Carnegie Mellon


# annual report 2005

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Jared L. Cohon

# Recognizing Faculty Achievements

On an October morning last year, we awoke to news from Stockholm that the 2004 Nobel Prize in Economic Sciences had gone to Carnegie Mellon's Finn Kydland and Edward Prescott. They received this highest of scholarly honors "for their contributions to dynamic macroeconomics: the time consistency of economic policy and the driving forces behind business cycles," work done while they were both at Carnegie Mellon in the early 1980s. It was a time when unraveling the business cycle effects of the oil price shocks and inflationary pressures of the 1970s was seizing the attention of the then-new generation of economists. Prescott, a young Carnegie Mellon Ph.D. and economics professor (now at Arizona State), and Kydland, his doctoral student (and now a faculty member in our Tepper School of Business), looked at how expectations about future policy can influence economic decisions and argued for the value of consistency in economic policy over the long term. Their work has changed business planning and strategy models everywhere.

Nobel Prizes are thrilling and, at the same time, humbling events on research university campuses; they present us with an opportunity to reflect on the powerful impact the work of the faculty can have over time, yet it reminds us that we must continue our efforts to solve the problems we face today. Carnegie Mellon counts 13 Nobelists among its faculty and alumni, an impressive achievement by this very small institution. This year, however, the Nobel was just one of many singular honors and recognitions of achievement bestowed on our faculty.

Kydland and Prescott were recognized for work done very early in their careers, as is often the case with Nobel laureates. In recent years, the National Science Foundation has created "early career development" awards to recognize with research grants those young American researchers whose work shows particular promise—the Nobelists of the future. From this group of several hundred, only 20 each year—the best of the best—are selected as Presidential Career Fellows. Last year, two of these awards went to Carnegie Mellon faculty: mechanical engineering and robotics professor Yoky Matsuoka, who is developing a robotic hand prosthesis that will be under the patient's own neural control; and social and decision scientist Jennifer Lerner, whose work on emotion and decision making includes studies of responses to terrorist incidents. Last year, both were selected by our provost, Mark Kamlet, to receive Carnegie Mellon's two McCandless Career Development chairs. This is a tremendous honor both for these two women and for Carnegie Mellon as a whole. Matsuoka and Lerner have distinguished themselves by their research approaches, their energy, their commitment to teaching and their willingness to take on tough problems with huge potential to improve human life. Our record continues: we recently learned that computational biologist Russell Schwartz was selected as a Presidential Career Fellow in 2005, and that alumnus John Hall will share the Nobel Prize in Physics.

So from the most distinguished senior faculty to these brilliant junior professors, it has been a gratifying year. There were so many other honors and well-deserved recognitions bestowed on our faculty in 2004-2005 that I can do no more than list them here [see pages 3 and 4] and add my congratulations and express my pride in their many, many achievements. It is my privilege to work with these extraordinary people every day.

There is one more award I must mention, for it is to all of us. This spring, Carnegie Mellon was selected by the Carnegie Corporation of New York to receive one of its first Academic Leadership Awards, a recognition of many successful educational innovations we have made in the last decade or so: we were cited for our "problem-solving, reflective practitioner's approach to undergraduate education," our integration of environmental issues across the curriculum, and our collaborative approach to everything. We are very grateful to the Carnegie Corporation for this honor.

### Investing in the Grand Challenges of Our Time

Of course, our faculty's achievements are more than just a collection of awards and recognition. The faculty and what they do are at the heart of the university's mission. It is the faculty's leadership in curriculum development and teaching that produce outstanding graduates. Moreover, it is their creativity, innovation and entrepreneurism that bring research grants and contracts to the university—support that represents more than 40 percent of the university's revenues. This year we attracted spectacular new grants that will extend and advance the university's contributions in each one of the fields that we pursue, from science and engineering to the arts and humanities. Of all these grants and contracts, I focus on two here. They are both related to Carnegie Mellon's very important thrust in the technology of education.

Last fall, the National Science Foundation awarded us a five-year, $25 million grant to create one of four national research institutes that will focus on improving education. The Pittsburgh Science of Learning Center, run jointly by Carnegie Mellon and the University of Pittsburgh, is co-directed by Carnegie Mellon psychologist and human-computer interaction scientist Ken Koedinger. This new center is in Pittsburgh in part because it stands "on the shoulders of giants": the decades of work by Herbert Simon, and later by John Anderson, on developing cognitive models of human learning. The new center will house the LearnLab, a national resource that will provide a structured but realistic setting for testing innovative technology for K-12 education, so that results can be readily implemented in the nation's classrooms. Koedinger's own work in developing cognitive tutors is a wonderful example of the kinds of applications this facility will develop; cognitive tutors are already helping tens of thousands of U.S. high school students to succeed in algebra and geometry, and the tutors are getting better all the time.

In the same area, we received renewed support this year from the William and Flora Hewlett Foundation for our Open Learning Initiative. This project will extend what we know about the cognitive science of learning to create the next generation of online college courses. Carnegie Mellon's online classes are different because they are predicated on a well-tested theory about how people learn, which, like the cognitive tutor project, derives from our interdisciplinary work in cognitive psychology and computer science. We are grateful to the Hewlett Foundation and share their belief that investing in Carnegie Mellon's approach will help to set the standard in this important and promising field.

As important as these grants and contracts—and the research they support—are, the fact is that no government or foundation grant covers all the expenses we must incur when we give these projects a home. We must make significant investment in the research infrastructure—the technology, the labs, the offices—that make future projects possible. The benefits of our research are vast, but the financial pressure we face is also large and growing.  Building our endowment is one of the most important things we can do to respond to these needs over the long term.

Fortunately, our many alumni, trustees and friends believe passionately in what we do here, and they have been wonderfully generous. New gifts and financial support have risen dramatically in the past two years, soaring far above our previous 10-year averages in every category. The largest gift this year was a gift from the Bill and Melinda Gates Foundation for $20 million for a new computer science building, which will be built near Newell-Simon Hall with an anticipated opening in fiscal year 2009. The momentum in our fundraising activities is building steadily, and for such generosity, we are encouraged and very grateful.

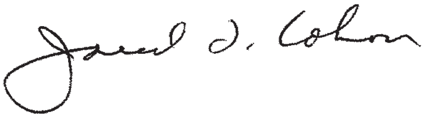
### Leadership to meet grand challenges

Carnegie Mellon depends on strong and visionary deans and department heads for leadership in our decentralized and entrepreneurial culture. This year we saw some important changes in leadership at our two oldest colleges. Pradeep Khosla was named the new dean of the Carnegie Institute of Technology in the summer of 2004, succeeding John Anderson who was appointed provost at Case Western Reserve University. Pradeep's energy and vision are unmatchable, and his own scientific accomplishments and his leadership of CyLab are known around the world; he is the right leader for the prestigious college of engineering. We also welcomed Hilary Robinson, an accomplished British artist, critic and academic leader, as the new dean of the College of Fine Arts; she succeeds Martin Prekop, who has returned to the art faculty after 12 years of outstanding leadership as dean. Hilary brings an exciting vision and an international perspective on the arts in a university setting.

Deborah Moon, who had served as acting chief financial officer since April 2004, was named vice president and CFO in January. Deb did an outstanding job in the acting role and has quickly built a strong financial management team.

Finally, this spring I was pleased to reappoint Mark Kamlet to a second five-year term as provost of the university, giving him the additional title of senior vice president to reflect the central leadership role he plays in the administration. He is a brilliant and energetic leader and colleague, who has deep knowledge of Carnegie Mellon's unique culture.

The success of Carnegie Mellon grows from the efforts of such talented administrators, from our justly honored faculty and, of course, from our creative and energetic students. This has always been so, and always will be. This past year brought us powerful reminders of how the intellectual strengths of Carnegie Mellon people, and their enduring commitment to solving problems that matter, are the most valuable assets we have.



**JARED L. COHON**
*President*
*Carnegie Mellon University*
*January 24, 2006*

# Faculty Honors

## 2004-2005

The Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel
*Finn Kydland and former faculty member Edward Prescott*

Presidential Early Career Award for Scientists and Engineers
*Jennifer Lerner, Estella Loomis McCandless Professor of Social and Decision Sciences and Psychology*
*Yoky Matsuoka, Anna Loomis McCandless Professor in Robotics*

Presidential Award for Excellence in Science, Mathematics and Engineering Mentoring
*Lenore Blum, Distinguished Career Professor of Computer Science*

National Medal of Technology
*Watts S. Humphrey, Fellow, Software Engineering Institute*

Academic Leadership Award, The Carnegie Corporation of New York
*Jared L. Cohon, President, and Carnegie Mellon University*
for Carnegie Mellon's abiding commitment to liberal arts and curricular innovations, including development of interdisciplinary and multidisciplinary programs that aim to bridge the gulf between the theoretical and the practical, and for leadership that supports K-12 reform and emphasizes community outreach

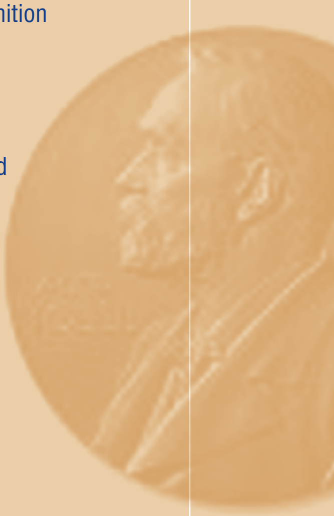
*Technology Review's* List of World's 100 Top Young Innovators
*Golan Levin, Assistant Professor of Art*
*Jesse Schell, Assistant Professor of the Practice, Entertainment Technology Center*

Member, Institute of Medicine, National Academies of Science
*Sheldon Cohen, Robert E. Doherty Professor of Psychology*

Fellows of the American Association for the Advancement of Science
*Pradeep K. Khosla, Dean of the College of Engineering*
*Clark Glymour, Alumni University Professor of Philosophy*

2004 Fellow, The Royal Society of Canada
*Stephen E. Fienberg, Maurice Falk University Professor of Statistics and Social Science*

David E. Rumelhart Prize for Contributions to the Formal Analysis of Human Cognition (Cognitive Science Society)
*John R. Anderson, Richard King Mellon University Professor of Psychology and Computer Science*



American Psychological Association's Distinguished Scientific Contribution Award
*Robert Siegler, Teresa Heinz Professor of Cognitive Psychology*

Thomas J. Wilson Memorial Prize from Harvard University Press
*Scott Sandage, Associate Professor of History*
for his book *Born Losers: A History of Failure in America*

National Endowment for the Arts Creative Writing Fellowships in Poetry
*Jim Daniels, Thomas Stockham Baker Professor of English*
*Terrance Hayes, Associate Professor of Creative Writing*

