effects of volatility in the energy markets.

OTHER EXPENSES Other expenses consist primarily of purchased services; expenses subcontracted to other institutions for sponsored projects; travel, publishing, and telephone costs. In fiscal 2005, other expenses increased 12% to \$556.9 million. Expense growth occurred in legal and settlement costs primarily associated with the Harvard Institute for International Development, as well as consulting fees for development in Allston and interest costs associated with the University's working capital.

Vendor partnerships helped to reduce expenditures in the areas of temporary employment, express mail, travel, and offset printing. A renegotiated contract with the University's major express mail vendor is expected to generate future cost savings. The University continues to seek additional cost savings by consolidating vendors, negotiating contracts, and leveraging purchasing activity.



THE UNIVERSITY

In July 2005, Professor Evelynn Hammonds was appointed as Senior Vice Provost for Faculty Development and Diversity. Her office will implement the recommendations made by the Task Forces on Women Faculty and Women in Science and Engineering, including collecting quality data on faculty appointments and diversity, establishing mentoring programs for junior faculty, enhancing work-family benefits, and improving the faculty appointment process to ensure both diversity and excellence.

The Task Force on Science and Technology issued a report in April 2005 focusing on opportunities for interdisciplinary ventures, highlighting those that would benefit from co-location in the developing Allston campus. Several key fields were identified: chemical biology, innovative computing, stem cells, systems biology, and certain areas of engineering. The proposed co-location of these programs, while

logistically challenging, promises to foster dynamic synergies and connections.

The Office of Technology Development (OTD) has been restructured and is in the process of defining a new technology development strategy, including a University-wide technology transfer program.

OTD is responsible for all activities pertaining to intellectual property, licensing, and technology transfer, aiming to translate new knowledge and innovations into practical advances beneficial to society, while providing further support for the University's goals and mission.

Review of endowment results

The University's endowment, the legacy of generous alumni and friends, achieved a record market value of \$25.9 billion in fiscal 2005. The University relies upon the endowment to provide support in perpetuity for its teaching and research mission.

A STRONG ENDOWMENT

The endowment is the financial cornerstone of the University, providing long-term funding for student financial aid, the faculty, and academic programs. The endowment contains approximately 10,840 separate funds, the majority of which are restricted for specific purposes. The endowment's growth and the resulting income stream depend upon gifts from generous alumni and friends as well as prudent investment management.

In fiscal 2005, endowment gifts totaled \$285.7 million, an increase of II% over the prior year. This increase reflects incremental endowment gifts at the Business School (HBS) and the Radcliffe Institute for Advanced Study (RIAS). HBS's endowment gifts increased by 70% to \$102.3 million, as its capital campaign entered its final phase. RIAS more than doubled its endowment gifts to \$8.8 million.

REAL ENDOWMENT GROWTH								
		Compound annual rate of growth						
	1974-84	1985–95	1996-05	1974-05				
Total general investment return	10.4%	12.7%	14.8%	13.4%				
Average per unit income distributed as a percent of unit value	(5.1)	(4.1)	(4.2)	(4.5)				
Total return reinvested	5.3	8.6	10.6	8.9				
Capital additions	3.3	1.5	2.0	2.2				
Total growth in endowment	8.6	10.1	12.6	11.1				
Inflation rate	(7.8)	(3.5)	(2.4)	(4.5)				
REAL ENDOWMENT GROWTH	0.8%	6.6%	10.2%	6.6%				

PERFORMANCE OVERVIEW

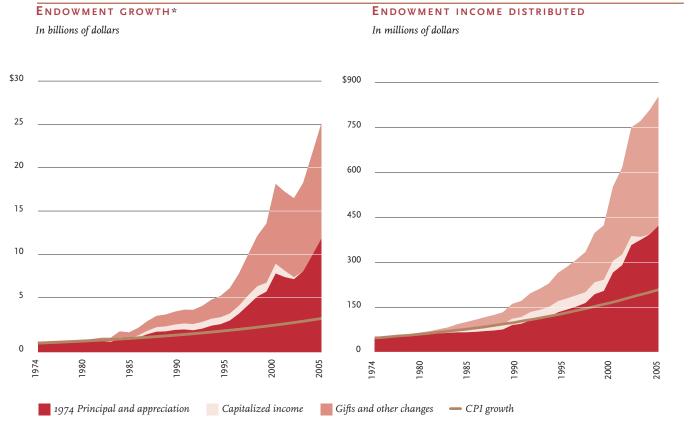
Harvard Management Company (HMC) is responsible for managing the endowment's investments. The unaudited *Annual Report of the Harvard Management Company*, beginning on page 23, discusses the University's investment philosophy and analyzes the endowment's fiscal 2005 performance.

In fiscal 2005, total return of the endowment's general investments was 19.2% versus 21.1% in fiscal 2004. The market value of the endowment increased from \$22.6 billion to \$25.9 billion during fiscal 2005, exceeding annual performance benchmarks by 5%. The change in market value includes all endowment activity: investment appreciation and depreciation; funds distributed to the Schools and departments for operations; new gifts and pledges; departmental additions to the endowment from

unrestricted fund and gift balances; and the use of endowment appreciation for specific purposes approved by the Corporation.

The University's endowment spending policy strives to sustain the purchasing power of the endowment while providing a reliable stream of income for operations. Accordingly, the University aims to distribute between 4.5% and 5.0% of the endowment's market value annually. In fiscal 2005, endowment distributions resulted in a spending rate of 4.5%.

Continuing donor support, strong investment management, and fiscal moderation will be required to ensure the endowment's future strength.



^{*} To allow for comparability with years prior to fiscal 1995, this chart does not include pledge balances and interests in perpetual trusts.

Review of capital activities

In fiscal 2005, the University was engaged in 329 construction and renovation projects. The University's property holdings include 23.2 million square feet of space in more than 600 buildings, as well as over 200 acres of land intended for long-term development.

APPROACH TO CAPITAL ISSUES

The University employs a comprehensive planning strategy to assess current and future space requirements while considering the impact of growth on the neighboring communities. Within this planning strategy, the University continues to pursue property development and acquisition in Cambridge and Boston.

The planning process for the University's new and existing space in Allston continued throughout fiscal 2005. The University collaborated with the Boston Redevelopment Authority to finalize a North Allston Neighborhood Strategic Plan, the product of a multi-year, community-centered planning process. Negotiations around critical issues involving the University's ability to use the land in Allston for the creation of a new teaching, research, and residential campus concluded favorably with the completed plan, which will form the basis for proposed institutional uses in the future. In June 2005, an external planning firm prepared an interim report proposing preliminary ideas and options for a basic campus and urban framework in Allston. The report has been distributed broadly to facilitate discussion among the University community, the City of Boston, the Allston neighborhood, and other regional groups.

In an effort to further demonstrate its commitment toward the Allston community, the University has pledged \$1.2 million to fund land-scape improvements and business development in Allston, including the creation of a city-run career and business resource center. This center will support local business operations and assist Allston residents with career planning.

The University intends to continue collaborating with the Allston community, the City of Boston, the faculty, students, and others across the University

as planning for the Allston campus progresses. In the coming year, the University will organize structured opportunities for all interested parties to hear about emerging ideas and options, contribute their thoughts, and help to ensure that the decisions made best reflect the long-term interests of both the University and its neighbors.

Strategic developments and planning also occurred in Cambridge during fiscal 2005. Discussions continued regarding planned construction in the area north of the main Cambridge campus for Faculty of Arts and Sciences (FAS) and Law School (HLS) facilities projects. The University secured building permits and commenced construction on two FAS buildings: the Northwest Science Building and the Laboratory for Integrated Science and Engineering. At HLS, planning for a major new building containing added academic and student-related space is underway. In addition, the University completed a comprehensive Cambridge campus transportation study to assess the cumulative impacts of the proposed developments and provide guidelines for future capital projects.

During fiscal 2005, the University made progress toward its goal of providing housing to 50% of its graduate students. In Boston, the University continued its participation in the Fenway mixed-use project, which will include affiliate apartments. The University received permits for two new construction projects in the Riverside area of Cambridge that will provide more than 300 units of new housing, primarily to graduate students. As a part of these Cambridge projects, the University will also be developing more than 34 units of affordable housing and creating nearly three quarters of an acre of new public open space in the Riverside area.

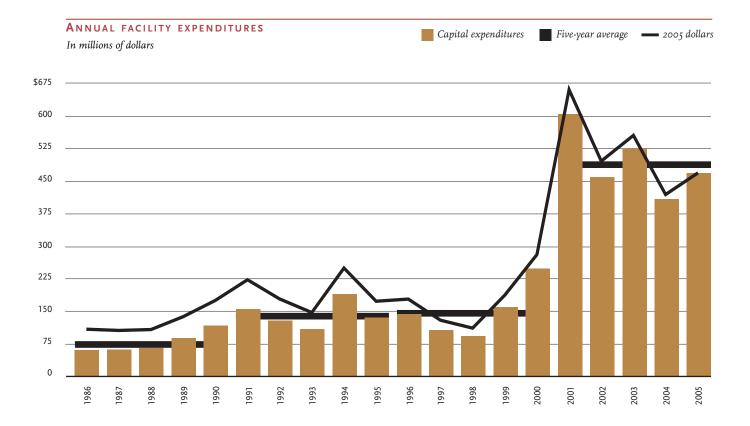
THE PHYSICAL PLANT

The University's property holdings comprised 23.2 million square feet of space at the end of fiscal 2005. The University's physical plant must meet diverse needs and requirements, including security, energy efficiency, accessibility, and 24-hour use. Student housing occupies 6.7 million square feet; offices and classrooms, 4.7 million square feet; laboratories, 4.4 million square feet; libraries, 1.6 million square feet; and other facilities including athletic, health care, and administrative facilities, as well as museums and commercial space, 5.8 million square feet.

The University invested \$469.9 million in 329 active capital projects and acquisitions in fiscal 2005, compared with \$409.9 million and 356 active projects in fiscal 2004. Investments in new construction and renovations included: 46% for laboratories, classrooms, and offices; 22% for libraries, museums, and assembly spaces; 3% for housing; and 29% for

athletic and other facilities. Strategic acquisitions in Allston and Cambridge also added to the University's plant.

Capital projects were funded by \$40.8 million of gifts, \$23.5 million of unrestricted balances, and \$19.0 million of endowment, with the remainder financed by debt. For more than 20 years, the University has employed a strategy of financing capital projects with bonds. This strategy has enabled new construction as well as renewal and improvement of existing facilities, while allowing payments for the projects to occur over time. The University's outstanding debt totaled \$2.8 billion at the end of fiscal 2005, a 9% increase over the prior year balance.



NEW CONSTRUCTION AND ACQUISITIONS

New construction and acquisitions accounted for 39% and 19%, respectively, of the University's capital expenditures during fiscal 2005. In Cambridge, construction was completed on the Oxford Street underground garage. In the Longwood Medical Area, the School of Dental Medicine opened its new Research and Education Building in December 2004. The facility contains three floors of research laboratories focused on bone biology and pathology as well as two floors dedicated to education. This new structure has enabled five formerly off-site research programs to come together in a single building. In addition, the University purchased six properties in Allston and two in Cambridge, adding 382,000 and 13,500 square feet, respectively, to existing holdings.

Significant progress on two FAS construction projects in the north campus continued: the Laboratory for Integrated Science and Engineering (LISE) and the Biology Research Infrastructure (BRI) building. The LISE facility will enable interaction among faculty and students in the areas of physics, chemistry, biology, engineering, and materials science. The LISE will also include laboratory space for the Center for Nanoscale Science Structures, as well as clean-room and vibration-free underground research space for work in materials science and nanotechnology. The BRI building, located under the Biological Laboratories courtyard, will house a multiscientist support facility for FAS research.

Construction commenced in the northwest campus on the new 520,000 square-foot FAS laboratory building, which will house the Center for Brain Science and the department of Systems Biology, as well as other multidisciplinary scientific efforts. The Northwest Science Building will include offices, classrooms, teaching and research laboratories, a chilled-water plant, and an electrical substation.

The new building will be used by neuroscientists, biologists, bioengineers, and astrophysics researchers, among others, and is slated for completion in fiscal 2008.

The fas Center for Government and International Studies (CGIS) project was completed in September 2005. CGIS will co-locate the Government department and various centers for regional and international studies while also accommodating a range of academic and administrative uses, including faculty offices, graduate student workspace, lecture halls, various seminar rooms, a library, the Harvard-MIT Data Center (a research center for quantitative social science data), and a cafe.

Work on a new building located on Mount Auburn Street in Cambridge continued as well. The building is intended to house strategic programs of the University Library, which provides essential services to the over 90 units of the library system. These programs include: the Weissman Preservation Center, with a specially equipped laboratory for the conservation of the University's rarest and most valuable manuscripts, images, and bound volumes; the Office for Information Systems and its Library Digital Initiative; the Harvard Depository administrators; and the global Open Collections Program, among other initiatives.

At the Dumbarton Oaks complex in Washington, D.C., significant progress was made in the construction of a new library that will provide much needed program space and allow for the relocation and consolidation of the library collection. The library, the recently completed central plant, a service and maintenance building, and the ongoing renovations to other existing buildings comprise a comprehensive multi-year capital construction and renewal program currently underway at Dumbarton Oaks.

RENOVATION AND RENEWAL

With a physical plant whose history spans nearly four centuries, the University is committed to renovation and renewal as a means of preserving its architectural assets and creatively adapting space to meet evolving needs. Investment in the existing physical plant represented 42% of total capital expenditures in fiscal 2005.

Renovations completed in September 2005 at Memorial Church included replacement of the slate roof and installation of a new heating, ventilation, and air conditioning system, among other necessary repairs and safety improvements to maintain this historic building. Major renovations to Loeb House began late in the fiscal year, striving to preserve yet modernize the building in a manner appropriate for its use by the Office of the Governing Boards.

The Radcliffe Institute for Advanced Study completed renovations at Schlesinger Library in January 2005. In addition to reviving some of its historic spaces and adding systems to ensure the long-term preservation of the library's collections, the project included installation of many modern amenities for students and researchers. The Institute also began renovating the Radcliffe Gym. The Gym will be converted into a spacious lecture hall for fellows' presentations and other events, as well as office space for Institute staff. This project is the second phase of the Radcliffe capital plan and is an important step in co-locating central meeting spaces and the core of the fellowship intellectual activities, as well as the overall consolidation of Institute staff, fellows, and programs into Radcliffe Yard.

