Report of the Senior Vice President for Business and Finance

To the Board of Trustees of Northwestern University:

In addition to the strong performance of the University's investments, fiscal year 2007 was notable for Northwestern's capturing unique opportunities that will enhance its ability to grow.

As reported in note 11 to the consolidated financial statements, the University at the end of calendar year 2007 entered into a onetime sale of a portion of its royalty interest in the pain relief drug Lyrica®, which was developed in University laboratories. The University sold a portion of its royalty interest to Royalty Pharma for $700 million in cash. The net proceeds from the sale will be placed in the University's endowment and used to support financial aid for undergraduate and graduate students, startup costs for the University's research efforts, construction of new buildings and laboratories, improvements to existing facilities, and other purposes.

Other major activities during the fiscal year included debt issuance and defeasance to leverage the benefits of the current financial climate. The University issued $145.1 million in new debt and defeased $145 million of prior debt.

During fiscal year 2007 Northwestern's total investments grew $1,224 million to nearly $6.5 billion, the result of a 21.9 percent return on the Long-Term Balanced Pool. Total assets grew to $8.9 billion, up from $7.7 billion reported at August 31, 2006. Total net assets of $7.2 billion reflect an increase of $1,234 million, or 20.7 percent, from August 31, 2006.

Unrestricted net assets increased $1,164.8 million, due primarily to investment gains reinvested of $997.4 million. Operating revenues increased 9.6 percent, or $127.6 million, while operating expenses increased 8.6 percent, or $106.5 million, over fiscal year 2006.

Temporarily restricted net assets increased by $19.8 million, due to new temporarily restricted contributions and investment returns totaling $70.5 million, offset by $50.7 million expended in accordance with donor restrictions. Permanently restricted net assets increased $49.6 million, primarily as a result of contributions received for endowment.

In sum, fiscal year 2007 was characterized both by steady financial growth built upon the stable performance of many years and by special gains in the University's position.

Eugene S. Sunshine

Eugene S. Sunshine
Senior Vice President for Business and Finance

Global economies continued their path of strong growth during fiscal year 2007, and nearly all asset classes had significant price increases and double-digit returns. The U.S. stock market rose 14.9 percent, while foreign equities gained nearly double that amount. Buyout activity continued to provide positive returns for private investments, while rising commodity prices, particularly oil, drove returns in real assets. In late summer, however, financial markets experienced increased volatility as subprime losses and tightening credit triggered a global equity sell-off, forcing the Federal Reserve to cut the discount rate 50 basis points.

Northwestern continued to benefit from this global economic and financial market momentum and registered solid portfolio growth. When the fiscal year ended on August 31, 2007, the University's investment assets totaled $6.59 billion, including cash and intra-University investments, an increase of $1.26 billion from August 31, 2006. It was the first year of asset growth of more than $1 billion and the fourth year in a row of more than $500 million.

The University's Total Investment Pools

The University maintains three primary investment vehicles: The Long-Term Balanced Pool, treasury funds, and separately invested assets. Each investment category has a specific set of objectives.

The Long-Term Balanced Pool, the primary fund, is managed with the objective of long-term total return. Because of its size and long-term orientation, performance data and investment strategy information in the discussion that follows relate to the Long-Term Balanced Pool.

Treasury funds are money market funds used for cash reserves and to preserve principal and maintain liquidity; intermediate-term bond investments; and working capital funds held by the University, which are generated through the temporary differences between operating receipts and disbursements. These funds are not unitized. The income from investing them is used for general operating purposes. Working capital investments are held in a variety of money market instruments and guaranteed student loans or, if not needed within 90 days, are invested in the Long-Term Balanced Pool.

Separately invested funds are donated funds, including restricted investments and some life-income plans.

The table below illustrates the net asset values and unitized information for the University's investment pools for the past five years.