Award of the Foundation for Polish Science (the "Polish Nobel Prize")
*Krzysztof Matyjaszewski, J.C. Warner University Professor of Natural Sciences*
for the discovery and commercialization of new methods of controlled radical polymerization

Fellow, Institute of Electrical and Electronics Engineers (IEEE)
*Edmund M. Clarke, FORE Systems Professor of Computer Science and Professor of Electrical and Computer Engineering*

Continued

# Faculty Honors
## 2004-2005 Continued

*Hispanic Engineer and Information Technology* Magazine's
List of America's 50 Most Important Hispanics in Technology and Business
*Cristina Amon, Raymond J. Lane Distinguished Professor of Mechanical Engineering*

Andrew W. Mellon Foundation's New Directions Fellowship
*Alex John London, Associate Professor of Philosophy*, to develop rigorous standards for evaluating whether medical research is conducted ethically

Commander's Award for Public Service, United States Army, Fort Leonard Wood, Missouri
*James Staszewski, Professor of Psychology*, for his use of cognitive learning models in training soldiers to improve detection of land mines

American Psychological Society Festschift, May 2005
*Robyn Dawes, Charles J. Queenan, Jr., University Professor of Psychology*

Pittsburgh Center for the Arts' Artist of the Year
*James Duesing, Associate Professor of Art*

New Book of the Year in Quantitative Finance, Wilmott Magazine
*Steven Shreve, Professor of Mathematical Sciences*, for his latest textbook, *Stochastic Calculus for Finance II: Continuous-Time Models*

Award for Outstanding Research in Privacy Enhancing Technologies, from The Association for Computing Machinery
*Alessandro Acquisti, Assistant Professor of Information Technology and Public Policy*

Basil O'Connor Starter Scholar Research Award from the March of Dimes
*Brooke McCartney, Assistant Professor of Biological Sciences*, for her work on cell activities that govern development and are linked to cancer

Beckman Foundation Young Investigator Award
*Philip LeDuc, Assistant Professor of Mechanical Engineering*, for his research on cell behavior

Fellow, British Academy of Management
*Denise Rousseau, H.J. Heinz II Professor of Organizational Behavior and Public Policy*

This listing includes honors announced July 1, 2004 – June 30, 2005. For errors or omissions, please call Catherine Davidson at 412-268-5262.

## Financial Highlights from the Chief Financial Officer

Carnegie Mellon's financial management strategies are focused on supporting the university's impact on the world and strengthening its leadership in teaching and research. This university is one of the world's great generators of ideas—in technology, in the arts, in business, in policy—and our obligation as financial managers is to be good stewards of this important resource.

Carnegie Mellon has taken its place among America's leading private research universities, but has done so without the large endowment that supports virtually all of our peers. As President Cohon has said, building our endowment is one of the most important things we can do to respond to our needs over the long term. To this end, the Board of Trustees has approved making an investment in building the endowment over the next several years through our fundraising efforts with a focus on securing new, major gifts to the endowment.

Another area of crucial investment in the coming years is in information technology infrastructure. This investment is essential, particularly at a technology-driven institution like ours; it will pay dividends in every classroom, every lab and every outreach effort. These essential investments in IT capability will make us even stronger competitors for sponsored research projects over the next decade.

These needed investments come at a time, however, when other costs are increasing and our ability to grow other unrestricted revenue sources is constrained. Health insurance and energy costs are rising quite rapidly, as they are for all employers and households in the U.S. We are doing everything we can to contain these expenses aggressively, but, inevitably, they are becoming a larger share of our annual budget.

During fiscal year 2005, the university achieved virtually break-even performance with a net increase in unrestricted operations of $1.5 million and overall growth in net assets of $103.8 million. The total investment portfolio of $1.1 billion at June 30, 2005, reflects an increase of $131.8 million from the prior year. The university's overall asset base at June 30, 2005, was $1.8 billion, an increase over the $1.7 billion reported at June 30, 2004.

## Overview of Consolidated Statements of Financial Position

During fiscal year 2005, Carnegie Mellon continued to strengthen its balance sheet. Total assets at June 30, 2005, were $1.8 billion, which is 7.8% higher than the prior year.

- Investments, which represent 61.5% of total assets, increased by $131.8 million, or 13.5% to $1.1 billion. This increase was primarily due to an increase in the endowment from improved market performance and the excess of positive returns and gifts over distributions.
- Additions for land, buildings and equipment were $94.9 million in fiscal year 2005, including movable equipment of $21.5 million, buildings and construction of $40.6 million, land of $0.7 million and non-cash additions for the Collaborative Innovation Center ("CIC") building of $32.1 million. There were movable equipment and other disposals of $31.9 million.

Total liabilities at June 30, 2005, were $491.4 million, which is 5.8% higher than the prior year.

- Long term debt outstanding at June 30, 2005, was $334.2 million, representing 68.0% of total liabilities. Long-term debt increased by $28.1 million from $306.1 million at June 30, 2004, principally due to the CIC financing. Most of the university's outstanding debt matures in 2025 and beyond.
- Total liabilities as a percentage of assets were 27.3% and 27.8% as of June 30, 2005 and 2004, respectively.

As the following table details, total net assets at June 30, 2005, were $1.3 billion, which is 8.6% higher than the prior year, reflecting strong market performance, successful fundraising and management's continued commitment to control costs of operations.

### Summary of Net Assets

($ in thousands)

| | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Unrestricted | $ 613,308 | $ 602,255 | $ 540,858 | $ 529,254 | $ 594,793 |
| Temporarily Restricted | 331,264 | 274,535 | 206,526 | 229,054 | 286,527 |
| Permanently Restricted | 365,287 | 329,241 | 300,019 | 287,878 | 272,302 |
| Total Net Assets | $ 1,309,859 | $ 1,206,031 | $ 1,047,403 | $ 1,046,186 | $ 1,153,622 |

Consistent with our commitment to fundraising for the endowment, permanently restricted net assets have grown 34.1% since fiscal year 2001.

## Overview of Consolidated Statements of Activities

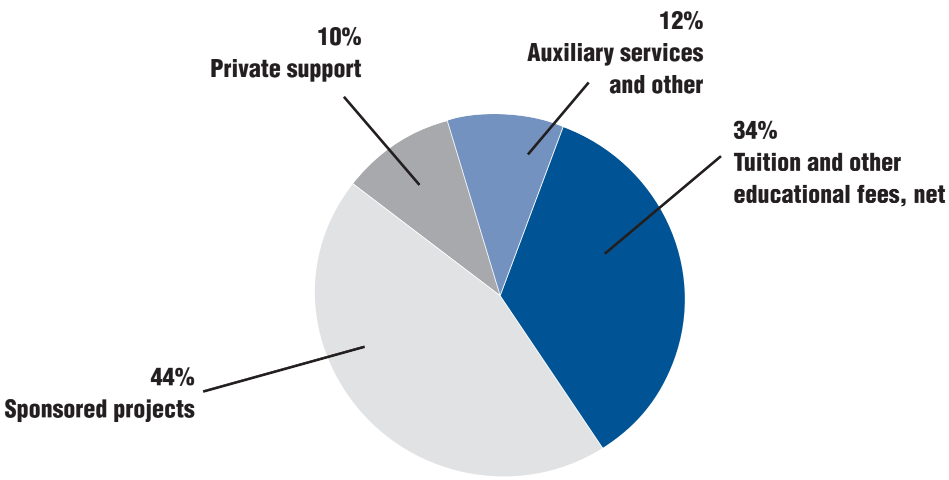
### Financial Highlights

($ in thousands)

| | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Unrestricted operating revenue | $ 676,241 | $ 631,710 | $ 576,993 | $ 553,432 | $ 484,503 |
| Unrestricted operating expenses | 674,759 | 620,076 | 559,755 | 551,006 | 482,981 |
| Increase from operations | $ 1,482 | $ 11,634 | $ 17,238 | $ 2,426 | $ 1,522 |
| Change in unrestricted net assets from non-operating activities | 9,571 | 49,763 | (5,634) | (67,965) | (29,489) |
| Change in temporarily restricted net assets | 56,729 | 68,009 | (22,528) | (57,473) | (71,895) |
| Change in permanently restricted net assets | 36,046 | 29,222 | 12,141 | 15,576 | 18,578 |
| Increase in net assets | $ 103,828 | $ 158,628 | $ 1,217 | $ (107,436) | $ (81,284) |

Carnegie Mellon, like its peer institutions, remains dependent on four major categories of revenue: tuition and other educational fees (net of financial aid), research (more precisely defined as sponsored projects), private support (composed of investment income, contributions and net assets released from restrictions), and revenue generated by sales of auxiliary services, such as housing and meals, and other revenue sources. The fiscal year 2005 operating revenue proportions remain relatively consistent with the prior year.

### Fiscal Year 2005 Unrestricted Operating Revenue



## Operating Revenues

**Tuition and other educational fees,** net of financial aid increased 4.9% to $227.8 million. The growth in tuition and other educational fees, net of financial aid, reflects increases in tuition rates, the number of graduate students, and the increased demand for executive education. The overall growth solidifies the increased demand for a Carnegie Mellon education. The following tables provide detailed information on enrolled students, including undergraduate, graduate and non-degree, in the fall semesters of 2004 and 2003 by school and undergraduate admissions information.

