

HARVARD UNIVERSITY FINANCIAL REPORT

FISCAL YEAR 2010



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Message from the President

I am pleased to present Harvard University's financial results for fiscal 2010. For the year ended June 30, 2010, the University's operating result was approximately breakeven, and our endowment portfolio earned an investment return of 11.0% and had a year-end value of \$27.6 billion.

In the wake of the extraordinary economic challenges of the last two years, we have made meaningful reductions in the amounts distributed from our endowment accounts. In addition, our early efforts in cutting costs have focused our attention on how we can operate in more disciplined and integrated ways—how we can seek out efficiencies through new collaborations and approaches to ensure that our spending aligns with core academic priorities, especially during a period of unaccustomed constraint and continued economic uncertainty.

The challenge is not just to tamp down costs but to re-imagine aspects of how we do our work: to make sure we embrace best practices and direct our resources to their highest and best use. For instance, we have made encouraging progress in a major effort to rethink organizational dimensions of our highly decentralized library system. We have an opportunity, and an obligation, to reconsider and rationalize how we administer one of Harvard's greatest treasures and to renew it for an era of unprecedented change in how we collect, transmit, and preserve knowledge and information.

Even as we have brought new discipline to our budgeting, we have made it a priority to hold our doors open wide to students of ability and promise, whatever their economic means. And we have attracted outstanding applicants in record numbers. For the first time, applications to Harvard College surpassed 30,000, for approximately 1,650 places in the entering class. Application numbers climbed in nearly all of our graduate and professional schools as well, with figures at or near historical highs in business, design, education, government, law, and medicine.

This year we have also welcomed new leaders in key domains. We've benefited from the energetic leadership of two first-year deans, Martha Minow at the Law School and Cherry Murray in the School of Engineering and Applied Sciences. Nitin Nohria, a scholar of leadership, ethics, and organizational change, became dean of Harvard Business School this summer. Katie Lapp joined us from the University of California as our executive vice president, and has undertaken a careful review of how the central administration both performs and funds its work. Bill Lee, a leading expert on intellectual property and a former Overseer, joined the Corporation on July 1, succeeding Jamie Houghton, who stepped down after 15 years of distinguished service.

Harvard is a university community of remarkable resilience and energy. It is a community with an uncommon capacity to weather challenges, to learn from them, to adapt and move forward. That we do so, individually and together, matters a great deal—not just to what happens on campus from day to day, not just to the realm of ideas, but to the prospects for progress and enlightened action in a complex and sometimes confounding world. I am grateful to all of you who together deliver Harvard's extraordinary promise.

Sincerely,



Drew Gilpin Faust
PRESIDENT

October 15, 2010

Financial Overview

From the Vice President for Finance and the Treasurer

In its fiscal year ended June 30, 2010, the University made significant progress in managing expenses, strengthening its balance sheet, and laying the foundation to further enhance its finances in the years ahead. At the same time, progress was made on advancing key teaching and research priorities and increasing financial aid for our students. The discussion that follows identifies the key factors affecting the University's operating result for the year ended June 30, 2010 and its financial position as of that date.

OPERATING RESULT

The University's operating result was a deficit of \$4.7 million in fiscal 2010, compared to a \$45.3 million surplus in fiscal 2009. Note that investment gains

and losses (including gains and losses associated with the endowment) are not included in the University's operating result.

SUMMARY OF FINANCIAL RESULTS

<i>In millions of dollars</i>	2010	2009	2008	2007	2006
Total operating revenue	\$ 3,724.8	\$ 3,807.4*	\$ 3,482.3	\$ 3,210.5	\$ 2,999.6
Total operating expenses	3,729.6	3,762.1*	3,464.9	3,170.7	2,999.5
Total gifts	597.0	597.1	690.1	615.0	595.8
Total investments	33,336.4	31,480.3	43,804.3	41,832.9	34,249.6
Fixed assets, net	5,500.6	5,393.5	4,951.3	4,524.2	4,078.5
Bonds and notes payable	6,284.2	5,980.5	4,089.9	3,847.0	2,922.2
Net assets—General Operating Account*	3,755.6	3,580.3	6,327.0	5,988.4	4,641.5
Net assets—endowment funds*	27,557.4	26,138.2	37,174.8	35,362.3	29,694.0

* These numbers have been recast to conform with fiscal 2010 presentation.

OPERATING REVENUE

Total operating revenue declined 2% to \$3.7 billion, primarily driven by a 7% reduction in endowment returns made available for operations from \$1.4 billion in fiscal 2009 to \$1.3 billion in fiscal 2010. Endowment returns made available for operations comprised 35% of total operating revenue in fiscal 2010, compared to 37% in fiscal 2009.

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 6.1% in fiscal 2010, on target with the University's budget projection. We expect the fiscal 2011 payout rate to be approximately 5.4%, a function of both positive

fiscal 2010 investment returns and the University's decision to reduce year-over-year distributions to most endowment funds by approximately 12% in fiscal 2011. The University continues to manage the payout rate within a targeted range of 5.0%–5.5%, with the overarching goal of balancing the maintenance of the endowment's purchasing power with the pursuit of nearer term goals and opportunities.

The University's sponsored revenue increased by 9%, from \$714 million in fiscal 2009 to \$777 million in fiscal 2010. The University has a vibrant research community that continues to compete effectively for sponsored funding.

The federal government provided \$621 million in sponsored revenue, with the Department of Health and Human Services accounting for approximately 83% of this amount. Federal funding increased by almost 11% primarily due to awards issued to Harvard through the American Recovery and Reinvestment Act (ARRA). As of June 30, 2010, Harvard had received 264 ARRA awards with a total of \$190 million to be spent over the next two to three years, of which \$48 million was spent in fiscal 2010.

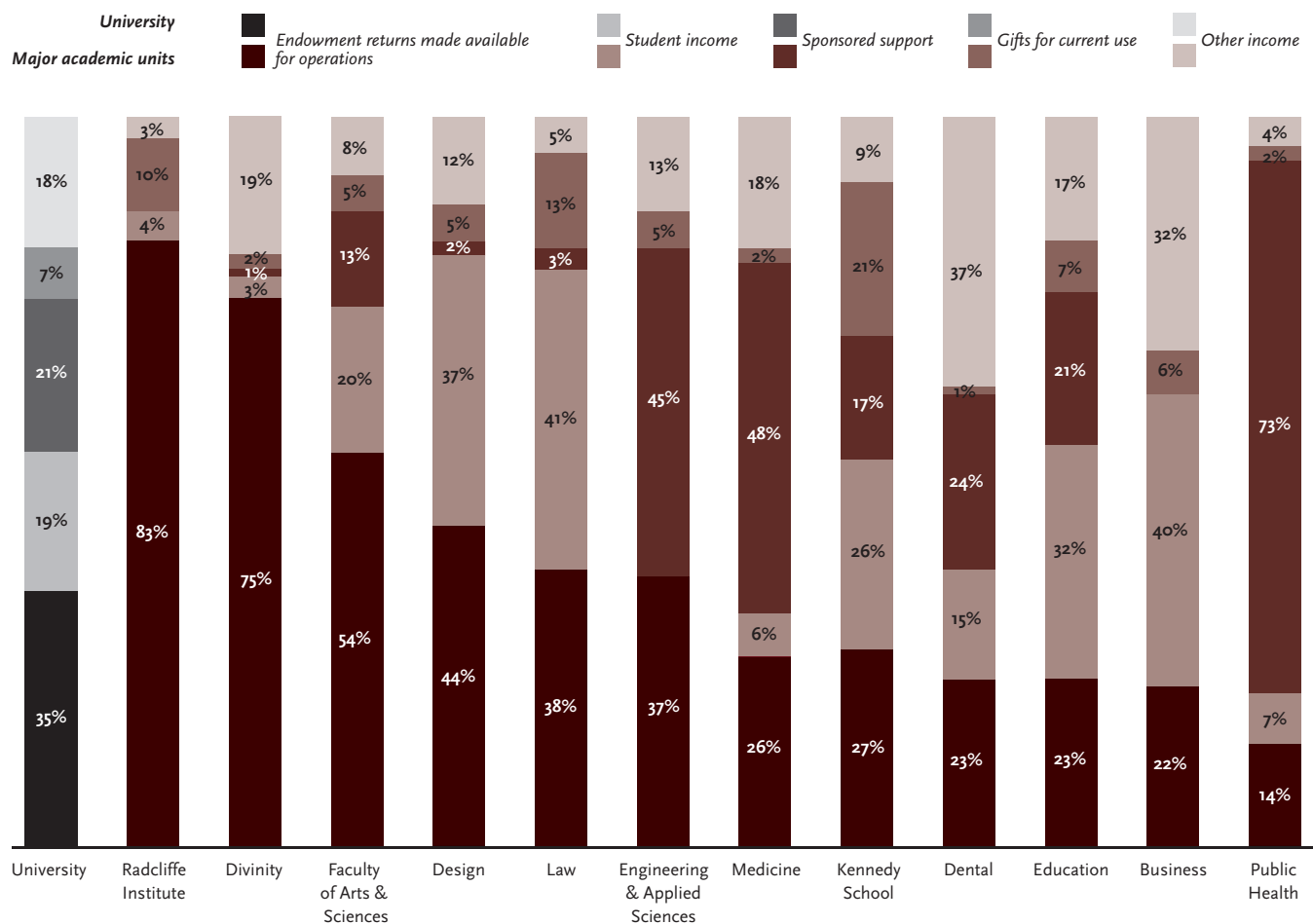
While Harvard's research enterprise has benefited from increased sponsored revenue, its longer-term sustainability will depend in large part on the overall federal budget and its future directions.

Student revenue increased 5%, from \$678 million in fiscal 2009 to \$712 million in fiscal 2010, driven principally by increases in executive and continuing education, and in revenue from graduate and professional degree programs. Undergraduate student revenue (i.e., undergraduate tuition, fees, board and lodging, less scholarships applied to student income) increased only 1%.

Financial aid (including both stipends and scholarships applied to student income) increased 4% in fiscal 2010. With this increase, the University reaffirmed its strong commitment to managing the net cost to students of attending Harvard. Focusing on net cost allows the University to attract the best students, regardless of their ability to pay, and to enable students to consider a broader range of opportunities after they graduate. For the Class of 2013, Harvard College received 29,000 applications, with a 7% admit rate and 77% yield rate. For the Class of 2014, applications surpassed 30,000 for the first time.

Current use giving decreased by 15%, from \$291 million in fiscal 2009 to \$248 million in fiscal 2010. Current use gifts provide important funding for the University's ongoing operations and strategic priorities, and are of particular value in sustaining key programs as distributions from the endowment are reduced. Although current use giving was down, total giving, including gifts designated as endowment, remained at the same level as fiscal 2009 (see *Note 17* of the audited financial statements).

FISCAL 2010 SOURCES OF OPERATING REVENUE



OPERATING EXPENSES

Operating expenses totaled \$3.7 billion, a 1% decrease compared to fiscal 2009, reflecting a 2% decline in non-sponsored outlays and a 8% increase in direct sponsored spending, as noted in the table below. Sponsored expenses are funded by the federal government and other sponsors of University activity, for the pursuit of those entities' specific objectives. Non-sponsored spending is more squarely within the University's

control, and the 2% decline demonstrates progress made in planned cost reductions.

Further excluding certain costs that tend to be fixed in the near term (i.e., tenured faculty compensation, financial aid, depreciation, and interest), and after adjusting for one-time nonrecurring charges in fiscal 2009 and fiscal 2010, the University's controllable non-sponsored operating expenses decreased by 6%.

<i>In thousands of dollars</i>	2010	2009	\$ change	% change
Operating expenses:				
Sponsored (direct)	\$ 588,181	\$ 542,318	\$ 45,863	8%
Non-sponsored	3,141,401	3,219,747	(78,346)	(2)
TOTAL OPERATING EXPENSES	\$ 3,729,582	\$ 3,762,065	\$ (32,483)	(1)%
CONTROLLABLE NON-SPONSORED OPERATING EXPENSES	\$ 2,174,673	\$ 2,304,392	\$ (129,719)	(6)%

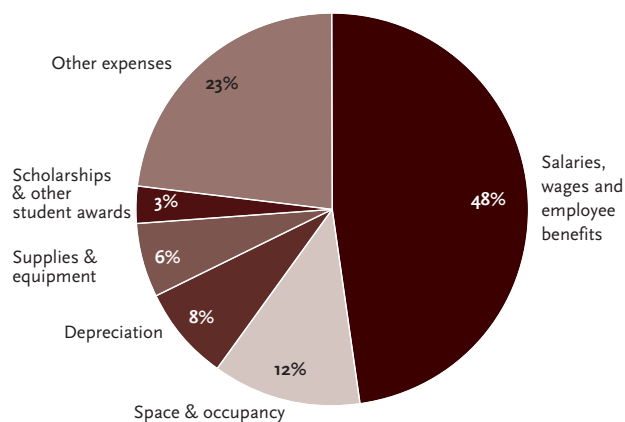
In practically all discretionary cost categories, the University achieved significant reductions in non-sponsored spending. Regarding compensation, which constitutes nearly half of the University's expenses, voluntary and involuntary staff workforce reductions, coupled with flat wage growth in fiscal 2010 in Harvard's faculty and exempt staff populations, led to a reduction of 3%, or approximately \$31 million, in non-sponsored salaries and wages. In other categories of spending, expense management efforts yielded equally beneficial results. For example, non-sponsored supplies and equipment, utility and space maintenance costs, travel expenditures, and services purchased declined by 11%, 19%, 13% and 7%, respectively, saving the University approximately \$88 million. Programs that enabled these results included utility reduction measures, targeted reviews challenging the need and frequency of routine maintenance and janitorial services, and more restrictive travel practices. Additionally, spending with our preferred vendors was more highly concentrated, allowing the University to achieve greater value through strategic buying. In summary, prudent management of expenses and operations resulted in meaningful savings for the University.

