



HARVARD UNIVERSITY
FINANCIAL REPORT

FISCAL YEAR **2009**

Message from the President

I write to report Harvard University's financial results for fiscal 2009. The crisis in the markets and the accompanying economic downturn made this an exceptionally challenging year, in financial terms, for all universities. Our investment returns were negative 27.3 percent for the fiscal year ending June 30. Subtracting disbursements for operations, net of new gifts, the endowment as of June 30 totaled $26.0 billion—down from $36.9 billion a year earlier.

We have taken important steps, as a result, to realign the University's cost base and capital structure. We have significantly reduced operating budgets in the Schools and in the central administration. These budget reductions entailed significant actions to control our personnel costs, which make up roughly half of the University's spending. We have aggressively slowed both new hiring and the filling of vacant positions; we offered voluntary retirement incentives for long-serving staff; we undertook a painful but important round of reductions in force, affecting more than 275 of our colleagues, many of whom had served Harvard ably for years; and we held salaries flat for both faculty and exempt staff. At the same time, we have slowed our ambitious capital plans—most obviously, with regard to our long-term aspirations in Allston. Overall, we expect to reduce by roughly half the capital spending we had originally anticipated for the next several years.

Notwithstanding the financial challenges of the past year, we continue to celebrate significant accomplishments across the University. We have carried forward faculty searches in key fields, resulting in the addition this academic year of 70 ladder faculty, and we have sustained our strong commitment to student financial aid. We have launched a new program in General Education, and created a new doctoral degree in education leadership. We inaugurated an institute for biologically inspired engineering, and strengthened our commitment to the arts, to public service, and to sustainability. We have more students than ever working and studying abroad. We named three outstanding new deans during the past year—in the School of Public Health, the School of Engineering and Applied Sciences, and the Law School—and we just enrolled the most diverse freshman class in Harvard history.

The world faces many very complex challenges that demand attention—economic uncertainty and financial systems in flux; climate change and threats to sustainability; infectious diseases and inadequate access to health care; persistent inequality as well as religious and cultural strife. What we do here can make a great difference in how these and other problems are understood and addressed—through research that generates fresh ideas, through the discovery of promising solutions, through the education of students we send into the world. In short, at a time when higher education faces new financial constraints, our work here has never mattered more.

I would like to express my gratitude to our students, faculty, staff and our generous alumni for their commitment and support in this unprecedented year. We have a great deal to be proud of, and I look forward to the opportunities that lie ahead.

Sincerely,

Drew Gilpin Faust

Drew Gilpin Faust
PRESIDENT

October 4, 2009

Financial Overview

From the Vice President for Finance and the Treasurer

The global economic crisis has fundamentally changed the financial condition not only of Harvard and other universities, but of most participants in the global economy. Harvard navigated challenging terrain in fiscal 2009—yet we have emerged with confidence for the future notwithstanding a significant decline in our resources. The discussion that follows identifies the key factors affecting the University's operating result for the year ended June 30, 2009 and its financial position as of that date.

OPERATING RESULT

Last fall, as the severity and likely longevity of the global economic downturn came into sharper focus, the University resolved to act quickly. As a result, Harvard achieved substantial savings that reduced the planned rate of growth in expenses, and will help the University adapt to a new economic reality for the longer term. This contributed to a net positive operating result of $71 million in fiscal 2009, compared to $17 million in fiscal 2008. Note that for accounting purposes, investment losses (including losses associated with the endowment) are not included in the University's operating result.

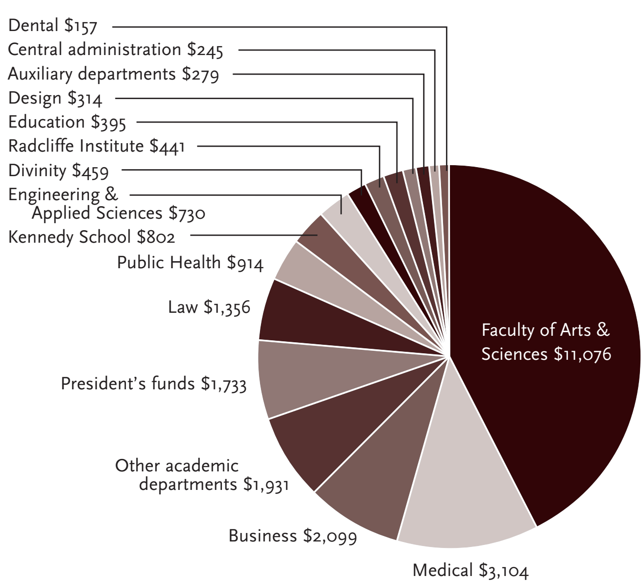
OPERATING REVENUE

Total operating revenue rose 10% to $3.8 billion. This was driven primarily by the growth in the University's endowment income made available for operations which increased by 20%, from $1.2 billion in fiscal 2008 to $1.4 billion in fiscal 2009, and comprised nearly 38% of total operating revenue in fiscal 2009.

The decline in the endowment's fair value—from $36.9 billion as of June 30, 2008 to $26.0 billion as of June 30, 2009—will have a significant impact on the University's operations going forward. Harvard's payout rate (i.e., the percentage of the endowment that is withdrawn annually for operations and for one-time or time-limited strategic purposes) was 4.6% in fiscal 2009 and we expect the fiscal 2010 payout rate to be approximately 6.0%. Despite this being well in excess of our targeted range of 5.0-5.5%—and the highest payout rate for the University in at least four decades—it will cause a decrease estimated at 8% in absolute dollars made available from the endowment for operations in fiscal 2010. We will be managing the payout rate very carefully over the next several years in order to maintain an appropriate balance between supporting the University's near-term programmatic needs and aspirations, and protecting the endowment's long-term purchasing power.

FAIR VALUE OF THE ENDOWMENT AS OF JUNE 30, 2009

In millions of dollars



TOTAL FAIR VALUE $26,035

Sponsored revenue also was a key driver of increased operating revenue. Sponsored support increased by 7%, from $668 million in fiscal 2008 to $714 million in fiscal 2009. Growth in federal funding was 4% while non-federal funding increased by 16%. Notwithstanding the relatively small growth in federal sponsorship, Harvard made important progress with the Catalyst initiative. Harvard Catalyst is a grant-making enterprise dedicated to improving human health by supporting clinical and translational activities across the University and in Harvard's affiliated teaching hospitals. Harvard Catalyst is supported by a five-year, $118 million award from the National Institutes of Health (NIH) of which $21 million was received in fiscal 2009.

The budget of the NIH, from which Harvard receives approximately two-thirds of its federal funding, was increased significantly as part of the recently enacted American Recovery and Reinvestment Act (ARRA). While many University faculty have applied for ARRA grants from the NIH and other federal agencies, actual amounts awarded as of June 30, 2009 were immaterial.

Student revenue declined by 1%, from $682 million in fiscal 2008 to $678 million in fiscal 2009. This was due to a 20% increase in scholarships applied against student income. The increased commitment to financial aid was evident in both undergraduate and graduate/professional programs, and is reflective of the University's aspiration to give the best students access to Harvard regardless of their ability to pay. The most noteworthy accomplishments in fiscal 2009 were the major financial aid enhancements at Harvard College to ensure greater affordability for students across the income spectrum.

The enhancements result in a significant decline in contributions toward the undergraduate tuition package from parents with incomes of $180,000 or less and assets typical for those income levels. Specifically, these parents are asked to contribute, on average, 10% of their total income toward the cost of the package. Additionally, home equity is no longer considered in determining a family's ability to contribute toward the cost of the undergraduate package, and students are not expected to take out loans (which have been replaced by need-based Harvard scholarships). These enhancements, combined with the continuation of the Harvard Financial Aid Initiative which eliminates the parental contribution for families earning $60,000 or less, underscore the University's commitment to maintaining financial aid support for undergraduates.

Current use giving increased by 23%, from $237 million in fiscal 2008 to $291 million in fiscal 2009. Of note, the University received a $21 million current use gift during fiscal 2009 as part of a $125 million pledge toward the support of the new Wyss Institute for Biologically Inspired Engineering. Current use gifts from alumni and friends provide vital funding for the University's ongoing operations and strategic priorities, and are of particular importance in sustaining key programs in the face of reduced endowment distributions. Notwithstanding the significant increase in current use giving, overall receipts from giving (which include gifts designated as endowment) declined as shown in more detail in *Note 16* of the audited financial statements.

SUMMARY OF FINANCIAL RESULTS

In millions of dollars	2009	2008	2007	2006	2005
Total operating revenue	**$ 3,827.6**	$ 3,482.3	$ 3,210.5	$ 2,999.6	$ 2,800.9
Total operating expenses	**3,756.1**	3,464.9	3,170.7	2,999.5	2,757.4
Total gifts	**597.1**	690.1	615.0	595.8	590.7*
Fixed assets, net	**5,393.5**	4,951.3	4,524.2	4,078.5	3,797.8
Total investments	**31,480.3**	43,804.3	41,832.9	34,249.6	29,938.2*
Bonds and notes payable	**5,980.5**	4,089.9	3,847.0	2,922.2	2,849.1
Net assets–General Operating Account	**3,683.1**	6,575.1	6,438.6	5,116.1	4,197.6
Net assets–endowment funds	**26,035.4**	36,926.7	34,912.1	29,219.4	25,853.0
Total return on general investments**	**(27.3)**%	8.6%	23.0%	16.7%	19.2%

* *These numbers have been recast to conform with fiscal 2006 presentation.*
** *Total return on general investments is net of all fees and expenses.*

OPERATING EXPENSES

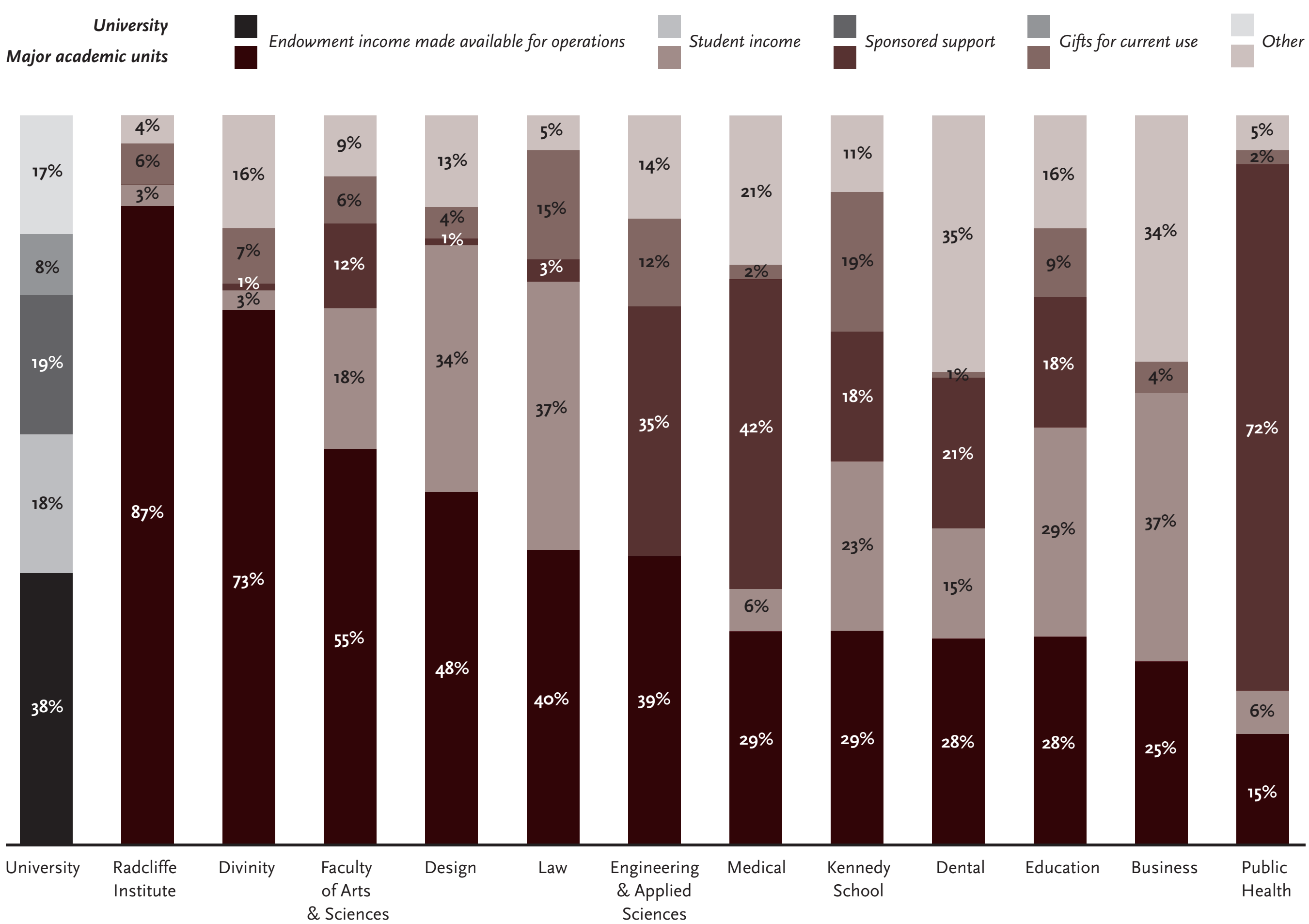
Operating expenses totaled $3.8 billion, an 8% increase over fiscal 2008. Salaries, wages and benefits represented 49% of the University's total operating expenses in fiscal 2009 and increased by 11% to $1.8 billion. The University has taken four important steps to reduce compensation expenses in response to the significant decline in endowment wealth. First, more aggressive practices were adopted across the University beginning last fall to slow both new hiring and the filling of vacant positions. Second, bonus payments were substantially eliminated in fiscal 2009 and salaries have been held flat in fiscal 2010 for faculty and exempt staff. Third, the University implemented a voluntary early retirement incentive program which was offered to 1,629 staff members and accepted by 533. And fourth, the University implemented reorganizations and other efficiency measures that resulted in a reduction in force affecting more than 275 positions. Although the latter two steps required approximately $59 million in upfront costs (related to severance payments, retirement benefit incentives, etc.) that were expended or accrued in fiscal 2009, we anticipate that they will lead to material annual compensation savings in future years. In many other cost categories, including supplies and equipment, collections, maintenance, and travel, the University was able to reduce expenses significantly through more aggressive cost-conscious practices adopted throughout fiscal 2009. At the same time, the University incurred approximately $58 million in increased interest costs primarily related to the University's new taxable and tax-exempt debt, as well as accounting charges relating to the reclassification of certain rental payments as capital leases.