University Operations Services (uos) began work on two significant projects at Blackstone Station, the primary source of power for over 200 Harvard buildings on both the Cambridge and Allston campuses. An office renovation project will refurbish the existing service building space and consolidate uos operations at the Blackstone location. A second Blackstone project will replace the 1930-vintage steam plant boiler and associated support equipment to ensure reliable, efficient, and environmentally responsible steam production to support campus power demands.

At Harvard Business School (HBS), Baker Library renovations were completed in September 2005. The historic lobby, reading room, and north facade were restored, and a new space was constructed to accommodate faculty, library, and research offices as well as book stacks, seminar rooms, and informal student gathering spaces. Aldrich Hall renovations were also completed, updating a total of 16 classrooms over two years with state-of-the-art technology while refurbishing the adjacent hallways and study alcoves. The renovation of Hamilton Hall, which began in fiscal 2005, will convert the existing space to 72 single rooms with private baths, several small kitchenettes, and group study rooms.

At the Law School, renovations concluded at Harkness Commons, resulting in improved dining facilities and social gathering spaces. Also at HLS, the Hemenway Gymnasium project, a joint effort of HLS, FAS, and the Athletic Department, was completed. The renovation included rebuilding three squash courts to international size, consolidating and upgrading the locker rooms, and creating an expanded state-of-theart fitness facility.

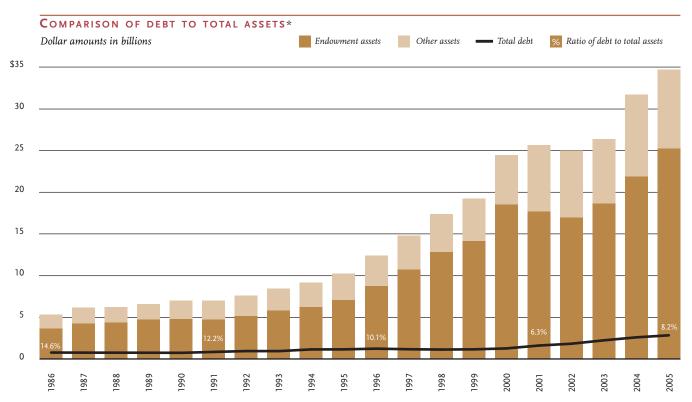
Several projects aimed to improve the overall undergraduate student experience at the University. Work on the Malkin Athletic Center (MAC) was completed prior to the beginning of the 2004-05 academic year, and the Quadrangle Recreational Athletic Center (QRAC) renovations concluded in September 2005. The MAC now has an expanded exercise space and new athletic equipment. Changes to the QRAC combined improvements to the athletic facility with renovation of space for a dance studio and performance center. One of the QRAC's basketball courts was converted into a two-level dance space, including a practice studio, green room, changing room, and costume storage space. Additionally, the building's cardiovascular exercise area was reconfigured and refurbished.

Renovations also occurred at Hilles Library, Widener Library, and Sever Hall. Hilles Library was consolidated to one floor, freeing space for student organization offices and meeting areas. The library project was completed in October 2005. Other Hilles renovations are expected to resume later in fiscal 2006.

The Widener Library project was completed, resulting in reconfigured administrative spaces and two new reading rooms. Original architectural features and finishes were restored throughout Widener. The periodicals and reading rooms on the first floor were renovated, a microform reading room adjacent to the periodicals room was created, and the second floor reading room was restored to its original configuration. Sever Hall improvements were completed in September 2005 and included work on both the exterior and interior of the historic building. The fourth floor of Sever is now dedicated to the Visual and Environmental Studies department and includes three new screening rooms, two studio classrooms, and faculty and staff offices, in addition to video-viewing stations and a new library.

Other renovation projects included Loker Commons, the Dunster and Mather dining halls, and the new College Theater, formerly known as the Hasty Pudding building. The reconfiguration of Loker Commons concluded at the beginning of the 2004-05 academic year, adding a late night grill and

providing space for undergraduate student gatherings and functions. Finalized in September 2005, the Dunster and Mather improvements mark the last of the University's multi-year series of dining hall renovations. The kitchen shared by both Dunster and Mather Houses was outfitted with the latest energy-efficient technologies. Also, the dining halls were redesigned, providing students with improved traffic-flow serving areas, modernized facilities, and beautified eating spaces. Late in fiscal 2005, renovation plans for the new College Theater were finalized. Three quarters of the structure will be razed, and the historic front facade will be preserved and restored. In addition to a comprehensive renovation, this project will create a high quality theater for undergraduates with improved support space, rehearsal rooms, and student offices. The renovated new College Theater building will enable students to stage public performances and learn theater craft in a contemporary facility, while also helping to satisfy the high demand for student performance space.



^{*} Assets are net of pledges, interests in perpetual trusts, and securities pledged to counterparties.

Annual report of the Harvard Management Company

Harvard Management Company (HMC), a wholly owned subsidiary of Harvard University, was founded in 1974 to manage the University's endowment, pension assets, working capital, and deferred giving accounts. HMC is governed by a Board of Directors that is appointed by the President and Fellows of the University.

As of June 30, 2005, HMC managed \$31.4 billion, of which \$29.4 billion resided in the General Investment Account (GIA), a pooled fund that consists primarily of endowment assets. The information presented in this report relates to the GIA.

THE POLICY PORTFOLIO

The cornerstone for the management of the GIA is the Policy Portfolio, 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 actual portfolio is measured. The components of the Policy Portfolio at the end of fiscal 2005 are shown below:

TOTAL	100%
Cash	(5)
Inflation-indexed bonds	6
Foreign bonds	5
Domestic bonds	11
Real estate	10
Commodities	13
High-yield securities	5
Absolute return funds	12
Private equities	13
Emerging markets	5
Foreign equities	10
Domestic equities	15%

Several points about the Policy Portfolio are worth noting. First, it is a diversified portfolio with an attractive expected return-to-risk ratio. It includes a higher allocation to foreign securities and commodity-based assets and a lower allocation to domestic fixed-income assets than the typical institutional fund. Second, while performance will be measured against the Policy Portfolio, the actual asset mix in the portfolio may differ from the Policy Portfolio at any point in time. For instance, if domestic equities are perceived to be overvalued, the actual portfolio may hold only 12% in domestic equities compared with the 15% weight in the Policy Portfolio. If these tactical asset allocation decisions are correct, on balance, the actual portfolio will tend to outperform the Policy Portfolio. Also, if нмс succeeds in outperforming the benchmarks for the individual asset classes (for example, the Lehman 5+ year Treasury Index for the domestic bond sector), the actual portfolio will outperform the Policy Portfolio. The Policy Portfolio is regularly reviewed and modifications are made periodically in light of experience and changing circumstances.

FISCAL 2005 INVESTMENT RESULTS

Total return on the GIA for the year ended June 30, 2005 was 19.2%, calculated on a time-weighted basis. This return is net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers, and compares with a 14.2% return on the Policy Portfolio.

The table below shows total return on the GIA for each of the past ten years. The Policy Portfolio is shown for comparison, as is the Trust Universe Comparison Service (TUCS) Median, a universe of more than 100 funds with assets of over \$1.0 billion. As the numbers indicate, endowment returns on average have exceeded returns on the Policy Portfolio and the TUCS Median by a substantial margin.

TOTAL RETURN			
	Harvard	Policy	TUCS
Fiscal year	GIA*	portfolio	median
1996	26.0%	22.3%	17.6%
1997	25.8	20.0	20.3
1998	20.5	17.1	17.9
1999	12.2	18.9	11.2
2000	32.2	18.6	10.4
FIVE-YEAR ANNUAL RATE	23.2	19.4	15.4
2001	(2.7)	(9.8)	(5.7)
2002	(0.5)	(4.5)	(5.9)
2003	12.5	8.3	4.0
2004	21.1	16.4	16.2
2005	19.2	14.2	10.5
FIVE-YEAR ANNUAL RATE	9.5	4.4	3.6
TEN-YEAR ANNUAL RATE	16.1%	11.6%	9.4%

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

ASSET ALLOCATION

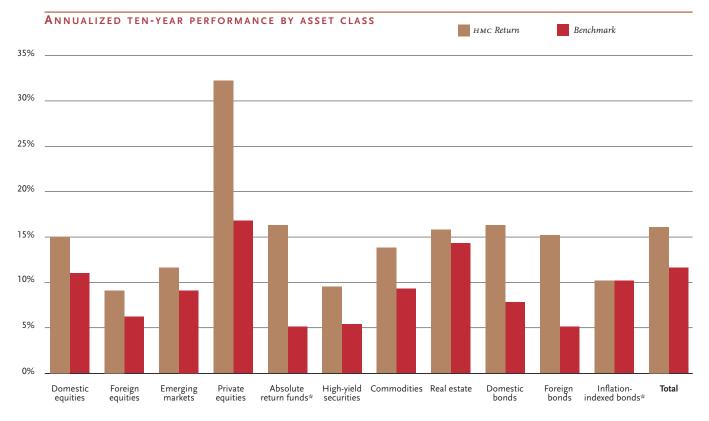
The table below shows the breakdown by asset category of the General Investment Account as of June 30, 2005 and 2004 (dollar amounts in millions):

	2	005	20	2004	
Domestic equities	\$ 5,332	18.2%	\$ 4,779	18.8%	
Foreign equities	3,848	13.1	3,447	13.6	
Emerging markets	1,782	6.0	1,829	7.2	
Private equities	2,358	8.0	1,968	7.7	
Subtotal	13,320	45.3	12,023	47.3	
Absolute return funds	3,837	13.1	2,907	11.4	
High-yield securities	1,831	6.2	1,497	5.9	
Commodities	3,675	12.5	2,986	11.8	
Real estate	1,940	6.6	1,420	5.6	
Subtotal	11,283	38.4	8,810	34.7	
Domestic bonds	2,411	8.2	1,708	6.7	
Foreign bonds	1,192	4.1	826	3.3	
Inflation-indexed bonds	1,589	5.4	1,446	5.7	
Cash	(417)	(1.4)	595	2.3	
Subtotal	4,775	16.3	4,575	18.0	
TOTAL	\$ 29,378	100.0%	\$ 25,408	100.0%	

RESULTS BY ASSET CLASS

Annualized ten-year performance by asset class is shown in the graph below. The graph provides the University's annualized returns, net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers, as well as the performance of the relevant benchmark. All

returns are calculated on a time-weighted basis with the exception of private equities, real estate, and commodities, which are calculated on a dollarweighted basis. Individual benchmarks are representative of each asset class and are approved by the Board of Directors.



^{*} Absolute return funds and inflation-indexed bonds have been held for less than ten years. For these asset classes, the нмс return and the benchmark reflect annualized performance of 6.75 years and 6.00 years, respectively.

RISK MANAGEMENT

The active management of a diverse portfolio involves inherent risks essential to meeting the long-term return objectives of the endowment. The primary risk factors include market risk, credit risk, liquidity risk, and operational risk. The management of these risks is the responsibility of the Board of Directors, its subcommittees, and senior management, who determine the objectives and policies that guide the management of the endowment. Subcommittees include the Corporate Governance and Nomination Committee, the Finance Committee, the Valuation Committee, the Compliance Committee, and the Compensation Committee.

Collectively, HMC has implemented a series of risk management processes to identify and quantify the risks to which the University is exposed, establish the proper mitigating controls, and monitor compliance with risk mitigation strategies. Risk management techniques are structured around fundamental principles including clearly defined policies and procedures; segregation of duties with clear reporting lines; strong management information systems, measurement, and analytical tools; disciplined relationship management; and independent review.

- 1) 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 tests are also conducted to determine how potential changes in market conditions could impact the market risk of the portfolio.
- 2) 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 creditworthy and requires collateral to the maximum extent possible. Limits are established for each counterparty based on their creditworthiness.
- 3) 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 managed actively 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.

4) 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.

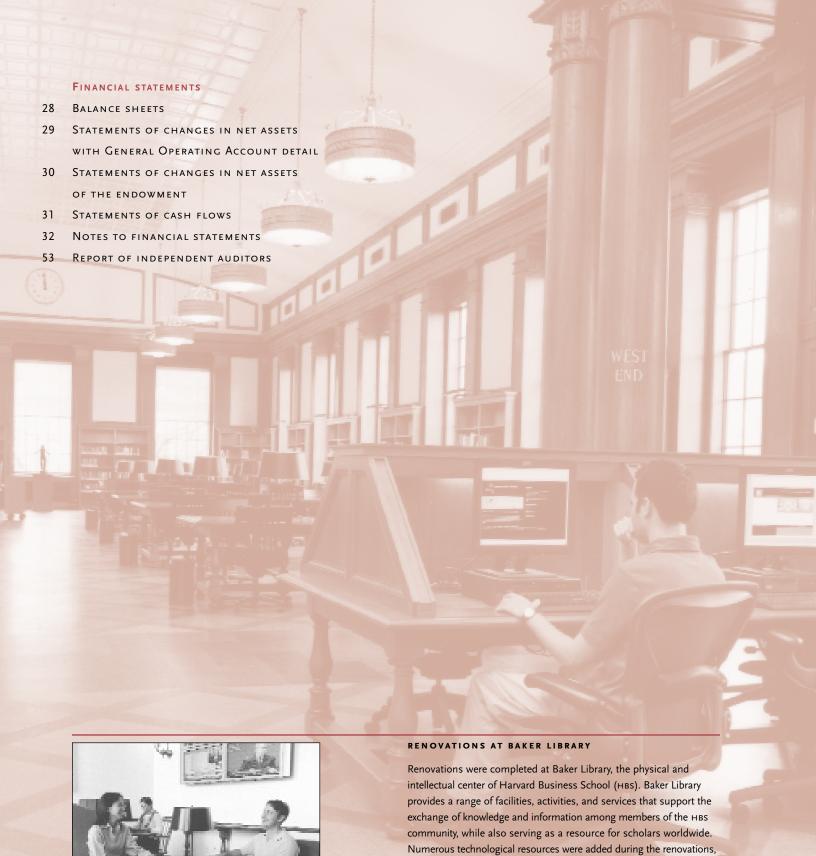
Jack Meyer, President and CEO of HMC since 1990, and the fixed income management team departed October I, 2005 to form their own firm. Mohamed A. El-Erian, currently a Managing Director at Pacific Investment Management Company (PIMCO), has been appointed President and Chief Executive Officer of HMC, commencing early in 2006. Peter Nadosy, an HMC Board member and former President of Morgan Stanley Asset Management, is serving as Interim Chief Investment Officer until Mr. El-Erian assumes his post.