### Fall 2004 and 2003 Semester Enrollment

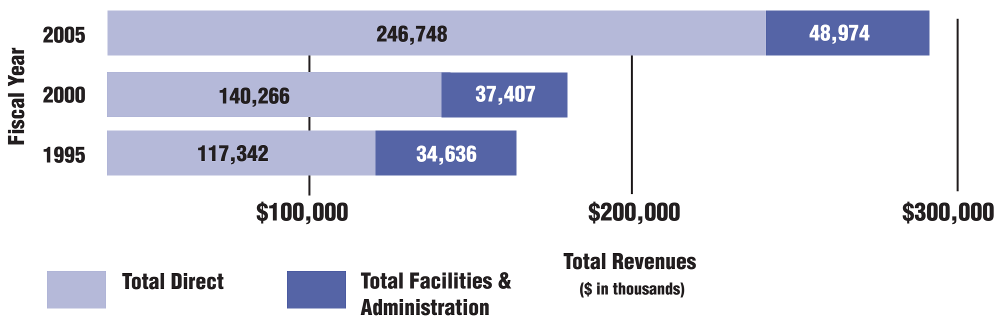
| School | 2004-2005 Undergraduate | 2004-2005 Graduate | Total Number of Students | Percentage | 2003-2004 Undergraduate | 2003-2004 Graduate |
|---|---|---|---|---|---|---|
| Carnegie Institute of Technology | 1,489 | 889 | 2,378 | 24% | 1,447 | 857 |
| David A. Tepper School of Business | 464 | 935 | 1,399 | 14% | 488 | 1,070 |
| College of Humanities | 1,045 | 271 | 1,316 | 14% | 1,043 | 258 |
| College of Fine Arts | 952 | 226 | 1,178 | 12% | 968 | 241 |
| School of Computer Science | 532 | 635 | 1,167 | 12% | 547 | 641 |
| Mellon College of Science | 620 | 229 | 849 | 9% | 591 | 235 |
| Interdisciplinary | 246 | 580 | 826 | 8.5% | 253 | 490 |
| H. John Heinz III School of Public Policy and Management | — | 509 | 509 | 5% | — | 480 |
| CMU-Q | 41 | — | 41 | .5% | — | — |
| Non-Degree & Other | — | — | 140 | 1% | — | — |
| Total | 5,389 | 4,274 | 9,803 | 100% | 5,337 | 4,272 |

### Undergraduate Admissions - Fall Semester

| | 2004-2005 | 2003-2004 | 2002-2003 | 2001-2002 | 2000-2001 |
|---|---|---|---|---|---|
| Applications | 14,113 | 14,467 | 14,271 | 16,696 | 14,621 |
| Acceptances | 5,858 | 5,561 | 5,440 | 5,211 | 5,241 |
| Matriculations | 1,394 | 1,341 | 1,365 | 1,318 | 1,329 |

In fiscal year 2005, **sponsored projects activity** provided 43.7% or $295.7 million of Carnegie Mellon's total operating revenues, which represents 6.0% growth over the prior year. This reflects increased revenues of 7.6% and 7.3% from the National Science Foundation and the Department of Defense, respectively, over the prior year support. Additionally, the funding from our "other federal" funding sources increased 24.4%. As President Cohon detailed, Carnegie Mellon faculty continue to be recognized nationally for their many achievements, which further substantiates the increase in sponsored projects activity. As shown in the chart below, over the past decade this revenue stream has grown approximately 94.6%, from $152.0 million to $295.7 million.

### Sponsored Projects Revenue



In addition to tuition and sponsored projects, overall contributions have increased. The following chart represents a summary of the contributions by category:

| | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Unrestricted | $13,227 | $10,782 | $9,149 | $10,520 | $31,009 |
| Temporarily Restricted | 35,637 | 21,435 | 14,521 | 10,404 | 14,316 |
| Permanently Restricted | 35,670 | 29,396 | 12,413 | 14,595 | 18,563 |
| **Total Contributions** | **$84,534** | **$61,613** | **$36,083** | **$35,519** | **$63,888** |

Revenue from the endowment plays a vital role in enriching and differentiating the basic educational experience of the students. The endowment's support has been declining as a percent of the operating budget over the past five years. It should be noted that the impact on the annual operating budget from endowed income is limited to income and capital gains/losses from the endowment, rather than the total amount of the gift.

## Expenses

In fiscal year 2005, operating expenses totaled $674.8 million or an 8.8% increase over fiscal year 2004. A significant portion of the growth in our expenses is due to sponsored projects. Carnegie Mellon has continued to control costs in an environment of double-digit healthcare increases and rising utility costs. As in the prior year, personnel costs remained the largest single expense category. Expense growth in all categories can be attributed to growth in the various revenue streams of Carnegie Mellon.

## Conclusion

The financial results presented for fiscal year 2005 underscore Carnegie Mellon's commitment to maintaining budgetary restraint while enhancing the programs that further our mission. Sponsored research funds increased as a proportion of our total budget, reflecting important new initiatives in robotics, engineering, computer science, psychology and many others. The size of our student body and the number of applicants remained approximately the same and the quality of our students remains very high.

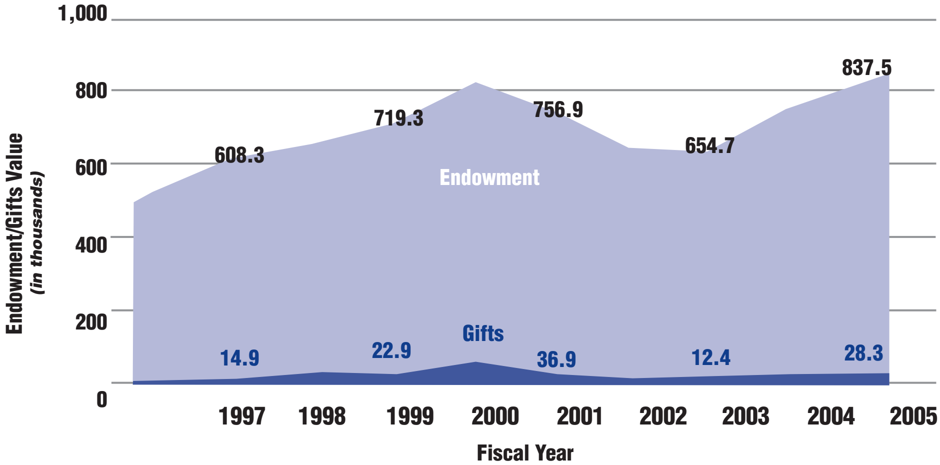
Our focus in the years ahead will be in finding the balance between necessary investments in the university and constraints on revenue growth; we are committed to steadily improve our physical and intellectual infrastructure, as well as to build public and alumni awareness and support for the impact this university has upon the world. Such prudent financial planning is the most effective way to support Carnegie Mellon's long-term contributions to the world through teaching and research, and it will continue to guide decision making in the coming years.

**DEBORAH J. MOON**
*Vice President and Chief Financial Officer*
*Carnegie Mellon University*
*January 24, 2006*

## Financial Highlights from the Treasurer

The endowment's market value grew by $68.5 million during the fiscal year and was valued at $837.5 million at June 30, 2005. The gain in market value reflects the net impact of $76.5 million in investment gains and $28.3 million in gifts and other additions, less $36.3 million in distributions to support university operations.

### Endowment Market Value and Fiscal Year Gifts




The investment performance of Carnegie Mellon's long-term fund, for the fiscal year ended June 30, 2005, was 10.6%. This return is indicative of favorable performance from the financial markets in general, and better than benchmark performance by most of the fund's money managers.

The twelve-month return for the S&P 500 Index was 6.3%; the MSCI All World Free Excluding US Index gained 17.0%; the Lehman Aggregate Bond Index advanced 6.8% while the NASDAQ composite was up 1.1%.

Carnegie Mellon invests its endowment together with a portion of its working capital reserves in a diversified long-term fund. Distributions from the endowment provide a key source of funds to support a variety of activities and programs, from general operations to very specific needs, such as scholarships and professorships.

### Endowment Fund

| *($ Thousands)* | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| Opening Value | 534.2 | 608.3 | 653.9 | 719.3 | 829.1 | 756.9 | 667.8 | 654.7 | 769.0 |
| Gifts/Transfers | 14.9 | 23.4 | 22.9 | 67.1 | 36.9 | 11.8 | 12.4 | 19.6 | 28.3 |
| Draw | (25.8) | (28.2) | (32.7) | (35.2) | (41.9) | (42.8) | (41.7) | (36.5) | (36.3) |
| Investment Performance | 85.0 | 50.4 | 75.2 | 77.9 | (67.2) | (58.1) | 16.2 | 131.2 | 76.5 |
| Closing Value | 608.3 | 653.9 | 719.3 | 829.1 | 756.9 | 667.8 | 654.7 | 769.0 | 837.5 |
| Draw Details | | | | | | | | | |
| Total Operating Expense | 377.0 | 406.7 | 426.2 | 462.0 | 500.1 | 551.0 | 559.8 | 620.1 | 674.8 |
| Draw % of Operating Expense | 6.8% | 6.9% | 7.7% | 7.6% | 8.4% | 7.8% | 7.5% | 5.9% | 5.4% |

During the past decade the draw has provided approximately 7%, on average of the university's operating budget. In fiscal year 2005, the draw represented approximately 5.4% of the university's operating budget, due to the growth in the operating budget related to sponsored projects.

During the year, Carnegie Mellon continued to implement its growth-oriented investment policy for the long-term fund. Subsequent to the fiscal year-end, the Investment Committee modified the fund's asset allocation policy to increase its diversification and to improve its expected efficiency. The revised asset allocation policy calls for allocations of 20% to domestic equities; 20% to non-U.S. equities; 20% to non-marketable equities (i.e. buyout and venture funds); 15% to fixed income; 10% to hedge funds; 5% to real estate; 5% to natural resources; and 5% to opportunistic investments. The university has made significant progress in expanding its allocation to alternative non-liquid investment funds and was successful in gaining access to several high quality venture capital and private equity funds.

The university's long-term investments must meet the needs of current and future generations of Carnegie Mellon students. With the continued generosity and support from the university's donors, we remain confident that the endowment will be able to provide for the university's current operating needs and generate additional resources for future growth.

**JOHN M. MAZUR**
*Treasurer and Chief Investment Officer*
*Carnegie Mellon University*
*January 24, 2006*

## Update from the Vice President for University Advancement

From its beginnings more than 100 years ago as a technical and art school for the children of steel workers, Carnegie Mellon has grown into a world-class university. Our small size and uniquely collaborative culture has allowed us to pursue and solve problems that cross traditional disciplinary boundaries. Our reputation as a source for innovative research and practical solutions to the world's pressing problems has led to an enviable level of sponsored research funds from federal agencies and corporations, funding that today accounts for approximately 44% of our operating budget.

The university has reached a new stage in its development, however; our success and our hopes for the future have heightened the need to plan for long-term financial strength and budget flexibility. The best means we have to accomplish this is by significantly increasing the revenues we receive from private philanthropy. For this reason, expanding the staff and activities of University Advancement has become a much higher priority than ever before. Our goal is to increase the size of the university's endowment and subsequently to increase the level of annual operating support.

In fiscal year 2005, the endowment provided approximately 5.4% of Carnegie Mellon's operating budget. This is a relatively low level compared to our peers; it provides the trustees very little flexibility in setting annual operating budgets, tuition rates and endowment spending rates. We believe it is essential to build income from the endowment over the next decade. Additionally, we need to grow expendable operating support.

Carnegie Mellon is now a leader among research universities worldwide, and our alumni are evermore prominent among those who lead major enterprises in the United States and around the globe. Therefore, we believe we can significantly increase philanthropic support, and we must do so, if Carnegie Mellon is to maintain its leadership position. We must provide more financial aid to our students; we must support our faculty and staff with appropriate and competitive compensation; we must provide classrooms and labs that are conducive to the most productive research and teaching; and we must continue to enhance the student experience outside the classroom. Raising private dollars, both for endowment and current use, has become more important than ever in accomplishing the university's vital missions of research and teaching.