History of the Merged Pools as of August 31

	2003	*2004*	*2005*	*2006*	*2007*
Long-Term Balanced Pool					
Net asset value (in thousands of dollars)	$3,156,423	$3,668,410	$4,374,206	$5,190,425	$6,380,194
Number of units (in thousands)	22,523	23,765	24,704	26,519	27,753
Net asset value per unit	$140.14	$154.36	$177.06	$195.73	$229.89
Payout amount per unit					
Current earned income	$0.21	$1.46	$2.73	$1.96	$3.25
Previously reinvested realized gains withdrawn	$6.69	$5.41	$4.02	$4.85	$3.97
Total payout per unit	$6.90	$6.87	$6.75	$6.81	$7.22
Summary of net asset values (in thousands of dollars)					
Treasury pool funds	$264,495	$294,391	$174,755	$61,217	$84,430
Separately invested funds	101,513	103,922	106,760	78,471	123,648
Total net asset value (in thousands of dollars)	**$3,522,431**	**$4,066,723**	**$4,655,721**	**$5,330,113**	**$6,588,272**

Asset Allocation for the Long-Term Balanced Pool

The Investment Committee of the University annually reviews asset allocation policy for the Long-Term Balanced Pool. In fiscal year 2007, the committee implemented modest changes to the allocation targets based on the Investment Office's optimization modeling of a more efficient portfolio that should generate higher returns with lower risk levels. The target allocations for absolute return and real assets were both increased by 2 percent. These target allocation increases were sourced entirely from fixed-income securities, which decreased by 4 percent. The next chart displays the current asset allocation policy for the University; actual allocations vary from targeted levels by modest amounts, reflecting the Investment Office's bias against market timing or tactical asset allocation as a primary driver of value added.

Policy Portfolio Targets and Ranges				
	Range	*Target*	*August 31, 2007*	*Difference*
U.S. equity securities	14–20%	17%	14.7%	-2.3%
International equity securities	14–20%	17%	15.4%	-1.6%
Fixed-income securities	7–13%	10%	11%	1%
High-yield credit	2–8%	5%	5.8%	0.8%
Absolute return	14–22%	18%	16.7%	-1.3%
Private investments	12–20%	16%	20.6%	4.6%
Real assets	13–21%	17%	15.4%	-1.6%
Cash		0%	0.4%	0.4%

Primary Investment Performance Objective: Preserving Purchasing Power and Growing Income

The principal objective for Northwestern's Long-Term Balanced Pool is to preserve purchasing power and to provide a growing stream of income to fund University programs. On average, the pool seeks to achieve an annual total rate of return (i.e., actual income plus appreciation) equal to inflation plus actual spending. This objective of preserving purchasing power emphasizes the need for a long-term perspective in formulating both spending and investment policies. A more detailed look at the University's spending guideline is on page 14 of this report.

The University's investments historically have grown at a rate exceeding the objective. As of August 31, 2007, the Long-Term Balanced Pool's assets were $6.38 billion, up approximately $1.19 billion from last year. For the 12-month period ending August 31, 2007, the portfolio increased 21.9 percent, which was 16.6 percent above the objective. For the 3-, 5-, 10-, and 15-year periods ending August 31, 2007, the objective was exceeded by 12.3 percent, 9.38 percent, 5.28 percent, and 5.34 percent, respectively.