BALANCE SHEET

Investments

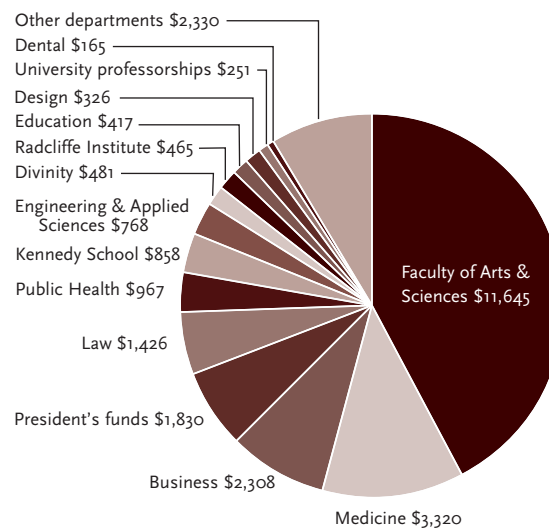
In fiscal 2010, the endowment generated positive investment returns of 11.0%, and its value (after the impact of endowment returns made available for operations and the addition of new gifts to the endowment during the year) increased from \$26.1 billion at the end of fiscal 2009 to \$27.6 billion at the end of fiscal 2010.

FISCAL 2010 OPERATING EXPENSES



FAIR VALUE OF THE ENDOWMENT AS OF JUNE 30, 2010

In millions of dollars



TOTAL FAIR VALUE \$27,557

Significant progress was made in transitioning the investment profile of the University's pooled operating funds to be more readily available, and less susceptible to illiquidity and market fluctuations. In past years, the University invested a substantial portion of its pooled operating funds alongside the endowment in the General Investment Account (GIA) managed by Harvard Management Company. The financial crisis highlighted the need for a more diversified investment strategy for these funds. The University already had begun a process of de-risking the funds in fiscal 2008, and through fiscal 2010, a substantial amount of pooled operating funds was moved into liquid investments. As a result, over the last two years, the University's holdings of liquid investments (e.g., cash and treasuries) outside the GIA have increased from approximately \$300 million (at June 30, 2008) to approximately \$1 billion (at June 30, 2010). Given the University's annual operating budget of \$3.7 billion, we expect to maintain or further increase the size of these cash holdings in fiscal 2011, and will continue to assess the most appropriate investment strategies to match the University's assets and liabilities and preserve a proper liquidity balance.

In addition to improving institutional liquidity in fiscal 2010, the University achieved further risk reduction relating to interest rate exchange agreements. The University used offsetting exchange agreements to reduce the portfolio's overall sensitivity to interest rate fluctuations by a substantial amount. The University did not incur any cash expense to execute these offsetting agreements; however, the agreements diminish the University's ability to recover past market value losses if interest rates were to increase in the future. At June 30, 2010, the liability related to interest rate exchange agreements was \$731 million (see *Note 3* of the audited financial statements). The University considers the risk of the remaining interest rate exposure to be manageable.

Debt

The University increased its debt to \$6.3 billion at June 30, 2010, compared with \$6.0 billion at June 30, 2009. This increase was driven by debt issued to support the University's capital spending program. 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 our most recent bond issue in January 2010. More detail on the bond issuance, and the University's broader debt portfolio, can be found in *Note 12* of the audited financial statements.

Capital Expenses

The University invested \$324 million in capital projects during fiscal 2010. Of this amount, 46% was spent on new construction and 54% was invested in the existing physical plant.

The University made progress on several significant capital projects during fiscal 2010, including the Harvard Art Museum's renovation and expansion of 32 Quincy Street, and the Harvard Law School's construction of a major new building (and an associated underground parking garage) on its campus.

Since December 2009, when Harvard announced a pause in construction on the Allston Science Complex site, the University has been re-evaluating its Allston strategies in the context of reduced financial resources following fiscal 2009 investment declines. The evaluation has had three areas of focus: property stewardship and community engagement, greening and planning and, as resources allow, campus development.

As it relates to stewardship and community engagement, the University has made significant progress leasing vacant Harvard properties in the Allston portfolio. This progress has been enabled by investing in upgrades and improvements to properties, and offering longer-term lease options in order to drive greater demand by potential tenants. Harvard also has engaged the community by creating interim uses of Allston properties—most notably this past winter's skating rink and this summer's Field and Fairway sports activity center.

Harvard remains committed to greening and landscape improvements, as evidenced by the construction of Library Park and the Ed Portal Learning Garden in Allston, as well as with the landscaping around the Science Complex site.

Finally, the University also is focused on exploring opportunities for campus development, and, to that end, has convened a Work Team composed of Deans, faculty members and alumni. The Work Team is considering academic priorities and planning assumptions, and how they might relate to potential opportunities for development in Allston. This assessment is ongoing, and the Work Team is expected to produce preliminary recommendations for review by University leadership this fiscal year.

SUMMARY

The University has made significant and productive progress in responding to changed economic circumstances. Nonetheless, we must continue to be vigilant in managing our finances in order to ensure that Harvard can fulfill its mission even with the continued uncertainty that surrounds us:

- Given lingering sluggishness in the global economy, it is prudent to expect Harvard's annual investment results to be modest in comparison to the extraordinary returns prior to fiscal 2009;
- Growth in net tuition, assuming constant enrollments, will remain quite moderate absent meaningful improvements in the economic well-being of our students and their families, and of the industries and geographies in which our students seek to have impact; and
- Sponsored revenue is heavily dependent on federal government support of biomedical research, which in turn is subject to budget pressures.

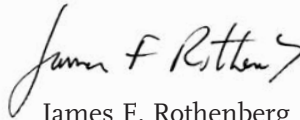
The confluence of these factors challenges not only Harvard, but all major research universities. In order to secure the resources that will allow our faculty and students to thrive, the University will continue to proactively pursue a multi-faceted financial management strategy: identifying administrative activities that can be done more efficiently; developing a clearer prioritization of our teaching, research, and service objectives in order to focus on activities and services that generate the highest value for the University community; exploring opportunities to share resources more extensively within the University and with strategic external partners; and evaluating new activities, consistent with Harvard's mission and values, that have the potential to enhance revenue.

Beyond these endeavors, we also will continue to engage intensively with our alumni and friends, in order to find areas of enhanced alignment between their philanthropic interests and the University's core teaching and research priorities. Notwithstanding the economic uncertainty that pervades most households, we continue to be grateful for, and humbled by, the generous support of our donors.

Whatever pressures may lay ahead, the University's position at the end of fiscal 2010 is strong. While this strength can be demonstrated in any of several financial measures included in the audited financial statements, Harvard's true strength rests with its unparalleled community of students, faculty, staff, alumni and friends, and their shared commitment to ensure the University's ability to impact the world. To this community, we offer our deepest thanks.



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



James F. Rothenberg
TREASURER

October 15, 2010

Message from the CEO of Harvard Management Company

The year ended June 30, 2010 was a successful one for the Harvard endowment and for Harvard Management Company (HMC). We added value over our Policy Portfolio benchmark, strengthened our organization and more closely aligned HMC with the University. In comparison to one year ago, our portfolio and our organization are now significantly better positioned to continue to deliver strong long-term returns as well as actively manage our risks.

The endowment portfolio earned an investment return of 11.0% for the year and was valued at \$27.6 billion as of June 30, 2010. The return for the year was 160 basis points above the return that would have been earned by our Policy Portfolio benchmark.

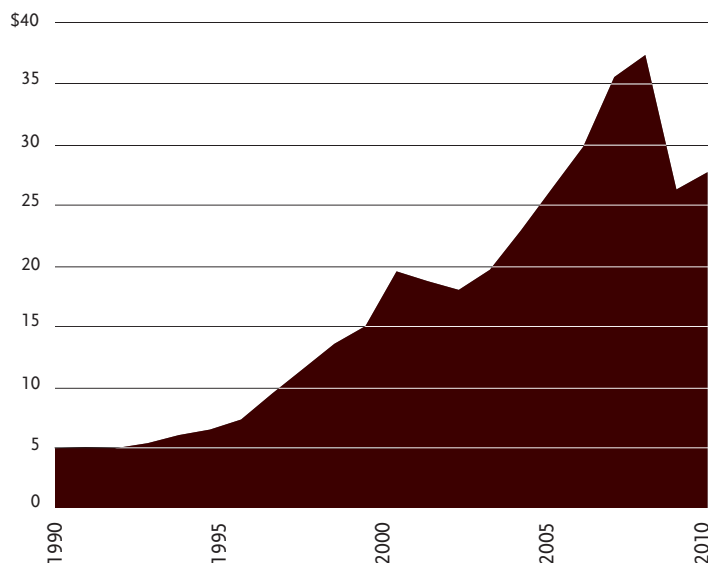
In addition to HMC's financial results, we are pleased with the much improved flexibility of the portfolio we are managing today. We have attended closely over the last two years to liquidity, capital commitments and risk management, while pursuing innovative investment strategies, growing our base of talent, and exploring cross-asset class opportunities.

HISTORICAL CONTEXT

Over the long term, HMC has produced excellent investment returns for the Harvard portfolio. The average annual return on the endowment over the last 20 years has been 11.9% per year. Over the more recent past, returns from the portfolio (and from the markets) have been more modest, averaging 7.0% over the last ten years and 4.7% over the last five years. This recent performance is weighed down substantially by the 2008–2009 global crisis, and it will take many years to recover these losses. However, as shown in the table below, the returns earned by the Harvard endowment have been substantially better over 5, 10 and 20 years

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	11.0%	9.4%	12.6%	13.3%
5 years	4.7	3.0	2.1	3.1
10 years	7.0	3.7	2.0	3.4
20 years	11.9	9.3	7.8	8.2

¹ Total return is net of all internal and external management fees and expenses.

² Individual benchmarks are representative of each asset class and are approved by the Board of Directors of HMC.

³ S&P 500 / CITI US BIG

⁴ Trust Universe Comparison Service as compiled by Wilshire Associates.

when compared with a simple 60/40 stock/bond portfolio or our Policy Portfolio. On average, over the last ten years, HMC has added 5.0% annually over and above the 60/40 portfolio, 3.3% over our Policy Portfolio and 3.6% over the TUCS median fund.

FISCAL YEAR 2010 PERFORMANCE

After a tumultuous ride in fiscal year 2009, the markets in the beginning of fiscal 2010 reflected a return to normalization and a restoration of confidence, at least temporarily. The equity markets pursued a strong upward climb through the first months of our fiscal year, surprising to some, given high unemployment in the U.S. and uncertain economic conditions. Bond markets were functioning fairly normally for the most part, with reasonable liquidity and persistently low rates. High yield spreads declined, indicating that the risk of default was lessening, resulting in strong returns for investors in that sector.

In the second half of the fiscal year, particularly in the June quarter, the positive sentiment began to reverse. As unease set in over the debt load in Greece, questions arose about the fate of the euro and fears of a double-dip recession took hold. Long rates on U.S. Treasuries were pushed lower as investors sought safe haven investments. There were a number of peaks and valleys, but in the end the quarter was quite damaging to equity investors, as many markets sustained double-digit losses for the three month period ended June 30. Despite this volatility, for the full fiscal year, the S&P 500 earned 14.4%, emerging market equities earned 23.2% and foreign developed market equities earned 5.9%. The U.S. Treasury market returned 6.7% while foreign bonds returned 3.0% for the year.

At HMC we began the year close to fully invested in the U.S. and international equity markets, in line with our Policy Portfolio. We also began the year with a small positive cash allocation specifically set aside to take advantage of new opportunities. We were able to add new talent to our team and new investments to the portfolio, a few examples of which are noted as follows:

- During the September quarter, we hired an experienced equity team from a leading hedge fund to expand our internal platform.
- We added to some unique low-beta opportunities (i.e., investments with low correlation to public markets) in our absolute return portfolio.
- We committed new capital to our highest conviction managers in private equity and venture capital funds.
- We made several new real estate investments in sectors we judged to be well-positioned for recovery.

In the majority of individual asset classes our active management added value for the year compared with their relevant market benchmarks. Our return in U.S. equities, at 17.1%, was about 2 percentage points over the U.S. markets and the return in international developed equities, at 12.9%, was over 6 percentage points ahead. Our internal fixed income teams all added value over and above their market benchmarks. Private equity, absolute return and natural resources also generated positive returns relative to their market comparables.

Our emerging market equities and high yield returns were strong, at 17.6% and 19.6%, respectively, although they did not beat their benchmarks. Our real estate portfolio also underperformed its benchmark, as real estate values continued to correct downward during the year. Nevertheless, real estate is one of the areas we find most interesting in terms of current and future opportunities. As a result, we have added experienced leadership to our real estate team that will enable us to strengthen HMC's strategic position and allow us to make high-potential investments over the next several years.

FISCAL 2010 PERFORMANCE

	Harvard ¹	Policy Portfolio Benchmark ²	Relative
Public market equities	15.8%	15.2%	0.6%
Private equity	16.2	13.3	2.9
Absolute return ³	15.2	12.3	2.9
Real assets ⁴	(2.7)	(4.7)	2.0
Fixed income	8.5	7.2	1.3
Total endowment	11.0	9.4	1.6

¹ Total return is net of all internal and external management fees and expenses.

² Individual benchmarks are representative of each asset class and are approved by the Board of Directors of HMC.