Over the next several years, our goal is to support growth both in the total dollars raised and in the number of donors and size of gifts at every level, the mark of a robust and growing fundraising program. We are increasing the size of the staff, providing them adequate support and expanding services to donors with the degree of sophistication and personalization that our alumni, students, parents and friends have come to expect from a university of our stature.

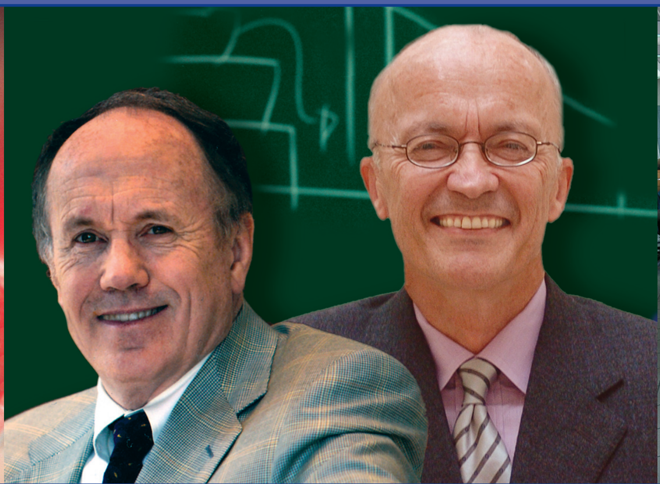
Growing the total Advancement program aggressively does require substantial investment, but we believe that this will result in a much healthier and more stable financial structure for the university in the long term.

Our results to date have been spectacular: in 2004 we surpassed our fundraising goal by 73%, and in 2005 we surpassed our goal by 21%. We saw positive growth at every level of giving and expanded our pool of prospective donors quite significantly. The Advancement program was recognized nationally for these extraordinarily strong achievements and for the last few years has been named by Charity Navigator, as one of the most efficient fundraising programs in higher education.

We have set ourselves ambitious goals, but this university has never shied away from challenges. I look forward to working with the president, the trustees and every member of our campus, alumni and donor communities to accomplish these goals, thereby fueling an ever stronger university well into the future.

**ROBBEE BAKER KOSAK**
*Vice President for University Advancement*
*Carnegie Mellon University*
*January 24, 2006*

CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT



## To the Board of Trustees
## Carnegie Mellon University and Subsidiaries
## Pittsburgh, Pennsylvania

We have audited the accompanying consolidated statements of financial position of Carnegie Mellon University and subsidiaries (the "University") as of June 30, 2005 and 2004, and the related consolidated statements of activities and cash flows for the years then ended. 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 audits.

We conducted our audits 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Carnegie Mellon University and subsidiaries as of June 30, 2005 and 2004, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

*Deloitte & Touche LLP*

*Pittsburgh, Pennsylvania*

*January 24, 2006*

# Consolidated Statements of Financial Position

June 30, 2005 and 2004

($ in thousands)

| | 2005 | 2004 |
|---|---|---|
| **Assets:** | | |
| Cash and cash equivalents | $ 24,426 | $ 74,294 |
| Accrued interest and dividends | 2,513 | 2,406 |
| Accounts receivable, net (Note C) | 68,756 | 74,176 |
| Pledges receivable, net (Note D) | 57,401 | 47,339 |
| Loans receivable, net (Note C) | 15,824 | 17,827 |
| Investments (Note E) | 1,107,416 | 975,597 |
| Assets held in trust by others | 5,546 | 5,287 |
| Other assets | 12,799 | 16,704 |
| Land, buildings and equipment, net (Note H) | 506,556 | 456,768 |
| **Total assets** | **$ 1,801,237** | **$ 1,670,398** |
| **Liabilities:** | | |
| Accounts payable and other liabilities | $ 76,478 | $ 68,574 |
| Deferred revenue | 46,352 | 54,910 |
| Federal loan programs | 14,607 | 14,324 |
| Present value of future annuities payable | 19,737 | 20,461 |
| Long-term debt (Note I) | 334,204 | 306,098 |
| **Total liabilities** | **$ 491,378** | **$ 464,367** |
| **Net assets:** | | |
| Unrestricted | $ 613,308 | $ 602,255 |
| Temporarily restricted | 331,264 | 274,535 |
| Permanently restricted | 365,287 | 329,241 |
| **Total net assets** | **$ 1,309,859** | **$ 1,206,031** |
| **Total liabilities and net assets** | **$ 1,801,237** | **$ 1,670,398** |

See Notes to Consolidated Financial Statements.

## Consolidated Statements of Activities

For the Year Ended June 30, 2005

($ in thousands)

| | 2005 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| **Revenue and other support:** | | | | |
| Tuition and other educational fees, net of financial aid | $ 227,841 | $ — | $ — | $ 227,841 |
| Sponsored projects (Note G) | 295,722 | — | — | 295,722 |
| Investment income | 25,809 | 6,945 | 376 | 33,130 |
| Contributions (Note D) | 13,227 | 35,637 | 35,670 | 84,534 |
| Auxiliary services | 36,371 | — | — | 36,371 |
| Other sources | 47,404 | 4,105 | — | 51,509 |
| Net assets released from restrictions | 29,867 | (29,867) | — | — |
| **Total revenue and other support** | **$ 676,241** | **$ 16,820** | **$ 36,046** | **$ 729,107** |
| **Expenses:** | | | | |
| Salaries | $ 347,716 | $ — | $ — | $ 347,716 |
| Benefits | 73,096 | — | — | 73,096 |
| Supplies and services | 132,077 | — | — | 132,077 |
| Occupancy and related expenses | 40,011 | — | — | 40,011 |
| Other operating expenses | 30,989 | — | — | 30,989 |
| Depreciation and amortization | 42,665 | — | — | 42,665 |
| Interest expense | 8,205 | — | — | 8,205 |
| **Total expenses** | **$ 674,759** | **$ —** | **$ —** | **$ 674,759** |
| **Increase in net assets before nonoperating activities** | **$ 1,482** | **$ 16,820** | **$ 36,046** | **$ 54,348** |
| **Nonoperating activities:** | | | | |
| Net realized gain on investments | $ 2,694 | $ 21,396 | $ — | $ 24,090 |
| Net unrealized gain on investments | 14,926 | 19,794 | — | 34,720 |
| Other sources | (9,330) | — | — | (9,330) |
| Net assets released from restrictions | 1,281 | (1,281) | — | — |
| **Total nonoperating activities** | **$ 9,571** | **$ 39,909** | **$ —** | **$ 49,480** |
| **Increase in net assets** | **$ 11,053** | **$ 56,729** | **$ 36,046** | **$ 103,828** |
| **Net assets, June 30, 2004** | **$ 602,255** | **$ 274,535** | **$ 329,241** | **$ 1,206,031** |
| **Net assets, June 30, 2005** | **$ 613,308** | **$ 331,264** | **$ 365,287** | **$ 1,309,859** |

See Notes to Consolidated Financial Statements.

# Consolidated Statements of Activities

For the Year Ended June 30, 2004

($ in thousands)

| | 2004 | | | |
|---|---|---|---|---|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| **Revenue and other support:** | | | | |
| Tuition and other educational fees, net of financial aid | $217,214 | $ — | $ — | $217,214 |
| Sponsored projects (Note G) | 278,900 | — | — | 278,900 |
| Investment income | 25,057 | 6,041 | (174) | 30,924 |
| Contributions (Note D) | 10,782 | 21,435 | 29,396 | 61,613 |
| Auxiliary services | 35,280 | — | — | 35,280 |
| Other sources | 34,294 | 2,221 | — | 36,515 |
| Net assets released from restrictions | 30,183 | (30,183) | — | — |
| **Total revenue and other support** | **$ 631,710** | **$ (486)** | **$ 29,222** | **$ 660,446** |
| **Expenses:** | | | | |
| Salaries | $ 325,578 | $ — | $ — | $ 325,578 |
| Benefits | 66,643 | — | — | 66,643 |
| Supplies and services | 116,167 | — | — | 116,167 |
| Occupancy and related expenses | 36,812 | — | — | 36,812 |
| Other operating expenses | 29,500 | — | — | 29,500 |
| Depreciation and amortization | 40,200 | — | — | 40,200 |
| Interest expense | 5,176 | — | — | 5,176 |
| **Total expenses** | **$ 620,076** | **$ —** | **$ —** | **$ 620,076** |
| **Increase (decrease) in net assets before nonoperating activities** | **$ 11,634** | **$ (486)** | **$ 29,222** | **$ 40,370** |
| **Nonoperating activities:** | | | | |
| Net realized (loss) gain on investments | $ (2,510) | $ 14,470 | $ — | $ 11,960 |
| Net unrealized gain on investments | 48,857 | 60,212 | — | 109,069 |
| Other sources | (2,771) | — | — | (2,771) |
| Net assets released from restrictions | 6,187 | (6,187) | — | — |
| **Total nonoperating activities** | **$ 49,763** | **$ 68,495** | **$ —** | **$ 118,258** |
| **Increase in net assets** | **61,397** | **68,009** | **29,222** | **158,628** |
| **Net assets, June 30, 2003** | **540,858** | **206,526** | **300,019** | **1,047,403** |
| **Net assets, June 30, 2004** | **$ 602,255** | **$ 274,535** | **$ 329,241** | **$ 1,206,031** |

See Notes to Consolidated Financial Statements.

## Consolidated Statements of Cash Flows

For the Years Ended June 30, 2005 and 2004
($ in thousands)

| | 2005 | 2004 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Increase in net assets | $ 103,828 | $ 158,628 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Realized gains on investments | (36,189) | (25,354) |
| Unrealized gains on investments | (34,982) | (106,614) |
| Depreciation and amortization | 42,665 | 40,200 |
| Gifts in kind | (998) | (903) |
| Loss on asset dispositions | 2,422 | 761 |
| Contributions for land, buildings, equipment and permanent endowment | (49,013) | (25,578) |
| Contributions held in perpetual trusts | (259) | (515) |
| Changes in assets and liabilities: | | |
| (Increase) decrease in: | | |
| Accrued interest and dividends | (107) | 244 |
| Accounts receivable, net | 5,420 | (8,543) |
| Pledges receivable, net | (10,062) | (10,389) |
| Other assets | 3,905 | (5,365) |
| Increase (decrease) in: | | |
| Accounts payable and other liabilities | 6,010 | 9,875 |
| Deferred revenue | (8,558) | 2,825 |
| Federal loan programs | 283 | 247 |
| Present value of future annuities payable | (724) | 2,101 |
| Other, net | 23 | 23 |
| **Net cash provided by operating activities** | **$ 23,664** | **$ 31,643** |
| **Cash flows from investing activities:** | | |
| Proceeds from sale and maturity of investments | 1,973,667 | 1,813,666 |
| Purchases of investments | (2,034,315) | (1,825,156) |
| Purchases of land, buildings and equipment | (59,917) | (43,897) |
| Proceeds from sale of land, buildings and equipment | 49 | 124 |
| Disbursements of loans to students | (2,378) | (6,519) |
| Repayments of loans from students | 4,357 | 3,767 |
| **Net cash used for investing activities** | **$ (118,537)** | **$ (58,015)** |
| **Cash flows from financing activities:** | | |
| Withdrawal of trusteed bond funds for construction | — | 7,489 |
| Repayments of long-term debt | (4,008) | (2,290) |
| Contributions for land, buildings, equipment and permanent endowment | 49,013 | 25,578 |
| **Net cash provided by financing activities** | **$ 45,005** | **$ 30,777** |
| **Net (decrease) increase in cash and cash equivalents** | **(49,868)** | **4,405** |
| **Cash and cash equivalents at beginning of year** | **74,294** | **69,889** |
| **Cash and cash equivalents at end of year** | **$ 24,426** | **$ 74,294** |
| Non-cash transactions: | | |
| Non-cash additions to property, plant and equipment | $35,009 | $1,000 |

See Notes to Consolidated Financial Statements.