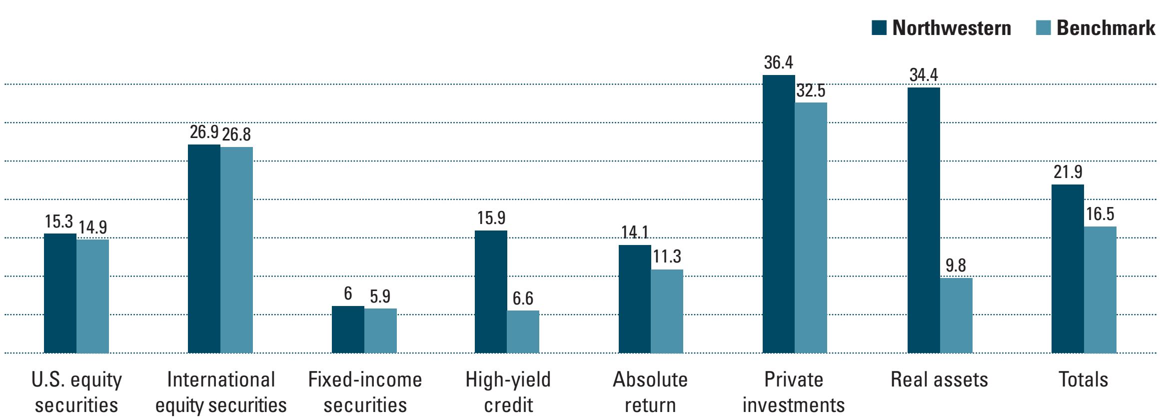
Annualized Returns: Exceeding the Objective					
	1-year	**3-year**	**5-year**	**10-year**	**15-year**
*Annual total return**	21.92%	19.08%	16.30%	11.57%	11.66%
– Spending	3.34%	3.64%	4.07%	3.82%	3.78%
– Inflation	1.98%	3.14%	2.85%	2.47%	2.54%
= Above objective	**16.60%**	**12.30%**	**9.38%**	**5.28%**	**5.34%**

**Total returns are net of fees and are calculated on annual changes in net asset value. They may differ from payout distributions.*

Secondary Investment Performance Objective: Benchmark Comparisons

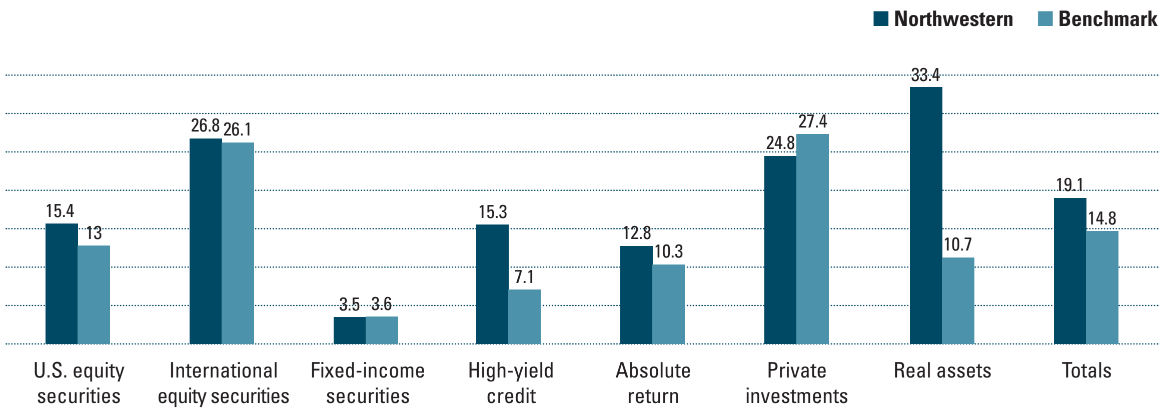
The pool's 21.9 percent gain for the 12-month period exceeded the 16.5 percent return of the composite benchmark, a blend of the benchmark returns for each asset class weighted by the policy allocation targets. Outperformance resulted primarily from the strong performance of the various portfolios relative to their respective benchmarks. In particular, real assets and high-yield credit enjoyed outstanding relative performance. Private investments and international equities were strong in absolute terms as well as ahead in relative terms. The following chart shows returns and benchmarks for all asset classes for the fiscal year. A more detailed explanation of activity and performance follows the three-year performance chart below.

Long-Term Balanced Pool: Fiscal 2007 Net Performance Relative to Benchmarks (in percentages)



For the three-year period ended August 31, 2007, the pool also outperformed the composite benchmark (19.1 percent versus 14.8 percent), as shown in the next chart. Five of the seven categories exceeded their benchmarks over three years.