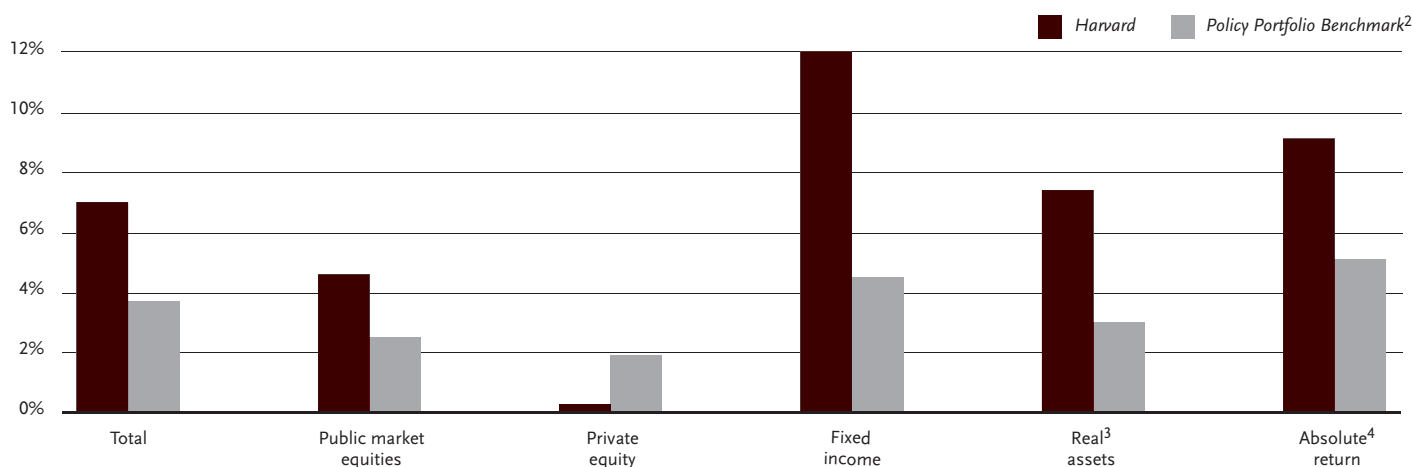
³ Absolute return asset class includes high yield.

⁴ Real assets consist of investments in liquid commodities, natural resources and real estate.

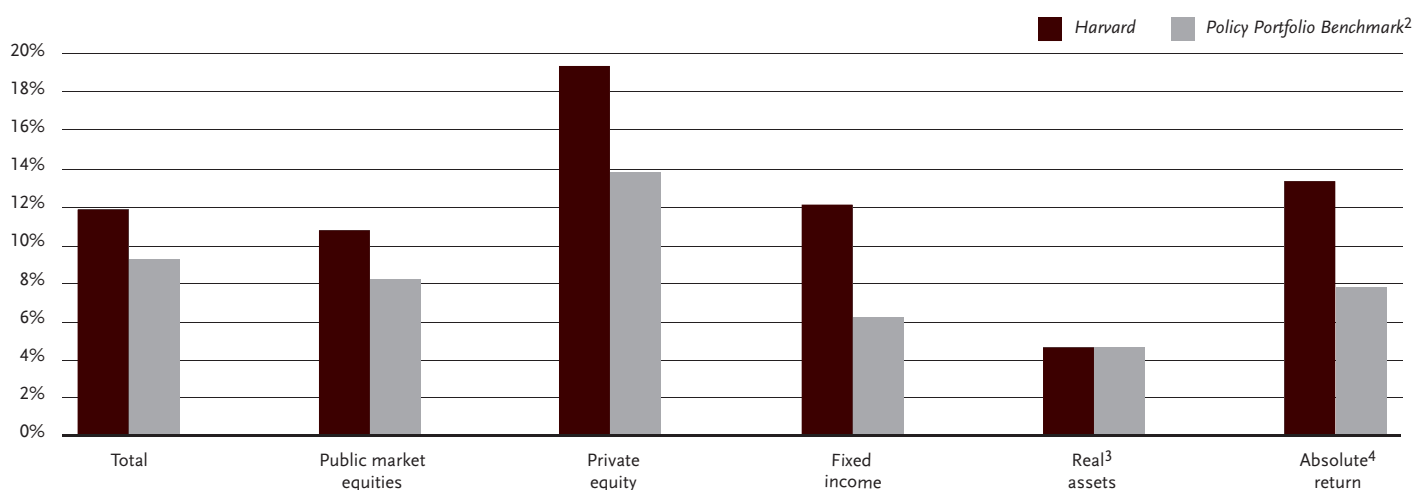
Another area where we are currently active is natural resources, a relatively new asset class that was pioneered by HMC. While nominal returns were relatively low this year, we outperformed the market benchmark significantly, as we have over time. We believe natural resources is a core strength in our portfolio, offering inflation protection, cash flow and long-term growth. At HMC we are well-equipped to recognize and negotiate good value in the natural resources arena, with an experienced in-house team, strong relationships with local operating partners around the world, and a track record of over a decade of transactions. The long-term return on our natural resources portfolio since inception is 13.3% annually.

In summary, with a few exceptions, our individual asset class strategies have been largely value-adding this year, and over the longer term. However, we can not afford to rest on past success. Each year new investment ideas and themes are explored in order to replace strategies that no longer provide attractive returns. We also need to be mindful that our portfolio, while large, still operates under liquidity constraints and spending demands that are greater than they were 5–10 years ago. The endowment now funds 35% of the total University budget. We need to continually tune our asset class strategies and our overall approach to managing the endowment in concert with changing market conditions and the University’s evolving needs.

ANNUALIZED TEN-YEAR PERFORMANCE BY ASSET CLASS¹



ANNUALIZED TWENTY-YEAR PERFORMANCE BY ASSET CLASS¹



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 internal and external management fees and expenses.

² Individual benchmarks are representative of each asset class and are approved by the Board of Directors of HMC.

³ Real assets consist of investments in liquid commodities, natural resources and real estate.

⁴ Absolute return asset class includes high yield.

ORGANIZATIONAL UPDATE

The reorientation of the HMC investment platform and organization that began in 2009 bore fruit this year in the form of improved investment performance. While the markets were helpful, there is no doubt that our portfolio and our company benefited from creative and talented new management in a number of key positions.

Investment management is now overseen by two senior executives, Stephen Blyth, the Head of Internal Management, and Andy Wiltshire, the Head of External Management. Stephen and Andy work closely with me and with each other on issues ranging from broadening and deepening our investment talent, evaluating current strategies to unlock competitive edge, and allocating incremental capital to the best investment ideas. Stephen and Andy have collaborated on several joint investigations this year, in one example leading to an improved active commodities strategy, which we will be implementing in fiscal year 2011.

During the course of the last year, we have also strategically focused our attention on key investment support areas. Bob Ettl, who joined HMC in late 2008 as our Chief Operating Officer, has significantly upgraded our operations and IT platforms throughout the company.

The environment for attracting investment talent and experience to HMC has been favorable over the last two years and we have taken advantage of this opportunity. Recognizing that staff will change over time, our approach is to continue to build depth in each of our teams and to install leadership that is not only extremely well-qualified, but is also committed to Harvard over the long term. HMC is well known for providing valuable experience and training which allows us to regularly hire best-in-class talent.

MANAGER RELATIONSHIPS

HMC is in the enviable position of working with some of the finest external managers in the world. We are dedicated to finding the best-in-class managers in each asset class and to creating and fostering long-term partnerships with them. Over time, as the endowment grew, the number of external manager relationships in the portfolio increased, and we found, particularly in the wake of the financial crisis, that some of these relationships and strategies (as well as the fees and terms to which we were bound) were not well-aligned

with our goals. We have been increasing manager concentration in the last couple of years, and the number of relationships in the Harvard portfolio has been reduced by about 20% as we focus on partnering with the best of the best and improving the terms under which we operate together, moving toward greater access to our capital and more reasonable fees.

RISK MANAGEMENT

In March, Neil Mason joined us as our new Chief Risk Officer. Neil brings an increased level of experience and sophistication to our analytical functions, and will provide an improved level of risk management to our portfolio. Neil and I have put considerable time, thought and effort into this area, applying lessons learned from the 2008–2009 time period. We have reassessed and augmented our risk models with tougher downside scenarios, analysis of different types of leverage, and liquidity stress tests. Continuous improvement in risk management is critical in what remains an extremely volatile environment.

In addition, senior management at HMC has been working closely with the University this year, and I believe all would agree that we have achieved deeper understanding of appropriate risk parameters and better alignment of the endowment's risk/return profile with the University's goals and needs. A concrete example of how we are achieving this is the Financial Management Committee established in 2009, on which I serve along with Jim Rothenberg, the University's Treasurer. President Faust has charged this group with pursuing integrated risk and financial management across HMC and the University.

COST OF MANAGEMENT

In fiscal year 2010, we engaged a leading consulting firm to assess HMC's cost structure in managing the Harvard endowment, adding an independent, third-party view to our own internal data on this subject. The consulting firm compared HMC's costs to a representative group of asset managers in order to identify areas of best practice and opportunities for improvement. Overall, the study assessed HMC's operating cost structure as significantly less expensive than the cost of equivalent external or outsourced management. This cost differential has saved Harvard over a billion dollars in management fees over the past decade.

We continue to be vigilant in our efforts to maintain our edge, both in our investment performance as well as in managing our business in the most cost effective manner. Through our hybrid model of internal and external management, and the pay-for-performance principles underlying our compensation system, we are able to achieve these goals while containing investment management costs.

STRENGTHENING COMPETITIVE ADVANTAGE

Looking ahead to fiscal year 2011 and beyond, we agree with Federal Reserve Chairman Ben Bernanke that at this point there is “unusual uncertainty” in the outlook for the economy and for the markets. Profit margins are high but unemployment is also high. Governments have been helpful in starting the economic healing process, but they may be running out of new maneuvers. Stocks and bonds, ETFs and options, high quality and risk assets are picked up and dropped by herds of investors in increasingly choppy cycles.

This is a time when our internal trading platform is especially valuable. The signals that our portfolio managers can glean from being in the markets day after day help us to adjust strategies throughout the year. While we do not know what direction markets will take in fiscal year 2011, we are pleased to have a well-diversified portfolio with some room to move. We continue to comb the markets for interesting opportunities, and we continue to sharpen our edge as an investment organization.

While I am often asked about my target for internal versus external management, any shift in assets under management will be incremental and driven by the addition of new talent and strategies, not by any arbitrary target for allocating Harvard’s endowment funds. My team and I do think that it makes sense to increase the share of internally managed assets under the right conditions, given the added agility and cost effectiveness of managing money this way.

In areas where we have had good long-term experience and where we have competitive strength, internal fixed income trading and natural resources for example, we have been increasing risk allocations and encouraging our teams to do more when they see good opportunities.

As mentioned earlier in this report, we are increasingly confident that we can develop an edge in real estate and commodities, taking a few pages from the books we’ve developed around timberland investing and internal trading. The repositioning of our real estate portfolio will take several years, but it began in earnest this year with several new investments outside of the traditional LP fund structure. On the topic of limited partnerships, we also intend to continue to reduce uncalled capital commitments to real estate and private equity fund managers. Our uncalled capital commitments at the end of fiscal year 2010 were \$6.6 billion, down from over \$11 billion two years ago.

Private equity bears a mention of its own as we look to the future. Harvard has benefited from being an early participant in the private equity arena, and we have a strong team in this area and many important relationships with a number of the best private equity and venture capital investors in the world. However, the field of private equity has become more and more crowded—with capital, with managers and with investors—over the last decade. Our expectations for this asset class are that returns will be more muted going forward, and we are even more committed to holding our fire for the best-in-class opportunities. We will continue to have a meaningful level of exposure to this asset class over the long term, and we are making new commitments to fund strategies that we like, but we anticipate that the number of active relationships within our private equity and venture capital portfolio will be reduced, while the concentration will be increased in our highest conviction managers.

Whether in public or private markets, we are continually aware that the market for good investment ideas is global, not local, and we are challenging ourselves to develop deeper understanding of, and more unique insights into, the world’s higher-growth markets. My team and I continually meet with managers and market participants from geographies where we have significant capital at work as well as other key markets. And I must note that we find the Harvard network is a superb resource and we are increasingly coordinating with alumni and faculty contacts as we continue to pursue emerging international investments.

CONCLUSION

At HMC we understand that endowment management is a very specific form of investment management. Unlike a typical investment firm, our sole purpose is to provide resources for a single mission—to support the educational and research objectives of Harvard University. Our constant challenge is to stay ahead of the pack, to distinguish the really unique ideas from the common beliefs, and to find the investments that will pay off best for Harvard.

Most importantly, we strive to add value relative to the Policy Portfolio which is specifically constructed to generate strong, long-term risk-adjusted returns. In this context, a strong year or two (or a weak year or two) pales in comparison to the importance of maintaining a rigorous investment strategy that meets the needs and expectations of the University. Endowment management is a long-term game—we need to keep our eyes on the horizon twenty years out while making investment decisions today.

Fiscal year 2010 was an important and productive year for HMC and for the Harvard portfolio. Going forward, we will continue to build on the success of HMC's strategy and strengthen our organization. We will continue to change—to evolve while not diluting our strengths, to adapt to a dynamic investment and economic landscape, and to position HMC for greater success in the future. We need to provide Harvard with the strength and financial support that it needs to fulfill its mission. I believe we are in an excellent position to do so.

Thank you for your attention and your support.



Jane L. Mendillo
PRESIDENT AND CEO

October 15, 2010

EVOLUTION OF THE POLICY PORTFOLIO

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 over the long term. The HMC Board and management team set the Policy Portfolio and review it annually for continued fit with the University's risk profile and our projections of long-term market returns, volatility and correlations. The Policy Portfolio provides HMC 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.

	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
Absolute return	0	12	16
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
Cash	-5	-5	2
TOTAL	100%	100%	100%

* Unchanged for fiscal year 2011.