# Notes to Consolidated Financial Statements

*June 30, 2005 and 2004*

## Note A—Carnegie Mellon

Carnegie Mellon University ("Carnegie Mellon") is a private, not-for-profit educational and research institution. Carnegie Mellon currently enrolls about 9,800 students and grants approximately 2,800 bachelor's, master's and doctor's degrees each year. Approximately 88% of undergraduate students are from the United States of America. International students comprise approximately 12% of undergraduate, 32% of master's and 56% of Ph.D. students.

A substantial portion of Carnegie Mellon's revenues are from sponsored research and other projects under federal, state, industrial and other contracts.

## Note B—Summary of Significant Accounting Policies

### Basis of Accounting and Reporting

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of Carnegie Mellon and its wholly owned subsidiaries. The accounts of the wholly owned subsidiaries are not significant; and, intercompany transactions have been eliminated in consolidation.

Carnegie Mellon's net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

**Unrestricted net assets** — Net assets that are not subject to donor-imposed stipulations.

**Temporarily restricted net assets** — Net assets subject to donor-imposed or legal stipulations that may or will be met either by actions of Carnegie Mellon and/or the passage of time.

**Permanently restricted net assets** — Net assets subject to donor-imposed stipulations that the assets be maintained permanently. Generally, the donors of these assets permit Carnegie Mellon to use all or part of the income earned on the related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as net assets released from restrictions between applicable classes of net assets.

Income and realized net gains and losses on investments are reported as follows:

- As changes in permanently restricted net assets if so restricted by the donor;
- As changes in temporarily restricted net assets if the terms of the gift or relevant state law impose restrictions on the use of the income or gains and losses; and
- As changes in unrestricted net assets in all other cases.

Equity securities with readily determinable fair values and all debt securities are measured at fair value with gains and losses reported in the statement of activities.

Carrying values of accounts and loans receivable approximate their fair values.

### Fund Accounting

In order to ensure observance of limitations and restrictions placed on the use of the resources available to Carnegie Mellon, the internal operating accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes are classified into funds that are in accordance with activities or objectives specified. These financial statements, however, have been prepared to focus on the entity as a whole and to present transactions according to the existence or absence of donor-imposed restrictions.

### Student Financial Aid

Tuition and other educational fees are reported net of student financial aid of $69.9 million and $65.6 million in the years ended June 30, 2005 and 2004, respectively.

### Sponsored Project Revenues

Sponsored project revenues include research and other programs sponsored by government and private sources. Direct sponsored project revenues represent reimbursement of costs incurred in direct support of sponsored projects. Such revenue is recognized when the direct costs are incurred. In addition, sponsored projects normally provide for the recovery of indirect costs supporting the project. Indirect sponsored project revenues are recorded at rates established in advance by Carnegie Mellon through negotiations with the United States Government and other sponsors. Amounts received from sponsors under agreements that require the exchange of assets, rights or other privileges between Carnegie Mellon and the sponsor are recorded as deferred revenue until the contract terms are fulfilled.

### Contributions with Restrictions Met in the Same Year

Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the temporarily restricted net asset class, and a release of restriction is made to unrestricted net assets to reflect the satisfaction or expiration of such restrictions.

### Contributions for Plant Activities

Donors' contributions to fund construction projects are classified as temporarily restricted net assets until the facility is placed in service. At that time, the temporarily restricted net assets are released from restriction and replenish unrestricted net asset balances.

### Operating Activities

Carnegie Mellon's measure of operations as presented in the Consolidated Statement of Activities includes revenue from tuition and other educational fees, sponsored projects, investment return distributed according to Carnegie Mellon's spending policy, unrestricted contributions, and revenues from auxiliary services and other sources. Operating expenses are reported by natural classification.

### Nonoperating Activities

Nonoperating activities presented in the Consolidated Statement of Activities includes realized and unrealized gains due to investment activities, certain investee and or subsidiary operating activities, any gains or losses on other financial instruments, and other activities that are not directly related to education and research or are non-recurring in nature.

These activities are related to system conversions, activities related to the write-off of certain accounts payable balances not attributable to current year operating activities, and the recording of activities related to investments in the Bellefield Boiler that are not attributable to current year operating activities.

Changes in the fair value of the interest rate swap agreement of $1.5 million (loss) as of June 30, 2005 are reported as nonoperating activities. Subsidiary losses of $1.4 million and $0.6 million as of June 30, 2005 and 2004, respectively, are reported as nonoperating activities.

As of June 30, 2005 and 2004, Carnegie Mellon reported nonoperating expenses of $5.9 million and $2.8 million, respectively, for activities related to the financial system conversion. As of June 30, 2005 and 2004, Carnegie Mellon reported nonoperating expenses of $0.4 million and $0.3 million, respectively, for activities related to the write-off of certain accounts payable balances which were not attributable to current year operating activities. As of June 30, 2004, nonoperating revenues of $0.9 million are reported related to investments in the Bellefield Boiler which are not attributable to current year operating activities.

## Cash Equivalents

Cash equivalents include U.S. treasury obligations, commercial paper and corporate notes with original maturities of three months or less, except that such instruments purchased with endowment and annuity and life income assets on deposit with trustees are classified as investments.

## Investments

Debt and equity securities held by Carnegie Mellon are carried at market values as established by the major securities markets. Diversified, non-liquid holdings are carried at market values based upon financial information provided by the portfolio managers. Investments received as a gift are reflected as contributions at their fair market value at the date of the gift. Carnegie Mellon utilizes various investment instruments. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, changes in the values of investment securities will occur in the near term and it is reasonably possible that such changes could materially affect the amounts reported in the Consolidated Statements of Financial Position.

## Endowment

Investment policy for endowment assets is the responsibility of the Investment Committee of the Board of Trustees. Substantially all endowment assets are managed by outside investment managers and are held in custody by an outside trustee.

Endowment net assets classified as unrestricted include Carnegie Mellon funds and unrestricted gifts from donors, and any accumulated income and appreciation thereon, which is intended to remain in the endowment for the long-term support of Carnegie Mellon activities, but may be expended under trustee authorization.

Temporarily restricted endowment net assets include certain expendable gifts, and any retained income and appreciation thereon, that are restricted by the donor to a specific purpose. When the temporary restrictions on these funds have been met, the gifts ordinarily remain in the endowment to continue supporting the same activities as those specified by the donors; however, by trustee designation, the funds are reclassified to unrestricted endowment net assets.

This classification also includes accumulated appreciation on permanent endowment assets. The Trustees of Carnegie Mellon must annually authorize release of endowment gains according to Pennsylvania law.

Permanently restricted endowment net assets include those assets that must be invested in perpetuity to provide a permanent source of income.

All endowment funds participate in a Carnegie Mellon investment pool. The investment pool provides income to its respective participants. Such income is used for the specific purpose prescribed by the donor or, if the purpose was not prescribed by the donor, the income is deemed to be unrestricted and used for general purposes. New endowment funds or additions to existing funds are assigned shares in the investment pool based upon the per share market value at the end of the previous month. Income distributions from the investment pool are based upon the number of shares held by each participant and the approved spending rate (see Note F). Income distributions from the investment pool are based upon the “total return concept”. The annual income distributed from the investment pool includes interest and dividends and could include a portion of the accumulated capital gains. Any capital gains not distributed currently are reinvested in the investment pool and are available for distribution from the endowment assets in future years.

## Derivative Instruments and Hedging Activities

Carnegie Mellon accounts for its derivative activities in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value with the change in the fair value of the derivative reported in the statement of activities.

In October 2004, Carnegie Mellon entered into an interest rate swap agreement (the "agreement") to minimize the effects of fluctuating interest rates on Carnegie Mellon. The notional amount of the agreement is $50 million. Under the terms of the agreement, Carnegie Mellon pays a fixed rate of 3.0267% to a counterparty in exchange for a variable payment equivalent to 67% of LIBOR. The transaction's term is fifteen years, with a termination date of October 1, 2019. This agreement also has an option on the part of the counterparty to cancel the agreement at any time after the expiration of ten years, which would be October 1, 2014. As a result of this agreement, interest expense increased by approximately $0.5 million for the year ended June 30, 2005, in the Consolidated Statement of Activities. The fair value of the agreement is estimated to be the amount that Carnegie Mellon would receive (receivable) or pay (liability) to voluntarily terminate the agreement. Carnegie Mellon estimates that it would have paid approximately $1.5 million as of June 30, 2005, to voluntarily terminate the agreement, which is recorded as a liability in the Consolidated Statement of Financial Position. The change in the fair value of the agreement is recorded as nonoperating activities: other sources in the Consolidated Statement of Activities.

In addition to the interest rate swap agreement, Carnegie Mellon also uses an electricity forward contract, which is physically settled, to hedge against the future changes in the cost of electricity. This contract is negotiated annually. This contract is entered into in order to limit Carnegie Mellon's exposure to higher electricity rates; however, it could also limit the benefit of decreases in electricity rates. This contract is not required to be recognized on the balance sheet at fair value because Carnegie Mellon takes physical delivery of the electricity and the gains and losses are already recognized in the cost of the electricity.