Long-Term Balanced Pool: Three-Year Net Performance Relative to Benchmarks (in percentages)



Marketable Securities Categories

The domestic equity portfolio rose 15.3 percent for the fiscal year, outpacing the 14.9 percent of the benchmark Russell 3000. The move from passive to active management has paid off; this portfolio has outperformed its benchmark by 240 basis points (15.4 percent versus 13 percent) over the three-year period since an active program began.

The fiscal-year performance for the international equity portfolio — a 26.9 percent gain — was strong in absolute terms. In relative terms the portfolio exceeded the benchmark by 0.1 percent. For the last three years, the international program was ahead of the benchmark by 0.7 percent annualized. This portfolio benefited from giving a heavier weight to smaller-cap foreign stocks as well as to emerging markets.

With the addition of several active fixed-income strategies for diversification, bonds slightly outperformed during the fiscal year. The portfolio gained 6 percent, compared with 5.9 percent for the Lehman Government Index. For the three-year period, however, the bond portfolio slightly underperformed the index by 10 basis points (3.5 percent versus 3.6 percent).

High-Yield Credit

The high-yield credit portfolio includes investments in distressed debt, emerging market debt, and other credit instruments with fixed-income characteristics but more specific risk tied to the securities and their underlying cash flows. The portfolio gained 15.9 percent during the fiscal year, outpacing the 6.6 percent achieved by the benchmark Merrill Lynch High-Yield Master II Index. Strong returns from distressed funds, high-yield hedge funds, and emerging market debt investments led the outsized returns for this asset class.

Absolute-Return Category

Made up of 24 different hedge funds, this portfolio aims to provide equity-like returns with low correlation to the equity markets. For the year, it gained 14.1 percent, beating the 11.3 percent return of its benchmark (80 percent, Treasury bills plus 400 basis points; 20 percent, Morgan Stanley Capital International All-Country World Index). Northwestern's absolute-return portfolio is weighted toward long-short equity managers (65 percent). The remaining hedge funds (35 percent) are more market neutral or represent diversifying strategies.

Private Investments Category

The private investments portfolio includes investments in global buyout funds as well as venture capital. This portfolio was the strongest asset category in fiscal 2007, gaining 36.4 percent, compared with the Cambridge Associates' universe pooled mean return of private investments' 32.5 percent. This benchmark, used for the third year, exhibits a closer correlation to actual returns than does a public equity benchmark. Increased merger and acquisition activity, higher stock markets, and growing economies worldwide contributed to a positive environment for these investments. Northwestern's managers took advantage of strong conditions facing the asset class, namely, a robust economy and available credit markets.

Cash flows were strong in this portfolio as trade sales, recapitalizations, and initial public offerings resulted in numerous distributions from the portfolio companies. Private investment distributions were $355.5 million for the fiscal year. The University's manager relationships and reputation in the marketplace are strong.

Real Assets Category

The real assets portfolio includes the University's investments in energy, timber, real estate, and other commodities. This portfolio had strong results in fiscal year 2007, gaining 34.4 percent. Realizations in private partnership energy investments, increased global demand for commodities and energy-related substances, and improved real estate fundamentals all contributed to the returns. These factors resulted in cash distributions of $316.5 million from energy and real estate partnerships.

Long-Term Balanced Pool Spending Guideline

After the University's Investment and Budget Committees reviewed the Long-Term Balanced Pool's spending guideline, the Board of Trustees in fiscal year 2006 ratified a revised spending guideline blending two elements:

- *Market element* adjusts annual endowment spending to the long-term sustainable target spending of 4.35 percent of the average actual market value of the endowment for the 12 months ending the October following the latest fiscal year. This component of the spending rate receives a 30 percent weighting in the spending rate calculation.
- *Spending element* increases the previous year's spending rate by actual inflation plus budget growth (1.5 percent). This element of the spending rate receives a weight of 70 percent.

The actual spending rate per unit for fiscal year 2007 was $7.22; it will be $7.80 for fiscal year 2008. The payout rate for fiscal year 2007 was 3.28 percent.