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, 2010, 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 2009 financial statements, and in our report dated October 4, 2009, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

October 15, 2010

BALANCE SHEETS

with summarized financial information as of June 30, 2009

In thousands of dollars	June 30	
	2010	2009
ASSETS:		
Cash	\$ 31,629	\$ 34,182
Receivables, net (Note 6)	242,474	244,444
Prepayments and deferred charges	165,511	151,197
Notes receivable, net (Note 7)	364,309	357,445
Pledges receivable, net (Note 8)	772,212	785,290
Fixed assets, net (Note 9)	5,500,585	5,393,464
Interests in trusts held by others (Notes 4, 10 and 14)	297,629	276,571
Investment portfolio, at fair value (Notes 3 and 4)	36,701,525	34,656,179
Securities pledged to counterparties, at fair value (Notes 3 and 4)	4,158,201	3,067,027
TOTAL ASSETS	48,234,075	44,965,799
LIABILITIES:		
Accounts payable	331,487	415,926
Deposits and other liabilities	683,902	679,619
Securities lending and other liabilities associated with the investment portfolio (Notes 3, 4 and 12)	7,523,366	6,242,874
Liabilities due under split interest agreements (Note 11)	705,601	696,987
Bonds and notes payable (Note 12)	6,284,197	5,980,451
Accrued retirement obligations (Note 13)	909,193	740,116
Government loan advances (Note 7)	61,396	69,540
TOTAL LIABILITIES	16,499,142	14,825,513
TOTAL NET ASSETS	31,734,933	30,140,286
TOTAL LIABILITIES AND NET ASSETS	\$ 48,234,075	\$ 44,965,799

	Unrestricted	Temporarily restricted	Permanently restricted	June 30	
				2010	2009
NET ASSETS:					
General Operating Account (Note 14)	\$ 2,497,600	\$ 1,155,112	\$ 102,844	\$ 3,755,556	\$ 3,580,292
Endowment (Note 10)	4,727,776	17,896,039	4,933,589	27,557,404	26,138,239
Split interest agreements (Note 11)		38,254	383,719	421,973	421,755
TOTAL NET ASSETS	\$ 7,225,376	\$ 19,089,405	\$ 5,420,152	\$ 31,734,933	\$ 30,140,286

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, 2009

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended	
				June 30	
				2010	2009
OPERATING REVENUE:					
Student income:					
Undergraduate program	\$ 245,885			\$ 245,885	\$ 240,139
Graduate and professional degree programs	394,917			394,917	371,826
Continuing education and executive programs	242,212			242,212	227,673
Board and lodging	147,735			147,735	141,084
Scholarships applied to student income (Note 15)	(318,911)			(318,911)	(302,369)
Total student income	711,838	0	0	711,838	678,353
Sponsored support (Notes 16 and 17):					
Federal government - direct costs	463,009			463,009	419,658
Federal government - indirect costs	157,516			157,516	139,005
Non-federal sponsors - direct costs	58,496	\$ 78,216		136,712	137,435
Non-federal sponsors - indirect costs	13,534	6,006		19,540	17,540
Total sponsored support	692,555	84,222	0	776,777	713,638
Gifts for current use (Note 17)	74,935	172,964		247,899	291,231
Investment income:					
Endowment returns made available for operations (Note 10)	233,897	1,086,677		1,320,574	1,416,337
GOA returns made available for operations	157,089			157,089	165,626
Other investment income	10,898	4,946		15,844	21,295
Total investment income	401,884	1,091,623	0	1,493,507	1,603,258
Other income (Note 18)	494,812			494,812	520,891
Net assets released from restrictions	1,313,451	(1,313,451)		0	0
TOTAL OPERATING REVENUE	3,689,475	35,358	0	3,724,833	3,807,371
OPERATING EXPENSES:					
Salaries and wages	1,363,348			1,363,348	1,384,626
Employee benefits (Note 13)	426,124			426,124	456,109
Scholarships and other student awards (Note 15)	122,021			122,021	122,479
Supplies and equipment	217,749			217,749	224,404
Space and occupancy (Note 12)	454,943			454,943	445,071
Depreciation (Note 9)	278,360			278,360	288,450
Other expenses (Notes 12 and 19)	867,037			867,037	840,926
TOTAL OPERATING EXPENSES	3,729,582	0	0	3,729,582	3,762,065
NET OPERATING SURPLUS/(DEFICIT)	(40,107)	35,358	0	(4,749)	45,306
NON-OPERATING ACTIVITIES:					
Income from GOA investments, net	36,607			36,607	22,943
Realized and unrealized appreciation/(depreciation), net (Note 3)	205,019			205,019	(2,698,805)
GOA returns made available for operations	(157,089)			(157,089)	(165,626)
Change in pledge balances (Note 8)		27,743		27,743	154,470
Change in interests in trusts held by others (Note 14)		(1,135)	\$ 7,625	6,490	(7,794)
Capital gifts for loan funds and facilities (Note 17)		6,412	321	6,733	2,649
Other changes (Note 13)	(112,660)			(112,660)	(338,363)
Transfers between GOA and endowment (Note 10)	(3,223)	158,904		155,681	202,324
Transfers between GOA and split interest agreements (Note 11)		8,953	2,536	11,489	36,269
Non-operating net assets released from restrictions	186,542	(186,542)		0	0
TOTAL NON-OPERATING ACTIVITIES	155,196	14,335	10,482	180,013	(2,791,933)
GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR	115,089	49,693	10,482	175,264	(2,746,627)
Endowment net change during the year	459,095	739,175	220,895	1,419,165	(11,036,587)
Split interest agreement net change during the year (Note 11)		(25,637)	25,855	218	(240,707)
NET CHANGE DURING THE YEAR	574,184	763,231	257,232	1,594,647	(14,023,921)
Net assets, beginning of year	6,651,192	18,326,174	5,162,920	30,140,286	44,164,207
NET ASSETS, end of year	\$ 7,225,376	\$ 19,089,405	\$ 5,420,152	\$ 31,734,933	\$ 30,140,286

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, 2009

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30	
				2010	2009
Investment return (Notes 3 and 10):					
Income from general investments	\$ 33,674	\$ 148,728		\$ 182,402	\$ 107,551
Realized and unrealized appreciation/(depreciation), net	566,444	1,881,424		2,447,868	(9,698,576)
Total investment return	600,118	2,030,152	0	2,630,270	(9,591,025)
Endowment returns made available for operations	(233,897)	(1,086,677)		(1,320,574)	(1,416,337)
Net investment return	366,221	943,475	0	1,309,696	(11,007,362)
Gifts for capital (Note 17)	3,564	25,420	\$ 211,809	240,793	194,459
Transfers between endowment and the COA (Note 10)	3,223	(158,904)		(155,681)	(202,324)
Capitalization of split interest agreements (Note 11)		42,570	41,176	83,746	47,110
Change in pledge balances (Note 8)		(21,586)	(17,565)	(39,151)	2,925
Change in interests in trusts held by others (Note 10)		82	14,486	14,568	(57,625)
Other changes	(423)	(31,262)	(3,121)	(34,806)	(13,770)
Net assets released from restrictions	86,510	(60,620)	(25,890)	0	0
NET CHANGE DURING THE YEAR	459,095	739,175	220,895	1,419,165	(11,036,587)
Net assets of the endowment, beginning of year	4,268,681	17,156,864	4,712,694	26,138,239	37,174,826
NET ASSETS OF THE ENDOWMENT, end of year	\$ 4,727,776	\$ 17,896,039	\$ 4,933,589	\$ 27,557,404	\$ 26,138,239

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

STATEMENTS OF CASH FLOWS

<i>In thousands of dollars</i>	For the year ended	
	June 30	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 1,594,647	\$ (14,023,921)
Adjustments to reconcile change in net assets to net cash provided by/(used in) operating activities:		
Depreciation	278,360	288,450
Change in fair value of interest rate exchange agreements	52,710	347,769
Change in interests in trusts held by others	(21,058)	65,419
Change in liabilities due under split interest agreements	8,614	(211,272)
Realized and unrealized (gain)/loss on investments, net	(2,847,547)	11,897,810
Gifts of securities	(74,919)	(48,134)
Gifts restricted for capital purposes	(213,029)	(187,174)
Changes in operating assets and liabilities:		
Receivables, net	1,970	4,915
Prepayments and deferred charges	(14,314)	(29,363)
Pledges receivable, net	13,078	(158,811)
Retirement assets, net	0	293,560
Accounts payable	(38,701)	25,708
Deposits and other liabilities	4,283	104,846
Accrued retirement obligations	169,077	132,689
NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES	(1,086,829)	(1,497,509)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans made to students, faculty, and staff	(42,821)	(56,596)
Payments received on student, faculty, and staff loans	35,344	35,211
Change in other notes receivable	613	25
Proceeds from the sales of gifts of securities	74,919	48,134
Proceeds from the sales and maturities of investments	55,986,287	68,474,563
Purchases of investments	(53,499,938)	(66,557,720)
Additions to fixed assets	(426,185)	(681,165)
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	2,128,219	1,262,452
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in overdrafts included in accounts payable	(5,034)	(7,976)
Proceeds from the issuance of debt	753,742	3,464,067
Debt repayments	(449,996)	(1,573,528)
Gifts restricted for capital purposes	213,029	187,174
Change associated with securities lending agreements	(1,547,540)	(1,838,443)
Change in government loan advances	(8,144)	10,638
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	(1,043,943)	241,932
NET CHANGE IN CASH	(2,553)	6,875
Cash, beginning of year	34,182	27,307
CASH, end of year	\$ 31,629	\$ 34,182
Supplemental disclosure of cash flow information:		
Change in accounts payable related to fixed asset additions	\$ (40,704)	\$ (15,480)
Non-cash additions to fixed assets related to capital leases		\$ 64,900
Cash paid for interest	\$ 274,742	\$ 154,626

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 7,180 undergraduate and 13,830 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 (GAAP). Accordingly, such information should be read in conjunction with the University’s financial statements for the year ended June 30, 2009, from which the summarized information is derived.

Certain prior year amounts have been reclassified to conform to current year presentation, including the presentation of certain items contributing to the net operating result. The primary reclassification was to reduce endowment returns made available for operations for recapitalizations to the endowment that are required by donor or University policy. These recapitalizations were previously recorded as non-operating transfers between the endowment and the General Operating Account (GOA). Additionally, endowment income from general investments previously reflected in the net assets of the GOA has been reclassified to the net assets of the endowment.

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 with General Operating Account Detail*.

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 endowment funds comprise 87% of the University’s unrestricted net assets as of June 30, 2010. 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 returns 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. Investment returns earned by restricted donor funds are initially classified as temporarily restricted net assets and then reclassified to 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 operating surplus/(deficit)

Revenues earned, expenses incurred, and returns 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 operating surplus/(deficit)” in the *Statements of Changes in Net Assets with General Operating Account Detail*.

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 incurred claims, including those related to Harvard Medical School activities occurring away from the affiliated teaching hospitals. The CRICO provided malpractice coverage applies with no deductible for medical professionals practicing within Harvard’s University Health Services department, the School of Dental Medicine, and the School of Public Health. The University also maintains reserves for the self-insured portion of claims related to automobile liability, property damage, 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 GAAP in the United States of America requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

New accounting pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-1 (Codification). The Accounting Standards Codification (ASC) combines all authoritative standards issued by organizations that are in levels A through D of the GAAP hierarchy, such as the FASB, American Institute of Certified Public Accountants and Emerging Issues Task Force, into a comprehensive, topically organized online database. Since this is an accumulation of existing guidance, there is no impact to the financial statements. The Codification became effective for reporting periods that end on or after September 15, 2009.

Effective July 1, 2009, the University adopted ASU 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. ASU 2009-12 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 (NAV), at times allowable under the terms of the investee’s governing documents, NAV 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. The effect of this amendment is addressed in *Note 4*.

Effective July 1, 2009, the University adopted ASC 815-10-50, *Disclosures about Derivative Instruments and Hedging Activities* (ASC 815-10-50). ASC 815-10-50 requires additional disclosures about derivative instruments and hedging activities. This new standard 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. The effect of adopting ASC 815-10-50 is further discussed in *Note 5*.

Effective July 1, 2009, the University adopted ASC 715-20, *Employers' Disclosures about Postretirement Benefit Plan Assets*, which provides guidance on expanded disclosures for plan assets of a defined benefit pension or other postretirement plan. ASC 715-20 requires additional disclosure only (see *Note 13*), and therefore did not have an impact on the valuation of the University's postretirement benefit plans.

As of June 30, 2009, the University adopted the provisions of ASC 855, *Subsequent Events* (ASC 855). ASC 855 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. This 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 15, 2010, the date the financial statements were available for issuance. This requires additional disclosures only, and therefore did not have an impact on the University's financial statements.

Effective July 1, 2008, the University adopted ASC 820-10, *Fair Value Measurement* (ASC 820-10), which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and enhances disclosures regarding fair value measurements. This general accounting principle 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 fair value measurements is further discussed in *Notes 3* and *4*.

During fiscal year 2009, the University adopted ASC 820-10-65-2, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (ASC 820-10-65-2). This ASC subtopic clarifies that determining fair value in an inactive or dislocated market depends on facts and circumstances and requires significant management judgment. Specifically, it 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 this guidance.

During fiscal year 2009, the University adopted ASC 820-10-65-4, *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* (ASC 820-10-65-4).

This ASC subtopic 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 this guidance.

During fiscal year 2009, the University adopted ASC 815-10, *Disclosures about Credit Derivatives and Certain Guarantees* (ASC 815-10), which amended 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 this amendment is addressed in *Note 5*.

Effective July 1, 2008, the University adopted ASC 825, *Financial Instruments* (ASC 825), which 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 elected to account for split interest agreement liabilities under the fair value option.

Effective July 1, 2008, the University adopted ASC 958-205, *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* (ASC 958-205). ASC 958-205 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 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. The adoption did not have an impact 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, 2010 and 2009. The University endeavors to utilize the best available information in measuring fair value. 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 option, swap, credit default, interest rate, and forward contracts are primarily valued using models with external inputs from independent service providers, or by using independent broker quotes. Investments in most asset classes are at least partially executed 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 investments are valued using discounted cash flow and other industry standard methodologies. Where applicable, independent appraisers and valuation agencies are utilized to assist in the valuation. These values are determined under the direction of, and subject to approval by, the Valuation Committee of the 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 certain illiquid and direct investments. 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 using the effective yield method and 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 included in "Investment portfolio, at fair value" in the *Balance Sheets*.

F) The collateral advanced under reverse repurchase and security borrowing agreements is in the form of cash. The minimum collateral the University requires by contract on each loaned security is 100% of the fair value of the security loaned. Collateral is exchanged 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. Other investments are managed separately from the GIA. These investments consist primarily of fixed income securities (principally government securities) held for the University's working capital needs, and publicly traded securities associated with split interest agreements. All investments are measured at fair value using valuation techniques consistent with ASC 820 and the accounting policies presented herein.