## Land, Buildings and Equipment

Land, buildings and equipment are recorded at cost at the date of acquisition or, if acquired by gift, at the estimated fair market value as of the date of the gift. Additions to plant assets are capitalized while scheduled maintenance and minor renovations are charged to operations. Buildings and equipment are reflected net of accumulated depreciation which is calculated on a straight-line basis over the estimated economic lives. Carnegie Mellon reviews its land, buildings and equipment and other long-lived assets for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Useful lives are as follows:

Buildings 35-50 years
Renovations 20 years
Land improvements 15 years
Movable assets 3-20 years

## Split Interest Agreements

Carnegie Mellon's split interest agreements with donors consist primarily of gift annuities, unitrusts, lead trusts, charitable remainder annuity trusts and life income agreements. Assets held under these agreements are included in investments. Generally, contribution revenues are recognized at the dates the agreements are established after recording liabilities for the present value of the estimated future payments to be made to the beneficiaries. The liabilities are adjusted during the term of the trusts for changes in the value of the assets, accretion of the discount and other changes in the estimates of future benefits. Distributions from the trusts are recorded as contributions and the carrying value of the assets is adjusted for changes in the fair value of the trust assets.

## Assets Held In Trust By Others

Assets Held In Trust By Others includes the value of Carnegie Mellon's beneficial interest in perpetual trusts held by outside trustees. The present values of the trust's estimated future cash receipts, which were measured by the fair value of the assets contributed to the trust, are recognized as assets and contribution revenues at the dates the trusts are established.

## Income Taxes

Carnegie Mellon is a not-for-profit organization as described in section 501(c)(3) of the Internal Revenue Code (the "Code") and is generally exempt from income taxes on related income pursuant to Section 501(a) of the Code.

## Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period and accompanying notes. Actual results could differ from those estimates and these differences could be material.

## Note C—Accounts and Loans Receivable

Accounts receivable at June 30, 2005 and 2004, consist of the following:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Sponsored project grants and contracts: | | |
| Federal | $ 42,689 | $ 50,544 |
| Other | 9,796 | 16,576 |
| **Total sponsored projects** | **$ 52,485** | **$ 67,120** |
| Student accounts | 9,433 | 8,135 |
| Other | 14,681 | 5,263 |
| | $ 76,599 | 80,518 |
| Allowance for doubtful accounts | (7,843) | (6,342) |
| **Net accounts receivable** | **$ 68,756** | **$ 74,176** |

Loans receivable, net, of approximately $15.8 million and $17.8 million, as of June 30, 2005 and 2004, respectively, primarily represent student loans made under a federal loan program. These loans are reported net of an allowance for doubtful accounts of approximately $1.6 million as of June 30, 2005 and 2004.

## Note D—Pledges Receivable and Contributions

Pledges and outside trusts as of June 30, 2005 and 2004, are discounted to the present value of future cash flows and are due as follows:

| $ in thousands | 2005 | | | |
|---|---|---|---|---|
| | Discount Rate | Temporarily Restricted | Permanently Restricted | Total |
| In one year or less | 3.45% | $337 | $5,315 | $5,652 |
| Between one year and five years | 3.66-3.72% | 9,841 | 28,173 | 38,014 |
| More than five years | 3.80% | 8,198 | 7,968 | 16,166 |
| Present value of pledges | | $18,376 | $41,456 | $59,832 |
| Less allowance for unfulfilled pledges | | (756) | (1,675) | (2,431) |
| **Pledges receivable, net of allowance** | | **$ 17,620** | **$ 39,781** | **$ 57,401** |

| $ in thousands | 2004 | | | |
|---|---|---|---|---|
| | Discount Rate | Temporarily Restricted | Permanently Restricted | Total |
| In one year or less | 2.1% | $ 4,250 | $ 7,464 | $ 11,714 |
| Between one year and five years | 2.7-3.8% | 4,923 | 20,460 | 25,383 |
| More than five years | 4.2% | 8,001 | 4,393 | 12,394 |
| Present value of pledges | | $ 17,174 | $ 32,317 | $ 49,491 |
| Less allowance for unfulfilled pledges | | (687) | (1,465) | (2,152) |
| **Pledges receivable, net of allowance** | | **$ 16,487** | **$ 30,852** | **$ 47,339** |

Pledges receivable as of June 30, 2005 and 2004, net of allowances, are intended for the endowment in the amounts of $39.8 million and $30.9 million, respectively, capital projects in the amounts of $1.0 million and $1.2 million, respectively, and other donor restricted purposes in the amounts of $16.6 million and $15.2 million, respectively.

Contribution revenue includes gifts, unconditional pledges to give and grants. Contributions are recorded in the appropriate net asset category based upon the intent of the donor or grantor. Contributions for the years ended June 30, 2005 and 2004 are as follows:

| $ in thousands | 2005 | | |
|---|---|---|---|
| | Gifts/Grants | Change in Pledges Receivable | Total |
| Unrestricted | $13,227 | $ — | $13,227 |
| Temporarily restricted | 34,502 | 1,135 | 35,637 |
| Permanently restricted | 26,743 | 8,927 | 35,670 |
| **Total** | **$ 74,472** | **$ 10,062** | **$ 84,534** |

| $ in thousands | 2004 | | |
|---|---|---|---|
| | Gifts/Grants | Change in Pledges Receivable | Total |
| Unrestricted | $ 10,782 | $ — | $ 10,782 |
| Temporarily restricted | 23,512 | (2,077) | 21,435 |
| Permanently restricted | 16,930 | 12,466 | 29,396 |
| **Total** | **$ 51,224** | **$ 10,389** | **$ 61,613** |

Conditional promises, which depend on the occurrence of a specified future and uncertain event, such as matching gifts from other donors, are recognized when the conditions are substantially met. Total combined conditional pledges for Carnegie Mellon were approximately $45.5 and $60.8 million as of June 30, 2005 and 2004, respectively. The conditions for these pledges were not met; thus no amounts have been recorded as contribution revenue.

Carnegie Mellon generally reports foundation grants as exchange contracts and accordingly, reports such revenues as sponsored project revenue in the accompanying Consolidated Statements of Activities. These revenues were $5.4 million and $5.9 million for the years ended June 30, 2005 and 2004, respectively.

## Note E—Investments

Investments by major category at June 30, 2005 and 2004, are as follows:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Restricted cash and cash equivalents | $ 29,949 | $ 40,715 |
| Fixed income | 330,394 | 255,952 |
| Common stock | 598,320 | 544,369 |
| Other investments | 148,753 | 134,561 |
| **Total investments** | **$ 1,107,416** | **$ 975,597** |

Investments are held for the following purposes:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Endowment | $ 832,125 | $ 763,718 |
| Reserves for debt service | 115,143 | 102,272 |
| Life income trusts | 27,632 | 27,793 |
| Other | 132,516 | 81,814 |
| **Total investments** | **$ 1,107,416** | **$ 975,597** |

Nearly all fixed income securities are U.S. investment grade and high yield bonds, asset backed securities, and United States Treasury and Agency obligations at June 30, 2005 and 2004. Common stock investments are composed of approximately 73% domestic equities and 27% international and emerging market equities at June 30, 2005. At June 30, 2004 approximately 74% of common stock investments consisted of domestic equities while the remaining 26% included international and emerging market equities. Other investments are largely investments in domestic buyout funds, venture capital, hedge funds and real estate. The difference between the ending balance of the endowment portion of the long term pool, in Investment Note E of $832,125 and the endowment rollforward included in Note F of $837,459 is a result of gifts and other transfers specific to the endowment portion of the long term pool that have been received and recorded by Carnegie Mellon but have not yet been invested as of June 30, 2005.

The allocation to each major category represents the actual allocation of all investment pools on a combined basis. Each investment pool maintains a unique investment strategy. Actual allocations on a combined basis should not be interpreted as an investment allocation policy for a particular investment pool. In addition, the above asset category allocations do not reflect the effective allocation exposures resulting from investment strategies that include derivatives. The following schedule summarizes the investment return for the years ended June 30, 2005 and 2004:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Dividends and interest | $ 20,769 | $ 17,779 |
| Net realized gains on sale of securities | 36,189 | 25,354 |
| Unrealized gains | 34,982 | 108,820 |
| **Total return on investments** | **$ 91,940** | **$ 151,953** |

Operating investment income includes dividends and interest earned on unrestricted funds and unrestricted accumulated gains utilized for current operations in the amount of $12.1 million and $13.4 million in the years ended June 30, 2005 and 2004, respectively.

Carnegie Mellon and certain of its outside investment managers purchase and sell derivative instruments in order to manage interest rate and foreign currency risk and market positions.

Carnegie Mellon's international portfolios maintain market benchmarks, for performance evaluation and risk control purposes, that are unhedged with respect to foreign currencies. Unhedged benchmarks reflect the full impact of foreign currency fluctuations stemming from the benchmarks' foreign currency positions. Investment managers of these international portfolios have the discretion to manage the portfolios' foreign currencies, relative to the currency exposures in their unhedged benchmarks, to protect the portfolios from potential foreign currency losses and to benefit from potential foreign currency gains. Carnegie Mellon's investment managers understand that they are assuming active management risks to the extent that they assume foreign currency exposures that differ from the foreign currency exposures in their relevant market benchmarks (as documented in the formal investment guidelines for each manager). Carnegie Mellon had foreign exchange contracts with a fair value of $4.1 million and $7.1 million at June 30, 2005 and 2004, respectively. Certain of these foreign exchange contracts are entered into with respect to pending settlements of foreign securities transactions.

Investment managers purchase and sell interest rate futures to control the risk of fluctuations in market interest rates, relative to portfolio benchmarks, on the university's fixed income investments. At June 30, 2005 and 2004, the notional value of interest rate futures was $(29.2) million and $2.5 million, respectively. The value as of June 30, 2005 is negative as the investment managers sold the securities in a short position, as compared to a long position as of June 30, 2004.

Certain domestic equity investment managers purchase S&P 500 futures contracts to obtain cost-efficient exposure to the S&P 500 Index when the S&P 500 Index is the portfolio benchmark. At June 30, 2005 and 2004, the notional value of S&P 500 futures contracts was $75.9 million and $71.3 million, respectively.

Gains or losses from derivative instruments are reported as realized and unrealized gains or losses in the Consolidated Statements of Activities. The market value of all derivative instruments is included in the market value of the investments.

Under the terms of certain limited partnership agreements, Carnegie Mellon is obligated to periodically advance additional funding for private-equity and real estate investments. At June 30, 2005 and 2004, Carnegie Mellon had commitments of approximately $50 and $62 million, respectively, for which capital calls had not been exercised. Such commitments generally have fixed expiration dates or other termination clauses. Carnegie Mellon maintains sufficient liquidity in its investment portfolio to cover such calls.