Payout Determined by Spending Guideline

	2003	*2004*	*2005*	*2006*	*2007*
Spending per unit	$6.90	$6.87	$6.75	$6.81	$7.22
Net asset value per unit	$140.14	$154.36	$177.06	$195.73	$229.89
Payout rate*	4.76%	4.46%	3.91%	3.53%	3.28%
Total (in millions)	$150.69	$160.44	$161.44	$176.21	$197.50
Growth in total spending	15.74%	6.47%	0.62%	9.15%	12.08%

*Payout rate is calculated as spending per unit divided by the two-year average net asset value per unit before distribution of the annual contribution to the budget.

The Long-Term Balanced Pool: In Conclusion

In summary, the addition of numerous uncorrelated strategies enhanced the diversification of the Long-Term Balanced Pool during the fiscal year. The portfolio is well positioned to perform over long time horizons in order to meet its investment objectives.

Securities Lending

Northwestern initiated a securities lending program with its bank custodian, Northern Trust, in 2003. The agreement allows the investment custodian to lend University securities to approved brokers in exchange for a fee. At August 31, 2007, investment securities with an aggregate market value of $512.3 million were loaned to various brokers and are returnable on demand. In exchange, the University received cash collateral of $470.7 million and noncash collateral of $52.5 million at August 31, 2007. The University earned $1.5 million on securities lending activities through the end of fiscal year 2007.

William H. McLean

William H. McLean
Vice President and Chief Investment Officer

Independent Auditors' Report

To the Board of Trustees of Northwestern University:

We have audited the accompanying consolidated statements of financial position of Northwestern University and subsidiaries (the "University") as of August 31, 2007 and 2006, 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 consolidated 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 consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 the University as of August 31, 2007 and 2006, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the consolidated financial statements, the consolidated financial statements include investments valued at $3,725.5 million (41.7 percent of total assets) and $2,805.3 million (36.6 percent of total assets) as of August 31, 2007 and 2006, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on estimates provided by external investment managers and are examined through a valuation review process performed by management.

As discussed in note 6 to the consolidated financial statements, in 2006 the University adopted Financial Accounting Standards Board (FASB) Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement No. 143," and changed its method of accounting for conditional asset retirement obligations.

Deloitte & Touche LLP

Chicago, Illinois, December 21, 2007

Consolidated Statements of Financial Position

As of August 31, 2007, and August 31, 2006

(in thousands of dollars)	*2007*	*2006*
Assets		
Cash and cash equivalents	$184,592	$177,588
Accounts receivable	232,939	224,474
Notes receivable	54,741	48,144
Contributions receivable	105,343	96,305
Collateral held for securities loaned	470,720	508,976
Investments	6,496,665	5,272,712
Land, buildings, and equipment	1,250,093	1,191,254
Bond proceeds held by trustees	81,136	108,886
Other assets	63,648	42,302
Total assets	**$8,939,877**	**$7,670,641**
Liabilities		
Accounts payable and accrued expenses	$146,227	$113,455
Deferred revenue	244,689	236,524
Payable under securities loan agreements	470,720	508,976
Actuarial liability of annuities payable and deposits payable	64,870	46,320
Reserves for self-insurance	51,586	65,531
Government advances for student loans	39,084	39,353
Asset retirement obligations	108,926	103,596
Bonds and notes payable	610,883	588,111
Total liabilities	**$1,736,985**	**$1,701,866**
Net assets		
Unrestricted	$6,182,157	$5,017,368
Temporarily restricted	149,139	129,362
Permanently restricted	871,596	822,045
Total net assets	**$7,202,892**	**$5,968,775**
Total liabilities and net assets	**$8,939,877**	**$7,670,641**

2007

Detail of net assets	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	
Operating funds	$689,342	$94,793		$784,135
Invested in plant facilities	1,131,879	16,208		1,148,087
Annuity and life income funds	21,683	16,073	$36,642	74,398
Endowment and similar funds	4,339,253	22,065	834,954	5,196,272
Total net assets	**$6,182,157**	**$149,139**	**$871,596**	**$7,202,892**

2006

Detail of net assets	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	
Operating funds	$590,290	$75,907		$666,197
Invested in plant facilities	1,029,816	17,314		1,047,130
Annuity and life income funds	26,257	18,419	$30,971	75,647
Endowment and similar funds	3,371,005	17,722	791,074	4,179,801
Total net assets	**$5,017,368**	**$129,362**	**$822,045**	**$5,968,775**

See Notes to the Consolidated Financial Statements, beginning on page 19.