James F. Rothenberg

James & Rotten

CHAIR

HMC BOARD OF DIRECTORS



including advanced research tools and "The Exchange," a gathering place where students, faculty, and staff can view and discuss the latest business and financial news from around the globe.

Balance sheets

with summarized financial information as of June 30, 2004

		June 30	
In thousands of dollars	2005	2004	
ASSETS:			
Cash and cash equivalents (Notes 3 and 4)	\$ 1,565,629	\$ 1,404,626	
Working capital investments, at market (Notes 3 and 4)	2,383,781	1,866,964	
Receivables, net (Note 5)	171,616	159,112	
Prepayments and deferred charges	77,810	64,686	
Notes receivable, net (Note 6)	269,544	257,161	
Pledges receivable, net (Note 7)	644,843	721,803	
Fixed assets, net (Note 8)	3,797,838	3,468,897	
Interests in perpetual trusts held by others (Note 9)	251,917	245,277	
Investment portfolio, at market (Notes 3 and 4)	26,418,985	24,472,444	
Market value of securities pledged to counterparties (Notes 3 and 4)	19,947,959	27,401,077	
TOTAL ASSETS	55,529,922	60,062,047	
LIABILITIES:			
Accounts payable	401,049	437,348	
Deposits and other liabilities	356,256	293,753	
Securities lending and other liabilities associated with investment portfolio (Notes 3 and 4)	20,343,700	28,897,526	
Liabilities due under life income fund agreements (Note 10)	568,112	492,138	
Bonds and notes payable (Note 11)	2,849,129	2,604,714	
Pension and other accrued retirement obligations (Note 12)	396,399	343,282	
Government loan advances (Note 6)	56,856	56,045	
TOTAL LIABILITIES	24,971,501	33,124,806	
NET ASSETS	\$ 30,558,421	\$ 26,937,241	

		Temporarily	Permanently		June 30		
	Unrestricted	restricted	restricted	2005	2004		
NET ASSETS:				-			
General Operating Account (Note 13)	\$ 3,061,167	\$ 1,054,561	\$ 81,866	\$ 4,197,594	\$ 3,935,474		
Endowment (Note 9)	4,032,215	17,899,424	3,921,409	25,853,048	22,587,305		
Life income funds (Note 10)	0	164,355	343,424	507,779	414,462		
TOTAL NET ASSETS	\$ 7,093,382	\$ 19,118,340	\$ 4,346,699	\$ 30,558,421	\$ 26,937,241		

 $\label{the accompanying notes are an integral part of the financial statements.$

Statements of changes in net assets with General Operating Account detail

with summarized financial information for the year ended June 30, 2004 For the year ended Temporarily June 30 Permanently In thousands of dollars Unrestricted restricted restricted 2005 2004 REVENUE: Student income: 200,047 200,047 190,619 Undergraduate program Graduate programs 307,695 307,695 287,102 112,609 106.736 Board and lodging 112,609 155,113 145,281 Continuing education and executive programs 155.113 Scholarships applied to student income (Note 14) (189,000)(189,000)(173,437)0 0 Total student income 586,464 586,464 556,301 Sponsored research support (Notes 15 and 16): Federal government—direct costs 367.600 342.026 367.600 Federal government-indirect costs 143,457 143,457 131.474 Non-federal sponsors—direct costs 31,306 71,926 103,232 106,621 Non-federal sponsors—indirect costs 6,606 5,545 12,151 9,048 0 77,471 Total sponsored research support 548,969 626,440 589,169 Gifts for current use (Note 16) 97,993 89,779 187,772 153,518 Investment income: Endowment income distributed for operations (Note 9) 854,757 807.645 134,895 719,862 Income on working capital investments distributed for operations 115,648 7,929 123,577 111,833 Interest received on student, faculty, and staff loans 6,232 6,232 6,544 Total investment income 256,775 727,791 0 984,566 926,022 Other operating income (Note 17) 415.694 415.694 372,696 Net assets released from restrictions (Note 2) 860,135 (860, 135)**TOTAL REVENUE** 2,766,030 34,906 0 2,800,936 2,597,706 **EXPENSES:** 1,093,179 1,093,179 1,036,028 Salaries and wages Employee benefits (Note 12) 313,844 313,844 304.281 Scholarships and other student awards (Note 14) 94,116 94,116 89,414 Supplies and equipment 206,660 206,660 187.362 296,125 265.821 Space and occupancy 296,125 Depreciation (Note 8) 196,563 196,563 182,138 556,886 Other expenses (Note 18) 556,886 495,875 TOTAL EXPENSES 2,757,373 0 0 2,757,373 2,560,919 **NET REVENUE** 34,906 0 36,787 8.657 43.563 OTHER PROVISIONS AND CREDITS: Change in appreciation, net of operating distribution 20,196 8,808 29,004 449,699 Change in undistributed general investment income 82,144 126,203 208,347 (66,848)TOTAL OTHER PROVISIONS AND CREDITS 102,340 135.011 0 237,351 382,851 **CAPITAL CHANGES:** Net change in pledge balances (Note 7) (11,889)(11,889)(10,098)836 29,790 Capital gifts for loan funds and facilities (Note 16) 10,401 11,237 Transfers between General Operating Account and endowment 73,949 (97,106)(334)(23,491) 51,135 Transfers between General Operating Account and life income funds (Note 10) 5,335 14 5,349 5,632 Non-operating net assets released from restrictions (Note 2) 51,846 (53,044)1,198 0 **TOTAL CAPITAL CHANGES** 125,795 (146,303)1,714 (18,794)76,459 GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR 236,792 23,614 1,714 262,120 496,097 Endowment net change during the year 657,580 2,443,322 164,841 3,265,743 3,292,570 Life income funds net change during the year (Note 10) 24,107 69,210 93,317 52,318 **NET CHANGE DURING THE YEAR** 2,491,043 894,372 235,765 3,621,180 3,840,985 Net assets, beginning of year 6.199.010 16,627,297 4.110.934 26,937,241 23,096,256 NET ASSETS, end of year \$ 7,093,382 \$ 19,118,340 \$ 4,346,699 \$ 30,558,421 \$ 26,937,241

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, 2004

with summarized financial information for the year ended June 30, 20				Tomomomomiles		Downson on the		For the y	or the year ended	
T .1 1 C 1 11		1		emporarily	•		_		1e 30	
In thousands of dollars	Uni	restricted		restricted		restricted		2005		2004
Gifts for capital (Note 16)	\$	11,170	\$	41,079	\$	233,410	\$	285,659	\$	257,767
Investment return (Notes 3, 4, and 9):										
Endowment income from general investments		59,745		312,151				371,896		192,843
Change in realized and unrealized appreciation during year		643,763		3,029,301				3,673,064		3,607,677
Total investment return		703,508		3,341,452		0		4,044,960		3,800,520
Endowment income distributed for operations	((134,895)		(719,862)				(854,757)		(807,645)
Change in undistributed general investment income		(29,892)		(149,161)				(179,053)		59,681
Net investment return after distributions		538,721		2,472,429		0		3,011,150		3,052,556
Transfers between endowment and General Operating Account:										
Unexpended income capitalized/(decapitalized)		(2,575)		6,537		5,967		9,929		14,985
Gifts capitalized		4		12,508		399		12,911		3,699
Other		(71,378)		78,061		(6,032)		651		(69,819)
Total transfers		(73,949)		97,106		334		23,491		(51,135)
Capitalization of life income funds (Note 10)				4,426		8,070		12,496		9,472
Net change in endowment pledge balances (Note 7)				(7,404)		(56,925)		(64,329)		(1,588)
Net change in interests in perpetual trusts held by others (<i>Note 9</i>)				, , ,		6,640		6,640		29,960
Other changes		(6)		(9,101)		(257)		(9,364)		(4,462)
Net assets released from restrictions (Note 2)		181,644		(155,213)		(26,431)		0		0
NET CHANGE DURING THE YEAR		657,580		2,443,322		164,841		3,265,743		3,292,570
Net assets of the endowment, beginning of year	3,	374,635		15,456,102		3,756,568	- 2	22,587,305	1	9,294,735
NET ASSETS OF THE ENDOWMENT, end of year	\$ 4,0	032,215	\$	17,899,424	\$:	3,921,409	\$ 2	25,853,048	\$2	2,587,305

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

Statements of cash flows

		ne year ended June 30
In thousands of dollars	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 3,621,180	\$ 3,840,985
Adjustments to reconcile change in net assets to net cash provided by/(used by) operating activities:		
Provision for depreciation	196,563	182,138
Increase in pension and retirement obligations	53,117	65,029
Increase in interests in perpetual trusts held by others	(6,640)	(29,960)
Increase in liabilities due under life income fund agreements	75,974	72,723
Net gain on sale of investments	(2,980,921)	(2,157,674)
Net unrealized appreciation on investments	(1,417,186)	(2,069,157)
Gifts restricted for capital purposes	(372,830)	(352,870)
Changes in operating assets and liabilities:		
Working capital investments	(516,817)	(984,589)
Receivables, net	(12,504)	40,344
Prepayments and deferred charges	(13,124)	1,574
Pledges receivable, net	76,960	10,912
Accounts payable	(36,299)	22,467
Deposits and other liabilities	62,503	36,605
NET CASH PROVIDED BY/(USED BY) OPERATING ACTIVITIES	(1,270,024)	(1,321,473)
CASH FLOWS FROM INVESTING ACTIVITIES: Loans made to students, faculty, and staff Payments received on student, faculty, and staff loans	(52,184) 42,406	(51,425) 53,498
Increase in other notes receivable	(2,605)	(296)
Proceeds from sale of investments	27,778,809	33,928,651
Purchase of investments	(17,741,834)	(26,116,555
Additions to fixed assets	(525,504)	(482,609
NET CASH PROVIDED BY/(USED BY) INVESTING ACTIVITIES	9,499,088	7,331,264
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of debt	629,901	371,913
Debt repayments	(385,486)	(14,109)
Gifts restricted for capital purposes	372,830	352,870
Advances under security lending agreements	5,897,964	15,708,183
Payments under security lending agreements	(14,584,081)	(22,771,455
Increase in government loan advances	811	590
NET CASH PROVIDED BY/(USED BY) FINANCING ACTIVITIES	(8,068,061)	(6,352,008)
NET CHANGE IN CASH AND CASH EQUIVALENTS	161,003	(342,217
Cash and cash equivalents, beginning of year	1,404,626	1,746,843
CASH AND CASH EQUIVALENTS, end of year	\$ 1,565,629	\$ 1,404,626

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

1. UNIVERSITY ORGANIZATION

Harvard University (the "University") is a private, not-forprofit institution of higher education with approximately 6,950 undergraduate and 12,780 graduate students. Established in 1636, the University includes the Faculty of Arts and Sciences, ten graduate and professional Schools, the Radcliffe Institute for Advanced Study, the Division of Continuing Education, a variety of research museums and institutes, and an extensive library system to support the teaching, learning, and research activities of the Harvard community. The President and Fellows of Harvard College (the "Corporation"), a governing board of the University, has oversight responsibility for all of the University's financial affairs. The Corporation delegates substantial authority to the Schools and departments for the management of their individual resources and operations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

Revenues 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" in the Statements of Changes in Net Assets with General Operating Account Detail. Net revenue is the measure of operating activity of the University.

Revenue from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Income earned by restricted fund and gift accounts is initially classified as temporarily restricted 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 (see *Note 7*). Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor 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*. Funds transferred to the University on behalf of specific beneficiaries are reported as agency transactions in the *Balance Sheets* and are not included in the *Statements of Changes in Net Assets*.

The *Balance Sheets* display both the assets and corresponding liabilities generated by securities lending transactions. These transactions are executed to support the investment activities of Harvard Management Company. 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*.

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.

There are certain trusts, held by third parties, in which Harvard has an interest where the University has not been provided with sufficient documentation to record the interest. The University's policy is to record such interest when it is estimable and adequate information is obtained.

The University, together with the Harvard-affiliated teaching hospitals, has formed a captive insurance company that arranges and provides professional liability, general liability, and medical malpractice insurance for its shareholders. Defined portions of claims paid by this company are self-insured. The University also maintains self-insurance programs for automobile liability, property, and workers' compensation. All these programs are supplemented with commercial excess insurance above the University's self-insured retention. In addition, the University is

self-insured for unemployment, life insurance, disability, the primary senior health plan, and, as of January 1, 2005, all health plans for active employees. The University's claims liabilities are recognized as claims are incurred, including claims incurred but not reported, and are included in operating expenses.

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

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates. The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2004, from which the summarized information was derived. Certain prior year amounts have been reclassified to conform to current year presentation.

3. POOLED GENERAL INVESTMENTS

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

- A) Investments are presented at fair market value based on trade date positions as of June 30. Instruments listed or traded on a securities exchange are valued at the last sale price on the primary exchange where the security is traded. Investments in publicly traded securities that are subject to restrictions limiting their salability are discounted from the current public market price to levels that reflect the estimated cost of those restrictions. Non-exchange traded debt instruments are valued 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 valued using models with externally verifiable model inputs, or by using independent broker quotes. Private equity, real estate, commodities, and absolute return funds consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are valued utilizing the most current information provided by the general partner. Direct investments are valued utilizing discounted cash flow and other industry standard methodologies. Where applicable, independent appraisers and engineers are utilized to assist in the valuation. These values are determined under the direction of, and subject to approval by, the Valuation Committee of the Harvard Management Company Board of Directors.
- B) The preparation of 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 funds, private equities, real estate, and certain commodities. Values for these instruments are often estimated using techniques such as discounted cash flow analysis and comparisons to similar instruments. Estimates developed using these methods are subjective and require judgment regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Estimates, by their nature, are based on judgment and available information. Changes in assumptions could have a significant effect on the fair value of these instruments. Actual results could differ from these estimates and could have a material impact on the financial statements.