BALANCE SHEET

Investments

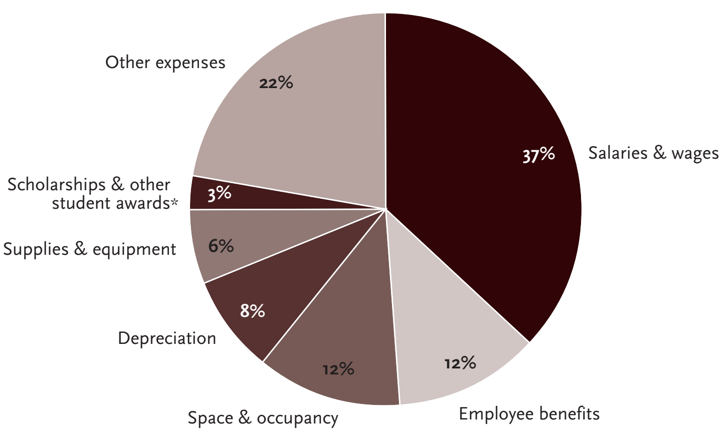
The University's investment losses in fiscal 2009 were caused by three primary factors: the loss in market value of the endowment; losses related to the University's portfolio of pooled cash balances; and realized and unrealized losses on interest rate exchange agreements held by the University as part of the financing strategy for its capital program.

FISCAL 2009 SOURCES OF OPERATING REVENUE

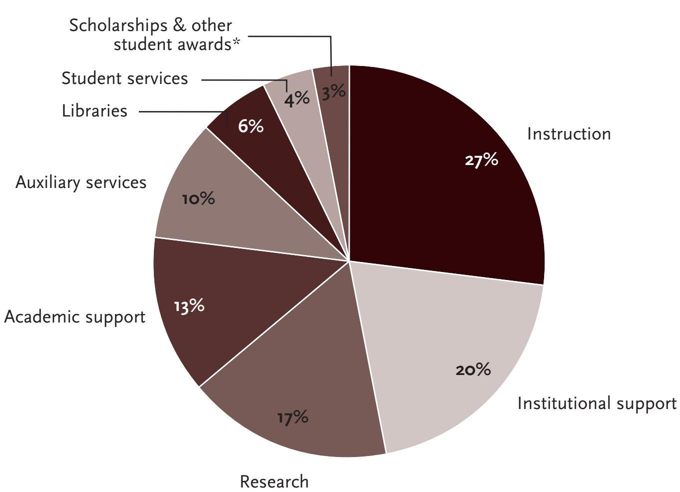


As shown further in *Note 13* of the audited financial statements, the University pools and centrally manages cash balances held by its various Schools and departments. Historically, a substantial portion of this pooled cash has been invested alongside the endowment in the General Investment Account (GIA) managed by Harvard Management Company (HMC). In the past this investment approach has generated significant positive investment results for the University. With the unprecedented market events of fiscal 2009, the approach this past year resulted not in gains but rather in substantial losses in the University's pooled cash which are reported both on the *Balance Sheets*, and also in the *Statements of Changes in Net Assets with General Operating Account Detail* in the line item "Change in appreciation on GOA investments, net." In fiscal 2008, after an evaluation of the appropriate investment strategy for this specific pool of cash, we determined that we would reduce the risk profile of the University's pooled cash investments, and we began implementing initial adjustments. In fiscal 2009, the risk reduction program was slowed by market conditions which required the University to prioritize efforts by HMC to manage liquidity risks within the GIA. We now are renewing our focus on the program and taking further steps toward de-risking these investments for the future.

FISCAL 2009 OPERATING EXPENSES



FISCAL 2009 FUNCTIONAL EXPENSES



**Excludes $302.4 million in scholarships applied to student income.*

The aforementioned line item in the *Statements of Changes in Net Assets with General Operating Account Detail* also reflects realized and unrealized losses under interest rate exchange agreements. Harvard, like many other institutions with large capital programs, uses interest rate exchange agreements as an element of our overall debt management strategy. This strategy is intended to create a more stable budgetary environment, by reducing Harvard's exposure to rising interest rates. The University's portfolio of interest rate exchange agreements is described in more detail in *Note 11* of the audited financial statements.

In fall 2008, interest rates fell with an unprecedented swiftness and trajectory. These declines caused Harvard's interest rate exchange agreements to incur sudden and precipitous declines in value, which in turn led to significant increases in associated collateral pledged to counterparties, creating liquidity pressures on the University. In response, Harvard terminated certain of these agreements at a cash cost of approximately $500 million. Following this and other risk reduction measures, the liquidity risk of the portfolio at June 30, 2009 has been managed to levels that we consider appropriate, although we engage in regular monitoring and are prepared to take further action should the need arise.

Debt

The University issued $1.0 billion in tax-exempt debt and $1.5 billion in taxable debt during fiscal 2009. The tax-exempt issuance was intended to manage liquidity risk by refinancing variable-rate bonds. The taxable debt issuance was undertaken to enhance the University's flexibility by increasing its cash position. The University has benefited from the enhanced protection and flexibility provided by the new debt, despite the significant incremental interest expense noted above. Importantly, the University continues to maintain its AAA/Aaa credit ratings with Standard & Poor's and Moody's Investors Service, both of which were affirmed in connection with the two bond issues. More detail on these debt issuances, and the University's broader debt portfolio, can be found in *Note 11* of the audited financial statements.

Retirement Obligations

As of June 30, 2009, the University's retirement assets related to its defined benefit plans were $43 million less than the plan's liabilities for accounting purposes. This compares with an "overfunded" position of $294 million as of June 30, 2008 (i.e., plan assets exceeded plan liabilities as of that date). The underfunded position as of June 30, 2009 was driven primarily by a negative investment return of $169 million, and also by $43 million of additional plan liabilities associated with the early retirement incentive program. The fair value of plan assets as of June 30, 2009 was $681 million. The University does not expect to be required to contribute to the defined benefit plan in fiscal 2010 under the Pension Protection Act of 2006, because for ERISA purposes, the plan actually remained overfunded as of January 1, 2009 (i.e. plan assets exceeded the accumulated benefit obligation at that time). The University is committed—regardless of funding status—to fully meet its obligations to defined benefit plan participants.

Capital Expenses

The University invested $644 million in capital projects and acquisitions during fiscal 2009. Of this amount, 61% was spent on new construction and acquisitions and 39% was invested in the existing physical plant.

The University continued to advance several important capital projects. Harvard Law School continued construction on its Northwest Corner building including an associated underground parking garage. The Harvard Art Museum has undertaken several relocation projects that will enable the renovation and expansion of 32 Quincy Street. And the Arnold Arboretum is nearing completion of its Weld Hill research and administrative building.

Construction on the Harvard Allston Science Complex, which began in January 2008 after an intensive public review process and approval by the Boston Redevelopment Authority, continued in fiscal 2009. However, in light of the University's new economic reality, President Faust determined that, simultaneous with continued construction to bring the structure to ground level, Harvard would assess its alternatives with regard to the complex. This assessment is ongoing, in the context of a broader re-examination of the scale and pacing of our aspirations to develop the Allston campus.

The University remains committed to the academic programs that originally were designated to occupy the Allston Science Complex. Toward that end, Harvard is undertaking a significant renovation of several science buildings on the Cambridge campus in order to accommodate the space needs of the University's Stem Cell and Regenerative Biology department. The University also has leased space in the Longwood Medical Area to serve as the principal site for the Wyss Institute for Biologically Inspired Engineering.

Notwithstanding the challenges we have faced during fiscal 2009, Harvard's financial foundation is strong and will continue to enable the University to deliver on its guiding purposes: to achieve excellence in research and education; to prepare students for leadership and for lives of meaning and value; to advance the course of knowledge and ideas; and to serve society. Like many other institutions, we have been reminded during the past year about the volatility of markets and the need to pay close attention to managing financial risk. But we also have been reminded of the dedication, expertise and passion of the many faculty, staff and alumni with whom we have engaged to discuss and resolve complicated issues that in many cases were truly unprecedented; and of the boundless energy of the many stakeholders within the Harvard community who have taken up the task of adapting to a new economic reality for the University. We are grateful to all of our students, faculty, staff, alumni and friends, for their continuing and unwavering support of Harvard University.

Daniel S. Shore
VICE PRESIDENT FOR FINANCE AND
CHIEF FINANCIAL OFFICER

James F. Rothenberg
TREASURER

October 4, 2009

Annual Report of Harvard Management Company

The fiscal year that ended June 30, 2009 marked the close of what was very likely the most challenging period in modern times for the financial markets as well as for the Harvard portfolio. We saw extreme uncertainty in our economy and a level of volatility and dysfunction in many types of investments that went well beyond all previous experience. At Harvard Management Company ("HMC"), we actively managed the endowment through truly unprecedented market conditions over the past year while maintaining the long-term focus on investment opportunities that has served Harvard so well historically.

OVERVIEW OF THE PAST YEAR

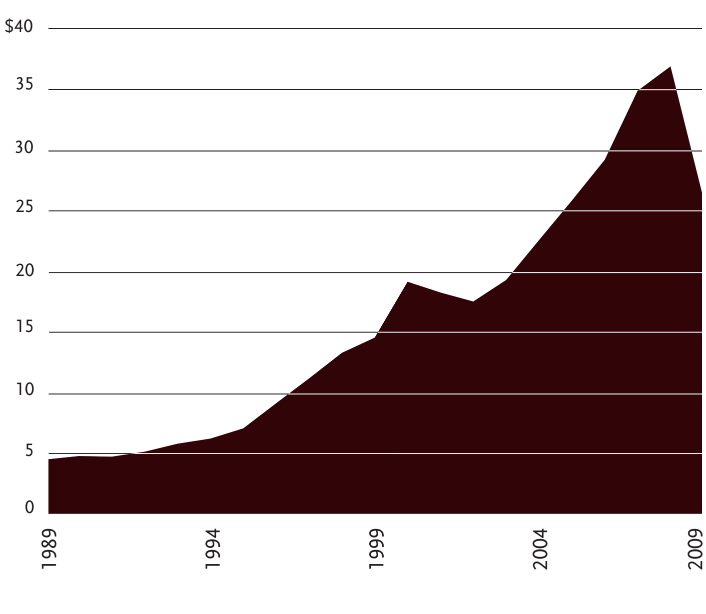
As of June 30, 2009, the value of Harvard's endowment was $26.0 billion. The return on the investments managed by HMC during fiscal 2009 was negative 27.3% and positive 6.2% annualized for the last five fiscal years. This compares with the return on our Policy Portfolio benchmark of negative 25.2% during fiscal 2009, and positive 3.9% annualized for the last five fiscal years. Clearly, the last year was a difficult one for Harvard as it was for almost all institutional investors.

Longer-term results, discussed in more detail later, are strong, even after the broad downdrafts of the past year. This strong long-term endowment performance has been increasingly critical to the University and its operating budget.

As markets worldwide corrected sharply last summer and fall, the endowment's return was negatively impacted both absolutely and relatively. Our portfolio had its share of challenges.

FAIR VALUE OF THE ENDOWMENT

In billions of dollars



HISTORICAL INVESTMENT RETURN
ANNUALIZED FOR PERIODS GREATER THAN ONE YEAR

	Harvard[1]	Policy Portfolio Benchmark[2]	60/40 stock/bond Portfolio[3]	TUCS Median[4]
1 year	(27.3)%	(25.2)%	(13.5)%	(18.2)%
5 years	6.2	3.9	1.0	2.5
10 years	8.9	4.5	1.4	3.2
20 years	11.7	9.5	7.8	8.0

FISCAL 2009 PERFORMANCE

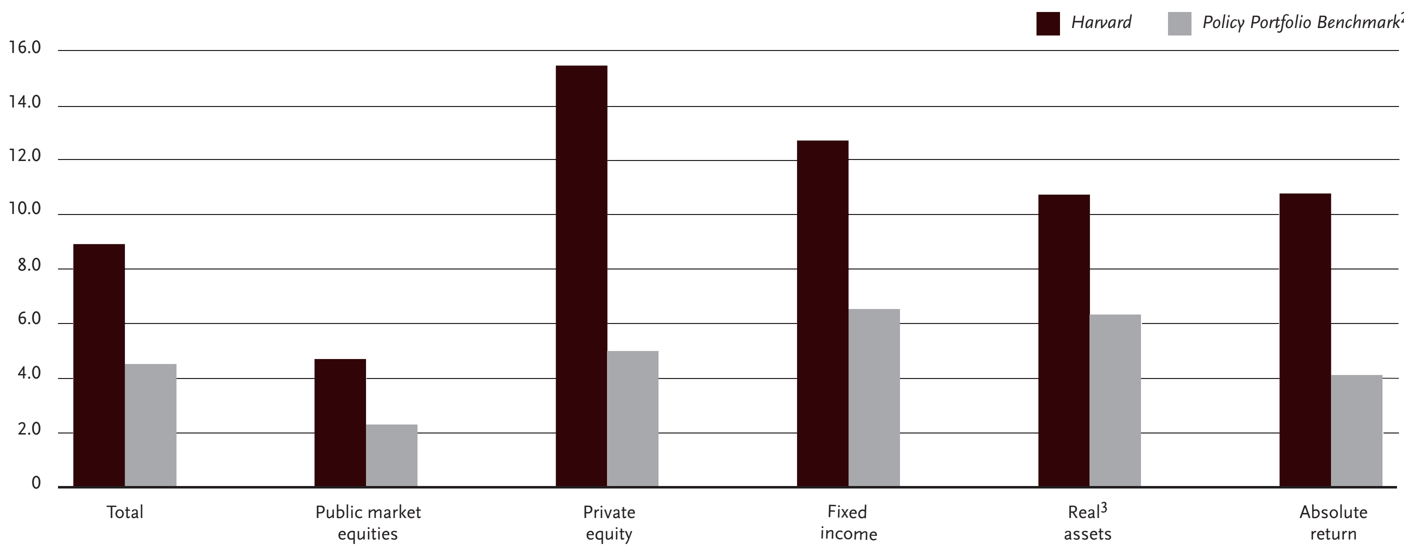
	Harvard[1]	Policy Portfolio Benchmark[2]	Relative
Public market equities	(28.3)%	(28.5)%	0.2%
Private equity	(31.6)	(23.9)	(7.7)
Absolute return	(18.6)	(13.2)	(5.4)
Real assets	(37.7)	(38.5)	0.8
Fixed income	(4.1)	(3.4)	(0.7)
Total investments	(27.3)	(25.2)	(2.1)

1 *Total return is net of all fees and expenses.*
2 *Individual benchmarks are representative of each asset class and are approved by the Board.*
3 *S&P 500/CITI US BIG*
4 *Trust Universe Comparison Service as compiled by Wilshire Associates.*

With a few notable exceptions, nearly every asset class did poorly. Our real estate portfolio, for example, suffered a loss of over 50% during the year after considering all final marks through June 30, 2009. While diversification has been a mainstay and a driver of the portfolio's return over the long-term, the benefits of diversification did not bear out through the rapidly evolving and widespread events that unfolded in fiscal 2009.