The University's investment holdings as of June 30, 2010 and 2009 are summarized in the following table (in thousands of dollars):

	2010	2009
Investment portfolio, at fair value:		
Pooled general investment assets ¹	\$ 34,831,617	\$ 33,436,198
Other investments ²	1,869,908	1,219,981
Total investment portfolio, at fair value	36,701,525	34,656,179
Securities pledged to counterparties, at fair value	4,158,201	3,067,027
Securities lending and other liabilities associated with the investment portfolio ³	(7,523,366)	(6,242,874)
TOTAL INVESTMENTS⁴	\$ 33,336,360	\$ 31,480,332

Investments as of June 30, 2010 and 2009 comprised the following (in thousands of dollars):

	2010	2009
Pooled general investments net assets:		
General Operating Account	\$ 4,502,335	\$ 4,625,249
Endowment ⁵	26,735,087	25,368,780
Split interest agreements	684,700	706,644
Other internally designated funds	275,168	237,806
Total pooled general investment net assets	32,197,290	30,938,479
Other investments ²	1,869,908	1,219,981
Interest rate exchange agreements, at fair value	(730,838)	(678,128)
TOTAL INVESTMENTS⁴	\$ 33,336,360	\$ 31,480,332

¹ Excludes fair value of securities pledged to counterparties.

² Includes split interest agreement assets of \$442,874 and \$412,098, as of June 30, 2010 and 2009, respectively.

³ Includes fair value of interest rate exchange agreements of (\$730,838) and (\$678,128) as of June 30, 2010 and 2009, respectively.

⁴ Investment holdings include cash and short-term investments that consist principally of funds that have maturities of 90 days or less. Cash and short-term investments were \$1,977,814 and \$4,158,947 at June 30, 2010 and 2009, respectively.

⁵ Includes only the portion of the endowment invested in the GIA and excludes pledges, interests in trusts held by others, other non-GIA investments and GIA income.

A summary of the University's total return on investments for fiscal 2010 and 2009 is presented below (in thousands of dollars):

	2010	2009
Return on pooled general investments:		
Realized and unrealized gains/(losses), net	\$ 2,905,448	\$ (11,838,870)
Investment income	208,972	128,602
Total return on pooled general investments*	3,114,420	(11,710,268)
Return on other investments:		
Realized and unrealized losses, net	(57,901)	(58,940)
Investment income	41,829	39,926
Total return on other investments	(16,072)	(19,014)
Realized and unrealized losses on interest rate exchange agreements, net	(107,540)	(879,178)
TOTAL RETURN ON INVESTMENTS	\$ 2,990,808	\$ (12,608,460)

* Net of all internal and external management 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 determined by the HMC Board of Directors and management team that is

considered most likely to meet the University's long-term return goals with the designated 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.

The pooled general investment assets and liabilities as of June 30, 2010 and 2009 are summarized as follows (in thousands of dollars):

	2010	2009
POOLED GENERAL INVESTMENT ASSETS:		
Investment assets:		
Domestic common and convertible equity	\$ 3,046,746	\$ 2,984,608
Foreign common and convertible equity	1,717,654	1,314,426
Domestic fixed income	3,116,566	1,908,280
Foreign fixed income	1,382,271	1,429,341
Emerging market equity and debt	2,793,060	2,704,521
High yield	1,517,709	1,705,432
Absolute return and special situations funds	5,286,057	5,146,719
Private equities	6,282,736	5,482,466
Real assets ¹	6,222,894	5,648,022
Inflation-indexed bonds	1,681,589	1,633,303
Due from broker	531,046	1,516,773
Total investment assets ²	33,578,328	31,473,891
Collateral advanced under reverse repurchase and security borrowing agreements	3,800,481	722,449
Cash and short-term investments	935,128	3,648,580
Other assets ³	675,881	658,305
POOLED GENERAL INVESTMENT ASSETS	38,989,818	36,503,225
POOLED GENERAL INVESTMENT LIABILITIES:		
Investment liabilities:		
Equity and convertible securities sold, not yet purchased	273,779	92,449
Fixed income securities sold, not yet purchased	1,216,819	365,101
Due to broker	516,061	1,171,683
Total investment liabilities	2,006,659	1,629,233
Cash collateral held under security lending agreements	3,241,959	1,711,467
Other liabilities ⁴	1,543,910	2,224,046
POOLED GENERAL INVESTMENT LIABILITIES	6,792,528	5,564,746
POOLED GENERAL INVESTMENT NET ASSETS⁵	\$ 32,197,290	\$ 30,938,479

¹ Real assets primarily include direct investments in projects and investments held through limited partnerships and commingled funds in natural resources, timber, and real estate.

² Includes fair value of securities pledged to counterparties where the counterparty has the right to sell or repledge the securities of \$4,158,201 and \$3,067,027 as of June 30, 2010 and 2009, respectively.

³ As of June 30, 2010, other assets consisted primarily of receivables for the sale of securities of \$408,566, and assets consolidated under ASC 810 of \$267,312. As of June 30, 2009, other assets consisted primarily of receivables for the sale of securities of \$464,467, and assets consolidated under ASC 810 of \$191,772.

⁴ As of June 30, 2010, other liabilities consisted primarily of undistributed income and payables for the purchase of securities of \$448,851, and other liabilities consolidated under ASC 810 of \$1,030,766. As of June 30, 2009, other liabilities consisted primarily of undistributed income and payables for the purchase of securities of \$1,157,496, and other liabilities consolidated under ASC 810 of \$1,002,058.

⁵ The cost of the total pooled general investment net assets was \$30,822,563 and \$31,435,906 as of June 30, 2010 and 2009, 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, concentration, 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 24 includes the total fair value of securities pledged to counterparties where the counterparty has the right, by contract or practice, to sell or repledge the securities. The total fair value of securities pledged that cannot be sold or repledged was \$288.7 million and \$169.8 million as of June 30, 2010 and 2009, respectively. The fair value of collateral accepted by the University was \$4,159.3 million and \$1,824.7 million as of June 30, 2010 and 2009, respectively. The portion of this collateral that was sold or repledged was \$234.2 million and \$327.3 million as of June 30, 2010 and 2009, respectively.

The University consolidates assets and liabilities held in partnerships or entities controlled by the University. The consolidation of these entities increased the pooled general investment assets and liabilities shown in the table on page 24 by equal amounts. Real asset investments increased by \$763.5 million and \$810.3 million as of June 30, 2010 and 2009, respectively. Other assets, consisting of cash, receivables, and fixed assets, increased by \$267.3 million and \$191.8 million as of June 30, 2010 and 2009, respectively. Other liabilities, consisting of accruals, payables, debt, and minority interests, increased by \$1,030.8 million and \$1,002.1 million as of June 30, 2010 and 2009, respectively.

4. FAIR VALUE OF INVESTMENT ASSETS AND LIABILITIES

As discussed in *Note 2*, in 2009, the University adopted ASC 820 and its applicable amendments. ASC 820 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). In evaluating the level at which the University's externally managed investments have been classified within this hierarchy, management has assessed factors including, but not limited to price transparency, the ability to redeem these investments at NAV at the measurement date, and the existence or absence of certain restrictions at the measurement date. The three levels of the fair value hierarchy under ASC 820 are:

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 significant to the fair value measurement, unobservable and/or require the University to develop its own assumptions.

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, 2010 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Cash and short-term investments	\$ 1,977,814			\$ 1,977,814
Domestic common and convertible equity	235,957	\$ 987,236	\$ 1,977,249	3,200,442
Foreign common and convertible equity	196,000	875,362	711,184	1,782,546
Domestic fixed income	3,143,022	205,776	24,613	3,373,411
Foreign fixed income	1,393,952			1,393,952
Emerging market equity and debt	1,651,883	722,744	418,433	2,793,060
High yield	161,800	500,003	869,213	1,531,016
Absolute return and special situations funds		2,606,418	2,679,639	5,286,057
Private equities			6,358,302	6,358,302
Real assets	34,377	59,559	6,145,956	6,239,892
Inflation-indexed bonds	1,701,857			1,701,857
Due from broker	8,623	476,450	45,973	531,046
Other investments	26,985	2,374	3,062	32,421
TOTAL INVESTMENT PORTFOLIO ASSETS*	10,532,270	6,435,922	19,233,624	36,201,816
Interests in trusts held by others			297,629	297,629
TOTAL INVESTMENT ASSETS	\$ 10,532,270	\$ 6,435,922	\$ 19,531,253	\$ 36,499,445

* Includes securities pledged to counterparties of \$4,158,201 (Note 3) and excludes investment assets not subject to fair value of \$4,657,910.

INVESTMENT LIABILITIES:				
Equity and convertible securities sold, not yet purchased	\$ 273,570		\$ 209	\$ 273,779
Fixed income securities sold, not yet purchased	1,100,924	\$ 115,275	620	1,216,819
Due to broker	3,014	1,227,984	15,901	1,246,899
TOTAL INVESTMENT LIABILITIES**	1,377,508	1,343,259	16,730	2,737,497
Liabilities due under split interest agreements		705,601		705,601
TOTAL LIABILITIES	\$ 1,377,508	\$ 2,048,860	\$ 16,730	\$ 3,443,098

** Includes fair value of interest rate exchange agreements of \$730,838 and excludes investment liabilities not subject to fair value of \$4,785,869.

The University's Level 3 investments consist almost entirely of investments managed by external advisors, and direct investments in natural resources and real estate. Investments in externally managed funds generally have limited redemption options for investors and, subsequent to final closing, may or may not permit subscriptions by new or existing investors. These entities may also have the ability to impose gates, lockups, and other restrictions on an investor's ability to readily redeem out of their investment interest in the fund. At June 30, 2010, externally managed funds where the University has the ability and the right to redeem interests within the next twelve months have been classified as Level 2 investments. These funds were classified as Level 3 investments in the previous year.

Also, for June 30, 2010, the University has classified its investments in U.S. government and sovereign debt securities as Level 1 investments. At June 30, 2009, these securities were classified as Level 2 investments.

The University has various sources of internal liquidity at its disposal, including approximately \$4.0 billion in cash and cash equivalents (including reverse repurchase agreements of \$2.3 billion) at June 30, 2010 in the General Operating Account and General Investment Account. In addition, management estimates that as of that date, it could liquidate additional unencumbered U.S. government securities in excess of \$2.1 billion within one business day to meet any immediate short-term needs of the University.

The following is a summary of the levels within the fair value hierarchy for those investment assets and liabilities subject to fair value measurement that have not been reclassified to reflect the level transfers identified above 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
Due from broker	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 \$1,564,951.

INVESTMENT LIABILITIES:				
Equity and convertible securities sold, not yet purchased	\$ 92,335		\$ 114	\$ 92,449
Fixed income securities sold, not yet purchased		\$ 361,426	3,675	365,101
Due to broker	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 \$3,935,513.

The following is a rollforward of Level 3 investments for the year ended June 30, 2010 (in thousands of dollars):

	Beginning balance as of July 1, 2009	Realized gains/ (losses)	Change in unrealized gains/ (losses)*	Net purchases/ (sales)	Net transfers in/ (out) of Level 3**	Ending balance as of June 30, 2010
INVESTMENT ASSETS:						
Domestic common and convertible equity	\$ 3,030,537	\$ 44,955	\$ 330,842	\$ 17,376	\$(1,446,461)	\$ 1,977,249
Foreign common and convertible equity	1,162,592	14,325	252,873	(306,126)	(412,480)	711,184
Domestic fixed income	88,837	(29,870)	43,177	(72,906)	(4,625)	24,613
Emerging market equity and debt	1,069,217	(69,309)	191,212	(63,895)	(708,792)	418,433
High yield	1,167,909	(91,587)	282,625	(388,977)	(100,757)	869,213
Absolute return and special situations funds	5,146,719	(39,387)	723,496	(500,961)	(2,650,228)	2,679,639
Private equities	5,587,397	127,711	609,101	52,870	(18,777)	6,358,302
Real assets	5,670,179	(185,899)	(20,814)	676,263	6,227	6,145,956
Inflation-indexed bonds	39,741	18,870	(13,301)	(45,310)		0
Due from broker	345,516	156,424	(219,274)	(214,742)	(21,951)	45,973
Other investments	6,871	126	(3,935)			3,062
TOTAL INVESTMENT PORTFOLIO ASSETS	23,315,515	(53,641)	2,176,002	(846,408)	(5,357,844)	19,233,624
Interests in trusts held by others	276,571		21,217	(159)		297,629
TOTAL INVESTMENT ASSETS	\$ 23,592,086	\$ (53,641)	\$ 2,197,219	\$ (846,567)	\$ (5,357,844)	\$ 19,531,253
INVESTMENT LIABILITIES:						
Equity and convertible securities sold, not yet purchased	\$ 114	\$ (7)	\$ 102			\$ 209
Fixed income securities sold, not yet purchased	3,675	(412)	1,238	(1,316)	(2,565)	620
Due to broker	287,804	273,167	(242,837)	(309,470)	7,237	15,901
TOTAL INVESTMENT LIABILITIES	\$ 291,593	\$ 272,748	\$ (241,497)	\$ (310,786)	\$ 4,672	\$ 16,730

* Total unrealized gains/(losses) on Level 3 investment assets and investment liabilities at fair value held by the University at June 30, 2010 were \$(554,309).

** As previously discussed, changes in classification for certain externally managed funds from Level 3 to Level 2 are included in the above table as transfers out of Level 3.

The following is a rollforward of Level 3 investments 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) of Level 3	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
Due from broker	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 PORTFOLIO 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 sold, not yet purchased	\$ 113		\$ 1			\$ 114
Fixed income securities sold, not yet purchased	120	\$ (7,034)	2,277	\$ 6,866	\$ 1,446	3,675
Due to broker	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

* Total unrealized gains/(losses) on Level 3 investment assets and investment liabilities at fair value held by the University at June 30, 2009 were \$(1,452,705).

The University has entered into agreements with private equity and real estate partnerships and external investment managers, which include commitments to make periodic

cash disbursements in future periods. The expected amount of these disbursements is broken out below (in thousands of dollars):

	Fair value*	Remaining unfunded commitments	Estimated remaining life**
Private equities	\$ 5,487,532	\$ 3,229,044	5–10
Real assets	2,128,300	2,877,591	8–10
Other externally managed funds***	1,145,183	533,306	2–8
TOTAL	\$ 8,761,015	\$ 6,639,941	

* Represents the portion of total fair value relating to the remaining unfunded commitment for each asset class.