- c) The University amortizes bond premiums and accretes bond discounts.
- D) The University utilizes a number of subsidiary entities to support the investment activities of the endowment. The consolidated financial statements include all assets and liabilities associated with these entities.
- 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 University's investment strategy incorporates a diversified asset allocation approach and maintains, within defined limits, exposure to the movements of the world equity, fixed-income, commodities, real estate, and private equity markets. 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 following table. 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 actual portfolio 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 on the asset or liability sections of the following table.

The following table delineates securities pledged to counterparties, where the counterparty has the right, by contract or custom, to sell or repledge the securities. The fair value of collateral pledged to counterparties that cannot be sold or repledged as of June 30, 2005 was \$967.9 million and as of June 30, 2004 was \$688.5 million. The fair value of collateral accepted by the University as of June 30, 2005 was \$4,468.6 million and as of June 30, 2004 was \$3,757.1 million. The portion of this collateral that was sold or repledged as of June 30, 2005 was \$3,007.7 million and as of June 30, 2004 was \$1,020.8 million.

The summarization of pooled general investment assets and liabilities as of June 30, 2005 and 2004 is as follows (in thousands of dollars):

	2	005		2004
ASSETS:				
Investments:				
Domestic equity and convertible securities	\$ 5,862,131		\$ 4,462,050	
Securities pledged to counterparties	232,511	6,094,642	169,540	4,631,590
Foreign equity and convertible securities	3,882,131		2,892,546	
Securities pledged to counterparties	504,233	4,386,364	590,064	3,482,610
Domestic fixed-income securities	209,902		75,442	
Securities pledged to counterparties	2,269,130	2,479,032	2,349,446	2,424,888
Foreign fixed-income securities	121,935		12,155	
Securities pledged to counterparties	653,828	775,763	137,547	149,702
Emerging markets equity and debt	1,194,241		1,636,487	
Securities pledged to counterparties	26,110	1,220,351	17,449	1,653,936
High-yield securities	1,235,380		814,259	
Securities pledged to counterparties	287,559	1,522,939	361,971	1,176,230
Absolute return funds		3,209,874		2,630,057
Private equities		2,357,811		1,980,619
Real estate		1,891,734		1,457,203
Commodities		3,301,986		2,197,088
Inflation-indexed bonds	537,182		353,654	
Securities pledged to counterparties Total investments	1,000,138	1,537,320 28,777,816	973,030	1,326,684 23,110,607
Financial instruments purchased under hedge transactions:				
Equity and convertible securities	2,327,607		1,393,766	
Securities pledged to counterparties	57,606	2,385,213	59,617	1,453,383
re 1:	1 011 604		1 262 007	
Fixed-income securities	1,011,684	15 750 245	1,263,807	22 007 107
Securities pledged to counterparties	14,746,561	15,758,245	22,733,300	23,997,107
Options		1,273,354		2,268,210
Commodities		15,584		336,965
Total financial instruments purchased under hedge transactions		19,432,396		28,055,665
C.11.1		1 747 022		1 105 050
Collateral advanced under security borrowing agreements	000 100	1,747,923	1.005.257	1,195,850
Cash and short-term investments	999,190	1 160 472	1,085,357	3 004 470
Securities pledged to counterparties	170,283	1,169,473	9,113	1,094,470
Accounts receivable/(payable), net ²		(1,405,956)		848,595
POOLED GENERAL INVESTMENT ASSETS		49,721,652		54,305,187
LIABILITIES:				
Financial instruments sold, not yet purchased, under hedge transactions:				
Equity and convertible securities		1,246,460		697,407
Fixed-income securities		468,383		424,267
Options		285,941		746,820
Total financial instruments sold, not yet purchased, under hedge transactions		2,000,784		1,868,494
Cash collateral held under security lending agreements ³		18,342,916		27,029,032
POOLED GENERAL INVESTMENT LIABILITIES		20,343,700		28,897,526
POOLED GENERAL INVESTMENT NET ASSETS		\$ 29,377,952		\$ 25,407,661

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.

¹ The collateral advanced under security borrowing agreements is in the form of cash.
2 As of June 30, 2005, accounts receivable and payable related to undistributed income and purchases and sales of securities were \$712,686 and \$2,118,642, respectively. The amounts at June 30, 2004 were \$1,547,256 and \$698,661, respectively. As of June 30, 2005, of the \$712,686 of accounts receivable, gross receivables relating to offbalance sheet instruments were \$112,603, and of the \$2,118,642 of accounts payable, gross payables relating to off-balance sheet instruments were \$1,231,324. As of June 30, 2004, of the \$1,547,256 of accounts receivable, gross receivables relating to off-balance sheet instruments were \$787,463, and of the \$698,661 of accounts payable, gross payables relating to off-balance sheet instruments were \$220,529.

The University uses a variety of financial instruments with off-balance sheet risk involving contractual or optional commitments for future settlement. These include futures, options, interest rate exchange agreements, interest rate cap and floor agreements, and forward purchase and sale agreements, which are exchange traded or executed over the counter. These instruments are primarily used in the arbitrage strategies that enhance the returns of certain asset classes without increasing the market risk to the underlying asset class (see "hedged" market exposure in the following tables). The market risk of a strategy is influenced by the relationship between the financial instruments with off-balance sheet risk and the offsetting positions recorded on the Balance Sheets. The University controls market risk through the use of industry standard analytical tools that measure the market exposure of each

position within a strategy. The strategies are monitored daily and positions are frequently adjusted in response to changes in the financial markets. Financial instruments with off-balance sheet risk are also used by the University to adjust the market exposure of a given asset class without changing the underlying instruments in the core investment portfolio (see "unhedged" market exposure in the following tables).

The following table summarizes the market exposure (expressed in cash market equivalents as discussed on the following page), net ending fair value, net average fair value, and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2005 (in thousands of dollars):

				Net ending	fair value of	Net	
		Market exposu	re	off-balance s	heet positions	average	
	Long	Long	Short			fair	Credit
	unhedged	hedged	hedged	Unhedged	Hedged	value	exposure ³
Equity futures	\$ 225,450	\$ 0	\$ (566,336)	\$ 0	\$ 1,148	\$ 1,071	\$ 40,026
Equity options	26,133	128,171	(159,872)	26,133	34,952	55,472	3,746
Equity exchange agreements	583,699	8,521	(809,079)	27,993	(18,302)	10,526	856
Total equity instruments	835,282	136,692	(1,535,287)	54,126	17,798	67,069	44,628
Fixed-income futures	0	0	(225,459)	0	321	253	321
Fixed-income options	0	473,098	(3,124,060)	0	379,164	572,964	274
Interest exchange agreements	124,678	1,901,762	(18,683,492)	1,079	(953,654)	(350,508)	0
Interest rate caps and floors	119,853	9,688,425	(1,848,720)	3,022	94,832	267,012	1,784
Total fixed-income instruments	244,531	12,063,285	(23,881,731)	4,101	(479,337)	489,721	2,379
Commodity futures	0	0	(77,613)	0	0	0	398
Commodity options	0	9	(10)	0	(60)	25,926	0
Commodity exchange agreements	1,168,997	0	(34,806)	0	183	9,125	80
Total commodity instruments	1,168,997	9	(112,429)	0	123	35,051	478
Currency forwards	1,028,901	973,103	(2,009,843)	(7)	(7,833)	(6,353)	974
Currency options	0	2,554,030	(509,310)	0	236,159	376,085	0
TOTAL	\$ 3,277,711	\$ 15,727,119	\$ (28,048,600)	\$ 58,220	\$ (233,090)	\$ 961,573	\$ 48,459

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

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

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

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

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

Financial instruments with off-balance sheet risk necessarily involve counterparty credit exposure. The policy of the University is to require collateral to the maximum extent possible under normal trading practices. Collateral is moved on a daily basis as is required by fluctuations in the market. The collateral is generally in the form of debt obligations issued by the U.S. Treasury. In the event of counterparty default, the University has the right to use the collateral to offset the loss associated with the replacements of the agreements. The University enters into arrangements only with counterparties believed to be creditworthy.

Specific credit limits are established for 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 entered into debt service put agreements in connection with its real estate investments. Under specific circumstances, these put agreements grant those who lend to certain investments held in these portfolios the right to sell senior secured loans to the University at a designated price. These put agreements have been valued by the University under policies previously described. The University has also entered into agreements,

primarily with private equity partnerships, that require periodic cash contributions totaling approximately \$3,461.2 million through fiscal 2015.

For the year ended June 30, 2005, the total return on the pooled general investments was 19.2%, or \$4,777.6 million, net of all expenses and fees, and including the impact of revenue-sharing agreements with certain fund managers. This compares with 21.1%, or \$4,391.7 million, in fiscal 2004 (see *Note 4*).

Subsequent to June 30, 2005, the University entered into an agreement to sell a significant portion of timber assets in a single transaction.

4. INVESTMENT HOLDINGS

The University's investment holdings as of June 30, 2005 and 2004 are summarized in the following tables (in thousands of dollars):

TOTAL INVESTMENT HOLDINGS	\$ 29,377,952	\$ 594,702	\$ 29,972,654	\$ 26,247,585
with the investment portfolio	(20,343,700)	0	(20,343,700)	(28,897,526
Securities lending and other liabilities associated				
Securities pledged to counterparties	19,947,959	0	19,947,959	27,401,077
Investment portfolio	26,364,782	54,203	26,418,985	24,472,444
Short-term investments*	\$ 3,408,911	\$ 540,499	\$ 3,949,410	\$ 3,271,590
	investments	investments	Total	Total
	general	Other		
	Pooled			
		2005		2004

Investment holdings are comprised of:

-		2005		
	Pooled			
	general	Other		
	investments	investments	Total	Total
Short-term investments*	\$ 3,408,911	\$ 540,499	\$ 3,949,410	\$ 3,271,590
Endowment investments	25,192,841	28,963	25,221,804	21,898,372
Life income fund investments	612,218	463,673	1,075,891	906,600
Pension investments, internally designated	24,574	0	24,574	26,772
Postretirement health investments, internally designated	125,997	0	125,997	97,913
Other investments, principally interest rate swaps	13,411	(438,433)	(425,022)	46,338
TOTAL INVESTMENT HOLDINGS	\$ 29,377,952	\$ 594,702	\$ 29,972,654	\$ 26,247,585

Short-term investments include working capital investments and cash and cash equivalents. Cash and cash equivalents of \$1,565,629 and \$1,404,626 as of June 30, 2005 and 2004, respectively, consist principally of funds deposited in cash management accounts with maturities when purchased of fewer than 90 days.

The University employs a unit method of accounting for pooled general investments. Each participating fund enters 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 that participates in the investment pool. Net general investment income distributed during the

year is allocated on a per unit basis to each participating fund (see *Note* 3).

The changes in the market value and income of participating units for the years ended June 30, 2005 and 2004 were as follows:

TOTAL UNIT RETURN PERCENTAGE USING MONTHLY COMPOUNDING*	19.2%	21.19
TOTAL UNIT RETURN ON POOLED GENERAL INVESTMENTS*	\$ 231.16	\$ 212.96
Net income earned on general investments	21.16	10.79
Change in realized and unrealized appreciation	210.00	202.17
Unit value at beginning of year	1,215.68	1,013.51
Unit value at end of year	\$ 1,425.68	\$ 1,215.68
	2005	2004

 $[^]st$ Net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers.

Other investments are managed separately from the pooled general investment account. These investments consist primarily of interest rate exhange agreements (interest rate swaps), fixed-income securities (principally government securities and certificates of deposit held for the University's working capital needs) and various managed bond and equity portfolios associated with life

income funds. Those investments that are not readily marketable are carried either at cost or a nominal value. Income on other investments is recorded and distributed when received.

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

TOTAL RETURN ON INVESTMENTS*	\$ 4,413,887	\$ 4,496,207
Other investment income and gains/(losses)	(363,711)	104,499
Total return on pooled general investments	4,777,598	4,391,708
Investment income	437,903	222,224
Realized and unrealized gains	\$ 4,339,695	\$ 4,169,484
Return on pooled general investments:		
	2005	2004

 $[^]st$ Net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers.

5. RECEIVABLES

The major components of receivables, net of reserves for doubtful accounts of \$3.7 million and \$2.5 million, as of June 30, 2005 and 2004, respectively, were as follows (in thousands of dollars):

	2005	2004
Investment income	\$ 8,953	\$ 0
U.S. Government,		
principally related to research	38,562	36,080
Non-federal sponsored research	6,343	5,044
Students	10,614	9,102
Other	107,144	108,886
TOTAL RECEIVABLES, NET	\$ 171,616	\$ 159,112

6. NOTES RECEIVABLE

Notes receivable as of June 30, 2005 and 2004 were as follows (in thousands of dollars):

TOTAL NOTES RECEIVABLE, NET	\$ 269,544	\$ 257,161
Other notes receivable	22,161	19,556
Faculty and staff notes receivable	118,794	108,994
Total student notes receivable	128,589	128,611
Federally insured loans	8,019	13,149
Institutional loans	59,984	52,251
Government revolving loans	\$ 60,586	\$ 63,211
Student notes receivable:		
	2005	2004

In addition to administering institutional loan programs, the University participates in various federal loan programs. Federally insured loans are generally repaid over a tenyear period and earn interest at an adjustable rate that approximates the 90-day U.S. Treasury Bill rate plus 3.0%. Principal and interest payments on these loans are insured by the American Student Assistance Corporation and are reinsured by the federal government.

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled \$56.9 million and \$56.0 million as of June 30, 2005 and 2004, respectively, and are classified as liabilities. Interest earned on the revolving and institutional loan programs is reinvested to support additional loans. The repayment and interest rate terms of the institutional loans vary considerably.

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

Notes receivable from faculty and staff are comprised primarily of 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.

7. 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, 2005 and 2004 are expected to be realized as follows (in thousands of dollars):

unconcensie proages	(00) (10)	(07,700)
uncollectible pledges	(83,428)	(87,780)
Less: discount and allowance for		
More than five years	240,768	275,599
Between one and five years	390,002	427,187
Within one year	\$ 97,501	\$ 106,797
	2005	2004

A discount of \$36.2 million and \$42.4 million for the years ended June 30, 2005 and 2004, respectively, was calculated using a discount factor based on the appropriate U.S. Treasury Note rate.