## Note F–Endowments

The following table provides a summary of the changes in value of the endowment assets excluding pledges for the years ended June 30:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| **Beginning of year endowment value** | **$ 768,990** | **$ 654,678** |
| Gifts and other additions: | | |
| Contributions (excluding pledges) | $ 27,114 | 17,895 |
| Terminated life income trusts and income and gains reinvested | 675 | 1,396 |
| Other | 531 | 350 |
| **Total gifts and other additions** | **$ 28,320** | **$ 19,641** |
| Investment income: | | |
| Interest and dividends | $ 14,196 | $ 12,165 |
| Net realized gains on sale of securities | 32,324 | 22,419 |
| Net unrealized gains | 29,899 | 96,569 |
| **Total investment income** | **$ 76,419** | **$ 131,153** |
| Income distributed for operating purposes: | | |
| Cash and accrued interest and dividends | $ (14,070) | $ (12,107) |
| Accumulated realized investment gains | (22,200) | (24,375) |
| **Total income distributed** | **$ (36,270)** | **$ (36,482)** |
| **End of year endowment value** | **$ 837,459** | **$ 768,990** |

Endowment net assets at June 30 are classified as follows:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Unrestricted | $ 276,059 | $ 264,254 |
| Temporarily restricted | 244,573 | 215,487 |
| Permanently restricted | 316,827 | 289,249 |
| **Total** | **$ 837,459** | **$ 768,990** |

Carnegie Mellon maintains a total return spending policy. Endowment income distributions can consist of dividend and interest income and a withdrawal of accumulated capital gains when necessary. The main objective of the total return spending policy is to separate spending policy from investment policy. Separating spending policy from investment policy permits asset allocation decisions to be made independently of the need for current income. The spending rate for endowment is determined annually as a percentage of the trailing three year average of December 31 endowment market values. For fiscal years 2005 and 2004, the spending rate was set at 5.0%. The actual spending rate based on average annual endowment market value for the year was 4.3% in fiscal year 2005, compared to 5.1% in fiscal year 2004.

## Note G–Sponsored Project Revenues

The major components of sponsored projects revenue for the years ended June 30, 2005 and 2004, are as follows:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Federal | | |
| Direct | $ 213,930 | $ 196,590 |
| Indirect | 43,523 | 40,180 |
| **Total Federal** | **$ 257,453** | **$ 236,770** |
| State, industrial and other | | |
| Direct | $ 32,818 | $ 37,575 |
| Indirect | 5,451 | 4,555 |
| **Total state, industrial and other** | **38,269** | **42,130** |
| **Total sponsored projects revenue** | **$ 295,722** | **$ 278,900** |

## Note H–Land, Buildings and Equipment

Land, buildings and equipment at June 30 consist of the following:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Buildings | $ 673,966 | $ 607,778 |
| Utilities and building-related assets | 52,893 | 51,441 |
| Moveable equipment | 247,287 | 255,148 |
| **Subtotal** | **$ 974,146** | **$ 914,367** |
| Accumulated depreciation | (480,729) | (467,489) |
| **Subtotal** | **$ 493,417** | **$ 446,878** |
| Land | 7,985 | 7,323 |
| Construction in progress | 5,154 | 2,567 |
| **Land, buildings and equipment, net** | **$506,556** | **$ 456,768** |

Included in the cost of buildings is an original cost of $21.1 million and $22.3 million in fiscal years 2005 and 2004, respectively, representing the initial present value of minimum lease payments under capital lease arrangements.

Included in the cost of buildings, which includes tenant improvements, is the Collaborative Innovation Center ("CIC"), capitalized in fiscal year 2005 at a cost of $37.3 million. The CIC building was constructed on land owned by Carnegie Mellon. This land is subject to a ground lease arrangement between Carnegie Mellon and the Regional Industrial Development Corporation ("RIDC"). The ground lease term concludes on March 20, 2038, but is subject to an additional four year renewal period exercisable at the RIDC's option. RIDC has elected to defer their rental payments related to the ground lease and accordingly, no amounts are recognized in the accompanying Consolidated Statement of Activities related to this arrangement.

## Note I–Long-Term Debt

Long-term debt consists of the following as of June 30:

| $ in thousands | Interest % | 2005 | 2004 |
|---|---|---|---|
| Pennsylvania Higher Education Facilities Authority, Variable Rate Refunding Bonds, Series 1995 | Variable | $176,800 | $ 176,800 |
| Allegheny County Higher Education Building Authority, Variable Rate University Revenue Bonds, Series 1998 | Variable | 78,000 | 78,000 |
| Allegheny County Higher Education Building Authority, University Revenue Bonds, Series 2002 | 5.125 - 5.5 | 43,874 | 43,844 |
| Dormitory bonds/mortgage notes | 2.75 - 3.50 | 2,537 | 2,726 |
| Collaborative Innovation Center financing | 5.017 | 31,808 | — |
| **Subtotal - bonds and mortgages** | | **$ 333,019** | **$ 301,370** |
| Capital lease obligations | 5.0 - 7.5 | 1,185 | 4,728 |
| **Total long-term debt** | | **$ 334,204** | **$ 306,098** |

On November 1, 1995, Carnegie Mellon issued through the Pennsylvania Higher Education Facilities Authority $176.8 million of Carnegie Mellon University Variable Rate Revenue Refunding Bonds, Series 1995 (the "1995 Bonds"). The proceeds of the 1995 Bonds were used to repay the Washington County Higher Education Pooled Equipment Leasing program debt and the Pennsylvania Higher Education Facilities Authority Variable Rate Option Revenue Bonds, First Series of 1985. The $176.8 million debt issue consists of $50 million Series 1995A due 2025, $50 million Series 1995B due 2027, $50 million Series 1995C due 2029, and $26.8 million Series 1995D due 2030. The 1995 Bonds have certain financial covenants consistent with similar types of financing arrangements. The 1995 Bonds structured as multiple mode obligations currently bear interest at a variable market rate determined daily by the bonds' remarketing agent. Interest was charged at rates ranging from 0.89% to 3.04% and 0.45% to 1.30% during fiscal years 2005 and 2004, respectively.

On December 30, 1998, Carnegie Mellon issued through the Allegheny County Higher Education Building Authority $88 million of Carnegie Mellon University Variable Rate Revenue Bonds, Series 1998 (the "1998 Bonds"). The proceeds of the 1998 Bonds were used to fund capital projects. The 1998 Bonds structured as multiple mode obligations currently bear interest at a variable market rate determined daily by the bonds' remarketing agent. Interest was charged at rates ranging from 0.89% to 3.08% and 0.45% to 1.50% during fiscal years 2005 and 2004, respectively.

For the 1995 Bonds and 1998 Bonds, Carnegie Mellon has entered into separate Standby Bond Purchase agreements with investment banking firms that have agreed to purchase the bonds under certain circumstances. The Standby Bond Purchase Agreement for the 1995 Bonds is renewed every 364 days, with the next renewal date being October 25, 2006. The Standby Bond Purchase Agreement for the 1998 Bonds is scheduled to continue until December 31, 2015. There are provisions in the agreement however, allowing the investment bank to exit the contract at specified times in 2008, 2011 and 2014.

On March 27, 2002, Carnegie Mellon issued, through the Allegheny County Higher Education Building Authority, University Revenue Bonds, Series 2002, with a face value of $44.665 million (the "2002 Bonds"). The proceeds of the 2002 Bonds were used to fund capital projects. The 2002 Bonds mature at $5 million in 2027, $7.665 million in 2028 and $32 million in 2032. The 2002 Bonds bear fixed rates of interest, and the effective interest rate on the 2002 Bonds, including the effect of the original issue discount, is 5.34%.

The dormitory bonds and mortgage notes mature in varying amounts through 2024 and bear interest at fixed rates that range from 2.75% through 3.5%. Facilities of Carnegie Mellon and the revenues thereon are pledged as collateral on the dormitory bonds and mortgage notes.

A lien has been recorded against the land on which the CIC building has been constructed related to a loan outstanding between the Pennsylvania Industrial Development Authority and the RIDC in connection with the CIC building. In addition, Carnegie Mellon has a financing obligation recorded in connection with the CIC building in the amount of $31.8 million at June 30, 2005. The interest rate associated with this financing obligation is 5.017%. Under terms of a space lease commitment, Carnegie Mellon makes monthly payments to the RIDC which approximated $0.9 million during fiscal year 2005. These monthly payments are applied to reduce the CIC financing obligation and record related interest expense. The space lease term concludes on January 31, 2015. The residual value of the financing obligation at the conclusion of the space lease term is approximately $26.0 million which represents the amount which Carnegie Mellon would have to pay in order to exercise a purchase option for the CIC building. The purchase option price is projected to be approximately $18.0 million plus an additional $8.0 million associated with a grant from the Commonwealth of Pennsylvania which may be required to be repaid.

Carnegie Mellon's investments include $11.7 million required under its various debt agreements to be held until the related debt is retired. An additional $103.4 million has been designated by management as a reserve to meet future debt service requirements.

Carnegie Mellon guarantees the payment of principal and interest due on $19.3 million RIDC Regional Growth Fund Revenue Refunding Bonds (Carnegie Mellon University Software Engineering Institute Facility), Series 1995, issued through the Pennsylvania Higher Educational Facilities Authority. These bonds, which had principal outstanding of $1.2 million and $4.7 million as of June 30, 2005 and 2004, respectively, were issued to refinance a prior debt issue used for construction of a building in accordance with the research contract for the Software Engineering Institute. Carnegie Mellon had a capital lease obligation in connection with this transaction in the amount of $1.0 million and $3.2 million at June 30, 2005 and 2004, respectively. The lease concludes in fiscal year 2006 and has an interest rate of 5%.

The fair value of Carnegie Mellon's long-term debt obligations as of June 30, 2005 and 2004, are approximately $338.3 million and $308.7 million, respectively.

Cash paid for interest for the years ended June 30, 2005 and 2004, totaled $7.4 million and $5.2 million, respectively.

Aggregate maturities of bonds and mortgages for each of the five years ending June 30 are as follows:

| $ in thousands | |
|---|---|
| 2006 | $ 694 |
| 2007 | 727 |
| 2008 | 760 |
| 2009 | 797 |
| 2010 | 804 |
| Thereafter | 329,237 |
| **Total** | **$ 333,019** |

## Note J–Expenses by Functional Category

Operating expenses by functional category for the years ended June 30, 2005 and 2004, are as follows:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Instruction and departmental research | $ 242,395 | $ 222,442 |
| Sponsored projects | 254,046 | 235,413 |
| Academic support | 54,302 | 51,621 |
| Student services | 31,413 | 28,134 |
| Administration and institutional support | 60,505 | 51,476 |
| Auxiliary services and activities | 32,098 | 30,990 |
| **Total** | **$ 674,759** | **$ 620,076** |

## Note K–Commitments and Contingencies

Carnegie Mellon is a defendant in a number of legal actions seeking damages and other relief. While the final outcome of each action cannot be determined at this time, legal counsel and management are of the opinion that the liability, if any, in these legal actions will not have a material effect on Carnegie Mellon's financial statements.