Consolidated Statements of Activities

For the fiscal years ended August 31, 2007, and August 31, 2006

(in thousands of dollars)	*2007*		*2006*	
Changes in unrestricted net assets				
Operating revenues				
Tuition and fees	$611,189		$562,633	
(less scholarships and fellowships)	(182,136)		(166,854)	
Net tuition and fees	429,053		395,779	
Auxiliary services	66,524		64,531	
Grants and contracts	367,338		351,590	
Private gifts	77,611		92,998	
Investment return designated for operations	258,111		232,407	
Professional fees	31,986		29,393	
Sales and services	123,981		112,989	
Royalties and trademarks	93,606		44,546	
Other income	10,793		7,139	
Total operating revenues		**$1,459,003**		**$1,331,372**
Operating expenses				
Instruction	502,585		452,427	
Research	321,949		309,323	
Academic support	157,691		156,823	
Student services	103,906		104,105	
Institutional support	158,050		120,394	
Auxiliary services	107,383		101,957	
Total operating expenses		**1,351,564**		**1,245,029**
Excess of operating revenues over expenses		**107,439**		**86,343**
Nonoperating				
Private gifts and grants for buildings and equipment	14,277		27,464	
Investment gains reinvested	997,366		446,082	
Loss on defeasance of bonds payable	(4,995)		—	
Change in unrestricted net assets from nonoperating activities		**1,006,648**		**473,546**
Net assets released from restrictions		**50,702**		**93,022**
Increase in unrestricted net assets before cumulative effect of change in accounting principle		**1,164,789**		**652,911**
Cumulative effect of change in accounting principle		—		**(84,115)**
Change in unrestricted net assets		**1,164,789**		**568,796**
Changes in temporarily restricted net assets				
Private gifts	67,896		45,270	
Net (loss) gain on annuity obligation	(892)		9,948	
Investment returns	3,475	70,479	2,016	57,234
Net assets released from restrictions		**(50,702)**		**(93,022)**
Change in temporarily restricted net assets		**19,777**		**(35,788)**
Changes in permanently restricted net assets				
Private gifts	47,916		27,885	
Net gain on annuity obligation	1,635	49,551	2,366	30,251
Change in permanently restricted net assets		**49,551**		**30,251**
Change in net assets		**1,234,117**		**563,259**
Beginning net assets		**$5,968,775**		**$5,405,516**
Ending net assets		**$7,202,892**		**$5,968,775**

See Notes to the Consolidated Financial Statements, beginning on page 19.