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

TOTAL PLEDGES RECEIVABLE, NET	\$ 644,843	\$ 721,803
Endowment	379,327	443,656
General Operating Account balances	265,516	278,147
Loan funds and facilities	34,217	35,270
Non-federal sponsored research	101,049	108,154
Gifts for current use	\$ 130,250	\$ 134,723
	2005	2004

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

8. FIXED ASSETS

Fixed assets are shown at cost or at fair value as of the date of the gift, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The major categories of fixed assets as of June 30, 2005 and 2004 are summarized as follows (in thousands of dollars):

Estimated

			useful life
	2005	2004	(in years)
Housing facilities	\$ 811,923	\$ 798,881	35
Research facilities	1,244,856	1,198,698	*
Classroom and office facilities	926,520	751,653	35
Libraries	340,711	242,057	35
Museums and assembly facilities	210,840	205,579	35
Athletic facilities	109,133	106,274	35
Service facilities	267,911	200,593	35
Other facilities and land	880,943	795,677	**
Construction in progress	288,816	328,749	N/A
Equipment	401,242	334,999	***
Total fixed assets at cost	5,482,895	4,963,160	
Less: accumulated depreciation	(1,685,057)	(1,494,263)	
TOTAL FIXED ASSETS, NET	\$ 3,797,838	\$ 3,468,897	

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

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

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

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

9. ENDOWMENT FUNDS

Harvard's endowment consists of approximately 10,840 separate funds established over many years for a wide variety of purposes. Endowment fund balances, including funds functioning as endowment, are classified and reported as either permanently restricted, temporarily restricted, or unrestricted 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 pooled general investment account (see *Notes 3* and *4*).

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

Endowment funds as of June 30, 2005 and 2004 are summarized below (in thousands of dollars):

	2005				2004
		Temporarily	Permanently		
	Unrestricted	restricted	restricted	Total	Total
Endowment funds	\$ 0	\$ 15,581,397	\$ 3,366,898	\$ 18,948,295	\$ 16,593,304
Funds functioning as endowment:					
Departmental funds	3,065,149	2,123,010	0	5,188,159	4,400,661
University funds	967,066	118,284	0	1,085,350	904,407
Pledge balances	0	76,733	302,594	379,327	443,656
Interests in perpetual trusts held by others	0	0	251,917	251,917	245,277
TOTAL ENDOWMENT FUNDS	\$ 4,032,215	\$ 17,899,424	\$ 3,921,409	\$ 25,853,048	\$ 22,587,305

The University's endowment income distribution policies are designed to preserve the value of the endowment in real terms (after inflation) and to generate a predictable stream of spendable income. Endowment investments are managed to achieve the maximum long-term total return. As a result of this emphasis on total return, the proportion of the annual income distribution funded by dividend and interest income or by capital gains may vary significantly from year to year. Amounts withdrawn from endowment capital gains to fund the fiscal 2005 and 2004 distributions totaled \$767.7 million and \$644.9 million, respectively.

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

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

	Endowment inve	stment returns (dollar a	mounts in thousands)		Distrib	oution rate ^{1,2}
Fiscal	Interest and	Net	Total	Total		As a % of
year	dividends	appreciation	return ³	return % ^{2,3}	Per unit	market value
2005	\$ 371,896	\$ 3,673,064	\$ 4,044,960	19.2%	\$ 60.99	4.3%
2004	192,843	3,607,677	3,800,520	21.1	54.17	4.5
2003	252,524	1,807,171	2,059,695	12.5	49.70	4.9
2002	378,999	(474,416)	(95,417)	(0.5)	47.11	5.1
2001	354,368	(844,638)	(490,270)	(2.7)	45.32	4.8
FIVE-YEAR TOTA	AI \$ 1.550.630	¢ 7 768 858	¢ 9 319 488			

¹Since current year interest and dividends are used to fund the following year's distribution, these represent distribution rates for the following fiscal year.
²Total return %, distribution rate per unit, and distribution rate as a % of market value are calculated in relation to pooled general investments.

³Total return and total return % are net of all expenses and fees, and include the impact of revenue-sharing agreements with certain fund managers.

10. LIFE INCOME FUNDS

As of June 30, 2005, the University held life income funds—pooled funds, gift annuities, and charitable remainder trusts—for approximately 1,900 donors. These funds are held in trust for one or more beneficiaries, and generally pay lifetime income to those beneficiaries, after which the principal is made available to the University in accordance with donor intentions. When a trust is established, life income fund net assets are recorded at fair market value, net of related liabilities for the present value of estimated future payments due to beneficiaries and net of obligations under charitable remainder trusts due to other institutions.

As of June 30, 2005, life income fund assets totaled \$1,075.9 million, with corresponding liabilities for amounts due to beneficiaries of \$473.7 million and amounts due to other institutions of \$94.4 million. Gifts for capital to life income funds are presented at full value. The discounted present value of these gifts was \$27.6 million and \$23.1 million for fiscal 2005 and 2004, respectively. The changes in life income fund net assets for fiscal 2005 and 2004 were as follows (in thousands of dollars):

		2005		2004
	Temporarily	Permanently		
	restricted	restricted	Total	Total
Gifts for capital (Note 16)	\$ 21,659	\$ 54,275	\$ 75,934	\$ 65,313
Investment return:				
Investment income	9,230	18,585	27,815	19,629
Change in realized and unrealized appreciation	44,375	89,359	133,734	98,771
Total investment return	53,605	107,944	161,549	118,400
Payments to annuitants	(16,706)	(33,641)	(50,347)	(43,568)
Life income funds converted to endowment	(4,426)	(8,070)	(12,496)	(9,472)
Life income funds transferred to General Operating Account	(5,335)	(14)	(5,349)	(5,632)
Change in liabilities due under life income agreements	(24,690)	(51,284)	(75,974)	(72,723)
NET INCREASE DURING THE YEAR	24,107	69,210	93,317	52,318
Total life income funds, beginning of year	140,248	274,214	414,462	362,144
TOTAL LIFE INCOME FUNDS, end of year	\$ 164,355	\$ 343,424	\$ 507,779	\$ 414,462

11. BONDS AND NOTES PAYABLE

Bonds and notes payable as of June 30, 2005 and 2004 are summarized as follows (in thousands of dollars):

	Fiscal	Remaining	One-year		
	year	years to	effective	Outstandi	ng principal
	of issue	maturity	interest rate	2005	2004
TAX-EXEMPT BONDS AND NOTES PAYABLE:					
Variable-rate bonds and notes:					
Series L - Weekly	1990	19	4.6%	\$ 71,140	\$ 71,140
Series R - Weekly	2000-2005	45	1.7	117,160	103,670
Series Y - Weekly	2000	30	5.4	117,905	117,905
Series BB - Weekly	2001	29	1.7	196,700	196,700
Series HH - Weekly	2004	29	5.8	92,235	92,235
Series GG-1 - Weekly	2005	24	4.5	205,935	0
Commercial Paper (Series EE)	Various	Various	1.7	318,792	519,434
Total variable-rate bonds and notes			3.2	1,119,867	1,101,084
Fixed-rate bonds:					
Series N	1992	15	6.3	78,848*	78,771
Series P	1995	27	5.5	103,530	104,730
Series Z	2001	11	5.1	101,834*	110,194
Series AA	2001	4	5.5	20,025*	24,769
Series DD	2002	30	5.0	134,884*	134,852
Series FF	2003	32	5.1	275,973*	275,968
Series 2005A	2005	31	5.0	94,205*	0
Radcliffe College Series 1997	1998	1	4.7	175	575
Total fixed-rate bonds			5.2	809,474	729,859
TOTAL TAX-EXEMPT BONDS AND NOTES PAYABLE			4.0	1,929,341	1,830,943
TAXABLE BONDS AND NOTES PAYABLE:					
Commercial paper	Various	Various	5.0	413,031	336,977
Fixed-rate bonds	1992	2	8.1	115,000	115,000
Series CC	2001	26	7.0	247,000	247,000
Series GG-2	2005	8	4.5	58,465	0
TOTAL TAXABLE BONDS AND NOTES PAYABLE			6.0	833,496	698,977
OTHER NOTES PAYABLE	Various	Various	Various	86,292	74,794
TOTAL BONDS AND NOTES PAYABLE			4.6%	\$ 2,849,129	\$ 2,604,714

^{*}Series N, DD, and FF principal are net of \$1.2 million, \$1.0 million, and \$0.2 million of discounts, respectively. Series Z, AA, and 2005A principal include premiums of \$1.7 million, \$0.7 million, and \$5.1 million, respectively.

Interest payments on a cash basis totaled \$94.6 million and \$77.1 million for fiscal 2005 and 2004, respectively. Interest expense was \$96.9 million and \$76.8 million for fiscal 2005 and 2004, 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
2006	\$ 13,960
2007	135,610
2008	20,680
2009	21,535
2010	19,460
Thereafter	1,814,645
TOTAL PRINCIPAL PAYMENTS	\$ 2,025,890

In fiscal 2005, the University issued \$205.9 million in tax-exempt weekly variable-rate Series GG-1 bonds and \$58.5 million in taxable weekly variable-rate Series GG-2 bonds to finance a new research facility. The Series GG-1 and Series GG-2 bonds mature in July 2029 and 2013, respectively. Also in fiscal 2005, the University issued \$94.2 million (including a premium of \$5.1 million) in tax-exempt fixed-rate bonds to finance a range of University capital projects. These Series 2005A bonds mature in 2036.

In fiscal 2005, the sixth tranche of Series R current refunding bonds was issued. This tranche totaled \$13.5 million and brought the total amount outstanding under this series to \$117.2 million. These bonds, which are in a weekly reset variable-rate mode, represent a current refunding of tax-exempt principal payments made throughout the calendar year.

In fiscal 2004, the University initiated its affiliate housing bond program with the issuance of \$92.2 million of Series HH tax-exempt weekly variable-rate bonds. Also in fiscal 2004, the University reauthorized its existing tax-exempt commercial paper program (Series EE). With this action, the authorized limit on the program was raised from \$300.0 million to \$650.0 million.

Based on quoted market prices, the estimated fair value of the University's outstanding bonds and notes payable, including accrued interest, was \$2,837.8 million and \$2,582.7 million as of June 30, 2005 and 2004, 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.

In August 2005, the University issued \$105.6 million (including a premium of \$5.1 million) of tax-exempt fixed-rate bonds. These Series 2005B bonds will mature in 2032. The bonds' proceeds are currently in escrow and will be used to refund the outstanding Series P bonds in November 2005.

Interest rate exchange agreements The University has entered into various interest rate exchange agreements in order to convert variable-rate borrowings to a fixed rate, thereby managing the interest cost and risk associated with its outstanding debt. The interest rate exchange agreements were not entered into for trading or speculative purposes. Under the terms of these agreements, the University pays a fixed rate, determined at inception, and receives a variable rate on the respective notional principal amounts. Each of these exchanges is collateralized, as described in *Note 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 \$3,723.8 million and \$(461.2) million, respectively, as of June 30, 2005 and \$1,376.6 million and \$(58.4) million, respectively, as of June 30, 2004. The substantial increase in the notional amount of agreements outstanding reflects that in December 2004, the University entered into a series of forward interest rate agreements relating to the funding of future University capital projects, including planned development in Allston.

The fair value of these agreements is included in the "Investment portfolio, at market" line in the *Balance Sheets*. The change in unrealized depreciation that was recognized for the interest rate exchange agreements was approximately \$402.8 million and \$61.7 million for fiscal 2005 and 2004, respectively. The loss realized from the monthly settling of these agreements was \$35.5 million and \$28.7 million for fiscal 2005 and 2004, respectively. All unrealized and realized gains and losses from interest rate exchange agreements are included in the "Change in appreciation, net of operating distribution" line in the *Statements of Changes in Net Assets with General Operating Account Detail*.

12. EMPLOYEE BENEFITS

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

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

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

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

was \$709.6 million and \$640.0 million as of June 30, 2005 and 2004, respectively. In addition, the University had internally designated and invested \$24.6 million and \$26.8 million as of June 30, 2005 and 2004, respectively, for its defined benefit pension plans. The University recorded expenses for its defined contribution plans of \$76.8 million and \$61.6 million for fiscal 2005 and 2004, 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, 2005, the University had internally designated and invested \$126.0 million to fund the postretirement health benefit accrued liability of \$371.8 million. As of June 30, 2004, the University had internally designated and invested \$97.9 million to fund an accrued liability of \$316.5 million.

	2005	2004	2005	2004
In thousands of dollars	Pensio	n benefits	Oth	er benefits
CHANGE IN PROJECTED BENEFIT OBLIGATION				
Benefit obligation at beginning of year	\$ 580,457	\$ 583,588	\$ 504,965	\$ 491,656
Service cost	12,783	14,737	19,368	23,080
Interest cost	34,462	34,796	26,554	29,949
Plan participants' contributions	0	0	2,770	2,868
Actuarial (gain)/loss	38,537	(18,941)	(19,062)	(28,247)
Benefits paid	(33,877)	(33,723)	(13,849)	(14,341)
PROJECTED BENEFIT OBLIGATION, end of year	\$ 632,362	\$ 580,457	\$ 520,746	\$ 504,965

The accumulated benefit obligation for pension benefits at June 30, 2005 and 2004 was \$565.6 million and \$495.7 million, respectively.

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	2005	2004	2005	2004
In thousands of dollars	Pension benefits		Othe	r benefits
CHANGE IN PLAN ASSETS				
Fair value of plan assets at beginning of year	\$ 639,952	\$ 575,366	\$ 0	\$ 0
Actual return on plan assets	103,564	98,309	0	0
Employer contributions	0	0	11,079	11,473
Plan participants' contributions	0	0	2,770	2,868
Benefits paid	(33,877)	(33,723)	(13,849)	(14,341)
FAIR VALUE OF PLAN ASSETS, end of year	\$ 709,639	\$ 639,952	\$ 0	\$ 0
ACCRUED BENEFIT LIABILITY				
Funded status	\$ 77,277	\$ 59,494	\$ (520,746)	\$ (504,965)
Unrecognized actuarial (gain)/loss	(72,635)	(51,632)	89,562	120,987
Unamortized unrecognized portion of net obligation at transition	0	0	48,497	54,560
Unamortized prior service cost/(credit)	(29,216)	(34,634)	10,862	12,908
ACCRUED BENEFIT LIABILITY	\$ (24,574)	\$ (26,772)	\$ (371,825)	\$ (316,510)
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT	OBLIGATIONS AS O	F JUNE 30:		
Discount rate	5.25%	6.25%	5.25%	6.25%
Rate of compensation increase	4.00%	4.00%	N/A	N/A

For measurement purposes, a 9.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2006, decreasing gradually to a 5.0% annual rate in 2010 and all years thereafter.