Carnegie Mellon and its affiliates receive significant financial assistance from the federal government, including the sponsorship of federal research projects. Research grants and contracts normally provide for the recovery of direct and indirect costs. Entitlement to the recovery of the applicable direct and related indirect costs is generally conditioned upon compliance with the terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants and Carnegie Mellon's indirect cost rate are subject to financial and compliance reviews and audits by the grantors. In management's opinion, the likelihood of an adverse material outcome upon its financial position from those reviews and audits is remote.

Lease expense was $10.7 million and $9.3 million for the years ending June 30, 2005 and 2004, respectively. Future minimum lease payments at June 30, 2005, are as follows:

| $ in thousands | Operating Leases | Capital Leases |
|---|---|---|
| 2006 | $ 2,456 | $ 1,145 |
| 2007 | 2,120 | 41 |
| 2008 | 1,991 | 11 |
| 2009 | 1,551 | — |
| 2010 | 1,501 | — |
| Thereafter | 602 | — |
| **Total** | **$ 10,221** | **$ 1,197** |
| Less amount representing interest | | (12) |
| **Present value of minimum capitalized lease payments** | | **$ 1,185** |

## Note L–Retirement Plans and Other Post-Employment Benefits

Carnegie Mellon has various pension and retirement programs covering substantially all of its employees. The two principal pension programs are a defined contribution plan sponsored by Carnegie Mellon, and the Central Pension Fund of the International Union of Operating Engineers, a multi-employer plan, with some prior credits held by the SEIU National Industry Pension Fund. Annual contributions are made to the plans equal to amounts accrued for pension expense. Such plans are fully funded on a current basis. Retirement plan expense for the years ended June 30, 2005 and 2004, totaled $20.4 million and $19.2 million, respectively.

Under ERISA, as amended by the Multi-Employer Pension Plan Amendment Act of 1980, a contributor to a multi-employer plan is liable, upon termination of the plan or withdrawal from the plan for the share of the plan's unfunded vested liabilities. Information to enable Carnegie Mellon to determine its share or unfunded vested liabilities (if any) is not readily available.

Carnegie Mellon provides certain health care benefits for eligible retired employees. Carnegie Mellon uses a measurement date of June 30 for the benefit obligation. The table below sets forth the health care plan's funded status at June 30, 2005 and 2004:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Benefit obligation | $ 18,132 | $ 24,173 |
| Unrecognized actuarial loss | (9,015) | (9,818) |
| Unrecognized prior service cost | 5,704 | — |
| Unrecognized net transition obligation | — | (1,856) |
| **Accrued benefit cost** | **$ 14,821** | **$ 12,499** |

The net periodic benefit cost for the years ended June 30 is as follows:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Benefit cost | $ 2,792 | $ 3,497 |
| Employer contribution | 470 | 510 |
| Plan participants' contributions | 312 | 227 |
| Benefits paid | 782 | 737 |

The reconciliation of the accumulated benefit obligation at June 30, 2005 and 2004, was as follows:

| $ in thousands | 2005 | 2004 |
|---|---|---|
| Benefit obligation, beginning of year | $ 24,173 | $ 21,440 |
| Service cost | 1,001 | 1,184 |
| Interest cost | 1,272 | 1,378 |
| Assumption changes and actuarial loss | (7,844) | 681 |
| Benefit payments | (470) | (510) |
| **Benefit obligation, end of year** | **$ 18,132** | **$ 24,173** |

The assumed discount rate used for calculating the benefit obligation was 5.25% for 2005 and 6.0% for 2004. A 10.0% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2005. The rate was assumed to decrease gradually to 5.0% for 2010 and remain at that level thereafter.

The health care cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed healthcare cost trend rate by 1% in each year would increase the benefit obligation as of June 30, 2005, by $2.9 million and increase the aggregate service cost and interest cost components for 2005 by $0.5 million. Decreasing the assumed health care cost trend rate by 1% in each year would decrease the benefit obligation as of June 30, 2005, by $2.6 million and decrease the aggregate service cost and interest cost components for 2005 by $0.4 million.

Expected benefits to be paid in future fiscal years are as follows:

| ($ in thousands) June 30 | Retiree Contributions | Employer Payments | Total Expected Benefit Payments |
|---|---|---|---|
| 2006 | $ 504 | $ 460 | $ 964 |
| 2007 | 638 | 579 | 1,217 |
| 2008 | 782 | 663 | 1,445 |
| 2009 | 949 | 746 | 1,695 |
| 2010 | 1,066 | 841 | 1,907 |
| 2011-2015 | 7,371 | 5,276 | 12,647 |

In conjunction with an agreement made with the federal government, Carnegie Mellon has established a separate trust, which is available to general creditors only in the event of insolvency. Assets in the trust to fund post-retirement health care and other post-employment benefits are $12.7 million and $9.9 million at June 30, 2005 and 2004, respectively. These assets are reflected as investments in the accompanying Consolidated Statements of Financial Position.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. Under the provisions of the Act, sponsors of retiree health plans that provide a benefit at least actuarially equivalent to the Medicare drug benefit created by the Act will receive an annual subsidy from the federal government.

During fiscal year 2005, Carnegie Mellon decided to integrate its postretirement Medicare plan with the Medicare Part D prescription drug benefits provided for in the Act with Medicare being the primary payor. This additional reduction in obligations has been recognized as an assumption change in the reconciliation of the accumulated benefit obligation. In particular, this yielded a decrease in Accumulated Postretirement Benefit Obligation of approximately $5.9 million as of July 1, 2004 with a corresponding reduction in the benefit cost of $1.1 million for the fiscal year ending June 30, 2005.

## Note M–Related Party Transactions

Sponsored research revenue for fiscal years 2005 and 2004 includes $12.9 million and $19.2 million, respectively, in research funding received from MPC Corporation ("MPC"), a nonprofit corporate joint venture of Carnegie Mellon and the University of Pittsburgh. The funding primarily represents federal funding under a $77.4 million contract received by MPC, for which MPC has subcontracted to Carnegie Mellon for the construction of a supercomputer and related activities.

In June 2002 Carnegie Mellon sold the net assets of Carnegie Technology Education ("CTE"), a wholly owned subsidiary, to iCarnegie, Inc. ("iCarnegie") in exchange for stock representing an approximate 41% interest in iCarnegie, approximately $5.8 million in notes, and certain license royalties. In October 2004, Carnegie Mellon converted $3.7 million of the outstanding notes to equity. Upon this conversion, Carnegie Mellon's interest in iCarnegie is approximately 85%, and the entity is consolidated as of June 30, 2005.

## Note N–Guarantees

In the ordinary course of business, Carnegie Mellon engages in commercial transactions with third parties involving the provision of goods and services. Such contracts may provide for Carnegie Mellon to indemnify the third party under certain limited circumstances. The terms of indemnity vary from contract to contract and the amount of the indemnification liability, if any, cannot be determined.

Carnegie Mellon provides indemnification to trustees, officers, and in some cases employees and agents against certain liabilities incurred as a result of their services on behalf of, or at the request of, Carnegie Mellon and also advances on behalf of covered individuals' costs incurred in defending against certain claims. Due to the nature of these idemnification provisions, it is not possible to quantify the aggregate exposure to Carnegie Mellon resulting from them.

Carnegie Mellon provides indemnification in connection with bond offerings in which it is involved. The indemnifications relate to losses, claims, damages, liabilities, and other expenses incurred by underwriters that would arise as a result of any untrue statements or material omissions made by Carnegie Mellon. Due to the nature of these indemnification provisions, it is not possible to quantify the aggregate exposure to Carnegie Mellon resulting from them.

Carnegie Mellon is also a party to a loan program for students who meet certain criteria called the Gate Loan program, which is administered by First Marblehead Corporation ("FMC"). In this program, Carnegie Mellon guarantees a certain percentage of loans to its students provided by FMC, which is based upon a percentage of indebtedness of borrowers that become uncollectible as part of the program. Because FMC assumes a first loan loss under this program, it is likely, given Carnegie Mellon's current experience, that Carnegie Mellon would not have to perform under this guarantee. The liability recorded in the Consolidated Statement of Financial Position as of June 30, 2005, is approximately $3.4 million. The maximum potential amount of future payments (undiscounted) that Carnegie Mellon could be required to make in the future under this program is estimated to be approximately $6.3 million. This amount represents the full undiscounted balance, and does not include any recourse provisions for debts that may become uncollectible.

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## TYPE OF UNIVERSITY

Private, coeducational, granting about 2,800 bachelor's, master's and doctor's degrees each year.

## NUMBER OF COLLEGES AND SCHOOLS

Seven — the Carnegie Institute of Technology (engineering); the College of Fine Arts, the College of Humanities and Social Sciences (liberal arts and professional studies); the David A. Tepper School of Business [formerly Graduate School of Industrial Administration (GSIA)]; the H. John Heinz III School of Public Policy and Management; the Mellon College of Science; the School of Computer Science.

## PHYSICAL SIZE

136-acre main campus; 81 buildings; 2 branch campuses.

## LOCATION

Main campus: Five miles east of downtown Pittsburgh, bordered by 500-acre Schenley Park and three culturally active residential neighborhoods.

Branch campuses: Doha, Qatar, and Moffett Field within the NASA Ames Research Center, California

## NUMBER OF STUDENTS

5,389 undergraduates; 2,844 master's and 1,430 doctoral students, and 140 special non-degree students.

## NUMBER OF FACULTY

602 tenure-track faculty; 609 full-time and 191 part-time non-tenure-track faculty.

## ATHLETICS

Team name is "The Tartans"; NCAA Division III classification; founding member of the University Athletic Association; 17 varsity sports; more than 60 intramural sports.

## NUMBER OF ALUMNI

66,869

## COMPUTERS

There are thousands of high-powered computer work stations and personal computers on our campuses; all student rooms and apartments and all academic and research facilities are linked to the university's Andrew computing network. Recognized twice as the "Most Wired College" by Yahoo! Internet Life, Carnegie Mellon boasts a university-wide wireless network with access available to all buildings on campus.

## HISTORY

Founded in 1900 by industrialist and philanthropist Andrew Carnegie as a technical school for working-class Pittsburgh; became Carnegie Institute of Technology, or "Tech," in 1912; merged with the Mellon Institute of Research in 1967 to become Carnegie Mellon University.

## FOUNDER'S MOTTO

"My Heart Is in the Work," as inscribed by founder Andrew Carnegie in his "contract" to the city of Pittsburgh written in 1900.

## FOR MORE INFORMATION ABOUT CARNEGIE MELLON, PLEASE CONTACT

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