** The estimated remaining lives of these funds, expressed in years, are forward-looking projections based on management's estimates and could vary significantly depending on the investment decisions of external managers, changes in the University's investment portfolio, and other circumstances.

*** Investments in externally managed funds primarily include exposures to Absolute return, Domestic, Foreign, and Emerging equities, and High yield asset classes.

The University's interests in private equity and real estate partnerships generally represent commitments that are not subject to redemption; instead the University is a limited partner in funds that invest in private companies or properties, and pursue special situation strategies. The nature of these investments is that distributions are received through the liquidation of the underlying assets of the partnership. The fair values of the investments in these asset classes have

generally been estimated using the NAV of the University's capital account balance with each partnership, unless management has deemed the NAV to be an inappropriate representation of fair value under the University's valuation policy. The University classifies its interest in these types of entities as Level 3 investments within the aforementioned fair value hierarchy.

5. DERIVATIVES

As discussed in *Note 2*, the University adopted ASC 815-10 as of July 1, 2009, which enhances disclosures about the University's derivative and hedging activities in relation to its investment portfolio, and is intended to provide users of financial statements with a greater understanding of how the use of derivatives affects the financial position, financial performance, and cash flows of the University. The University uses a variety of financial instruments with off-balance sheet risk involving contractual or optional commitments for future settlement, which are exchange traded or executed over the counter. These instruments are used in both the core portfolio to increase or decrease exposure to a given asset class and in the arbitrage strategies, with the goal of enhancing the returns of certain asset classes. The University may also invest in derivative instruments when it believes investments or other derivatives are mispriced in relation to other investments, and the University can benefit from such mispricing. The fair value of these financial instruments is included in the "Investment portfolio, at fair value" and "Securities lending and other liabilities associated with the investment portfolio" line items of the *Balance*

Sheets, with changes in fair value reflected as "Realized and unrealized appreciation/(depreciation), net" within the *Statements of Changes in Net Assets*.

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.

Derivatives held by limited partnerships and commingled investment vehicles pose no off-balance sheet risk to the University due to the limited liability structure of the investments.

The following tables present the gross fair values, and the net profit/(loss) from derivatives by primary risk exposure for the years ended June 30, 2010 and 2009 (in thousands of dollars):

	As of June 30, 2010		For the year ended
	Gross derivative assets	Gross derivative liabilities	June 30, 2010
			Net profit/(loss)
Primary risk exposure			
Equity instruments:			
Equity futures			\$ 47,857
Equity options	\$ 2,103	\$ 489	493
Equity exchange agreements	42,303	141,108	49,553
TOTAL EQUITY INSTRUMENTS	44,406	141,597	97,903
Fixed income instruments:			
Fixed income futures	3,731	10,745	3,001
Fixed income options	5,556	2,573	(910)
Interest rate exchange agreements ¹	350,967	1,024,347	(108,539)
Interest rate caps and floors	154,952	140,177	(8,105)
TOTAL FIXED INCOME INSTRUMENTS	515,206	1,177,842	(114,553)
COMMODITY INSTRUMENTS	1,354	1,011	(38,523)
Currency instruments:			
Currency forwards	1,191,258	1,190,086	(2,971)
Currency options	63,698	37,770	1,721
Currency exchange agreements	16,707	6,076	7,972
TOTAL CURRENCY INSTRUMENTS	1,271,663	1,233,932	6,722
CREDIT INSTRUMENTS	79,622	65,510	(165,634)
GROSS VALUE OF DERIVATIVE CONTRACTS	1,912,251	2,619,892	(214,085)
Counterparty netting ²	(1,299,951)	(1,307,572)	
INCLUDED IN INVESTMENT PORTFOLIO, AT FAIR VALUE	\$ 612,300	\$ 1,312,320	

¹ Includes \$81,254 and \$796,259 of gross derivative assets and liabilities, respectively, and a net profit/(loss) of \$(107,540), related to interest rate exchange agreements on the University's debt portfolio, further discussed in *Note 12*.

² GAAP permits the netting of derivative assets and liabilities and the related cash collateral received and paid when a legally enforceable master netting agreement exists between the University and a derivative counterparty.

	As of June 30, 2009		For the year ended
	Gross derivative assets	Gross derivative liabilities	June 30, 2009 Net profit/ (loss)
Primary risk exposure			
Equity instruments:			
Equity futures		\$ 2,378	\$ 130,977
Equity options	\$ 1,007		(1,396)
Equity exchange agreements	164,027	66,004	(1,103,727)
TOTAL EQUITY INSTRUMENTS	165,034	68,382	(974,146)
Fixed income instruments:			
Fixed income futures	4,610	3,719	(7,612)
Fixed income options	12,224	9,370	73
Interest rate exchange agreements ¹	265,004	950,749	(840,492)
Interest rate caps and floors	127,320	70,410	112,447
TOTAL FIXED INCOME INSTRUMENTS	409,158	1,034,248	(735,584)
Commodity instruments:			
Commodity futures			(1,363,456)
Commodity exchange agreements	1,835		12,824
TOTAL COMMODITY INSTRUMENTS	1,835		(1,350,632)
Currency instruments:			
Currency forwards	1,308,279	1,311,012	113,535
Currency options	51,932	37,400	10,532
Currency exchange agreements	14,186	14,293	(82,788)
TOTAL CURRENCY INSTRUMENTS	1,374,397	1,362,705	41,279
CREDIT INSTRUMENTS	860,079	654,726	553,474
GROSS VALUE OF DERIVATIVE CONTRACTS	2,810,503	3,120,061	\$ (2,465,609)
Counterparty netting ²	(1,293,730)	(1,297,950)	
INCLUDED IN INVESTMENT PORTFOLIO, AT FAIR VALUE	\$ 1,516,773	\$ 1,822,111	

¹ Includes \$650,428 of gross derivative liabilities and a net profit/(loss) of \$(879,178) related to interest rate exchange agreements on the University's debt portfolio, further discussed in Note 12.

² GAAP permits the netting of derivative assets and liabilities and the related cash collateral received and paid when a legally enforceable master netting agreement exists between the University and a derivative counterparty.

The following section details the accounting for each type of derivative contract, as well as the University's intended purpose for entering into each type of derivative instrument.

Options

The University purchases and sells put and call options to take advantage of mispricings due to expectations in the marketplace of future volatility of the underlying instruments. When purchasing an option, the University pays a premium, which is included in the Pooled General Investments table in Note 3 as an asset and subsequently marked-to-market to reflect the current value of the option. Premiums paid for purchased options that expire unexercised are treated as realized losses within the *Statements of Changes in Net Assets of the Endowment*.

When the University sells (writes) a call or put option, an amount equal to the premium received is recorded as a liability in the Pooled General Investments table in Note 3 and

subsequently marked-to-market to reflect the current value of the option written. Premiums received from writing options that expire unexercised are treated as realized gains within the *Statements of Changes in Net Assets of the Endowment*.

When a purchased option is closed before expiration or exercise, the University records a realized gain or loss equal to the difference between the proceeds received upon closing and the premium paid. When a written option is closed before expiration or exercise, the University records a realized gain or loss equal to the difference between the cost to close the option and the premium received from selling the option.

During fiscal 2010, the University transacted approximately 800 equity and fixed income option trades with an average transaction size of approximately 500 contracts. Additionally, the University transacted approximately 200 currency option contracts with average USD equivalent notional amounts of approximately \$25.0 million per contract.

Swap contracts

The University enters into swap contracts, which are contracts between two parties to exchange future cash flows at periodic intervals based on a notional principal amount. Payments are exchanged at specified intervals, accrued daily commencing with the effective date of the contract and recorded as realized gains or losses. Gains or losses are realized in the event of an early termination of a swap contract. Risks of loss may include unfavorable changes in the returns of the underlying instruments or indexes, adverse fluctuations of interest rates, failure of the counterparty to perform under the terms of the agreement and lack of liquidity in the market.

Collateral in the form of securities or cash may be posted to or received from the swap counterparty in accordance with the terms of the swap contract. Realized gains or losses are recorded within the *Statements of Changes in Net Assets with General Operating Account Detail* and within the *Statements of Changes in Net Assets of the Endowment* on periodic payments received or made on swap contracts and with respect to swaps that are closed prior to termination date. When the University enters into a swap transaction, it may make or receive a payment equal to the value of the swap on the entry date and amortizes such payments to realized gain or loss over the outstanding term of the swap. The terms of the swap contracts can vary, and they are reported at fair value based on a valuation model or a counterparty provided price.

The University enters into swap contracts to increase or decrease its exposure to changes in the level of interest rates, underlying asset values and/or credit risk. In the normal course of its trading activities, the University enters into credit default, interest rate, and total return swap contracts.

Credit default contracts

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. During fiscal 2010, the University transacted approximately 1,000 credit default contracts with average notional amounts of approximately \$10.0 million.

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, 2010, the University's purchased and written credit derivatives had gross notional amounts of \$5.6 billion and \$0.4 billion, respectively, for total net purchased protection of \$5.2 billion in notional value. 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 written as of June 30, 2010 and 2009 (in thousands of dollars):

Credit rating on underlying	Purchased protection		As of June 30, 2010					
	Purchased notional amount*	Purchased fair value	Written protection notional amount		Total written credit protection	Offsetting purchased credit protection**	Net written credit protection	Net written credit protection fair value
			Years to maturity					
			< 5 years	5-10 years				
A- to AAA	\$ 775,124	\$ 8,561	\$ 28,749	\$ 23,000	\$ 51,749	\$ 12,249	\$ 39,500	\$ (1,635)
BBB- to BBB+	4,581,625	11,235	208,280		208,280	5,000	203,280	863
Non-investment grade	164,281	39,771	145,021	20,934	165,955	39,000	126,955	(72,530)
TOTAL	\$ 5,521,030	\$ 59,567	\$ 382,050	\$ 43,934	\$ 425,984	\$ 56,249	\$ 369,735	\$ (73,302)

Credit rating on underlying	Purchased protection		As of June 30, 2009					
	Purchased notional amount*	Purchased fair value	Written protection notional amount		Total written credit protection	Offsetting purchased credit protection**	Net written credit protection	Net written credit protection fair value
			Years to maturity					
			< 5 years	5-10 years				
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 reference obligation, 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.

Interest rate contracts

The University enters into interest rate swaps (including swaptions) to hedge certain investment positions against interest rate fluctuations; to benefit from interest rate fluctuations; to obtain better interest rate terms than it would have been able to get without the swap; or to manage the interest, cost, and risk associated with its outstanding debt and to hedge issuance of future debt. Interest rate swaps involve the exchange by the University with another party of its respective commitments to pay or receive interest at specified

intervals based on a notional amount of principal. During fiscal 2010, the University transacted approximately 2,050 interest rate swap and cap and floor contracts with average notional amounts of approximately \$225.0 million.

Total return swaps

The University enters into total return swaps to manage its exposure to market fluctuations in various asset classes. Total return swaps involve commitments to pay interest in exchange for a market linked return, both based on notional amounts. To the extent the total return of the security or index underlying the transaction exceeds or falls short of the offsetting interest rate obligation, the University will receive a payment from or make a payment to the counterparty, respectively. During fiscal 2010, the University transacted approximately 100 commodity swap contracts, 1,000 equity swap contracts, and 200 currency swap contracts with average notional amounts of approximately \$15.0 million, \$2.0 million, and \$25.0 million, respectively.

Forward currency contracts

The University enters into forward currency contracts in connection with settling planned purchases or sales of securities, for investment purposes, or to hedge the currency exposure associated with some or all of the University's portfolio securities. A forward currency contract is an agreement between two parties to buy and sell a currency at a set price on a future date. The value of a forward currency contract fluctuates with changes in forward currency exchange rates. Forward currency contracts are marked-to-market daily and the change in value is recorded by the University as an unrealized gain or loss. Realized gains or losses equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed are recorded upon delivery or receipt of the currency or, if a forward currency contract is offset by entering into another forward currency contract with the same broker, upon settlement of the net gain or loss. During fiscal 2010, the University transacted approximately 4,400 forward currency contracts with average USD equivalent notional amounts of approximately \$2.5 million.

Futures contracts

The University uses futures to manage its exposure to financial markets, including to hedge such exposures. Buying futures tends to increase the University's exposure to the underlying instrument. Selling futures tends to decrease exposure to the underlying instrument. Upon entering into a futures contract, the University is required to deposit with its prime broker an amount of cash or liquid securities in accordance with the initial margin requirements of the broker or exchange.

Gains and losses are realized when the contracts expire or are closed. Futures contracts are marked-to-market daily based on settlement prices established by the board of trade or exchange on which they are traded, and an appropriate payable or receivable for the change in value is recorded by the University. During fiscal 2010, the University transacted approximately 1,000 futures trades with an average transaction size of approximately 200 contracts.

Counterparty credit exposure

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 by the University and are adjusted according to policy.

Some of the financial instruments entered into by the University contain credit-risk-related contingency features that allow the parties to the agreement to demand immediate payment for outstanding contracts and/or collateral. If material credit-risk-related contingency features were triggered on June 30, 2010, the additional collateral due to counterparties for derivative contracts would be \$20.6 million.

6. RECEIVABLES

The major components of receivables, net of reserves for doubtful accounts of \$6.6 million and \$8.0 million as of June 30, 2010 and 2009, respectively, were as follows (in thousands of dollars):

	2010	2009
Investment income	\$ 66,248	\$ 65,714
Federal sponsored support	43,518	46,453
Non-federal sponsored support	12,954	10,692
Tuition and fees	13,094	13,427
Publications	34,452	30,882
Gift receipts	13,108	9,114
Executive education	20,939	18,056
Other	38,161	50,106
TOTAL RECEIVABLES, NET	\$ 242,474	\$ 244,444

7. NOTES RECEIVABLE

Notes receivable are recorded initially at face value plus accrued interest which approximates fair value. Notes receivable, net of reserves for doubtful accounts of \$8.7 million and \$7.9 million as of June 30, 2010 and 2009, respectively, were as follows (in thousands of dollars):

	2010	2009
Student loans:		
Government revolving	\$ 79,295	\$ 78,957
Institutional	76,447	76,211
Federally insured	1,681	1,954
Total student loans	157,423	157,122
Faculty and staff loans	178,460	171,284
Other loans	28,426	29,039
TOTAL NOTES RECEIVABLE, NET	\$ 364,309	\$ 357,445

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled \$61.4 million and \$69.5 million as of June 30, 2010 and 2009, 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.