	2005	2004	2005	2004
In thousands of dollars	Pensio	n benefits	Oth	er benefits
COMPONENTS OF NET PERIODIC BENEFIT (INCOME)/COST				
Service cost	\$ 12,783	\$ 14,737	\$ 19,369	\$ 23,080
Interest cost	34,462	34,796	26,554	29,949
Expected return on plan assets and reserves	(46,686)	(48,160)	(7,569)	(6,083)
Amortization of the:				
Unrecognized transition obligation	0	0	6,062	6,062
Recognized prior service (credit)/cost	(5,418)	(5,418)	2,046	2,046
Recognized actuarial (gain)/loss	(2,447)	(3,127)	980	6,620
Net periodic benefit (income)/cost	(7,306)	(7,172)	47,442	61,674
Investment return on invested reserves	5,108	6,068	18,951	15,932
TOTAL PERIODIC (INCOME)/COST	\$ (2,198)	\$ (1,104)	\$ 66,393	\$ 77,606

WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE THE NET PERIODIC BENEFIT (INCOME)/COST FOR THE YEARS ENDED JUNE 30: 6.25% 6.00% 6.00% Discount rate 6.25% Expected return on plan assets for the year 8.00% 7.75% 8.00% 7.75% 4.00% 5.00% 5.00% Rate of compensation increase 4.00%

		Expected			
In thousands of dollars	benefit payments			Part D subsidies	
	Pension		Other		
2006	\$ 33,254	\$	18,189	\$	1,288
2007	33,555		19,717		2,773
2008	34,375		21,195		2,978
2009	35,442		22,675		3,175
2010	36,530		24,189		3,375
2011–2015	206,090		148,535		20,911

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

After calculating 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.

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

	20	25		2004	
	One percentage	One percentage	One percentage	One percentage	
In thousands of dollars	point decrease	point increase	point decrease	point increase	
Effect on total of service cost and interest cost components	\$ (8,051)	\$ 10,522	\$ (9,420)	\$ 12,332	
Effect on the postretirement benefit obligation	(71,540)	89,878	(70,573)	88,900	
ASSET ALLOCATION BY CATEGORY FOR THE PENSION PORTFO	DLIO:	2006 Target	2005 Actual	2004 Actual	
Equity securities	IIO:	50.0%	50.3%	49.3%	
Debt securities		20.0	20.1	20.6	
Real estate		9.0	8.6	8.8	
Other		21.0	21.0	21.3	
TOTAL ALL ASSET CATEGORIES		100.0%	100.0%	100.0%	

The University's investment strategy for the pension portfolio is to manage the assets across a broad and diversified range of investment categories, both domestic and international. The objective is to achieve a risk-adjusted return 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 Medicare Prescription Drug Improvement and Modernization Act of 2003 (the "Act") was signed into law in December 2003. The Act provides certain prescription drug-related benefits for retirees, as well as subsidies for employers providing actuarial equivalent subsidies to their retirees. In January 2004, the Financial Accounting Standards Board (the "FASB") issued a Staff Position permitting companies to defer accounting for the effects of the Act. The University elected this deferral for fiscal 2004. As such, the University's postretirement benefit obligation and net periodic postretirement benefit cost as of June 30, 2004 do not reflect the effects of the Act. The University believes that benefits provided to certain

participants will be at least actuarially equivalent to Medicare Part D and, accordingly, the University will be entitled to the Medicare Part D subsidy.

In May 2004, the FASB issued Staff Position FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003" ("FSP 106-2"). FSP 106-2 requires that the effects of the federal subsidy be considered an actuarial gain that is recognized in the same manner as other actuarial gains and losses. It also requires that employers who sponsor postretirement health care plans that provide prescription drug benefits make certain disclosures.

The University adopted FSP 106-2 prospectively as of July I, 2004. The expected subsidy reduced the accumulated postretirement benefit obligation at July I, 2004 by \$68.2 million and the net periodic cost for fiscal 2005 by \$10.9 million.

13. GENERAL OPERATING ACCOUNT

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

University financial transactions, except for those related to investment activities conducted by the Harvard Management Company.

The major components of the GOA net asset balances as of June 30, 2005 and 2004 are summarized as follows (in thousands of dollars):

		2005			
		Temporarily	Permanently		
	Unrestricted	restricted	restricted	Total	Total
Departmental balances:					
Unexpended endowment income	\$ 113,990	\$ 505,769	\$ 0	\$ 619,759	\$ 450,509
Unexpended gift balances	67,854	206,331	0	274,185	339,311
Pledge balances	0	242,786	0	242,786	263,313
Loan funds	30,262	0	81,866	112,128	111,035
Funds for construction	0	18,486	0	18,486	48,382
Funds invested in fixed assets	1,248,158	0	0	1,248,158	1,189,028
Other departmental purposes	432,167	0	0	432,167	407,743
Total departmental balances	1,892,431	973,372	81,866	2,947,669	2,809,321
University balances	1,168,736	81,189	0	1,249,925	1,126,153
TOTAL GOA NET ASSET BALANCES	\$ 3,061,167	\$ 1,054,561	\$ 81,866	\$ 4,197,594	\$ 3,935,474

14. STUDENT FINANCIAL AID

Financial aid granted to students in fiscal 2005 and 2004 is summarized as follows (in thousands of dollars):

	2005	2004
Scholarships applied to student income	\$ 189,000	\$ 173,437
Scholarships and other student awards paid directly to students	94,116	89,414
Total scholarships and other student awards	283,116	262,851
Student employment	56,722	51,866
Student loans	26,189	25,255
Agency financial aid*	13,740	12,999
TOTAL STUDENT FINANCIAL AID	\$ 379,767	\$ 352,971

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

Approximately 65% and 68% of scholarships and other student awards for fiscal 2005 and 2004, respectively, were funded by gifts, endowment income, and sponsored support.

15. SPONSORED RESEARCH

Total expenditures funded by U.S. government sponsors or by institutions that subcontract federally sponsored research to the University were \$511.1 million and \$473.5 million in fiscal 2005 and 2004, respectively. Approximately 95% of federal research support for the years ended June 30, 2005 and 2004 was received by the Medical School, the School of Public Health, and the Faculty of Arts and Sciences. The University's principal source of federal research funds is the Department of Health and Human Services. The University also has many non-federal sources of sponsored support, including corporations, foundations, state and local governments, foreign governments, and research institutes.

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

16. 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 construction, 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 for the years ended June 30, 2005 and 2004 are summarized as follows (in thousands of dollars):

285,659 75,934 11,237 372,830	257,767 65,313 29,790 352,870
75,934	65,313
,	•
285,659	257,767
78,442	85,445
187,772	\$ 153,518
2005	2004
	187,772

^{*} Gifts for capital to life income funds are presented at full value. The discounted present value of these gifts was \$27,566 and \$23,062 for fiscal 2005 and 2004, respectively.

17. OTHER OPERATING INCOME

The major components of other operating income for the years ended June 30, 2005 and 2004 were as follows (in thousands of dollars):

	2005	2004
Publications	\$ 75,445	\$ 76,901
Rental and parking	93,389	78,503
Royalties from patents,		
copyrights, and trademarks	57,818	50,697
Other student income	24,413	20,698
Nonstudent health and clinic fees	23,409	23,472
Other	141,220	122,425

TOTAL OTHER OPERATING INCOME \$ 415,694 \$ 372,696

18. OTHER EXPENSES

The major components of other expenses for the years ended June 30, 2005 and 2004 were as follows (in thousands of dollars):

	2005	2004
Services purchased	\$ 274,355	\$ 226,088
Subcontract expenses		
under sponsored projects	83,441	79,794
Travel	53,532	51,779
Publishing	39,392	40,702
Telephone	10,777	11,110
Other	95,389	86,402
TOTAL OTHER EXPENSES	\$ 556 886	\$ 495 875

19. 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, 2005 and 2004 were as follows (in thousands of dollars):

,	2005	2004
Instruction	\$ 754,267	\$ 709,869
Research	624,660	585,709
Libraries	173,977	162,781
Academic support	225,867	225,804
Scholarships and other student awards	94,116	89,414
Student services	110,179	101,686
Institutional support	451,367	378,449
Auxiliary services	322,940	307,207
TOTAL EXPENSES	\$ 2,757,373	\$ 2,560,919

20. COMMITMENTS AND CONTINGENCIES

The University receives funding from federal 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.

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 within MIT that is jointly governed by the University, MIT, and the Broad Foundation. The Institute is focused on applying knowledge of the human genome to clinical medicine and making such knowledge widely available to the scientific community.

In connection with the founding of the Broad Institute, the University and MIT agreed to strive to jointly raise \$20.0 million per year in gifts and non-federal grants and awards to support the Institute's endeavors. In the event this fundraising goal is not reached, the University has agreed to provide MIT with a portion of the shortfall, subject to certain conditions. The University's obligation for such payments will not exceed \$20.0 million over the initial five-year term, or \$30.0 million in total if the term is extended for a second five years. The University will make payments and record the corresponding expenses as these conditions are met. The University had a \$4.0 million commitment to MIT as of June 30, 2005, which was appropriately recorded as a liability in the financial statements. No such commitment existed as of June 30, 2004.

The University and MIT will equally share certain laboratory construction fit-out costs for the Broad Institute's new building, which is expected to be completed in April 2006. The University's portion of these costs is expected to be approximately \$13.0 million. If the University's participation in the collaboration terminates under certain

circumstances, the University may also be obligated to pay MIT up to \$5.0 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. Some of the University's contributions to the fit-out and on-going capital costs will be reimbursed in the future through indirect cost recoveries associated with the Institute's grant funding.

In April 1997, the Harvard Institute for International Development (HIID) learned of an investigation by the Inspector General's Office of the U.S. Agency for International Development (USAID). USAID had awarded amounts to HIID under two cooperative agreements to provide assistance to Russia in implementing economic and legal reforms. In September 2000, the United States filed an eleven-count civil complaint against the University and others. The district court has since dismissed or entered judgment for the University on all counts against it, except for one count alleging breach of contract. Regarding this breach of contract count, the University entered into an agreement during fiscal 2005 to pay the government \$26.5 million. This liability was appropriately recorded in the financial statements as of June 30, 2005. Payment was made in early fiscal 2006.

The University is a defendant in various other legal actions arising out of the normal course of its operations. Although the final outcome of such actions cannot currently be determined, the University believes that eventual liability, if any, will not have a material effect on the University's financial position.

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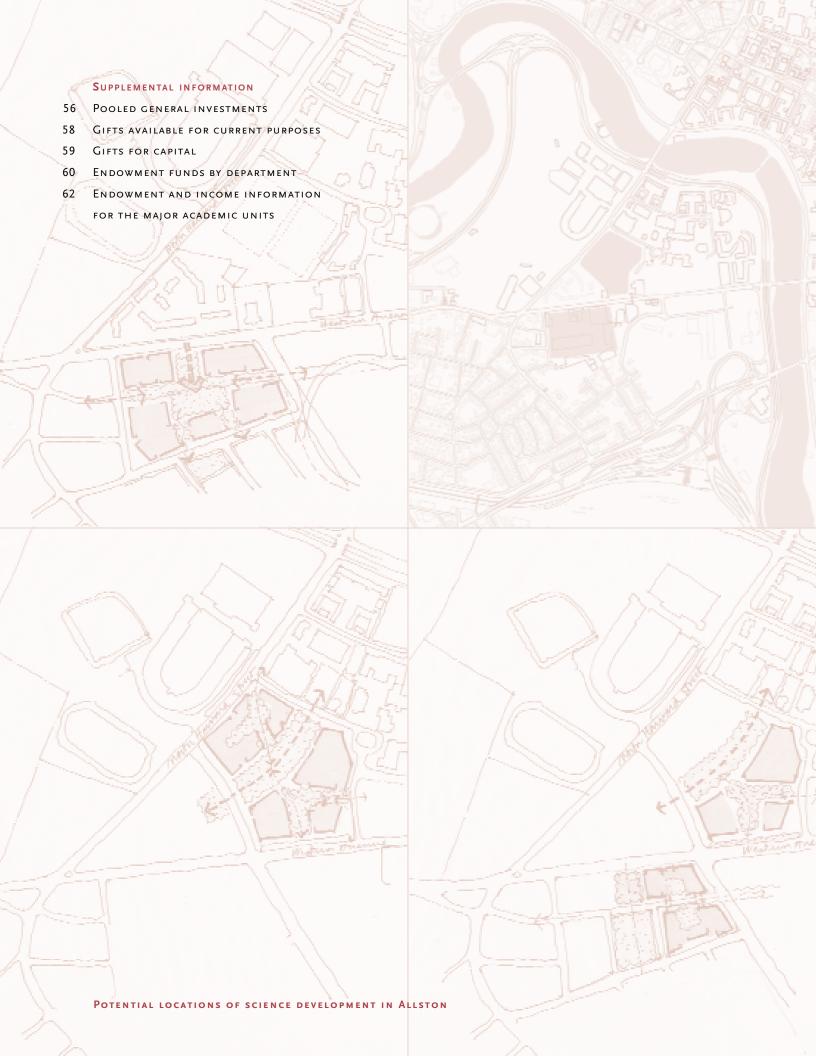
PricewaterhouseCoopers LLP One International Place Boston MA 02110-2611 Telephone (617) 530 5000 Facsimile (617) 530 5001

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") at June 30, 2005, 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 2004 financial statements, and in our report dated October 1, 2004, 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.

Price Strange Goods (CP)
October II, 2005





Pooled general investments

The "Asset allocation" for the General Investment Account is based on the Policy Portfolio as described in the unaudited Annual Report of the Harvard Management Company. The Policy Portfolio is the asset mix that is most likely to meet the long-term needs of the University with the appropriate level of risk. While the Policy Portfolio defines the University's market risk profile, Harvard Management Company (HMC) undertakes a number of diversified arbitrage activities to enhance the returns without changing the portfolio's risk profile. These trades are subtle and complex and tend to have a long volatility bias. The focus of these return enhancement strategies is to identify mispricings of specific financial instruments relative to other similar instruments. Once these mispricings are identified, a series of long and short transactions are undertaken to capture the mispricings and to remain neutral to changes in the value of the underlying asset class. These offsetting positions are taken in both instruments recorded on the summary of assets and liabilities (balance sheet cash positions) and in off-balance sheet products (futures, options, over-the-counter exchange agreements, and forwards), as exhibited in Note 3 to the University's financial statements.