With perfect hindsight we and most other investors would have started this year in a more liquid position and with less exposure to some of the alternative asset categories that were hardest hit during fiscal 2009. It is important to note, however, that our portfolio has benefited greatly from our asset allocation over the long-term, which has included substantial exposure to less conventional asset classes. Private equity, for example, has earned an average of 15.5% per year for the Harvard portfolio for the last ten years even after a 32% correction in fiscal 2009. Our natural resources portfolio, a more recent addition, has returned 13.0% per year for the last ten years. It would be a mistake to categorically avoid these types of investments because they are less liquid. But the balance of liquid and illiquid investments within the portfolio needs to remain in the forefront of our portfolio strategy.

ANNUALIZED TEN-YEAR PERFORMANCE BY ASSET CLASS[1]



[1] *Returns are calculated on a time-weighted basis with the exception of private equity, which is calculated on a dollar-weighted basis. Returns are net of all fees and expenses.*
[2] *Individual benchmarks are representative of each asset class and are approved by the Board.*
[3] *Real assets consist of investments in liquid commodities, natural resources, and real estate.*

We are never pleased with negative results either relative or absolute. However, HMC's active management during fiscal 2009, involving every area of the company and every part of the portfolio, helped control the damage against the headwinds we faced. Some specifics include:

- Enhanced comprehensive management across investment platforms instituted through the newly-created positions of Head of Internal Management and Head of External Management;
- Stronger operations management spearheaded by the newly-created position of Chief Operating Officer;
- Creative approaches to managing some of our illiquid exposures including early exploration of private equity secondary markets;
- Quick reactions on the part of our internal portfolio managers to both changing market conditions and the portfolio's liquidity needs.

Even in a year like this one, where virtually every asset class behaved in ways that were highly correlated, some of our individual strategies performed well:

- HMC's international fixed income team had an extraordinary year, outperforming its benchmark by over 900 basis points in fiscal 2009 (and achieving average outperformance of nearly 400 basis points over the last three fiscal years);
- Our internal emerging markets team outperformed its market by a meaningful margin (370 basis points) in fiscal 2009, amidst a sharply negative and rapidly evolving market;
- The natural resources portfolio was nearly flat in an environment of negative returns for virtually all other growth assets, confirming the diversification benefit of this category of investments even in turbulent markets;
- The overall portfolio performance was buffered by positive returns in a category of trades employed as top-down portfolio hedges.

Active management was essential throughout this period. We worked decisively to make changes to our asset allocation and to increase our flexibility early in the fiscal year. Once the ship was steadied, the team adjusted its focus to incorporate incremental market exposure and active investments within the portfolio over the last few months. We never lost sight of our focus on our long-term goal to seek substantial growth in endowment assets while managing investment risk on behalf of the University. We are acutely aware that the investment portfolio must support current University operations and maintain the purchasing power of the endowment over time.

THE POLICY PORTFOLIO AND RELATIVE PERFORMANCE

The underlying framework for our investment activity is the Policy Portfolio, a concept that has been employed by HMC for many years. The Policy Portfolio represents our best thinking about the optimal long-term mix for Harvard's endowment assets.

The Policy Portfolio is a theoretical portfolio allocated among asset classes in a mix that is judged to be most appropriate for the University from both the perspective of potential return and risk. The HMC Board and management team create the Policy Portfolio and review it for continued fit with the University's risk profile and our projections of long-term market returns, volatility and correlations. The Policy Portfolio provides us with a guide as to the actual allocation in the investment portfolio and also serves as a measuring stick against which we judge the success of our active investment management activities. As in any measure of investment performance, long-term results relative to the Policy Portfolio are most meaningful.

The following table shows the evolution of the Policy Portfolio:

	Fiscal year		
	1995	2005	2010
Domestic equities	38%	15%	11%
Foreign equities	15	10	11
Emerging markets	5	5	11
Private equities	12	13	13
Total equities	70	43	46
Commodities	6	13	14
Real estate	7	10	9
Total real assets	13	23	23
Domestic bonds	15	11	4
Foreign bonds	5	5	2
High-yield	2	5	2
Inflation-indexed bonds	0	6	5
Total fixed income	22	27	13
Absolute return	0	12	16
Cash	-5	-5	2
TOTAL	**100%**	**100%**	**100%**

HMC's active management of the investment portfolio relative to the Policy Portfolio has added an average of 4.4% per year to our returns over the last 10 years. During fiscal 2009 the investment portfolio underperformed the Policy Portfolio by 2.1%. Our underperformance relative to the Policy Portfolio in part stemmed from the fact that our portfolio entered the crisis with some complicating factors including:

- Aggressive commitments to illiquid asset classes;
- Within liquid asset classes, a larger proportion of strategies with long holding periods;
- A lack of ready liquidity in the portfolio to meet our obligations along with the needs of the University.

Both our internally and externally managed portfolios suffered from our overall lack of ready access to sufficient liquidity going into the financial crisis. For example, our internally managed domestic fixed income portfolio carried exposure to some of the structured credit securities that were most impacted as the market imploded. A subset of our external hedge fund managers, while experiencing their own performance problems, changed their investors' ability to redeem capital, ostensibly to protect their funds' remaining assets. We have made changes to both of these areas and other aspects of the portfolio to increase the flexibility and control we have in managing our funds while maintaining attractive return expectations.

It would be unrealistic to expect to beat the Policy Portfolio each and every year. However, over the last ten years HMC has added $13 billion of value over the return of the Policy Portfolio and $18 billion of value over what would have been earned by a simple 60/40 stock/bond portfolio.

STRATEGIC REORIENTATION

Harvard's endowment remains a core strength of the University, supporting the outstanding teaching and research that is central to Harvard's mission. Even after the decline suffered this past year, Harvard's endowment is significantly larger than that of any other university and has demonstrated long-term performance superior to what would have been achieved had HMC pursued a more conservative investment strategy over the longer term.

We remain committed to the basic principle of managing and measuring ourselves against a Policy Portfolio benchmark focused on long-term returns and appropriate risk management. Managing the Harvard portfolio through the unprecedented market turmoil of the last twelve months has been challenging, but it also has provided us with an opportunity to begin to position HMC and the investment portfolio in new ways.

Importantly, we have taken action to increase flexibility, reduce leverage and position ourselves to explore the most attractive investment themes that we foresee emerging from the crisis we have experienced. With increased market liquidity, we rebalanced the portfolio productively towards undervalued assets. We have decreased our uncalled capital commitments by roughly $3 billion. We have increased the depth and breadth of talent in our investment team. We have begun reorienting our strategy and our organization to better fit with what we believe will be a rich and complex opportunity set in the future.

Past changes to the Policy Portfolio generally have been incremental. We are now in the process of rethinking certain aspects of the model to better suit current realities and lessons learned. Elements of the re-engineered Policy Portfolio may include:

- Fewer distinctions among the finely tuned asset classes to encourage greater collaboration among our teams in exploring investment themes;
- Greater concentration in areas where HMC has unique competitive strengths such as fixed income and real assets;
- Rigorous reassessment of the fit between the endowment's risk profile and the University's needs.

We expect these adjustments to our investment approach and strategy to maximize our effectiveness as active managers and to yield results over time that are well suited to the University's needs and risk parameters.

ORGANIZATION AND STRUCTURE

This has also been a year of change for HMC. In July 2008, I returned to HMC as CEO. Before rejoining HMC, I served as Chief Investment Officer at Wellesley College for six years. Prior to that experience, I was a senior member of the investment team at HMC for 15 years (1987–2002) starting my tenure as a member of the internal management team in public equities and ending as the portfolio manager in charge of all of the endowment's externally managed assets.

While HMC has made many changes in recent times, we continue to employ a "hybrid model"—a unique approach to endowment management. We use a mix of internal and external investment management teams that focus on specific investment areas. We believe this gives us the best of both worlds—top-quality investment management by our internal team and access to cutting edge capability from specialized teams around the world through our externally managed portfolio. While some parts of the portfolio, like private equity, are better suited for external management, and others, like parts of the publicly traded markets, lend themselves more naturally to internal strategies, we are not compelled to manage internally or externally in any particular proportion. Rather, we will use the mix of internal and external managers that best represents our conviction regarding opportunities and gives us access to the best possible strategies.

The benefits of the hybrid model are both broad and deep:

- Harvard's partnerships with investment management teams around the world provide diversification, insight, and perspective that goes beyond what could possibly be achieved through our relatively small team in Boston;
- Our internal investment management team, currently responsible for investing approximately a third of the portfolio, is our eyes and ears on the markets—constantly attuned and responsive to changing conditions, and frequently ahead of the curve in recognizing market inefficiencies and ways that we might profit from them;
- In addition to this close feel for the markets, our internal management approach gives us increased control, total transparency and greater nimbleness in the face of changing market conditions or University needs. Finally, our internal team is extraordinarily cost effective—with total expenses equal to a fraction of the costs of employing outside managers for similar asset pools with similar results.

For all of these reasons, while we do not have a specific target for internal or external management as a proportion of the total portfolio, we are looking to increase the share of our internally managed assets under the right conditions.

Over the last year the management team and investment support structure has been strengthened substantially including the addition of a Chief Operating Officer, Bob Ettl. Bob joined HMC in October with extensive experience most recently at Allianz/PIMCO. Bob has significantly redesigned and upgraded the investment support organization of the company and has added considerable bench strength including a new Chief Financial Officer and new Chief Technology Officer.

In further positioning HMC as an organization driven to uncover and integrate the highest quality investment opportunities across traditional asset classes, the individual investment teams were aggregated this year under two of our senior investment professionals. As the new Head of Internal Management, Stephen Blyth oversees the investment portfolios and strategies of the public equity, fixed income and foreign currency specialists investing directly for Harvard. Andy Wiltshire, our new Head of External Management, manages the groups making investments utilizing outside managers or partners in areas such as private equity, real estate, natural resources and marketable securities.

With the management team substantially in place, we implemented a restructuring in February to better align our company structure with investment opportunities going forward. We are now focused on strengthening staff and adding world-class talent to supplement our core areas of expertise. As a result, we recently made several additions to our investment teams, including in fixed income/Asian markets, in equity arbitrage, in real estate and in externally managed funds. We will continue to seek out exceptional individuals with unique investment insights that will drive value for the portfolio.

COMPENSATION AT HMC

The investment management team at HMC is compensated in a way that achieves exceptionally strong alignment of interest between the manager and the University. For each asset class a benchmark is established that reflects the return that can be achieved by a passive investor (e.g., the S&P 500 is the benchmark for a large cap equity manager). When a manager outperforms their market benchmark, they earn a performance bonus which is based on the dollars of value added to the endowment portfolio over and above the benchmark. It is important to note that a sizable portion of this earned bonus is held back against the risk of possible underperformance by the manager in subsequent years. This approach has the effect of focusing the manager on sustained outperformance over multi-year periods and guards against rewarding outperformance gained through inappropriate risk-taking. As a result of this system, last year a substantial number of portfolio managers at HMC had portions of their bonuses earned in prior years "clawed back" into the endowment. A smaller group of managers—those who outperformed their markets in fiscal 2009—retained their past bonuses while earning additional performance compensation this year.

RISK MANAGEMENT

Risk management is a critical component of successful portfolio management and must be integrated into the fabric of our investment strategy in order to protect the assets we are managing. HMC management and the HMC Board devote substantial staff, time and attention to the complexities that relate to the risk inherent in our portfolio.

There are multiple forms of risk in an investment portfolio—market risk, leverage, counterparty risk, illiquidity, the risk of stronger-than-expected correlation and the risk of less-than-complete transparency. The past year has offered up many lessons regarding the means to perceive, measure and control risk in a highly diversified portfolio such as Harvard's. Overall, our risk management was adequate. We did not suffer the extreme volatility of many of the markets in which we participate. We did not find we were in partnership with fraudulent third party management. Even with the bankruptcy of Lehman Brothers and other major credit events, we had negligible losses related to counterparty risk. We kept the ship righted in a real-life correction that exceeded our most extreme theoretical stress tests.

All of this having been said, we can do and are doing more to manage the risks we face, given the lessons of the past year. The most important of these lessons is that the risk tolerance of the University continues to be a critical factor in the decisions regarding asset allocation, flexibility and accessibility of the investment strategies we choose.

THE ROAD AHEAD

As we enter the new fiscal year, many questions remain about the underlying health of the world economies albeit there have been recent encouraging signs of slower deterioration and possible growth in profits ahead. Massive government stimulus has provided some optimism in the markets, but spirited debates continue about the dangers of specific sectors including the financial institutions upon which so many markets and consumers depend.

We continue to debate the dueling threats of inflation and deflation, and can make cases for both. In any event, we expect a prolonged period of instability and slower growth in some markets. For the economy overall, we do not anticipate a quick return to the rapid, sustained growth experienced in recent times.

Even so, there will be many opportunities to create value through prudent and creative investment strategies in the coming months and years. In times of uncertainty active management is increasingly important. We expect to find some of our most interesting investment opportunities outside of and across traditional asset class boundaries and are pursuing investments consistent with this theme today. While we will be guided by our Policy Portfolio, we will continue to explore with rigor creative new opportunities whether contemplated by the Policy Portfolio or not (such as our timberland investments were when they were first made). In addition, we will maintain a continuous measure of accessible liquidity in the portfolio to preserve both our ability to capture unforeseen opportunities and to support the needs of the University.

In navigating the past year's storm, we have developed greater financial flexibility, strengthened our investment team, sharpened our focus and positioned both HMC and the Harvard portfolio to be robust, steady and importantly, poised to benefit from growth in the world's economies. We have reset the building blocks for a solid, innovative and sustainable investment strategy. Given all of this, we have ample cause for optimism in the next few years particularly given the following:

- Our liquidity is much improved and increasingly under our control;
- Our HMC team is stronger and the opportunity to engage new talent is greater than it has been in years;
- We are alert to new and different ways of looking at what have become the traditional models.

While we are implementing a variety of shifts to our portfolio strategy and are confident that these shifts will bear fruit over time, it is important to be realistic about near-term returns and about our expectations for several years to come. The impact of the events of 2008–2009 will not be reversed overnight. For Harvard, as for almost every major investor, regaining the market value lost as a result of the recent global economic crisis will take time.