8. 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 \$56.5 million and \$78.9 million for the years ended June 30, 2010 and 2009, respectively, were calculated using discount factors based on the appropriate U.S. Treasury Bill rates for pledges received prior to the adoption of ASC 820, and using the University's taxable unsecured borrowing rate for pledges received beginning in fiscal 2009.

Pledges receivable included in the financial statements as of June 30, 2010 and 2009 are expected to be realized as follows (in thousands of dollars):

	2010	2009
Within one year	\$ 135,665	\$ 138,788
Between one and five years	542,658	555,148
More than five years	204,998	233,428
Less: discount and allowance for uncollectible pledges	(111,109)	(142,074)
TOTAL PLEDGES RECEIVABLE, NET	\$ 772,212	\$ 785,290

Pledges receivable as of June 30, 2010 and 2009 have been designated for the following purposes (in thousands of dollars):

	2010	2009
General Operating Account balances:		
Gifts for current use	\$ 319,851	\$ 284,385
Non-federal sponsored grants	96,515	111,484
Loan funds and facilities	21,663	16,087
Total General Operating Account balances	438,029	411,956
Endowment	334,183	373,334
TOTAL PLEDGES RECEIVABLE, NET	\$ 772,212	\$ 785,290

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 \$40.3 million and \$45.6 million as of June 30, 2010 and 2009, respectively.

9. FIXED ASSETS

Fixed assets are reported at cost or, if a gift, 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, 2010 and 2009 are summarized as follows (in thousands of dollars):

	2010	2009	Estimated useful life (in years)
Research facilities	\$ 1,936,396	\$ 1,876,123	*
Classroom and office facilities	1,301,983	1,257,030	35
Housing facilities	1,108,432	1,072,255	35
Other facilities	531,103	528,402	35
Service facilities	484,110	461,512	35
Libraries	408,508	418,252	35
Museums and assembly facilities	317,193	291,211	35
Athletic facilities	161,046	163,258	35
Land	609,872	609,872	N/A
Construction in progress	740,699	617,502	N/A
Equipment	804,315	730,980	**
Total fixed assets, at cost	8,403,657	8,026,397	
Less: accumulated depreciation	(2,903,072)	(2,632,933)	
TOTAL FIXED ASSETS, NET	\$ 5,500,585	\$ 5,393,464	

* 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 \$183.2 million and \$188.1 million as of June 30, 2010 and 2009, 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 \$65.9 million and \$42.2 million, which are included in "Deposits and other liabilities" in the *Balance Sheets* as of June 30, 2010 and 2009, respectively.

10. ENDOWMENT

The University's endowment consists of approximately 11,700 separate funds established over many years for a wide variety of purposes. Endowment fund balances, including funds functioning as endowment, are classified and reported as 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. As of June 30, 2009, unrestricted net assets were reduced by \$123.0 million for such losses. As of June 30, 2010, \$83.7 million of that amount remains. Although unrestricted funds functioning as endowment are not subject to donor restrictions, decisions to spend their principal in most cases 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, 2010 and 2009 (in thousands of dollars):

	2010			Total	2009 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Endowment funds	\$ (83,700)	\$ 15,512,873	\$ 4,390,186	\$ 19,819,359	\$ 18,926,526
Funds functioning as endowment	4,811,476	2,339,244		7,150,720	6,599,805
Pledge balances		32,948	301,235	334,183	373,334
Interests in trusts held by others		10,974	242,168	253,142	238,574
TOTAL ENDOWMENT	\$ 4,727,776	\$ 17,896,039	\$ 4,933,589	\$ 27,557,404	\$ 26,138,239

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 based on presumptive guidance from a formula that is intended to provide budgetary stability by smoothing the impact of annual investment gains and losses. The formula's inputs reflect expectations about long-term returns and inflation rates. For fiscal 2010, the endowment distribution approved by the Corporation (prior to decapitalizations) was equal to 5.3% of the fair value of the endowment invested in the GIA as of the beginning of

the fiscal year. The total endowment returns made available for operations were \$1.3 billion and \$1.4 billion in fiscal 2010 and 2009, respectively.

Each year the Corporation also approves certain decapitalizations from the endowment to support strategic, mission-critical activities or objectives that typically are one-time or time-limited. These decapitalizations totaled \$237.4 million and \$239.6 million in fiscal 2010 and 2009, respectively. These additional decapitalizations, in combination with the endowment distribution, resulted in an aggregate payout rate of 6.1% and 4.5% in fiscal 2010 and 2009, respectively.

11. 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 *Notes 3 and 4*. 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 Bill rates for gifts received prior to the adoption of ASC 820, and using the University's current taxable unsecured borrowing rate for gifts received beginning in fiscal 2009.

The changes in split interest agreement net assets for fiscal 2010 and 2009 were as follows (in thousands of dollars):

	2010		2009	
	Temporarily restricted	Permanently restricted	Total	Total
Investment return:				
Investment income	\$ 4,278	\$ 11,638	\$ 15,916	\$ 16,604
Realized and unrealized appreciation/(depreciation), net	23,286	63,356	86,642	(377,674)
Total investment return	27,564	74,994	102,558	(361,070)
Gifts for capital (<i>Note 17</i>)*	3,598	9,662	13,260	16,002
Payments to annuitants	(15,521)	(42,228)	(57,749)	(64,358)
Capitalization to the endowment	(42,570)	(41,176)	(83,746)	(47,110)
Transfers between SIA and the GOA	(8,953)	(2,536)	(11,489)	(36,269)
Change in liabilities and other adjustments	10,245	27,139	37,384	252,098
NET CHANGE DURING THE YEAR	(25,637)	25,855	218	(240,707)
Total split interest agreement net assets, beginning of year	63,891	357,864	421,755	662,462
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	\$ 38,254	\$ 383,719	\$ 421,973	\$ 421,755

* Shown at net present value. The undiscounted value of these gifts was \$32,707 and \$32,494 for the years ended June 30, 2010 and 2009, respectively.

Split interest agreement net assets as of June 30, 2010 and 2009 consisted of the following (in thousands of dollars):

	2010	2009
Split interest agreement investments (<i>Note 3</i>):		
Charitable remainder trusts	\$ 745,099	\$ 701,042
Charitable lead trusts	91,144	89,758
Charitable gift annuities	195,831	239,904
Pooled income funds	95,500	88,038
Total split interest agreement investments	1,127,574	1,118,742
Liabilities due under split interest agreements:		
Amounts due to beneficiaries	(605,476)	(603,522)
Amounts due to other institutions	(100,125)	(93,465)
Total liabilities due under split interest agreements	(705,601)	(696,987)
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	\$ 421,973	\$ 421,755

12. BONDS AND NOTES PAYABLE

Bonds and notes payable as of June 30, 2010 and 2009 were as follows (in thousands of dollars):

	Fiscal year of issue	Remaining years to maturity	One-year effective interest rate	Outstanding principal	
				2010	2009
Tax-exempt bonds and notes payable:					
Variable-rate bonds and notes payable:					
Series L - weekly	1990	14	3.6%	\$ 71,140	\$ 71,140
Series R - daily	2000–2006	22	0.2	131,200	131,200
Series Y - weekly	2000	25	5.1	117,905	117,905
Series BB - weekly	2001	24	0.2	196,700	196,700
Series HH - weekly	2004	23	6.7	92,235	92,235
Commercial paper	2010	< 1	0.3	407,081	449,259
Total variable-rate bonds and notes payable			1.6	1,016,261	1,058,439
Fixed-rate bonds:					
Series N	1992	10	6.3	79,008*	78,908**
Series Z	2001	6	5.3	28,858*	67,788**
Series DD	2002	25	5.0	135,038*	135,005**
Series FF	2003	27	5.1	221,831*	274,973**
Series 2005A	2005	26	4.8	93,376*	93,539**
Series 2005B	2006	22	4.8	104,700*	104,888**
Series 2005C	2006	25	4.8	129,776*	129,930**
Series 2008B	2008	28	4.8	216,358*	216,622**
Series 2009A	2009	26	5.4	986,006*	986,908**
Series 2010A	2010	24	4.4	530,395*	
Total fixed-rate bonds			5.2	2,525,346	2,088,561
Total tax-exempt bonds and notes payable			4.0	3,541,607	3,147,000
Taxable bonds and notes payable:					
Series GG2 - weekly	2005	3	4.6	31,810	38,935
Series 2006A	2006	27	6.3	401,416*	401,395**
Series 2008A	2008	28	4.9	387,715*	387,670**
Series 2008C	2008	8	5.3	125,205	125,205
Series 2008D	2009	29	5.9	1,495,716*	1,495,275**
Commercial paper	2010	< 1	5.5	214,759	296,977
Total taxable bonds and notes payable			5.7	2,656,621	2,745,457
Other notes payable	Various	Various	Various	85,969	87,994
TOTAL BONDS AND NOTES PAYABLE			4.8%	\$ 6,284,197	\$ 5,980,451

* Series N, DD, FF, 2006A, 2008A, 2008D and 2009A principal are net of \$1.0 million, \$0.8 million, \$1.3 million, \$0.6 million, \$0.3 million, \$4.3 million and \$14.0 million of discounts, respectively. Series Z, 2005A, 2005B, 2005C, 2008B and 2010A principal include premiums of \$0.02 million, \$4.3 million, \$4.2 million, \$3.9 million, \$7.5 million and \$50.4 million, respectively.

** 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 \$264.9 million and \$210.5 million for fiscal 2010 and 2009, respectively. Excluding maturity of commercial paper and unamortized discounts and premiums, scheduled principal payments are (in thousands of dollars):

Fiscal year	Principal payments
2011	\$ 16,553
2012	17,353
2013	188,258
2014	518,324
2015	38,603
Thereafter	4,835,378
TOTAL PRINCIPAL PAYMENTS	\$ 5,614,469

In fiscal 2010, the University issued \$480.0 million of tax-exempt fixed-rate Series 2010A Bonds. The series was comprised of a \$108.7 million issue that will mature in 2034, and various other issues totaling \$371.3 million that will mature beginning in 2013 and ending in 2034. Proceeds from Series 2010A were used to refinance a portion of Series Z and Series FF bonds, to finance capital projects under construction, and to finance capital projects initially funded by the University's commercial paper program.

In connection with the issuance of Series 2010A, the University's AAA/Aaa credit ratings were affirmed with Standard & Poor's and Moody's Investors Service, respectively.

In fiscal 2010, the University received reauthorization for its tax-exempt commercial paper program.

In fiscal 2009, the University issued \$1.5 billion of taxable fixed-rate Series 2008D Bonds. Proceeds from Series 2008D were used for general University purposes, including the refunding of taxable commercial paper. Also in fiscal 2009, the University issued \$1.0 billion of tax-exempt fixed-rate Series 2009A Bonds. Proceeds from Series 2009A were used primarily for refinancing purposes, and to finance capital projects and acquisitions initially funded by the University's commercial paper program. Finally, in fiscal 2009, the University increased the capacity of its taxable commercial paper program to \$2.0 billion from \$1.0 billion.

Based on quoted market prices, the estimated fair value of the University's outstanding bonds and notes payable, including accrued interest, was \$6,786.1 million and \$6,161.3 million as of June 30, 2010 and 2009, respectively.

As of June 30, 2010, the University had \$641.0 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 38. In the event that the University receives notice of any optional tender on its variable-rate bonds, or if the bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a general obligation to purchase the bonds tendered.

In fiscal 2010, the University entered into a \$1.75 billion unsecured, 364-day revolving credit facility with a syndicate of banks that matured in August 2010. In August 2010, the University entered into a \$2.0 billion unsecured, revolving credit facility with a syndicate of banks, of which \$1.0 billion matures in February 2012 and \$1.0 billion matures in February 2014.

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 5*, 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 38 reflect any applicable exchange agreements.

In fiscal 2010, the University entered into interest rate exchange agreements with a notional value of \$695.5 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 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 \$3,823.4 million and \$(730.8) million, respectively, as of June 30, 2010 and \$3,141.2 million and \$(678.1) million, respectively, as of 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 \$54.8 million and \$33.9 million for fiscal 2010 and 2009, respectively. All unrealized and

realized gains and losses from interest rate exchange agreements are included in the “Realized and unrealized appreciation/(depreciation), 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, 2009	\$ 3,141,210
Offsetting interest rate exchange agreements	695,500
Scheduled amortizations	(13,302)
ENDING BALANCE, JUNE 30, 2010	\$ 3,823,408

13. 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 was \$666.0 million and \$680.7 million as of June 30, 2010 and

2009, respectively. In addition, the University had internally designated and invested \$32.0 million and \$29.0 million as of June 30, 2010 and 2009, respectively, for its defined benefit pension plans. The University recorded expenses for its defined contribution plans of \$100.6 million and \$101.6 million for fiscal 2010 and 2009, 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, 2010, the University had internally designated and invested \$238.1 million to fund the postretirement health benefit accrued liability of \$812.3 million. As of June 30, 2009, the University had internally designated and invested \$204.1 million to fund an accrued liability of \$697.5 million.