The accompanying table combines the balance sheet and the off-balance sheet financial instruments in a form consistent with HMC's approach to the management of the General Investment Account. The table categorizes the information presented in the financial statements into groupings reflecting the type of strategy. There are several key points to be noted:

- A) The "Balance sheet cash positions" are the assets and liabilities shown on the summary of assets and liabilities included in *Note* 3 to the University's financial statements.
- B) The on-balance sheet and off-balance sheet positions, both long and short, net to the core market exposure of the portfolio, which approximates the market exposure of the Policy Portfolio.
- c) The off-balance sheet amounts represent the market exposure on the notional value of the forwards, futures, options, and exchange agreements included in *Note 3* to the University's financial statements.
- D) From a market exposure standpoint, нмс uses onbalance sheet and off-balance sheet financial instruments interchangeably.

The "Asset class" column describes the basic assets of the Policy Portfolio broken down into its major categories with the addition of a series of diversified arbitrage accounts related to the equity, commodity, and fixed-income portfolios. The arbitrage accounts represent the positions taken in value-added strategies to enhance the returns of the underlying Policy Portfolio. The "Other" asset class represents on-balance sheet and off-balance sheet positions that are not subject to market risk, but which may be subject to credit risk. Included in this category are financial instruments such as cash, premiums paid or received on option positions, and balances related to securities lending (collateral held under security lending agreements) and securities borrowing (collateral advanced under security borrowing agreements).

The remainder of the schedule shows the on-balance sheet and off-balance sheet positions of the specific investment categories. The "Balance sheet cash positions" columns show the financial positions that are reported on the pooled general investment balance sheet. These columns include ownership or short sales in stock and bond positions, as well as investments in real estate, commodities, and private equities, either directly or through limited partnerships.

The "Forwards," "Futures," "Options," and "Exchange agreements" columns represent the long and short values of the off-balance sheet positions. Option positions have been adjusted to reflect the market exposure of the underlying assets. Fixed-income futures have been adjusted to reflect duration weighting where appropriate. The positions in these categories are primarily used for the value-added arbitrage transactions, but may also be used to adjust the core asset mix in a non-disruptive and cost-effective manner.

The "Net market exposure" column aggregates long and short exposure across all types of instruments and may differ from the "Asset allocation" as reported in the unaudited *Annual Report of the Harvard Management Company*. The balance sheet cash positions and off-balance sheet amounts are reported in accordance with generally accepted accounting principles and do not necessarily reflect "market risk" exposure amounts. For instance, in the equity area, the University owns convertible debt positions hedged by equity. The balance sheet reflects the market value of the convertible debt;

however, depending on the conversion features of the bond and the volatility of the underlying equity, the convertible debt will have significantly less equity market exposure than the amount recorded on the balance sheet. In the fixed-income area, a fully hedged strategy designed to capture shifts in the yield curve may reflect a mismatch in long and short market exposure due to the duration of the underlying instruments. In some instances, option strategies have been employed to take advantage of market volatility. While these strategies may appear to generate unhedged market exposure, the potential losses are limited to the option premium, which is comparatively small relative to the indicated exposure.

The activities of arbitrage accounts are focused on adding value to the Policy Portfolio, taking advantage of mispricings in a variety of financial instruments, and creating a well-diversified set of specific strategies. The market, credit, legal, operational, and liquidity risks associated with these strategies are monitored on a daily basis by an internal,

independent risk management group. This risk management group utilizes a number of different methodologies to evaluate and control the various risks of the core portfolios and value-added strategies. Individual strategies and portfolios are reviewed to monitor value at risk, compliance with cash and margin requirements, and adherence to credit risk limits established by HMC for each counterparty. All positions other than private equity, certain commodities and real estate are marked to market on a daily basis, with applicable profit and loss statements generated for each strategy. Risk monitoring and control is described in greater detail in the unaudited *Annual Report of the Harvard Management Company*, beginning on page 23.

Year ended June 30, 2005 (in millions of dollars)			MARKET EXPOSURE OF OFF-BALANCE SHEET INSTRUMENTS						TOTAL					
	BALANCE SHEET CASH POSITIONS		Forwards		Futures		Options	EXCHANGE AGREEMENTS		MARKET EXPOSURE		Net market	Asset	
ASSET CLASS	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short	exposure	
Equity:														
Domestic	6,095	-	-	-	225	-	-	-	-	-	6,320	-	6,320	5,332
Absolute return	3,210	-	-	-	-	-	-	-	-	-	3,210	-	3,210	3,837
Foreign	4,386		-	-		-	-	-	-	-	4,386	-	4,386	3,848
Emerging markets	1,220	-	-	-	-	-	26	-	584	(34)	1,830	(34)	1,796	1,782
Arbitrage accounts	2,385	(1,246)	-	-	-	(566)	128	(160)	9	(775)	2,522	(2,747)	(225)	
Total equity market exposure	17,296	(1,246)	-	-	225	(566)	154	(160)	593	(809)	18,268	(2,781)	15,487	14,799
Fixed-income:														
Domestic	2,479	-	-	-	-	-	-	-	-	(85)	2,479	(85)	2,394	2,411
Foreign	776	-	-	-	-	-	120	(4)	125	(346)	1,021	(350)	671	1,192
High-yield securities	1,523	-	-	-	-	-	-	-	-	-	1,523	-	1,523	1,831
Inflation-indexed	1,537	-	-	-	-	-	-	-	-	-	1,537	-	1,537	1,589
Arbitrage accounts	15,758	(1,515)	-	-	-	(225)	10,162	(4,969)	1,902	(18,252)	27,822	(24,961)	2,861	
Total fixed-income market exposure	22,073	(1,515)	-	-	-	(225)	10,282	(4,973)	2,027	(18,683)	34,382	(25,396)	8,986	7,023
Commodities:														
Core	3,302	-	-	-	-	(78)	-	-	1,169	-	4,471	(78)	4,393	3,675
Arbitrage accounts	16	-	-	-	-	-	-	-	-	(35)	16	(35)	(19)	
Total commodities market exposure	3,318	-	-	-	-	(78)	-	-	1,169	(35)	4,487	(113)	4,374	3,675
Private equities	2,358	-	-	-	-	-	-	-	-	-	2,358	-	2,358	2,358
Real estate	1,892	-	-		-	-	-	-	-	-	1,892	-	1,892	1,940
Total market exposure	46,937	(2,761)	-		225	(869)	10,436	(5,133)	3,789	(19,527)	61,387	(28,290)	33,097	29,795
Cash and other:														
Cash and cash equivalents	1,169	-												(417)
Collateral advanced on borrowings	1,748	-												-
Collateral held on loans	-	(17,296)												
Accounts receivable	(1,406)	-												
Option premium	1,274	(287)												-
Total cash and other	2,785	(17,583)												(417)
NET ASSETS PER BALANCE SHEET	49,722	(20,344)												29,378

Gifts available for current purposes

	Non-federal
Gifts for	sponsored
	research grants
FACULTIES:	
Faculty of Arts and Sciences \$ 54,531	\$ 14,651
Business School 15,283	
School of Dental Medicine 386	51
Graduate School of Design 2,606	160
Divinity School 1,131	379
Graduate School of Education 4,355	4,632
John F. Kennedy School of Government	7,561
Law School 12,669	4,100
Medical School 41,211	22,958
School of Public Health 6,910	20,451
Radcliffe Institute for Advanced Study 2,655	570
TOTAL FACULTIES 161,703	75,513
OTHER ACADEMIC DEPARTMENTS:	
Arnold Arboretum 288	
Harvard University Art Museums 3,342	240
Joint Center for Housing Studies 1,427	826
Nieman Foundation 62	272
Villa I Tatti 720	337
TOTAL OTHER ACADEMIC DEPARTMENTS 5,839	1,675
SERVICE DEPARTMENTS:	
Harvard University Press 3	
University Health Services 5	
TOTAL SERVICE DEPARTMENTS 8	0
CENTRAL ADMINISTRATION:	
Memorial Church 516	
President's Initiatives 17,432	4
University Library 2,016	1,250
Other 258	,
TOTAL CENTRAL ADMINISTRATION 20,222	1,254
TOTAL GIFTS AVAILABLE FOR CURRENT PURPOSES \$ 187,772	\$ 78,442

Gifts for capital

	Endowment	Construction	Loan	
Year ended June 30, 2005 (in thousands of dollars)	funds	funds	funds	Total
FACULTIES:				
Faculty of Arts and Sciences	\$ 78,024	\$ 2,067	\$ 262	\$ 80,353
Business School	102,304	5,691	14	108,009
School of Dental Medicine	94	295		389
Graduate School of Design	648			648
Divinity School	1,386			1,386
Graduate School of Education	558	435		993
John F. Kennedy School of Government	6,579	475		7,054
Law School	23,547	250	190	23,987
Medical School	29,511	484	370	30,365
School of Public Health	6,135			6,135
Radcliffe Institute for Advanced Study	8,850	73		8,923
TOTAL FACULTIES	257,636	9,770	836	268,242
OTHER ACADEMIC DEPARTMENTS:				
Arnold Arboretum	1,352			1,352
Harvard University Art Museums	1,025	18		1,043
Nieman Foundation	1,023	283		286
Villa I Tatti		330		
TOTAL OTHER ACADEMIC DEPARTMENTS	1,757 4,137	631	0	2,087 4,768
	.,			.,
SERVICE DEPARTMENTS:				
Harvard University Press	156			156
University Health Services	12			12
University Operations Services	10			10
TOTAL SERVICE DEPARTMENTS	178	0	0	178
CENTRAL ADMINISTRATION:				
Memorial Church	493			493
President's Initiatives	22,287			22,287
University Library	752			752
Other	176			176
TOTAL CENTRAL ADMINISTRATION	23,708	0	0	23,708
TOTAL ENDOWMENT, CONSTRUCTION, AND LOAN FUNDS	\$ 285,659	\$ 10,401	\$ 836	296,896
LIFE INCOME FUNDS:				
Charitable Remainder Annuities and Unitrusts				58,691
Gift Annuities				15,691
Harvard Balanced Fund				653
Harvard Growth Fund				571
Harvard Life Return Fund				
TOTAL LIFE INCOME FUNDS				328 75,93 4
				,
TOTAL GIFTS FOR CAPITAL				\$ 372,830

Endowment funds by department

Year ended June 30, 2005 (dollar amounts in thousands)

Endowment		aima1	
EHGOWIHEIIL	DIIII	cidal	

					Doutisinstins
	Book value	Gifts and	Book value	Market value	Participating units
	July 1, 2004	other changes	June 30, 2005	June 30, 2005	June 30, 2005
FACULTIES:)/ -,		, ,.,,	, ,.,,	, ,., =
Faculty of Arts and Sciences	\$ 2,491,100	\$ 98,189	\$ 2,589,289	\$ 11,711,315	8,201,977
Business School	572,999	116,358	689,357	1,923,709	1,341,179
School of Dental Medicine	29,672	141	29,813	158,759	111,357
Graduate School of Design	59,768	580	60,348	321,190	225,289
Divinity School	76,367	2,749	79,116	455,271	319,337
Graduate School of Education	93,181	2,216	95,397	389,178	272,977
John F. Kennedy School of Government	219,746	5,633	225,379	765,781	532,173
Law School	301,292	31,495	332,787	1,278,171	896,256
Medical School	750,877	93,003	843,880	2,922,663	2,049,390
School of Public Health	159,014	8,723	167,737	848,137	594,900
Radcliffe Institute for Advanced Study	202,562	7,529	210,091	404,234	283,464
TOTAL FACULTIES	4,956,578	366,616	5,323,194	21,178,408	14,828,299
	, ,				
OTHER ACADEMIC DEPARTMENTS:					
Arnold Arboretum	39,027	4,949	43,976	222,827	156,295
Harvard University Art Museums	104,612	2,445	107,057	470,861	328,538
Joint Center for Housing Studies	0	0	0	0	0
Nieman Foundation	15,238	(249)	14,989	102,487	71,886
Villa I Tatti	45,055	4,983	50,038	197,851	138,777
TOTAL OTHER ACADEMIC DEPARTMENTS	203,932	12,128	216,060	994,026	695,496
SERVICE DEPARTMENTS:					
Harvard University Press	16,254	3,491	19,745	77,042	54,039
University Health Services	3,610	4,384	7,994	36,834	25,836
University Operations Services	818	10	828	4,012	2,814
TOTAL SERVICE DEPARTMENTS	20,682	7,885	28,567	117,888	82,689
Central Administration	541,974	19,006	560,980	2,931,482	2,064,287
SUBTOTAL	5,723,166	405,635	6,128,801	25,221,804	17,670,771
Pledges outstanding	443,656	(64,329)	379,327	379,327	
Interests in perpetual trusts held by others	245,277	6,640	251,917	251,917	
TOTAL	\$ 6,412,099	\$ 347,946	\$ 6,760,045	\$ 25,853,048	17,670,771
	· ·	· · · · · · · · · · · · · · · · · · ·		<u> </u>	· ,

Year ended	Tune 20	2005 (in thousar	de	of dollars)
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lowment	