Few could have predicted the extent of the external market turmoil of the past year. As we enter a new fiscal year, we continue to be inspired by the mission of this great university and the role of HMC in supporting that mission. We are confident that the portfolio is well positioned, from both a risk and return standpoint, to support the University and its operations into the future.

Jane L. Mendillo
PRESIDENT AND CEO

October 4, 2009

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

To the Board of Overseers of Harvard College:

In our opinion, the accompanying Balance Sheet and the related Statements of Changes in Net Assets with General Operating Account Detail, Changes in Net Assets of the Endowment, and Cash Flows, present fairly, in all material respects, the financial position of Harvard University (the "University") at June 30, 2009, 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 2008 financial statements, and in our report dated October 5, 2008, 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.

Effective July 1, 2008, the University changed the manner in which it evaluates the fair value of financial instruments.

PricewaterhouseCoopers LLP

October 4, 2009

BALANCE SHEETS

with summarized financial information as of June 30, 2008

In thousands of dollars	June 30 2009	2008
ASSETS:		
Cash	$ **34,182**	$ 27,307
Receivables, net (*Note 5*)	**178,730**	249,359
Prepayments and deferred charges	**151,197**	121,834
Notes receivable, net (*Note 6*)	**357,445**	336,085
Pledges receivable, net (*Note 7*)	**785,290**	626,479
Fixed assets, net (*Note 8*)	**5,393,464**	4,951,329
Net retirement assets (*Note 12*)		293,560
Interests in trusts held by others (*Notes 4, 9 and 13*)	**276,571**	341,990
Investment portfolio, at fair value (*Notes 3 and 4*)	**34,759,859**	51,084,894
Fair value of securities pledged to counterparties (*Notes 3 and 4*)	**3,067,027**	6,398,168
TOTAL ASSETS	**45,003,765**	**64,431,005**
LIABILITIES:		
Accounts payable (*Note 20*)	**350,212**	413,674
Deposits and other liabilities (*Note 8*)	**679,619**	509,873
Securities lending and other liabilities associated with the investment portfolio (*Notes 3, 4 and 11*)	**6,346,554**	13,678,751
Liabilities due under split interest agreements (*Note 10*)	**696,987**	908,259
Bonds and notes payable (*Note 11*)	**5,980,451**	4,089,912
Accrued retirement obligations (*Note 12*)	**740,116**	607,427
Government loan advances (*Note 6*)	**69,540**	58,902
TOTAL LIABILITIES	**14,863,479**	**20,266,798**
NET ASSETS	**30,140,286**	**44,164,207**
TOTAL LIABILITIES AND NET ASSETS	$ **45,003,765**	$ **64,431,005**

	Unrestricted	Temporarily restricted	Permanently restricted	June 30 2009	2008
NET ASSETS:					
General Operating Account (*Note 13*)	$ 2,414,084	$ 1,176,696	$ 92,362	$ **3,683,142**	$ 6,575,052
Endowment (*Note 9*)	4,250,770	17,071,925	4,712,694	**26,035,389**	36,926,693
Split interest agreements (*Note 10*)		63,891	357,864	**421,755**	662,462
TOTAL NET ASSETS	$ **6,664,854**	$ **18,312,512**	$ **5,162,920**	$ **30,140,286**	$ **44,164,207**

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, 2008

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2009	2008
OPERATING REVENUE:					
Student income:					
Undergraduate program	$ 240,139			**$ 240,139**	$ 232,070
Graduate programs	371,826			**371,826**	357,071
Board and lodging	141,084			**141,084**	131,061
Continuing education and executive programs	227,673			**227,673**	213,919
Scholarships applied to student income (*Note 14*)	(302,369)			**(302,369)**	(252,126)
Total student income	678,353	0	0	**678,353**	681,995
Sponsored support (*Notes 15 and 16*):					
Federal government - direct costs	419,658			**419,658**	398,084
Federal government - indirect costs	139,005			**139,005**	136,870
Non-federal sponsors - direct costs	53,211	$ 84,224		**137,435**	119,215
Non-federal sponsors - indirect costs	11,659	5,881		**17,540**	14,257
Total sponsored support	623,533	90,105	0	**713,638**	668,426
Gifts for current use (*Note 16*)	140,061	151,170		**291,231**	236,599
Investment income:					
Endowment income made available for operations (*Note 9*)	250,066	1,192,458		**1,442,524**	1,201,307
Income on GOA investments made available for operations	157,029	31,490		**188,519**	175,056
Interest earned on student, faculty, and staff loans	7,443			**7,443**	8,047
Total investment income	414,538	1,223,948	0	**1,638,486**	1,384,410
Other income (*Note 17*)	505,856			**505,856**	510,887
Net assets released from restrictions	1,374,714	(1,374,714)		**0**	0
TOTAL OPERATING REVENUE	**3,737,055**	**90,509**	**0**	**3,827,564**	**3,482,317**
OPERATING EXPENSES:					
Salaries and wages	1,384,626			**1,384,626**	1,298,604
Employee benefits (*Note 12*)	456,109			**456,109**	362,067
Scholarships and other student awards (*Note 14*)	122,479			**122,479**	110,532
Supplies and equipment	224,404			**224,404**	235,031
Space and occupancy (*Note 11*)	445,071			**445,071**	411,095
Depreciation (*Note 8*)	288,450			**288,450**	246,654
Other expenses (*Notes 11 and 18*)	834,932			**834,932**	800,910
TOTAL OPERATING EXPENSES	**3,756,071**	**0**	**0**	**3,756,071**	**3,464,893**
NET REVENUE/(DEFICIT)	**(19,016)**	**90,509**	**0**	**71,493**	**17,424**
OTHER PROVISIONS AND CREDITS:					
Change in appreciation on GOA investments, net (*Note 11*)	(2,819,425)	475		**(2,818,950)**	68,961
Change in undistributed general investment income	(60,902)	(106,919)		**(167,821)**	(231,663)
Other changes (*Note 12*)	(338,363)			**(338,363)**	(29,299)
TOTAL OTHER PROVISIONS AND CREDITS	**(3,218,690)**	**(106,444)**	**0**	**(3,325,134)**	**(192,001)**
CAPITAL CHANGES:					
Change in pledge balances (*Note 7*)		154,470		**154,470**	8,260
Change in interests in trusts held by others (*Note 13*)		(7,794)		**(7,794)**	15,761
Capital gifts for loan funds and facilities (*Note 16*)		2,355	$ 294	**2,649**	4,865
Transfers between the GOA and endowment (*Note 9*)	220,339	(44,202)		**176,137**	268,061
Transfers between the GOA and split interest agreements (*Note 10*)		34,148	2,121	**36,269**	14,071
Non-operating net assets released from restrictions	63,658	(64,950)	1,292	**0**	0
TOTAL CAPITAL CHANGES	**283,997**	**74,027**	**3,707**	**361,731**	**311,018**
GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR	**(2,953,709)**	**58,092**	**3,707**	**(2,891,910)**	**136,441**
Endowment net change during the year	(1,889,978)	(9,097,895)	96,569	**(10,891,304)**	2,014,625
Split interest agreement net change during the year (*Note 10*)		(124,646)	(116,061)	**(240,707)**	20,753
NET CHANGE DURING THE YEAR	**(4,843,687)**	**(9,164,449)**	**(15,785)**	**(14,023,921)**	**2,171,819**
Net assets, beginning of year	11,508,541	27,476,961	5,178,705	**44,164,207**	41,992,388
NET ASSETS, end of year	**$ 6,664,854**	**$ 18,312,512**	**$ 5,162,920**	**$ 30,140,286**	**$ 44,164,207**

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, 2008

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2009	2008
Investment return (*Note 3*):					
Income from general investments	$ 18,912	$ 88,639		$ **107,551**	$ 248,133
Change in realized and unrealized appreciation	(1,583,048)	(8,115,528)		**(9,698,576)**	2,632,842
Total investment return	(1,564,136)	(8,026,889)	0	**(9,591,025)**	2,880,975
Endowment income made available for operations	(250,066)	(1,192,458)		**(1,442,524)**	(1,201,307)
Change in undistributed general investment income	24,047	121,236		**145,283**	202,045
Net investment return after distributions	(1,790,155)	(9,098,111)	0	**(10,888,266)**	1,881,713
Gifts for capital (*Note 16*)	8,895	26,948	$ 158,616	**194,459**	336,059
Transfers between endowment and the GOA (*Note 9*)	(220,339)	44,202		**(176,137)**	(268,061)
Capitalization of split interest agreements (*Note 10*)		36,598	10,512	**47,110**	23,843
Change in pledge balances (*Note 7*)		(11,266)	14,191	**2,925**	93,247
Change in interests in trusts held by others (*Note 9*)		(7,549)	(50,076)	**(57,625)**	(32,065)
Other changes	(604)	(20,722)	7,556	**(13,770)**	(20,111)
Net assets released from restrictions	112,225	(67,995)	(44,230)	**0**	0
NET CHANGE DURING THE YEAR	**(1,889,978)**	**(9,097,895)**	**96,569**	**(10,891,304)**	**2,014,625**
Net assets of the endowment, beginning of year	6,140,748	26,169,820	4,616,125	**36,926,693**	34,912,068
NET ASSETS OF THE ENDOWMENT, end of year	**$ 4,250,770**	**$ 17,071,925**	**$ 4,712,694**	**$ 26,035,389**	**$ 36,926,693**

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

STATEMENTS OF CASH FLOWS

In thousands of dollars	For the year ended June 30 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	**$ (14,023,921)**	$ 2,171,819
Adjustments to reconcile change in net assets to net cash provided by/(used in) operating activities:		
Depreciation	**288,450**	246,654
Change in fair value of interest rate exchange agreements	**347,769**	317,084
Change in interests in trusts held by others	**65,419**	16,304
Change in liabilities due under split interest agreements	**(211,272)**	1,678
Realized and unrealized loss/(gain) on investments, net	**11,978,540**	(3,170,532)
Gifts of securities	**(48,134)**	(93,636)
Gifts restricted for capital purposes	**(187,174)**	(274,874)
Changes in operating assets and liabilities:		
Receivables, net	**70,629**	(41,360)
Prepayments and deferred charges	**(29,363)**	(23,116)
Decrease in net retirement assets	**293,560**	9,722
Increase in accrued retirement obligations	**132,689**	61,729
Pledges receivable, net	**(158,811)**	(101,507)
Accounts payable	**(40,006)**	43,269
Deposits and other liabilities	**104,846**	31,402
NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES	**(1,416,779)**	**(805,364)**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans made to students, faculty, and staff	**(56,596)**	(56,515)
Payments received on student, faculty, and staff loans	**35,211**	28,657
Change in other notes receivable	**25**	(584)
Proceeds from the sales of gifts of securities	**48,134**	93,636
Proceeds from the sales and maturities of investments	**68,393,833**	72,683,691
Purchases of investments	**(66,557,720)**	(71,950,544)
Additions to fixed assets	**(681,165)**	(680,224)
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	**1,181,722**	**118,117**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in overdrafts included in accounts payable	**(7,976)**	6,312
Proceeds from the issuance of debt	**3,464,067**	1,737,010
Debt repayments	**(1,573,528)**	(1,494,076)
Gifts restricted for capital purposes	**187,174**	274,874
Change associated with securities lending agreements	**(1,838,443)**	148,878
Increase in government loan advances	**10,638**	1,756
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	**241,932**	**674,754**
NET CHANGE IN CASH	**6,875**	**(12,493)**
Cash, beginning of year	**27,307**	39,800
CASH, end of year	**$ 34,182**	**$ 27,307**

Supplemental disclosure of cash flow information:		
Change in accounts payable related to fixed asset additions	$ (15,480)	$ (6,403)
Non-cash additions to fixed assets related to capital leases	64,900	
Cash paid for interest	148,488	145,391

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

1. UNIVERSITY ORGANIZATION

Harvard University (the "University") is a private, not-for-profit institution of higher education with approximately 7,160 undergraduate and 13,070 graduate students. Established in 1636, the University includes the Faculty of Arts and Sciences, the School of Engineering and Applied Sciences, the Division of Continuing Education, ten graduate and professional Schools, the Radcliffe Institute for Advanced Study, a variety of research museums and institutes, and an extensive library system to support the teaching and research activities of the Harvard community. The President and Fellows of Harvard College (the "Corporation"), a governing board of the University, has oversight responsibility for all of the University's financial affairs. The Corporation delegates substantial authority to the Schools and departments for the management of their resources and operations.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

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

The financial statements include certain prior year summarized comparative information in total, not by net asset classification. This information is not presented in sufficient detail to conform with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2008, from which the summarized information is derived. Certain prior year amounts have been reclassified to conform to current year presentation.

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

Net asset classifications

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

UNRESTRICTED net assets are not subject to donor-imposed restrictions. Funds invested in fixed assets and unrestricted funds functioning as endowment comprise 85% of the University's unrestricted net assets as of June 30, 2009. In addition, this category includes unrestricted gifts and endowment income balances, University-designated loan funds, and other unrestricted current funds.

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

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

Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Income earned by restricted donor funds is initially classified as temporarily restricted net assets and is reclassified as unrestricted net assets when expenses are incurred for their intended purpose.

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

Net revenue/(deficit)

Revenues earned, expenses incurred, and income made available for operations for the purpose of teaching, conducting research, and the other programs and services of the University are the components of "Net revenue/(deficit)" in the *Statements of Changes in Net Assets with General Operating Account Detail*. Net revenue/(deficit) is the measure of the University's operating result.

Collections

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

Insurance programs

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

Tax-exempt status

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

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

New accounting pronouncements

Effective July 1, 2008, the University adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and enhances disclosures regarding fair value measurements. FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) on the measurement date, in the principal or most advantageous market for the asset or liability, and in an orderly transaction between market participants. The effect of adopting FAS 157 is further discussed in *Notes 3 and 4*.

The FASB issued Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP FAS 157-3). FSP FAS 157-3 clarifies that determining fair value in an inactive or dislocated market depends on facts and circumstances and requires significant management judgment. Specifically, this statement specifies that it is acceptable to use inputs based on management estimates or assumptions, or for management to make adjustments to observable inputs to determine fair value when markets are not active and relevant observable inputs are not available. The University's valuation policy is consistent with the guidance in FSP FAS No. 157-3.

The FASB issued Staff Position No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. Specifically, it emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, a fair value measurement assumes that the asset or liability is exchanged in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date. The University's valuation policy is consistent with the guidance in FSP FAS No. 157-4.

The FASB issued Staff Position No. FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB No. 161* (FSP FAS 133-1). FSP FAS 133-1 amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to require disclosures by sellers of credit derivatives that address the potential adverse effects of changes in credit risk on the financial position, financial performance and cash flows of the sellers of credit derivatives. The effect of adopting FSP FAS 133-1 and FIN 45-4 is addressed in *Note 3*.