The following table sets forth the pension and postretirement plans’ funded status that is reported in the *Balance Sheets* as of June 30, 2010 and 2009 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2010	2009	2010	2009
Change in projected benefit obligation:				
Projected benefit obligation, beginning of year	\$ 723,381	\$ 586,309	\$ 697,483	\$ 607,427
Service cost	12,979	11,757	30,936	29,439
Interest cost	43,815	37,849	44,803	40,815
Plan participants’ contributions			2,659	1,955
Federal subsidy on benefits paid			1,376	1,224
Gross benefits paid	(63,089)	(30,187)	(21,362)	(19,657)
Actuarial (gain)/loss	45,776	74,708	56,441	31,410
Special termination benefits*		42,945		4,870
PROJECTED BENEFIT OBLIGATION, end of year	762,862	723,381	812,336	697,483
Change in plan assets:				
Fair value of plan assets, beginning of year	680,748	879,869		
Actual return on plan assets	48,346	(168,934)		
Gross benefits paid	(63,089)	(30,187)		
FAIR VALUE OF PLAN ASSETS, end of year	666,005	680,748	0	0
FUNDED / (UNFUNDED) STATUS	\$ (96,857)	\$ (42,633)	\$ (812,336)	\$(697,483)

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

The accumulated benefit obligation associated with pension benefits was \$636.7 million and \$618.9 million at June 30, 2010 and 2009, respectively. When comparing the accumulated

benefit obligation with the fair value of the plan assets, under the Pension Protection Act of 2006 and for ERISA purposes, the plan remains overfunded.

Net periodic benefit (income)/cost

Components of net periodic benefit (income)/cost recognized in operating activity and other amounts recognized in non-operating activity in unrestricted net assets in the

Statements of Changes in Net Assets with General Operating Account Detail are summarized as follows for the years ended June 30 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2010	2009	2010	2009
Components of net periodic benefit (income)/cost:				
Service cost	\$ 12,979	\$ 11,757	\$ 30,936	\$ 29,439
Interest cost	43,815	37,849	44,803	40,815
Expected return on plan assets	(55,656)	(56,056)		
Amortization of:				
Actuarial (gain)/loss	(2,792)	(10,103)	1,826	(252)
Prior service (credit)/cost	(4,694)	(4,374)	1,411	1,411
Transition (asset)/obligation			6,062	6,062
Special termination benefits		42,945		4,870
Total net periodic benefit (income)/cost recognized in operating activity	(6,348)	22,018	85,038	82,345
Other amounts recognized in non-operating activity in unrestricted net assets:				
Current year actuarial loss	53,086	299,697	56,441	31,410
Amortization of:				
Transition asset/(obligation)			(6,062)	(6,062)
Prior service credit/(cost)	4,694	4,374	(1,411)	(1,411)
Actuarial gain/(loss)	2,792	10,103	(1,826)	252
Total other amounts recognized in non-operating activity*	60,572	314,174	47,142	24,189
Total recognized in Statements of Changes in Net Assets with General Operating Account Detail	\$ 54,224	\$ 336,192	\$ 132,180	\$ 106,534

Cumulative amounts recognized as non-operating changes in unrestricted net assets are summarized as follows for the years ended June 30 (in thousands of dollars):

	2010	2009	2010	2009
Net actuarial (gain)/loss	\$ 61,114	\$ 5,235	\$ 83,289	\$ 28,674
Prior service (credit)/cost	(5,762)	(10,455)	2,152	3,563
Transition (asset)/obligation			18,187	24,249
Cumulative amounts recognized in unrestricted net assets*	\$ 55,352	\$ (5,220)	\$ 103,628	\$ 56,486

* These amounts totaling \$107.7 million in fiscal 2010 and \$338.4 million in fiscal 2009 include gains and losses and other changes in the actuarially determined benefit obligations arising in the current period but that have not yet been reflected within net periodic benefit (income)/cost and are included in the "Other Changes" line in the Statements of Changes in Net Assets with General Operating Account Detail.

The estimated net actuarial gain and prior service credit for the defined benefit plan that will be amortized from unrestricted net assets into net periodic benefit (income)/cost in fiscal 2011 are \$(0.9) million and \$(4.6) million, respectively. The estimated net actuarial loss, prior service cost and transition

obligation for the postretirement health benefits that will be amortized from unrestricted net assets into net periodic benefit (income)/cost in fiscal 2011 are \$3.0 million, \$1.4 million and \$6.1 million, respectively.

Assumptions and health care cost trend rates used in determining the year end obligation as well as the net periodic benefit (income)/cost of the pension and postretirement health plans are summarized as follows for fiscal 2010 and 2009:

	Pension benefits		Postretirement health benefits	
	2010	2009	2010	2009
Weighted-average assumptions used to determine benefit obligation as of June 30:				
Discount rate	6.00%	6.25%	6.00%	6.25%
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%
Health care cost trend rate:				
– Initial rate	N/A	N/A	11.00%	8.00%
– Rate in Year 2	N/A	N/A	8.50%	7.50%
– Ultimate rate	N/A	N/A	5.00%	5.00%
– Years to ultimate rate	N/A	N/A	8	6
Weighted-average assumptions used to determine net periodic benefit (income)/cost:				
Discount rate	6.25%	6.50%	6.25%	6.50%
Expected long-term rate of return on plan assets	7.50%	7.50%	N/A	N/A
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

As an indicator of sensitivity, a one percentage point change in assumed health care cost trend rate would affect 2010 as shown in the following table (in thousands of dollars):

	1% point increase	1% point decrease
Effect on 2010 postretirement health benefits service and interest cost	17,689	(13,528)
Effect on postretirement health benefits obligation as of June 30, 2010	216,854	(145,126)

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.

Plan assets

The actual asset allocation of the investment portfolio for the pension plan for fiscal 2010 and 2009, along with target allocations for fiscal 2011, is as follows:

	2011 target	2010 actual	2009 actual
Asset allocation by category for pension plan:			
Equity securities	44.0%	50.2%	44.5%
Fixed income securities	17.0	13.5	14.4
Real estate	8.0	5.7	6.4
Commodities	3.0	2.2	2.3
Natural resources	5.0	0.7	2.5
Absolute return	18.0	20.4	20.3
Cash	5.0	7.3	9.6
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 following is a summary of the levels within the fair value hierarchy for the pension plan assets subject to the fair value measurement as of June 30, 2010 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Absolute return		\$ 61,246	\$ 80,446	\$ 141,692
Cash and short-term investments	\$ 45,879			45,879
Commodities			2,036	2,036
Domestic and convertible equity	23,159	91,858		115,017
Domestic fixed income	46,487	10		46,497
Emerging equities, debt and options	76,461			76,461
Equity and convertible equity	192			192
Foreign and convertible equity	38,311	40,752	1,547	80,610
High yield		4,273	57	4,330
Inflation-indexed bonds	38,127			38,127
Private equities			76,337	76,337
Real estate			37,214	37,214
TOTAL INVESTMENT ASSETS*	\$ 268,616	\$ 198,139	\$ 197,637	\$ 664,392

* Excludes investment assets not subject to fair value of \$1,613.

The following is a rollforward of Level 3 investments for the year ended June 30, 2010 (in thousands of dollars):

	Beginning balance as of July 1, 2009	Realized gains/ (losses)	Change in unrealized gains/ (losses)	Net purchases/ (sales)	Net transfers in/ (out) of Level 3	Ending balance as of June 30, 2010
INVESTMENT ASSETS:						
Absolute return	\$ 152,833	\$ (1,263)	\$ 11,765	\$ (12,443)	\$ (70,446)	\$ 80,446
Commodities	14,821	4,672	(12,360)	(5,097)		2,036
Domestic and convertible equity	79,724				(79,724)	0
Foreign and convertible equity	2,151	(2,329)	3,256	(1,531)		1,547
High yield	1,584		(1,527)			57
Private equities	74,763	1,608	8,083	(8,117)		76,337
Real estate	43,642	302	(14,589)	7,859		37,214
TOTAL INVESTMENT ASSETS	\$ 369,518	\$ 2,990	\$ (5,372)	\$ (19,329)	\$ (150,170)	\$ 197,637

Expected future benefit payments

There are no expected employer contributions for fiscal 2011 to funded pension or postretirement health benefit plans. The

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

Fiscal year	Expected benefit payments		Expected Medicare Part D subsidies
	Pension	Postretirement health	
2011	\$ 51,356	\$ 26,418	\$ 2,517
2012	46,249	29,737	2,912
2013	47,721	32,323	3,263
2014	49,205	34,997	3,625
2015	50,623	37,642	4,009
2016–2020	273,260	232,622	26,759

14. GENERAL OPERATING ACCOUNT

The 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, 2010 and 2009 are summarized as follows (in thousands of dollars):

	2010	2009
Departmental balances:		
Unexpended endowment income balances	\$ 356,484	\$ 336,251
Unexpended gift balances	357,286	360,295
Pledge balances	378,029	367,967
Interests in trusts held by others	39,924	31,115
Loan funds	117,860	115,789
Funds for construction	4,673	10,503
Funds invested in fixed assets	1,570,771	1,393,072
Other departmental purposes	359,627	458,797
Total departmental balances	3,184,654	3,073,789
University balances*	570,902	506,503
TOTAL GOA NET ASSET BALANCES	\$ 3,755,556	\$ 3,580,292

* Includes interests in trusts held by others of \$4,563 and \$6,882 for the years ended June 30, 2010 and 2009, respectively.

15. STUDENT FINANCIAL AID

Financial aid granted to students in fiscal 2010 and 2009 is summarized as follows (in thousands of dollars):

	2010	2009
Scholarships and other student awards:		
Scholarships applied to student income	\$ 318,911	\$ 302,369
Scholarships and other student awards paid directly to students	122,021	122,479
Total scholarships and other student awards	440,932	424,848
Student employment	65,347	65,977
Student loans	20,173	25,481
Agency financial aid*	13,485	12,516
TOTAL STUDENT FINANCIAL AID	\$ 539,937	\$ 528,822

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

16. SPONSORED SUPPORT

Total expenditures funded by U.S. government sponsors or by institutions that subcontract federally sponsored projects to the University were \$620.5 million and \$558.7 million in fiscal 2010 and 2009, 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 and the Medical School (including the School of Dental Medicine) through fiscal 2010. For fiscal 2011 and beyond, the University Area and the Medical School (including the School of Dental Medicine) have provisional rates. The University Area and the Medical School anticipate negotiating indirect cost rates for fiscal 2011 and beyond in the fall of 2010. The School of Public Health has predetermined indirect cost rates through fiscal 2013. Funds received for federally sponsored activity are subject to audit.

17. 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, 2010 and 2009 are summarized as follows (in thousands of dollars):

	2010	2009
Gifts for current use	\$ 247,899	\$ 291,231
Non-federal sponsored grants	88,364	92,798
Gifts for capital:		
Endowment funds	240,793	194,459
Split interest agreements*	13,260	16,002
Loan funds and facilities	6,733	2,649
Total gifts for capital	260,786	213,110
TOTAL GIFTS	\$ 597,049	\$ 597,139

* Shown at net present value. The gross value of these gifts was \$32,707 and \$32,494 for the years ended June 30, 2010 and 2009, respectively.

18. OTHER INCOME

The major components of other income for the years ended June 30, 2010 and 2009 were as follows (in thousands of dollars):

	2010	2009
Rental and parking	\$ 128,378	\$ 125,908
Royalties from patents, copyrights, and trademarks	88,431	88,667
Publications	69,568	75,660
Services income	55,527	52,960
Health and clinic fees	48,700	44,906
Sales income	46,023	57,249
Other student income	7,083	6,101
Interest income	9,409	9,041
Other	41,693	60,399
TOTAL OTHER INCOME	\$ 494,812	\$ 520,891

19. OTHER EXPENSES

The major components of other expenses for the years ended June 30, 2010 and 2009 were as follows (in thousands of dollars):

	2010	2009
Services purchased	\$ 369,529	\$ 394,643
Subcontract expenses under sponsored projects	153,103	139,904
Interest	89,405	56,631
Travel	63,724	69,431
Publishing	42,919	46,861
Taxes and fees	25,764	25,330
Advertising	18,668	18,516
Postage	17,376	20,149
Insurance	15,665	15,009
Telephone	11,886	12,715
Other	58,998	41,737
TOTAL OTHER EXPENSES	\$ 867,037	\$ 840,926

20. 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, 2010 and 2009 were as follows (in thousands of dollars):

	2010	2009
Instruction	\$ 989,969	\$ 995,853
Research	664,508	624,242
Institutional support	636,699	742,911
Academic support	513,438	505,169
Auxiliary services	433,981	392,768
Libraries	224,595	239,708
Student services	144,371	138,935
Scholarships and other student awards	122,021	122,479
TOTAL OPERATING EXPENSES	\$ 3,729,582	\$ 3,762,065

21. COMMITMENTS AND CONTINGENCIES

Lease commitments

The University is the lessee of equipment and space under operating (rental) and capital leases. Rent expense related to leases was \$33.5 million and \$33.1 million in fiscal 2010 and 2009, respectively. Future minimum payments under these operating and capital leases are as follows (in thousands of dollars):

	Operating	Capital
2011	\$ 43,386	\$ 6,839
2012	41,974	6,947
2013	38,193	6,964
2014	34,110	7,033
2015	31,740	7,316
Thereafter	141,046	188,000
TOTAL FUTURE MINIMUM PAYMENTS	\$ 330,449	\$ 223,099

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, 2010 totaled approximately \$332.7 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.

Electricity purchase commitments

In fiscal 2010, the University entered into Power Purchase Agreements (PPAs) with a series of energy providers to purchase electricity for various quantities and time periods. Future obligations under the PPAs are as follows (in thousands of dollars):

2011	\$ 20,107
2012	20,973
2013	18,098
2014	13,788
2015	9,846
Thereafter	35,312
TOTAL ELECTRICITY FUTURE OBLIGATIONS	\$ 118,124

Broad Institute

On July 1, 2009, the Broad Institute was established as a separate permanent entity. The University, the Massachusetts Institute of Technology (MIT), and the Broad Foundation have transferred employees, research agreements, and related assets and liabilities to the new entity. Included in the "Other expenses" line of the *Statements of Changes in Net Assets with General Operating Account Detail*, is a \$52.0 million charge related to this transaction.

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 the Broad Institute 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 \$60.0 million in total; of this, \$32.5 million has been paid through June 30, 2010. The University had an accrual related to this obligation of \$4.5 million and \$6.5 million as of June 30, 2010 and 2009, respectively, which is recorded in "Accounts payable" in the *Balance Sheets*.

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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