		Endowment incom	e	
Unexpended	Investment			Unexpended
income	income	Other receipts	Fund income	income
July 1, 2004	distributed	and transfers	availed of	June 30, 2005
\$ 99,439	\$ 366,313	\$ (43,058)	\$ (324,965)	\$ 97,729
346	58,743	3,262	(61,926)	425
893	4,999	89	(5,057)	924
1,305	10,147	998	(11,395)	1,055
6,635	14,430	1,114	(15,427)	6,752
2,648	12,212	684	(11,286)	4,258
11,416	23,991	3,764	(26,767)	12,404
9,981	38,983	730	(40,281)	9,413
82,898	89,047	(1,999)	(74,092)	95,854
34,712	26,987	(1,889)	(24,796)	35,014
4,688	12,094	(1,415)	(11,469)	3,898
254,961	657,946	(37,720)	(607,461)	267,726
1.733	7.616	(183)	(7.966)	1,200
,	•	, ,	, ,	5,855
41	0	39	, ,	0
2.076	3.268	(21)	` ,	1,900
,	•	` ,	(' '	2,723
11,513	31,674	(4,341)	(27,168)	11,678
4 410	2.413	4.345	(9.560)	1,608
,	•	,	(' '	144
	,		(' '	157
		. ,		1,909
., •	-,	.,0	(,)	.,,,,,
41,420	91,602	(39,812)	(49,231)	43,979
\$ 312,604	\$ 784,814	\$ (77,657)	\$ (694,469)	\$ 325,292
	\$ 99,439 346 893 1,305 6,635 2,648 11,416 9,981 82,898 34,712 4,688 254,961 1,733 5,197 41 2,076 2,466 11,513 4,410 144 156 4,710 41,420	income july 1, 2004 distributed \$ 99,439 \$ 366,313 346 58,743 893 4,999 1,305 10,147 6,635 14,430 2,648 12,212 11,416 23,991 9,981 38,983 82,898 89,047 34,712 26,987 4,688 12,094 254,961 657,946 1,733 7,616 5,197 14,737 41 0 2,076 3,268 2,466 6,053 11,513 31,674 4,410 2,413 144 1,051 156 128 4,710 3,592	Unexpended income July 1, 2004 Investment income distributed Other receipts and transfers \$ 99,439 \$ 366,313 \$ (43,058) 346 58,743 3,262 893 4,999 89 1,305 10,147 998 6,635 14,430 1,114 2,648 12,212 684 11,416 23,991 3,764 9,981 38,983 730 82,898 89,047 (1,999) 34,712 26,987 (1,889) 4,688 12,094 (1,415) 254,961 657,946 (37,720) 1,733 7,616 (183) 5,197 14,737 (3,811) 41 0 39 2,076 3,268 (21) 2,466 6,053 (365) 11,513 31,674 (4,341) 4,410 2,413 4,345 144 1,051 (2) 156 128 (127) 4,7	Unexpended income July 1, 2004 Investment income distributed Other receipts and transfers Fund income availed of \$ 99,439 \$ 366,313 \$ (43,058) \$ (324,965) 346 58,743 3,262 (61,926) 893 4,999 89 (5,057) 1,305 10,147 998 (11,395) 6,635 14,430 1,114 (15,427) 2,648 12,212 684 (11,286) 11,416 23,991 3,764 (26,767) 9,981 38,983 730 (40,281) 82,898 89,047 (1,999) (74,092) 34,712 26,987 (1,889) (24,796) 4,688 12,094 (1,415) (11,469) 254,961 657,946 (37,720) (607,461) 1,733 7,616 (183) (7,966) 5,197 14,737 (3,811) (10,268) 41 0 39 (80) 2,076 3,268 (21) (3,423) <tr< td=""></tr<>

Endowment and income information for the major academic units

The charts and graphs in this section present summaries of endowment and income information for each of the University's major academic units, as well as for the University as a whole.

The endowment graphs display the growth since 1974 of the major components of the endowment: 1974 appreciated principal, capitalized income, and gifts and other changes. To allow for comparability with years prior to fiscal 1995, endowment values exclude pledge balances and interests in perpetual trusts.

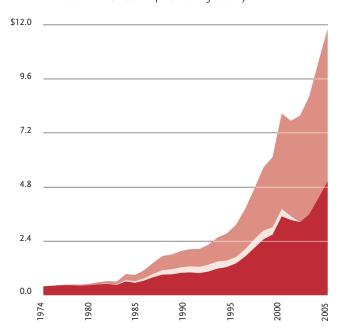
The income charts show the major components of income in fiscal 1995 and 2005. Shown below each of these charts is the ten-year compound growth rate after inflation for total income.

On October 1, 1999, Harvard University and Radcliffe College merged and established the Radcliffe Institute for Advanced Study (RIAS). Therefore, the information for RIAS is presented beginning with fiscal 2000.

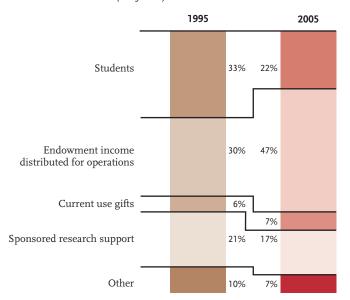
UNIVERSITY ENDOWMENT GROWTH (in billions of dollars) Sources of income (% of total) 1995 2005 Students 26% 21% Endowment income 31% 21% distributed for operations Current use gifts 7% 7% Sponsored research support 24% 22% Other 22% 19% 1995 2000 Real growth rate of income 1995-2005: 4.3% 1974 Principal Capitalized income Gifts and other and appreciation changes

FACULTY OF ARTS AND SCIENCES

ENDOWMENT GROWTH (in billions of dollars)



Sources of income (% of total)

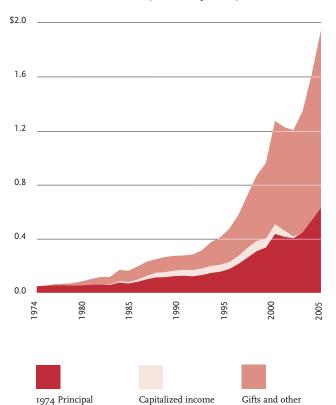


Real growth rate of income 1995-2005: 4.0%

BUSINESS SCHOOL

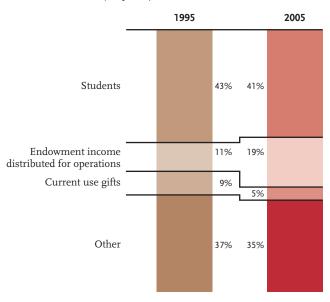
1974 Principal and appreciation

ENDOWMENT GROWTH (in billions of dollars)



changes

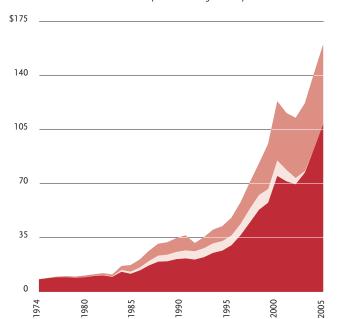
Sources of income (% of total)



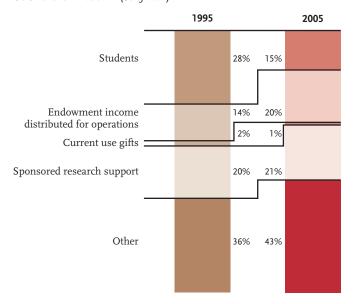
Real growth rate of income 1995–2005: **4.1**%

SCHOOL OF DENTAL MEDICINE

ENDOWMENT GROWTH (in millions of dollars)



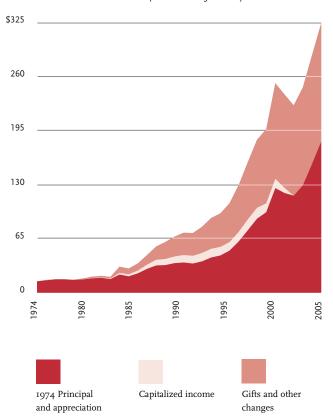
Sources of income (% of total)



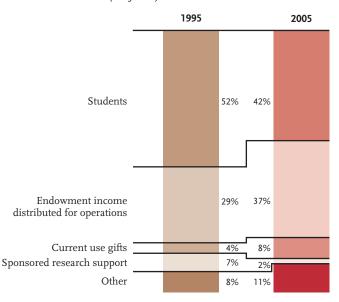
Real growth rate of income 1995-2005: **4.9**%

GRADUATE SCHOOL OF DESIGN

ENDOWMENT GROWTH (in millions of dollars)



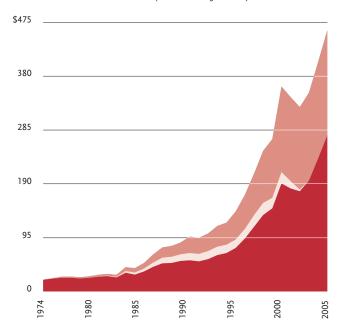
SOURCES OF INCOME (% of total)



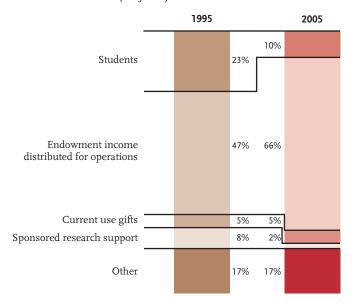
Real growth rate of income 1995-2005: 4.9%

DIVINITY SCHOOL

ENDOWMENT GROWTH (in millions of dollars)



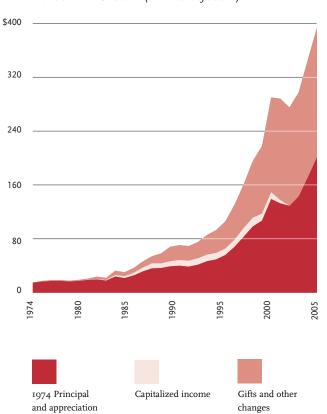
Sources of income (% of total)



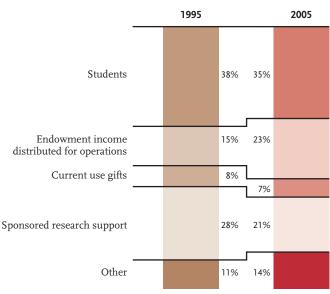
Real growth rate of income 1995–2005: **5.0**%

GRADUATE SCHOOL OF EDUCATION

ENDOWMENT GROWTH (in millions of dollars)



Sources of income (% of total)



Real growth rate of income 1995–2005: **5.3**%

JOHN F. KENNEDY SCHOOL OF GOVERNMENT

ENDOWMENT GROWTH (in millions of dollars)

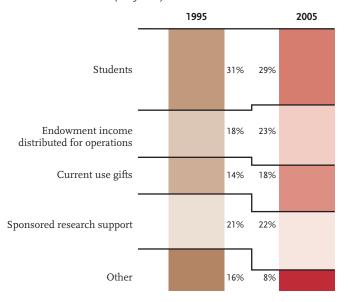
\$800 640 480 320

1990

2000

2005

Sources of income (% of total)



Real growth rate of income 1995-2005: 7.7%

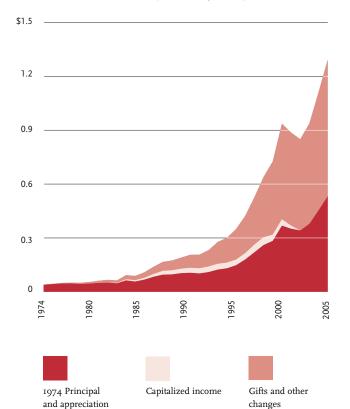
LAW SCHOOL

0

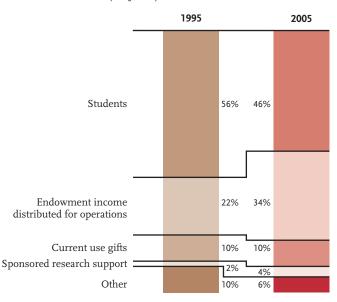
1974

ENDOWMENT GROWTH (in billions of dollars)

1985



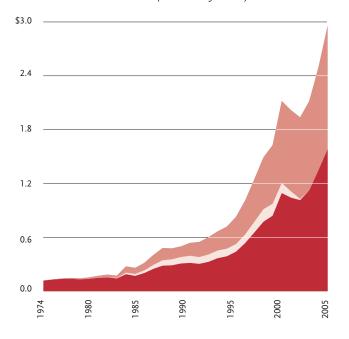
Sources of income (% of total)



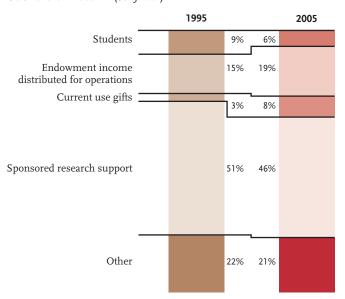
Real growth rate of income 1995-2005: 4.5%

MEDICAL SCHOOL

ENDOWMENT GROWTH (in billions of dollars)



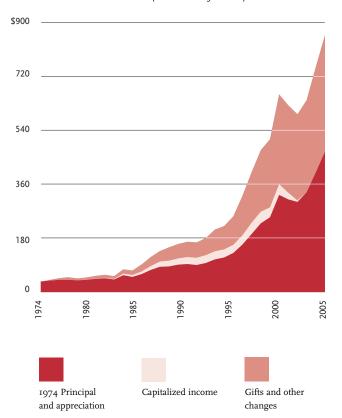
Sources of income (% of total)



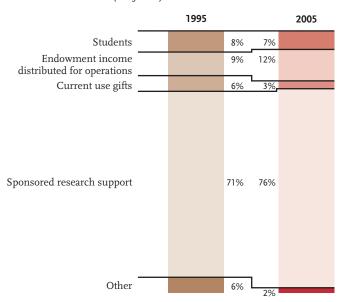
Real growth rate of income 1995–2005: **6.7**%

SCHOOL OF PUBLIC HEALTH

ENDOWMENT GROWTH (in millions of dollars)



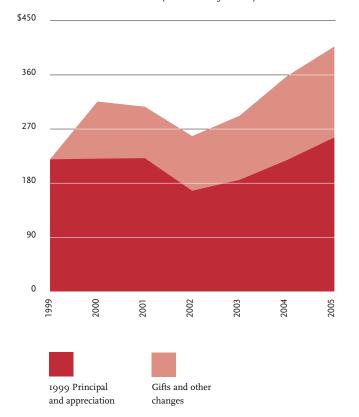
Sources of income (% of total)



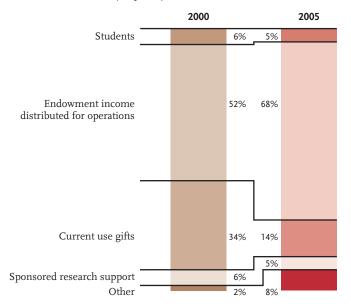
Real growth rate of income 1995-2005: **5.7**%

RADCLIFFE INSTITUTE FOR ADVANCED STUDY*

ENDOWMENT GROWTH (in millions of dollars)



Sources of income (% of total)



Real growth rate of income 2000-2005: (0.6)%

^{*} On October 1, 1999, Harvard University and Radcliffe College merged and established the Radcliffe Institute for Advanced Study (RIAS). Therefore, the information for RIAS is presented beginning with fiscal 2000.