Effective July 1, 2008, the University adopted FASB Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115* (FAS 159). FAS 159 provides entities with the option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different fair value measurement attributes for similar types of assets and liabilities. The University did not elect to account for any assets or liabilities under FAS 159 and therefore FAS 159 did not have any impact on the financial statements.

The FASB issued Staff Position No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP FAS 117-1). FSP FAS 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This FSP also requires additional disclosures about an organization's endowment funds (both donor-restricted and board-designated endowment funds), whether or not the organization is subject to UPMIFA. FSP FAS 117-1 was effective for the University's financial statements for the year beginning on July 1, 2008. The adoption of FSP FAS 117-1 did not have an impact on the financial statements.

Effective July 1, 2007, the University adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 sets a minimum threshold for financial statement recognition of the benefit of a tax position taken or expected to be taken in a tax return. Tax positions for the open tax years as of June 30, 2009 were reviewed, and it was determined that no provision for uncertain tax positions is required.

As of June 30, 2009, the University adopted the provisions of FAS 165, *Subsequent Events* (FAS 165). FAS 165 provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before the University financial statements are issued or are available to be issued. FAS 165 requires the University to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. The University has evaluated subsequent events through October 4, 2009, the date of the Report of Independent Auditors. FAS 165 requires additional disclosures only, and therefore did not have an impact on the University's financial statements.

The FASB issued Staff Position No. FAS 157-g, *Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, Investment Companies* (FSP FAS 157-g). FSP FAS 157-g clarifies that for investments in entities that permit the investor to redeem the investment directly with (or receive distributions from) the investee at net asset value per share at times allowable under the terms of the investee's governing documents, net asset value per share is the most relevant estimate of fair value available that would not require undue cost and effort for the reporting entity. A reporting entity is permitted to estimate the fair value of an investment if the net asset value per share of the investment (or its equivalent) is determined in accordance with the Investment Companies Guide as of the reporting entity's measurement date. FSP FAS 157-g will be effective for the University's financial statements issued for the year beginning on July 1, 2009. Management is currently evaluating the impact the adoption of FAS 157-g will have on the financial statements.

The FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (FAS 161) which changes the disclosure requirements for derivative instruments and hedging activities. FAS 161 requires that (1) objectives for using derivative instruments be disclosed in terms of underlying risks and accounting designation, (2) the fair values of derivative instruments and their gains and losses be disclosed in tabular format, and (3) information be disclosed about credit-risk contingent features of derivative contracts. FAS 161 will be effective for the University's financial statements issued for the year beginning on July 1, 2009. Management is currently evaluating the impact the adoption of FAS 161 will have on the financial statements.

3. INVESTMENTS

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

A) Investments are presented at fair 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. Restrictions that are attached to a security are factored into the valuation of that security, reflective of the estimated impact of those restrictions. Non-exchange traded debt instruments are primarily valued using independent pricing services or by broker/dealers who actively make markets in these securities. Over-the-counter positions such as options contracts, forward contracts, exchange agreements, interest rate cap and floor agreements, and credit default swaps are primarily valued using models with externally verifiable inputs, or by using independent broker quotes. Investments in most asset classes are at least partially achieved through external managers. The majority of these external investments are not readily marketable and are valued utilizing the most current information provided by the general partner, subject to assessments that the value is representative of fair value and consideration of any additional factors deemed pertinent to the valuations. Direct private equity and real asset investments are valued using discounted cash flow and other industry standard methodologies. Where applicable, independent appraisers and engineers assist in the valuation. These values are determined under the direction of, and subject to approval by, the Valuation Committee of the HMC Board of Directors.

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

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

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

F) 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 fair value of the security loaned. Collateral is moved as required by fluctuations in the fair value of the security loaned.

The majority of the University's investments are managed in the General Investment Account (GIA), a pooled fund that consists primarily of endowment assets. The University employs a unit method of accounting for its pooled general investment assets.

Other investments are managed separately from the GIA. These investments consist primarily of fixed income securities (principally government securities and certificates of deposit held for the University's working capital needs) and publicly traded securities associated with split interest agreements. These securities are measured at fair value on a recurring basis at quoted market prices.

The University's investments as of June 30, 2009 and 2008 are summarized in the following table (in thousands of dollars):

	2009	2008
Investment portfolio, at fair value:		
Pooled general investment assets[1]	**$ 33,539,878**	$ 49,998,480
Other investments[2]	**1,219,981**	1,086,414
Total investment portfolio, at fair value	**34,759,859**	51,084,894
Fair value of securities pledged to counterparties	**3,067,027**	6,398,168
Securities lending and other liabilities associated with the investment portfolio[3]	**(6,346,554)**	(13,678,751)
TOTAL INVESTMENTS[4]	**$ 31,480,332**	**$ 43,804,311**

Investments as of June 30, 2009 and 2008 comprised the following (in thousands of dollars):

	2009	2008
Pooled general investment net assets:		
General Operating Account	**$ 4,625,249**	$ 5,493,884
Endowment	**25,368,780**	36,193,970
Split interest agreements	**706,644**	1,065,564
Other internally designated funds	**237,806**	294,838
Total pooled general investment net assets	**30,938,479**	43,048,256
Other investments[2]	**1,219,981**	1,086,414
Fair value of interest rate exchange agreements	**(678,128)**	(330,359)
TOTAL INVESTMENTS[4]	**$ 31,480,332**	**$ 43,804,311**

[1] *Excludes fair value of securities pledged to counterparties.*
[2] *Includes split interest agreement assets of $412,098 and $505,157 as of June 30, 2009 and 2008, respectively.*
[3] *Includes fair value of interest rate exchange agreements of $(678,128) and $(330,359) as of June 30, 2009 and 2008, respectively.*
[4] *Investment holdings include cash and cash equivalents that consist principally of funds that have maturities of 90 days or less. Cash and cash equivalents classified as investments were $4,158,947 and $1,846,492 at June 30, 2009 and 2008, respectively.*

A summary of the University's total return on investments for fiscal 2009 and 2008 is presented below (in thousands of dollars):

	2009	2008
Return on pooled general investments:		
Realized and unrealized gains/(losses), net	**$ (11,838,870)**	$ 3,180,799
Investment income	**128,602**	297,690
Total return on pooled general investments*	**(11,710,268)**	3,478,489
Return on other investments:		
Realized and unrealized losses, net	**(139,670)**	(10,267)
Investment income	**120,863**	42,310
Total return on other investments	**(18,807)**	32,043
Realized and unrealized losses on interest rate exchange agreements, net	**(879,178)**	(332,720)
TOTAL RETURN ON INVESTMENTS	**$ (12,608,253)**	**$ 3,177,812**

* *Net of all fees and expenses.*

The University's investment strategy incorporates a diversified asset allocation approach and maintains, within defined limits, exposure to the movements of the global equity, fixed income, real estate, commodities, and private equity markets. The core investment portfolio is structured to closely mirror the market exposures defined by the Policy Portfolio. The Policy Portfolio is the long-term asset mix that is considered most likely to meet the University's long-term return goals with the appropriate level of risk. It serves as the benchmark against which the performance of the pooled general investments is measured. In addition, the University seeks to enhance the returns of certain asset classes through strategies designed to capture mispricing in specific financial instruments without changing the fundamental risk profile of the core investment account. Depending on the characteristics of the financial instruments, the specific positions within a given strategy may be recorded in the asset or liability sections of the table below.

The pooled general investment assets and liabilities as of June 30, 2009 and 2008 are summarized as follows (in thousands of dollars):

	2009	2008
POOLED GENERAL INVESTMENT ASSETS:		
Domestic common and convertible equity	**$ 2,984,608**	$ 5,387,605
Foreign common and convertible equity	**1,314,426**	2,625,784
Domestic fixed income	**1,908,280**	4,552,457
Foreign fixed income	**1,429,341**	1,582,035
Emerging market equity and debt	**2,704,521**	4,161,743
High-yield	**1,705,432**	2,064,218
Absolute return and special situations funds	**5,146,719**	7,943,422
Private equities	**5,482,466**	7,296,369
Real assets[1]	**5,648,022**	8,029,084
Inflation-indexed bonds	**1,633,303**	3,155,115
Derivatives[2]	**1,516,773**	1,690,913
Total investment assets[3]	**31,473,891**	48,488,745
Collateral advanced under security borrowing agreements[4]	**774,289**	2,969,522
Cash and short-term investments	**3,648,580**	1,476,434
Other assets[5]	**710,145**	3,461,947
POOLED GENERAL INVESTMENT ASSETS	**36,606,905**	**56,396,648**
POOLED GENERAL INVESTMENT LIABILITIES:		
Equity and convertible securities	**92,449**	794,442
Fixed income	**365,101**	2,435,950
Derivatives[2]	**1,171,683**	1,115,265
Total investment liabilities	**1,629,233**	4,345,657
Cash collateral held under security lending agreements	**1,763,307**	5,796,982
Other liabilities[6]	**2,275,886**	3,205,753
POOLED GENERAL INVESTMENT LIABILITIES	**5,668,426**	**13,348,392**
POOLED GENERAL INVESTMENT NET ASSETS[7]	**$ 30,938,479**	**$ 43,048,256**

1 *Real assets include investments in commodities and real estate.*

2 *Includes futures, options, credit default swaps, exchange agreements, interest rate cap and floor agreements, and forward purchase and sale agreements, which are exchange traded or executed over the counter.*

3 *Securities pledged to counterparties where the counterparty has the right to sell or repledge the securities were $3,067,027 and $6,398,168 as of June 30, 2009 and 2008, respectively.*

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

5 *As of June 30, 2009, other assets consisted primarily of accounts receivable for the sale of securities of $516,307, and assets consolidated under EITF 04-5 of $191,772. As of June 30, 2008, other assets consisted primarily of accounts receivable for the sale of securities of $2,899,912, and assets consolidated under EITF 04-5 of $410,806.*

6 *As of June 30, 2009, other liabilities consisted primarily of accounts payable for undistributed income and the purchase of securities of $1,209,336, and other liabilities consolidated under EITF 04-5 of $1,002,058. As of June 30, 2008, other liabilities consisted primarily of accounts payable for undistributed income and the purchase of securities of $1,839,248, and other liabilities consolidated under EITF 04-5 of $1,300,806.*

7 *The cost of the total pooled general investment net assets was $31,435,906 and $38,594,686 as of June 30, 2009 and 2008, respectively.*

The asset allocation of the University's investment 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 table on page 25 includes 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 was $169.8 million and $910.7 million as of June 30, 2009 and 2008, respectively. The fair value of collateral accepted by the University was $1,824.7 million and $3,927.6 million as of June 30, 2009 and 2008, respectively. The portion of this collateral that was sold or repledged was $327.3 million and $1,112.0 million as of June 30, 2009 and 2008, respectively.

The University consolidates assets and liabilities held in partnerships or entities controlled by HMC in accordance with EITF 04-5, *Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights*. The consolidation of these entities increased the pooled general investment assets and liabilities shown in the table on page 25 by equal amounts. Real asset investments increased by $810.3 million and $890.0 million as of June 30, 2009 and 2008, respectively. Other assets, consisting of cash, receivables, and fixed assets, increased by $191.8 million and $410.8 million as of June 30, 2009 and 2008. Other liabilities, consisting of accruals, payables, debt, and minority interests, increased by $1,002.1 million and $1,300.8 million as of June 30, 2009 and 2008, respectively.

The University has also entered into agreements with private equity and real estate partnerships and external investment managers, which include commitments to make periodic cash contributions totaling approximately $8,773.8 million through fiscal 2019.

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, credit default swaps, exchange agreements, interest rate cap and floor agreements, and forward purchase and sale agreements, which are exchange traded or executed over the counter. These instruments are used in both the core portfolio to gain exposure to a given asset class and in the arbitrage strategies, with the goal of enhancing the returns of certain asset classes without increasing the market risk to the underlying asset class. The market risk of a strategy is influenced by the relationship between the financial instruments with off-balance sheet risk and the offsetting positions recorded in the *Balance Sheets*. The University manages exposure to market risk through the use of industry standard analytical tools that measure the market exposure of each position within a strategy. The strategies are monitored daily, and positions are frequently adjusted in response to changes in the financial markets.

The following table summarizes the market exposure (expressed in delta-weighted notional amounts), net ending fair value, net average fair value (an average of the five quarters ending June 30, 2009), and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2009 (in thousands of dollars):

	Market exposure		Net ending fair value of off-balance sheet positions	Net average fair value	Credit exposure*
	Long	Short			
Equity instruments:					
Equity futures	$ 397,647			$ 4,179	$ 40,830
Equity options	(1,004)		$ 1,007	1,104	
Equity exchange agreements	994,221	$ (17,039)	97,334	(19,746)	18,159
Total equity instruments	1,390,864	(17,039)	98,341	(14,463)	58,989
Fixed income instruments:					
Fixed income futures	617,562	(607,523)	2,054	(2,883)	2,748
Fixed income options	2,867,387	(2,694,200)	(9,580)	(49,367)	41
Interest rate exchange agreements	17,438,313	(18,438,358)	(23,585)	(75,677)	17,330
Interest rate caps and floors	1,737,224	(1,322,363)	56,911	123,353	39,660
Total fixed income instruments	22,660,486	(23,062,444)	25,800	(4,574)	59,779
Commodity exchange agreements	809,620		1,835	367	
Currency instruments:					
Currency forwards	1,308,279	(1,311,012)	(2,733)	12,046	16
Currency options	43,353	(36,337)	14,532	7,031	5,329
Currency exchange agreements	783,974	(645,030)	87	404	561
Total currency instruments	2,135,606	(1,992,379)	11,886	19,481	5,906
Credit instruments	1,290,058	(8,420,979)	206,549	677,786	10,718
TOTAL	**$ 28,286,634**	**$ (33,492,841)**	**$ 344,411**	**$ 678,597**	**$ 135,392**

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

The following table summarizes the market exposure (expressed in delta-weighted notional amounts), net ending fair value, net average fair value (an average of the five quarters ending June 30, 2008), and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2008 (in thousands of dollars):

	Market exposure		Net ending fair value of off-balance sheet positions	Net average fair value	Credit exposure*
	Long	Short			
Equity instruments:					
Equity futures	$ 413,617	$ (530,773)	$ 16,257	$ 7,683	$ 30,149
Equity options	10,615	(1,219)	12,048	7,257	
Equity exchange agreements	3,472,873	(527,118)	(74,119)	20,506	274
Total equity instruments	3,897,105	(1,059,110)	(45,814)	35,446	30,423
Fixed income instruments:					
Fixed income futures	499,630	(635,951)	1,871	12,823	9,590
Fixed income options	4,562,112	(3,018,565)	(59,256)	(4,539)	963
Interest rate exchange agreements	13,457,708	(11,826,808)	(50,686)	(26,523)	1,180
Interest rate caps and floors	6,396,100	(7,754,459)	127,653	107,683	10,697
Total fixed income instruments	24,915,550	(23,235,783)	19,582	89,444	22,430
Commodity instruments:					
Commodity options				(4,157)	
Commodity exchange agreements	3,702,822				12,353
Total commodity instruments	3,702,822	0	0	(4,157)	12,353
Currency instruments:					
Currency forwards	16,369,315	(16,358,151)	11,164	4,048	912
Currency options	1,043,132	(1,099,194)	(2,287)	(10,116)	4,256
Currency exchange agreements	115,530	(109,691)	1,932	1,099	259
Total currency instruments	17,527,977	(17,567,036)	10,809	(4,969)	5,427
Credit instruments	2,007,666	(7,918,917)	622,174	485,467	54,920
TOTAL	**$ 52,051,120**	**$ (49,780,846)**	**$ 606,751**	**$ 601,231**	**$ 125,553**

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

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

The University enters into credit derivatives to simulate long and short bond exposure that is either unavailable or considered to be less attractively priced in the bond market, or to hedge exposure obtained in the bond market. The University also uses these derivatives to reduce risk where it has exposure to the issuer, or to take an active long or short position with respect to the likelihood of an event of default. The reference obligation of the derivative can be a single issuer, a "basket" of issuers, or an index.

In instances where the University has purchased credit protection on an underlying reference obligation, the University is obligated to pay the seller of the credit protection a periodic stream of payments over the term of the contract in return for a contingent payment upon the occurrence of a credit event with respect to the underlying reference obligation. The contingent payment may be a cash settlement or a physical delivery of the reference obligation in return for payment of the face amount of the obligation. The amount paid for purchased protection is typically a small percentage of the notional amount. In instances where the University has sold credit protection on an underlying reference obligation, the University receives a fixed rate of income throughout the term of the contract, which typically is between one month and five years, and in some instances up to ten years. In the case where the University sold credit protection, if a credit event occurs, the University may cash settle the contract or pay the purchaser of credit protection the full notional value of the contract in exchange for the reference obligation.

As of June 30, 2009, the University's purchased and written credit derivatives had gross notional amounts of $9.8 billion and $1.4 billion, respectively, for total net purchased protection of $8.4 billion in notional value. The notional amounts of these credit derivatives are not recorded in the *Balance Sheets*.

The table below summarizes certain information regarding credit protection purchased and sold as of June 30, 2009 (in thousands of dollars):

	Purchased protection		Written protection notional amount					
			Years to maturity					
Credit rating on underlying	Purchased notional amount*	Purchased fair value	< 5 years	5-10 years	Total written credit protection	Offsetting purchased credit protection**	Net written credit protection	Net written credit protection fair value
A- to AAA	$ 2,350,000	$ 331,276	$ 108,500	$ 118,000	$ 226,500	$ 73,500	$ 153,000	$ (11,389)
BBB- to BBB+	6,376,332	211,384	377,832	77,700	455,532	101,232	354,300	(4,018)
Non-investment grade	712,091	297,599	706,993		706,993	202,953	504,040	(436,905)
TOTAL	**$ 9,438,423**	**$ 840,259**	**$ 1,193,325**	**$ 195,700**	**$ 1,389,025**	**$ 377,685**	**$ 1,011,340**	**$ (452,312)**

* *Amounts shown are net of purchased credit protection that directly offsets written credit protection, as discussed in the note (**) below.*

** *Offsetting purchased credit derivatives represent the notional amount of purchased credit derivatives to the extent they hedge written credit derivatives with identical underlyings.*

Credit ratings on the underlying, together with the period of expiration, are indicators of payment/performance risk. For example, the seller of credit protection is least likely to pay or otherwise be required to perform where the credit ratings are AAA and the period of expiration is "< 5 years". The likelihood of payment or performance is generally greater as the credit ratings fall and period of expiration increases.

4. FAIR VALUE OF INVESTMENT ASSETS AND LIABILITIES

As discussed in *Note 2*, in 2009, the University adopted FAS 157 and its applicable amendments. FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FAS 157 are described below:

LEVEL 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

LEVEL 2 Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

LEVEL 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The following is a summary of the levels within the fair value hierarchy for those investment assets and liabilities subject to fair value measurement as of June 30, 2009 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Cash and short-term investments	$ 4,158,947			$ 4,158,947
Domestic common and convertible equity	88,495	$ 7,243	$ 3,030,537	3,126,275
Foreign common and convertible equity	208,698		1,162,592	1,371,290
Domestic fixed income	326,133	1,602,265	88,837	2,017,235
Foreign fixed income	13,645	1,429,308		1,442,953
Emerging market equity and debt	1,631,308	3,996	1,069,217	2,704,521
High-yield	15,866	536,663	1,167,909	1,720,438
Absolute return and special situations funds			5,146,719	5,146,719
Private equities	4,283		5,587,397	5,591,680
Real assets	44		5,670,179	5,670,223
Inflation-indexed bonds	19,303	1,593,562	39,741	1,652,606
Derivatives	15,320	1,155,248	345,516	1,516,084
Other investments	30,257	2,156	6,871	39,284
TOTAL INVESTMENT PORTFOLIO ASSETS*	**6,512,299**	**6,330,441**	**23,315,515**	**36,158,255**
Interests in trusts held by others			276,571	276,571
TOTAL INVESTMENT ASSETS	**$ 6,512,299**	**$ 6,330,441**	**$ 23,592,086**	**$ 36,434,826**

* *Includes fair value of securities pledged to counterparties of $3,067,027 (see Note 3) and excludes investment assets not subject to fair value of $1,668,631.*

	Level 1	Level 2	Level 3	Total
INVESTMENT LIABILITIES:				
Equity and convertible securities	$ 92,335		$ 114	$ 92,449
Fixed income		$ 361,426	3,675	365,101
Derivatives	11,459	1,550,548	287,804	1,849,811
TOTAL INVESTMENT LIABILITIES**	**$ 103,794**	**$ 1,911,974**	**$ 291,593**	**$ 2,307,361**

** *Includes fair value of interest rate exchange agreements of $678,128 and excludes investment liabilities not subject to fair value of $4,039,193.*

The University's Level 3 investments consist almost entirely of investments managed by external advisors. The University primarily utilizes fair values provided to it by the external managers, but will make adjustments where deemed necessary as discussed in *Note 3*.

The following is a rollforward of Level 3 investments, as required under FAS 157, for the year ended June 30, 2009 (in thousands of dollars):

	Beginning balance as of July 1, 2008	Realized gains/ (losses)	Change in unrealized gains/ (losses)	Net purchases/ (sales)	Net transfers in/(out)	Ending balance as of June 30, 2009
INVESTMENT ASSETS:						
Domestic common and convertible equity	$ 3,924,154	$ (723,379)	$ 148,931	$ (326,046)	$ 6,877	$ 3,030,537
Foreign common and convertible equity	2,112,383	(45,139)	(595,607)	(69,553)	(239,492)	1,162,592
Domestic fixed income	1,142,974	(16,873)	(367,338)	(483,860)	(186,066)	88,837
Foreign fixed income	8,580				(8,580)	0
Emerging market equity and debt	1,563,606	5,311	(775,272)	(25,305)	300,877	1,069,217
High-yield	1,000,923	(105,628)	(129,643)	(9,042)	411,299	1,167,909
Absolute return and special situations funds	7,943,422	(147,678)	(1,207,587)	(1,923,626)	482,188	5,146,719
Private equities	7,368,053	(439,429)	(1,886,115)	689,844	(144,956)	5,587,397
Real assets	7,964,834	239,743	(2,385,350)	549,543	(698,591)	5,670,179
Inflation-indexed bonds	703,710	144,610	(190,224)	(618,355)		39,741
Derivatives	785,546	825,805	(547,438)	(854,549)	136,152	345,516
Other investments	19,554	3,324	(15,954)	(53)		6,871
TOTAL INVESTMENT ASSETS	**34,537,739**	**(259,333)**	**(7,951,597)**	**(3,071,002)**	**59,708**	**23,315,515**
Interests in trusts held by others	341,990		(52,742)	(12,677)		276,571
TOTAL INVESTMENT ASSETS	**$ 34,879,729**	**$ (259,333)**	**$ (8,004,339)**	**$ (3,083,679)**	**$ 59,708**	**$ 23,592,086**
INVESTMENT LIABILITIES:						
Equity and convertible securities	$ 113		$ 1			$ 114
Fixed income	120	$ (7,034)	2,277	$ 6,866	$ 1,446	3,675
Derivatives	524,199	249,142	(230,858)	(249,041)	(5,638)	287,804
TOTAL INVESTMENT LIABILITIES	**$ 524,432**	**$ 242,108**	**$ (228,580)**	**$ (242,175)**	**$ (4,192)**	**$ 291,593**

5. RECEIVABLES

The major components of receivables, net of reserves for doubtful accounts of $8.0 million and $11.8 million as of June 30, 2009 and 2008, respectively, were as follows (in thousands of dollars):

	2009	2008
Federal sponsored support	**$ 46,453**	$ 39,519
Non-federal sponsored support	**10,692**	9,841
Tuition and fees	**13,427**	9,751
Publications	**30,882**	31,274
Gift receipts	**9,114**	11,159
Executive education	**18,056**	23,398
Investment income		67,876
Other	**50,106**	56,541
TOTAL RECEIVABLES, NET	**$ 178,730**	**$ 249,359**

6. NOTES RECEIVABLE

Notes receivable are recorded initially at fair value and then amortized using the effective interest method. Notes receivable, net of reserves for doubtful accounts of $7.9 million and $7.6 million as of June 30, 2009 and 2008, respectively, were as follows (in thousands of dollars):

	2009	2008
Student loans:		
Government revolving	**$ 78,957**	$ 72,315
Institutional	**76,211**	75,703
Federally guaranteed	**1,954**	2,423
Total student loans	**157,122**	150,441
Faculty and staff loans	**171,284**	156,580
Other	**29,039**	29,064
TOTAL NOTES RECEIVABLE, NET	**$ 357,445**	**$ 336,085**

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled $69.5 million and $58.9 million as of June 30, 2009 and 2008, respectively, and are classified as liabilities in the *Balance Sheets*. Interest earned on the revolving and institutional loan programs is reinvested to support additional loans. The repayment and interest rate terms of the institutional loans vary considerably.

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

Faculty and staff notes receivable primarily contain mortgage 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 initially recorded at fair value (pledge net of discount) and subsequently amortized over the expected payment period, net of an allowance for uncollectible pledges. Discounts of $78.9 million and $64.5 million for the years ended June 30, 2009 and 2008, respectively, were calculated using discount factors based on the appropriate U.S. Treasury Note rates for pledges received prior to the adoption of FAS 157, and using the University's taxable unsecured borrowing rate for pledges received in fiscal 2009.

Pledges receivable included in the financial statements as of June 30, 2009 and 2008 are expected to be realized as follows (in thousands of dollars):

	2009	2008
Within one year	**$ 138,788**	$ 103,484
Between one and five years	**555,148**	413,936
More than five years	**233,428**	229,019
Less: discount and allowance for uncollectible pledges	**(142,074)**	(119,960)
TOTAL PLEDGES RECEIVABLE, NET	**$ 785,290**	**$ 626,479**

Pledges receivable as of June 30, 2009 and 2008 have been designated for the following purposes (in thousands of dollars):

	2009	2008
General Operating Account balances:		
Gifts for current use	**$ 284,385**	$ 150,768
Non-federal sponsored grants	**111,484**	88,388
Loan funds and facilities	**16,087**	16,914
Total General Operating Account balances	**411,956**	256,070
Endowment	**373,334**	370,409
TOTAL PLEDGES RECEIVABLE, NET	**$ 785,290**	**$ 626,479**

Because of uncertainties with regard to realizability and valuation, bequest intentions and other conditional promises are only recognized as assets if and when the specified conditions are met. Non-bequest conditional pledges totaled $45.6 million and $24.6 million as of June 30, 2009 and 2008, respectively.

8. FIXED ASSETS

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

The major categories of fixed assets as of June 30, 2009 and 2008 are summarized as follows (in thousands of dollars):

	2009	2008	Estimated useful life (in years)
Research facilities	**$ 1,876,123**	$ 1,812,063	*
Classroom and office facilities	**1,257,030**	1,107,330	35
Housing facilities	**1,072,255**	1,109,710	35
Other facilities	**528,402**	372,878	35
Service facilities	**461,512**	411,146	35
Libraries	**418,252**	384,993	35
Museums and assembly facilities	**291,211**	261,449	35
Athletic facilities	**163,258**	145,783	35
Land	**609,872**	597,910	N/A
Construction in progress	**617,502**	460,256	N/A
Equipment	**730,980**	634,021	**
Total fixed assets, at cost	**8,026,397**	7,297,539	
Less: accumulated depreciation	**(2,632,933)**	(2,346,210)	
TOTAL FIXED ASSETS, NET	**$ 5,393,464**	$ **4,951,329**	

* *Estimated useful lives of components range from 10 to 45 years.*
** *Estimated useful lives of equipment range from 3 to 8 years.*

Certain University facilities are subject to restrictions as to use, structural modifications, and ownership transfer. Included in the fixed asset balances are restricted facilities with a net book value of $188.1 million and $171.2 million as of June 30, 2009 and 2008, respectively.

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

Equipment includes general and scientific equipment, computers, software, furniture, and vehicles.

The University has asset retirement obligations of $42.2 million and $42.6 million, which is included in "Deposits and other liabilities" in the *Balance Sheets* as of June 30, 2009 and 2008, respectively.

9. ENDOWMENT

The University's endowment consists of approximately 11,600 separate funds established over many years for a wide variety of purposes. Endowment fund balances, including funds functioning as endowment, are classified and reported as unrestricted, temporarily restricted, or permanently restricted net assets in accordance with donor specifications and state law. Net unrealized losses on permanently restricted endowment funds are classified as a reduction to unrestricted net assets until such time as the fair value equals or exceeds historic dollar value. At June 30, 2009, unrestricted net assets were reduced by $123.0 million for such losses. No reduction in unrestricted net assets was necessary at June 30, 2008. Although funds functioning as endowment are not subject to donor restrictions, decisions to spend their principal require the approval of the Corporation. All but a small fraction of the endowment is invested in the GIA (*Note 3*).

The University is also the beneficiary of certain irrevocable trusts held and administered by others. The estimated fair values of trust assets, which include the present values of expected future cash flows from outside trusts and the fair value of the underlying assets of perpetual trusts, are recognized as assets and increases in net assets when the required trust documentation is provided to the University. The fair values of these trusts are provided by the external trustees and are adjusted annually by the University. These are included as Level 3 investments in the fair value hierarchy table in *Note 4*.

The endowment consisted of the following as of June 30, 2009 and 2008 (in thousands of dollars):

	2009				2008
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Endowment funds		$ 14,798,375	$ 4,166,212	$ **18,964,587**	$ 26,931,408
Funds functioning as endowment	$ 4,250,770	2,208,124		**6,458,894**	9,328,677
Pledge balances		54,534	318,800	**373,334**	370,409
Interests in trusts held by others		10,892	227,682	**238,574**	296,199
TOTAL ENDOWMENT	$ **4,250,770**	$ **17,071,925**	$ **4,712,694**	$ **26,035,389**	$ **36,926,693**

The University's endowment distribution policies are designed to preserve the value of the endowment in real terms (after inflation) and generate a predictable stream of available income. Each fall, the Corporation approves the endowment distribution for the following fiscal year. The endowment distribution is not based on a specific formula, nor is it directly tied to current investment returns. Rather, it reflects expectations about long-term returns, inflation rates, and the University's ongoing spending needs. For fiscal 2009, the endowment distribution approved by the Corporation (prior to decapitalizations) was equal to 4.1% of the fair value of the endowment invested in the GIA as of the beginning of the fiscal year. The total endowment distribution made available for operations was $1.4 billion and $1.2 billion in fiscal 2009 and 2008, respectively.

Each year the Corporation also approves certain decapitalizations from the endowment to support strategic, mission-critical activities or objectives that are typically one-time or time-limited. These decapitalizations totaled $239.6 million and $454.5 million in fiscal 2009 and 2008, respectively. These additional decapitalizations, in combination with the endowment distribution, resulted in an aggregate payout rate of 4.6% and 4.8% in fiscal 2009 and 2008, respectively.

10. SPLIT INTEREST AGREEMENTS

Under split interest agreements, donors enter into trust arrangements with the University in which the University receives benefits that are shared with other beneficiaries and institutions. Split interest agreement investment (SIA) assets are invested primarily in the GIA and publicly traded securities, a small segment is managed by an external advisor, and all are recorded at fair value as discussed in *Note 3*. The publicly traded securities are included as Level 1 and externally managed investments are included as Level 3 investments in the fair value hierarchy table in *Note 4*. Associated liabilities are recorded at the present value of estimated future payments due to beneficiaries and other institutions. These liabilities were calculated using discount factors based on the appropriate U.S. Treasury Note rates for gifts received prior to the adoption of FAS 157, and using the University's taxable unsecured borrowing rate for gifts received in fiscal 2009.

The changes in split interest agreement net assets for fiscal 2009 and 2008 were as follows (in thousands of dollars):

	2009			2008
	Temporarily restricted	Permanently restricted	Total	Total
Investment return:				
Investment income	$ 5,096	$ 11,508	**$ 16,604**	$ 25,436
Change in realized and unrealized appreciation, net	(115,919)	(261,755)	**(377,674)**	38,509
Total investment return	(110,823)	(250,247)	**(361,070)**	63,945
Gifts for capital (*Note 16*)*	7,364	8,638	**16,002**	28,489
Payments to annuitants	(19,753)	(44,605)	**(64,358)**	(70,855)
Transfers to endowment	(36,598)	(10,512)	**(47,110)**	(23,843)
Transfers between SIA and the GOA	(34,148)	(2,121)	**(36,269)**	(14,071)
Change in liabilities and other adjustments	69,312	182,786	**252,098**	37,088
NET CHANGE DURING THE YEAR	**(124,646)**	**(116,061)**	**(240,707)**	**20,753**
Total split interest agreement net assets, beginning of year	188,537	473,925	**662,462**	641,709
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	**$ 63,891**	**$ 357,864**	**$ 421,755**	**$ 662,462**

* *Shown at net present value. The undiscounted value of these gifts was $32,494 and $65,771 for the years ended June 30, 2009 and 2008, respectively.*

Split interest agreement net assets as of June 30, 2009 and 2008 consisted of the following (in thousands of dollars):

	2009	2008
Split interest agreement investments (*Note 3*):		
Charitable remainder trusts	**$ 701,042**	$ 948,446
Charitable lead trusts	**89,758**	121,400
Charitable gift annuities	**239,904**	399,295
Pooled income funds	**88,038**	101,580
Total split interest agreement investments	**1,118,742**	1,570,721
Liabilities due under split interest agreements:		
Amounts due to beneficiaries	**(603,522)**	(794,983)
Amounts due to other institutions	**(93,465)**	(113,276)
Total liabilities due under split interest agreements	**(696,987)**	(908,259)
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS	**$ 421,755**	**$ 662,462**

11. BONDS AND NOTES PAYABLE

Bonds and notes payable as of June 30, 2009 and 2008 were as follows (in thousands of dollars):

	Fiscal year of issue	Remaining years to maturity	One-year effective interest rate	Outstanding principal 2009	Outstanding principal 2008
Tax-exempt bonds and notes payable:					
Variable-rate bonds and notes payable:					
Series L - weekly	1990	15	3.7%	$ **71,140**	$ 71,140
Series R - daily	2000–2006	40	0.8	**131,200**	131,200
Series Y - weekly	2000	26	5.2	**117,905**	117,905
Series BB - weekly	2001	25	1.0	**196,700**	196,700
Series HH - weekly	2004	24	5.9	**92,235**	92,235
Series GG1 - weekly	2005	N/A	3.3		205,935
Series 2006B1 - daily	2007	N/A	2.9		112,900
Series 2006B2 - weekly	2007	N/A	2.3		112,900
Commercial paper	2009	Various*	1.5	**449,259**	533,109
Total variable-rate bonds and notes payable			2.3	**1,058,439**	1,574,024
Fixed-rate bonds:					
Series N	1992	11	6.3	**78,908****	79,078
Series Z	2001	7	5.2	**67,788****	77,388
Series AA	2001	N/A	5.5		5,154
Series DD	2002	26	5.0	**135,005****	134,982
Series FF	2003	28	5.1	**274,973****	275,990
Series 2005A	2005	27	5.0	**93,539****	93,713
Series 2005B	2006	23	5.0	**104,888****	105,047
Series 2005C	2006	26	5.0	**129,930****	129,998
Series 2008B	2008	29	5.0	**216,622****	216,886
Series 2009A	2009	27	5.4	**986,908****	
Total fixed-rate bonds			5.2	**2,088,561**	1,118,236
Total tax-exempt bonds and notes payable			**3.9**	**3,147,000**	**2,692,260**
Taxable bonds and notes payable:					
Series GG2 - weekly	2005	4	5.0	**38,935**	45,745
Series 2006A	2006	28	6.3	**401,395****	401,372
Series 2008A	2008	29	4.9	**387,670****	387,606
Series 2008C	2008	9	5.3	**125,205**	125,205
Series 2008D	2009	30	5.8	**1,495,275****	
Commercial paper	2009	Various*	5.2	**296,977**	347,652
Total taxable bonds and notes payable			**5.6**	**2,745,457**	**1,307,580**
Other notes payable	Various	Various	Various	**87,994**	90,072
TOTAL BONDS AND NOTES PAYABLE			**4.7%**	**$ 5,980,451**	**$ 4,089,912**

* *All commercial paper will mature in fiscal 2010.*

** *Series N, Z, DD, FF, 2006A, 2008A, 2008D and 2009A principal are net of $1.1 million, $0.2 million, $0.9 million, $1.2 million, $0.6 million, $0.3 million, $4.7 million and $13.1 million of discounts, respectively. Series 2005A, 2005B, 2005C and 2008B principal include premiums of $4.4 million, $4.3 million, $4.0 million and $7.8 million, respectively.*

Interest expense, recorded in both "Space and occupancy" and "Other expenses" in the *Statements of Changes in Net Assets with General Operating Account Detail*, was $204.4 million and $146.1 million for fiscal 2009 and 2008, respectively. Excluding maturity of commercial paper and unamortized discounts and premiums, scheduled principal payments are (in thousands of dollars):

Fiscal year	Principal payments
2010	$ 17,835
2011	16,553
2012	17,353
2013	188,258
2014	519,000
Thereafter	4,476,725
TOTAL PRINCIPAL PAYMENTS	**$ 5,235,724**

In fiscal 2009, the University issued $1.5 billion of taxable fixed-rate Series 2008D bonds. The series was comprised of a $500.0 million issue that will mature in 2014, a $500.0 million issue that will mature in 2019, and a $500.0 million issue that will mature in 2039. Proceeds from Series 2008D were used for general University purposes, including the refunding of taxable commercial paper.

In fiscal 2009, the University issued $1.0 billion of tax-exempt fixed-rate Series 2009A bonds. The series was comprised of a $700 million issue that will mature in 2036, and various other issues totaling $300 million that will mature beginning in 2014 and ending in 2023. Proceeds from Series 2009A were used to fund the full redemption of Series GG1, Series 2006B1 and Series 2006B2 (including the termination of any interest rate exchange agreements associated with those Series), and to finance capital projects and acquisitions initially funded by the University's commercial paper programs.

In connection with the issuances of Series 2008D and 2009A, the University's AAA/Aaa credit ratings were affirmed with Standard & Poor's and Moody's Investors Service, respectively.

In fiscal 2009, the University increased the capacity of its taxable commercial paper program to $2.0 billion from $1.0 billion.

In fiscal 2008, the University issued $388.0 million of taxable fixed-rate Series 2008A bonds. The series was comprised of a $145.0 million issue that will mature in 2013 and a $243.0 million issue that will mature in 2038. Also in fiscal 2008, the University issued $208.9 million of tax-exempt fixed-rate Series 2008B bonds that will mature in 2038, and $125.2 million of taxable fixed-rate Series 2008C bonds that will mature in 2018. All bond issues were used to finance capital projects and acquisitions initially funded by the University's commercial paper programs. Finally, in fiscal 2008, the University reauthorized its tax-exempt commercial paper program.

Based on quoted market prices, the estimated fair value of the University's outstanding bonds and notes payable, including accrued interest, was $6,161.3 million and $4,022.3 million as of June 30, 2009 and 2008, respectively.

The University has $648.1 million of variable-rate bonds outstanding (excluding commercial paper) with either a daily or weekly interest rate reset, as noted in the bonds and notes payable table on page 35. In the event 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 current obligation to purchase the bonds tendered.

In fiscal 2009, the University renewed a $2.0 billion unsecured, 364-day revolving credit facility with a syndicate of banks which matured in August 2009. In August 2009, the University entered into a $1.8 billion unsecured, 364-day revolving credit facility with a syndicate of banks maturing in August 2010.

Interest rate exchange agreements

The University has entered into various interest rate exchange agreements in order to manage the interest cost and risk associated with its outstanding debt and to hedge issuance of future debt. The interest rate exchange agreements were not entered into for trading or speculative purposes. Each of these exchanges is collateralized, as described in *Note 3*, and thereby carries liquidity risk to the extent the relevant agreements have negative mark-to-market valuations (pursuant to methodologies described below). The interest rates in the table on page 35 reflect any applicable exchange agreements.

In fiscal 2009, the University terminated interest rate exchange agreements with a notional value of $1,138.0 million, for which it realized a loss of $497.6 million. A portion of this loss was offset by $85.9 million in gains on the sale of U.S. Treasury bonds which had been purchased to hedge a portion of the liquidity risk associated with the interest rate exchange agreements.

Also in fiscal 2009, the University entered into additional interest rate exchange agreements with a notional value of $764.0 million, under which the University receives a fixed rate and pays a variable rate. These new interest rate exchange agreements, or 'offsetting' agreements, were intended to reduce the risk of further losses in value (with associated collateral posting requirements) within the portfolio of interest rate 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 $3,141.2 million and $(678.1) million, respectively, as of June 30, 2009 and $3,524.7 million and $(330.4) million, respectively, as of June 30, 2008. The table on page 37 is a rollforward of the notional amount of the University's interest rate exchange agreements from July 1, 2008 to June 30, 2009. The fair value of these agreements is included in the "Securities lending and other liabilities associated with the investment portfolio" line in the *Balance Sheets*.

The loss realized from the monthly settling of interest rate exchange agreements was $33.9 million and $15.6 million for fiscal 2009 and 2008, respectively. All unrealized and realized gains and losses from interest rate exchange agreements are included in the "Change in appreciation on GOA investments, net" line in the *Statements of Changes in Net Assets with General Operating Account Detail*.

NOTIONAL AMOUNT OF INTEREST RATE EXCHANGE AGREEMENTS
In thousands of dollars

Beginning balance, July 1, 2008	$ 3,524,705
Interest rate exchange agreements terminated	(1,138,035)
Amortizations	(9,460)
Offsetting interest rate exchange agreements	764,000
ENDING BALANCE, JUNE 30, 2009	**$ 3,141,210**

12. EMPLOYEE BENEFITS

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

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

Pension benefits

All eligible faculty members, staff and hourly employees are covered by retirement programs that include 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 fair value of the trust's assets were $680.7 million and $879.9 million as of June 30, 2009 and 2008, respectively. In addition, the University internally designated and invested $29.0 million and $40.0 million as of June 30, 2009 and 2008, respectively, for its defined benefit pension plans. The University recorded expenses for its defined contribution plans of $101.6 million and $94.7 million for fiscal 2009 and 2008, 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, 2009, the University had internally designated and invested $204.1 million to fund the postretirement health benefit accrued liability of $697.5 million. As of June 30, 2008, the University had internally designated and invested $248.3 million to fund an accrued liability of $607.4 million.

The following table provides a reconciliation of the benefit obligation for the University for fiscal 2009 and 2008 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2009	2008	2009	2008
Benefit obligation, beginning of year	**$ 586,309**	$ 593,682	**$ 607,427**	$ 545,698
Service cost	**11,757**	12,121	**29,439**	25,564
Interest cost	**37,849**	36,868	**40,815**	35,164
Plan participants' contributions			**1,955**	1,927
Federal subsidy on benefits paid			**1,224**	1,528
Plan amendments		11		
Gross benefits paid	**(30,187)**	(38,529)	**(19,657)**	(18,981)
Actuarial (gain)/loss	**74,708**	(17,844)	**31,410**	16,527
Special termination benefits*	**42,945**		**4,870**	
BENEFIT OBLIGATION, end of year	**$ 723,381**	**$ 586,309**	**$ 697,483**	**$ 607,427**

* *Represents costs associated with a voluntary early retirement program offered to plan participants during fiscal 2009.*

	Pension 2009	Pension 2008	Postretirement 2009	Postretirement 2008
Accumulated benefit obligation	**$ 618,937**	$ 497,387	**N/A**	N/A
Weighted-average assumptions used to determine benefit obligation at end of year:				
Discount rate	**6.25%**	6.50%	**6.25%**	6.50%
Rate of compensation increase	**4.00%**	4.00%	**4.00%**	4.00%
Health care cost trend rate:				
– Initial rate	**N/A**	N/A	**8.00%**	8.50%
– Ultimate rate	**N/A**	N/A	**5.00%**	5.00%
– Years to ultimate rate	**N/A**	N/A	**6**	7
Effect of one-percentage-point change in assumed health care cost trend rate on postretirement benefit obligation:				
– Increase	**N/A**	N/A	**$ 131,235**	$ 109,066
– Decrease	**N/A**	N/A	**$ (103,512)**	$ (86,415)

The following table provides a reconciliation of the fair value of plan assets for the University for fiscal 2009 and 2008 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2009	2008	2009	2008
Fair value of plan assets, beginning of year	$ **879,869**	$ 896,964	$ **0**	$ 0
Actual return on plan assets	**(168,934)**	21,434		
Gross benefits paid	**(30,187)**	(38,529)		
FAIR VALUE OF PLAN ASSETS, end of year	$ **680,748**	$ **879,869**	$ **0**	$ **0**

The actual asset allocation of the investment portfolio for the pension plan for fiscal 2009 and 2008, along with target allocations for fiscal 2010, are as follows:

	2010 Target	2009 Actual	2008 Actual
Equity securities	44.0%	44.5%	48.7%
Fixed income securities	17.0	14.4	19.6
Real estate	8.0	6.4	6.8
Other	31.0	34.7	24.9
TOTAL OF ASSET ALLOCATION CATEGORIES	**100.0**%	**100.0**%	**100.0**%

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

The following tables provide the funded status at the end of the year and the related amounts recognized in the *Balance Sheets* for the University for fiscal 2009 and 2008 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2009	2008	2009	2008
Funded status, end of year:				
Fair value of plan assets	$ **680,748**	$ 879,869		
Benefit obligations	**(723,381)**	(586,309)	$ **(697,483)**	$ (607,427)
(UNFUNDED)/FUNDED STATUS, end of year	**(42,633)**	**293,560**	**(697,483)**	**(607,427)**
Amounts recognized in the *Balance Sheets*:				
Net retirement assets		$ 293,560		
Accrued retirement obligations	$ **(42,633)**		$ **(697,483)**	$ (607,427)
TOTAL AMOUNTS RECOGNIZED IN THE *BALANCE SHEETS*	$ **(42,633)**	$ **293,560**	$ **(697,483)**	$ **(607,427)**
Amounts recognized in unrestricted net assets:				
Net actuarial (gain)/loss	$ **5,235**	$ (304,565)	$ **28,674**	$ (2,988)
Prior service (credit)/cost	**(10,455)**	(14,829)	**3,563**	4,974
Transition (asset)/obligation			**24,249**	30,311
TOTAL AMOUNTS RECOGNIZED IN UNRESTRICTED NET ASSETS	$ **(5,220)**	$ **(319,394)**	$ **56,486**	$ **32,297**
Amounts recognized in changes in unrestricted net assets:				
New prior service (credit)/cost		$ 11		
New net actuarial (gain)/loss	$ 299,697	11,728	$ 31,410	$ 11,253
Amortization of:				
transition asset/(obligation)			(6,062)	(6,062)
prior service credit/(cost)	4,374	4,375	(1,411)	(1,796)
actuarial gain/(loss)	10,103	4,456	252	280
TOTAL AMOUNTS RECOGNIZED IN CHANGES IN UNRESTRICTED NET ASSETS	$ **314,174**	$ **20,570**	$ **24,189**	$ **3,675**

The fiscal 2009 total amount recognized in changes in unrestricted net assets of $338.4 million is included in "Other changes" in the *Statement of Changes in Net Assets with General Operating Account Detail*.

There are no expected employer contributions for fiscal 2010 to funded pension or other benefit plans under the Pension Protection Act of 2006, because for ERISA purposes the plan actually remains overfunded as of January 1, 2009.

The following table summarizes expected benefit payments and subsidies for pension and other postretirement benefits for the University (in thousands of dollars):

	Expected benefit payments		
Fiscal year	Pension	Postretirement health	Expected Medicare Part D subsidies
2010	$ 71,717	$ 24,591	$ 1,094
2011	49,126	27,579	1,307
2012	49,785	29,948	1,493
2013	50,660	32,236	1,710
2014	51,533	34,624	1,935
2015–2019	265,535	211,558	13,794

The following table summarizes the components of the net periodic benefit (income)/cost for the University for fiscal 2009 and 2008 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2009	2008	2009	2008
Service cost	$ **11,757**	$ 12,121	$ **29,439**	$ 25,564
Interest cost	**37,849**	36,868	**40,815**	35,164
Expected return on plan assets	**(59,057)**	(54,327)	**(16,733)**	(12,886)
Amortization of the:				
Actuarial (gain)/loss	**(10,103)**	(4,456)	**(252)**	(280)
Prior service (credit)/cost	**(4,374)**	(4,375)	**1,411**	1,796
Transition (asset)/obligation			**6,062**	6,062
Special termination benefits	**42,945**		**4,870**	
Net periodic benefit (income)/cost	**19,017**	(14,169)	**65,612**	55,420
Adjustment for return on invested reserves	**3,001**	3,321	**16,733**	2,634
TOTAL NET PERIODIC BENEFIT (INCOME)/COST	$ **22,018**	$ **(10,848)**	$ **82,345**	$ **58,054**
Weighted-average assumptions used to determine net periodic benefit (income)/cost:				
Discount rate	**6.50%**	6.25%	**6.50%**	6.25%
Expected long-term rate of return on plan assets	**7.50%**	7.50%	**7.50%**	7.50%
Rate of compensation increase	**4.00%**	4.00%	**4.00%**	4.00%
Health care cost trend rate:				
– Initial rate	**N/A**	N/A	**8.50%**	9.00%
– Ultimate rate	**N/A**	N/A	**5.00%**	5.00%
– Years to ultimate rate	**N/A**	N/A	**7**	4
Effect of one-percentage-point change in assumed health care cost trend rate on aggregate service and interest cost:				
– Increase	**N/A**	N/A	$ **16,188**	$ 13,778
– Decrease	**N/A**	N/A	$ **(12,379)**	$ (10,576)

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

The estimated amounts that will be amortized from unrestricted net assets into net periodic benefit (income)/cost in fiscal 2010 are as follows (in thousands of dollars):

	Pension benefits	Postretirement health benefits
Actuarial (gain)/loss	$ (2,792)	$ 658
Prior service (credit)/cost	(4,694)	1,411
Transition (asset)/obligation		6,062
TOTAL AMOUNTS TO BE AMORTIZED	**$ (7,486)**	**$ 8,131**

13. GENERAL OPERATING ACCOUNT

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

The major components of the GOA net asset balances as of June 30, 2009 and 2008 are summarized as follows (in thousands of dollars):

	2009				2008
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Departmental balances:					
Unexpended endowment income	$ 63,551	$ 375,550		**$ 439,101**	$ 565,556
Unexpended gift balances	86,811	273,484		**360,295**	325,940
Pledge balances		367,967		**367,967**	236,919
Interests in trusts held by others		31,115		**31,115**	42,537
Loan funds	23,427		$ 92,362	**115,789**	119,396
Funds for construction		10,503		**10,503**	9,162
Funds invested in fixed assets	1,393,072			**1,393,072**	1,326,368
Other departmental purposes	458,797			**458,797**	764,412
Total departmental balances	2,025,658	1,058,619	92,362	**3,176,639**	3,390,290
University balances*	388,426	118,077		**506,503**	3,184,762
TOTAL GOA NET ASSET BALANCES	**$ 2,414,084**	**$ 1,176,696**	**$ 92,362**	**$ 3,683,142**	**$ 6,575,052**

* *Includes interests in trusts held by others of $6,882 and $3,254 for the years ended June 30, 2009 and 2008, respectively.*

14. STUDENT FINANCIAL AID

Financial aid granted to students in fiscal 2009 and 2008 is summarized as follows (in thousands of dollars):

	2009	2008
Scholarships and other student awards:		
Scholarships applied to student income	**$ 302,369**	$ 252,126
Scholarships and other student awards paid directly to students	**122,479**	110,532
Total scholarships and other student awards	**424,848**	**362,658**
Student employment	**65,977**	56,784
Student loans	**25,481**	32,635
Agency financial aid*	**12,516**	12,609
TOTAL STUDENT FINANCIAL AID	**$ 528,822**	**$ 464,686**

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

15. SPONSORED SUPPORT

Total expenditures funded by U.S. government sponsors or by institutions that subcontract federally sponsored projects to the University were $558.7 million and $535.0 million in fiscal 2009 and 2008, respectively. The University's principal source of federal sponsored funds is the Department of Health and Human Services. The University also has many non-federal sources of sponsored awards and grants, including corporations, foundations, state and local governments, foreign governments, and research institutes.

Sponsored grants and contracts normally provide for the recovery of direct and indirect costs. The University recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related indirect costs is generally recorded at fixed or predetermined rates negotiated with the federal government and other sponsors. Predetermined federal indirect cost rates have been established for the University Area, the Medical School (including the School of Dental Medicine), and the School of Public Health through fiscal 2010. Funds received for federally sponsored 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 grants," as appropriate. Gifts that have been restricted by the donor or designated by the Corporation for facilities, loan funds, endowment, or similar purposes are classified as "Gifts for capital." Gifts for current use, non-federal sponsored grants, and gifts for capital are classified as unrestricted, temporarily restricted, or permanently restricted net assets in accordance with donor specifications.

Gifts received for the years ended June 30, 2009 and 2008 are summarized as follows (in thousands of dollars):

	2009	2008
Gifts for current use	**$ 291,231**	$ 236,599
Non-federal sponsored grants	**92,798**	84,044
Gifts for capital:		
Endowment funds	**194,459**	336,059
Split interest agreements*	**16,002**	28,489
Loan funds and facilities	**2,649**	4,865
Total gifts for capital	**213,110**	369,413
TOTAL GIFTS	**$ 597,139**	**$ 690,056**

* *Shown at net present value. The undiscounted value of these gifts was $32,494 and $65,771 for the years ended June 30, 2009 and 2008, respectively.*

17. OTHER INCOME

The major components of other income for the years ended June 30, 2009 and 2008 were as follows (in thousands of dollars):

	2009	2008
Rental and parking	**$ 125,908**	$ 134,141
Publications	**75,660**	85,150
Royalties from patents, copyrights, and trademarks	**82,667**	84,514
Services income	**52,960**	48,345
Sales income	**57,249**	46,634
Non-student health and clinic fees	**25,168**	24,370
Other student income	**25,845**	25,113
Other	**60,399**	62,620
TOTAL OTHER INCOME	**$ 505,856**	**$ 510,887**

18. OTHER EXPENSES

The major components of other expenses for the years ended June 30, 2009 and 2008 were as follows (in thousands of dollars):

	2009	2008
Services purchased	**$ 388,649**	$ 414,138
Subcontract expenses under sponsored projects	**139,904**	110,019
Travel	**69,431**	78,413
Publishing	**46,861**	52,961
Advertising	**18,516**	16,610
Taxes and fees	**25,330**	24,312
Interest	**56,631**	13,326
Postage	**20,149**	22,976
Insurance	**15,009**	10,482
Telephone	**12,715**	12,017
Other	**41,737**	45,656
TOTAL OTHER EXPENSES	**$ 834,932**	**$ 800,910**

19. FUNCTIONAL CLASSIFICATION OF OPERATING EXPENSES

Operating expenses are allocated functionally on a direct basis. Interest, depreciation, and operations and maintenance expenses are allocated based on square footage.

Operating expenses by functional classification for the years ended June 30, 2009 and 2008 were as follows (in thousands of dollars):

	2009	2008
Instruction	**$ 995,853**	$ 946,944
Research	**624,242**	570,162
Libraries	**239,708**	212,334
Academic support	**505,169**	456,779
Scholarships and other student awards	**122,479**	110,532
Student services	**138,935**	125,025
Institutional support	**736,917**	625,176
Auxiliary services	**392,768**	417,941
TOTAL OPERATING EXPENSES	**$ 3,756,071**	**$ 3,464,893**

20. COMMITMENTS AND CONTINGENCIES

Sponsored support

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

Broad Institute

The University together with the Harvard-affiliated teaching hospitals, the Massachusetts Institute of Technology (MIT), and the Whitehead Institute for Biomedical Research jointly govern the Eli and Edythe L. Broad Institute (the "Broad Institute").

In connection with the founding of the Broad Institute, the University and MIT agreed to strive to jointly raise $20.0 million per year in gifts and non-federal grants and awards to support the Broad Institute's endeavors. In the event this fundraising goal is not reached, the University has agreed to provide MIT with a portion of the shortfall, subject to certain conditions. The University will make payments and record the corresponding expenses as these conditions are met. The University's obligation for such payments will not exceed $32.5 million over the initial five-year term, or $60.0 million in total if the term is extended for a second five years. The University had a commitment related to this obligation of $6.5 million as of June 30, 2009 and 2008, which is recorded in "Accounts payable" in the *Balance Sheets*.

On July 1, 2009, the Broad Institute was established as a separate permanent entity. The University, MIT, and the Broad Foundation have transferred employees, research agreements, and related assets and liabilities to the new entity. Included in the University's balance sheet on June 30, 2009 are investment assets of the Broad Institute of $52.0 million, which will be written off in fiscal 2010.

Lease commitments

The University is the lessee of equipment and space under operating (rental) and capital leases. Rent expense related to leases was $24.4 million and $39.9 million in fiscal 2009 and 2008, respectively. Future minimum payments under these operating and capital leases are as follows (in thousands of dollars):

	Operating	Capital
2010	$ 39,683	$ 6,158
2011	34,808	6,309
2012	29,715	6,420
2013	25,025	6,420
2014	22,409	6,471
Thereafter	166,372	180,997
TOTAL FUTURE MINIMUM PAYMENTS	**$ 318,012**	**$ 212,775**

Fixed asset-related commitments

The University has various commitments for capital projects involving construction and renovation of certain facilities, real estate acquisitions, and equipment purchases, for which the outstanding commitments as of June 30, 2009 totaled approximately $483.3 million.

Environmental remediation

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

General

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

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