Consolidated Statements of Cash Flows

For the fiscal years ended August 31, 2007, and August 31, 2006

(in thousands of dollars)	*2007*	*2006*
Cash flows from operating activities		
Change in net assets	**$1,234,117**	**$563,259**
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Cumulative effect of change in accounting principle	—	84,115
Depreciation	76,643	70,471
Accretion for asset retirement obligations	5,330	5,118
Loss on retirement of equipment	1,534	848
Amortization of discount on bonds payable	73	73
Accretion of premium on bonds payable	(152)	—
Net realized and unrealized gains on investments	(1,100,339)	(567,800)
Private gifts and grants for long-term investments	(14,277)	(27,464)
Changes in assets and liabilities		
Accounts receivable	(3,053)	(28,897)
Contributions receivable	(9,038)	66,478
Other assets	(21,346)	558
Accounts payable and accrued expenses	23,215	(11,424)
Deferred revenue	8,165	32,350
Reserves for self-insurance	(13,945)	(14,775)
Government advances for student loans	(269)	(462)
Net cash provided by operating activities	**186,658**	**172,448**
Cash flows from (used in) investing activities		
Purchases of investments	(2,526,922)	(2,567,346)
Proceeds from sales of investments	2,407,758	2,378,049
(Increase) decrease in trusts held by others	(5,412)	36
Increase in investments held for others	(4,450)	(3,379)
Acquisitions of land, buildings, and equipment	(127,459)	(87,042)
Student loans disbursed	(99,331)	(107,925)
Principal collected on student loans	92,734	111,623
Net cash used in investing activities	**(263,082)**	**(275,984)**
Cash flows from (used in) financing activities		
Net proceeds from issuance of notes payable and bonds payable	25,241	—
Principal payments on notes payable and bonds payable	(2,390)	(7,310)
Decrease in bond proceeds held by trustees	27,750	17,813
Proceeds from private gifts and grants for long-term investments	14,277	27,464
Decrease (increase) in annuities payable and deposits payable	18,550	(23,089)
Net cash provided by financing activities	**83,428**	**14,878**
Increase (decrease) in cash and cash equivalents	**7,004**	**(88,658)**
Cash and cash equivalents at beginning of year	**177,588**	**266,246**
Cash and cash equivalents at end of year	**$184,592**	**$177,588**
Supplemental disclosure of cash flow information		
Accrued liabilities for construction in progress	$17,846	$8,289
Capitalized interest	1,128	12,118
Cash paid for interest	23,294	22,356
Defeasance of bonds payable	145,000	—

See Notes to the Consolidated Financial Statements, beginning on page 19.

1. Summary of Significant Accounting Policies

University Activities
Northwestern University (the University) is a major private research university with more than 17,000 students enrolled in 11 academic divisions on two lakefront campuses. Its mission is to provide the highest-quality education for its students, to develop innovative programs in research, and to sustain an academic community that embraces these enterprises. Activities supporting its mission may be classified as either operating or nonoperating.

Operating activities primarily reflect transactions of a current nature, such as tuition or unrestricted gift revenues, as well as instructional or auxiliary services expenses. Investment return from operations is defined as the investment payout, according to the spending guideline (see note 4 on page 24) for the Long-Term Balanced Pool and the actual investment income for all other investments.

Nonoperating activities primarily reflect transactions of a noncurrent nature such as long-term investment or capital events, including contributions to be invested for the support of future operations, contributions to be used for facilities and equipment, and unrealized gains or losses that are not defined as from operations.

Basis of Accounting

General
The University maintains its accounts and prepares its consolidated financial statements on the accrual basis of accounting in conformity with generally accepted accounting principles in the United States of America (GAAP). These statements include all wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

Contributions
The University prepares its financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 116, "Accounting for Contributions Received and Contributions Made." SFAS No. 116 requires that contributions received, including unconditional promises to give (pledges), be recognized as revenues at their fair values. Private gifts, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not included in revenue until the conditions are substantially met. Pledges receivable due in more than one year are recorded at the present value of the estimated future cash flows.

Net Asset Classifications
SFAS No. 117, "Financial Statements of Not-for-Profit Organizations," establishes standards for external financial reporting by not-for-profit organizations and requires that net assets and the flow of those assets be classified in three net asset categories according to the existence or absence of donor-imposed restrictions.

The category *Unrestricted Net Assets* describes funds that are legally available for any purpose and have no donor-imposed restrictions. All revenues, expenses, gains, and losses are classified as unrestricted net assets unless they are changes in temporarily or permanently restricted net assets.

The category *Temporarily Restricted Net Assets* includes gifts for which donor-imposed restrictions have not been met (these are primarily future capital projects) and trust activity and pledges receivable whose ultimate use is not permanently restricted.

The category *Permanently Restricted Net Assets* applies to gifts, trusts, and pledges whose donors required that the principal be held in perpetuity and that only the income be available for stipulated program operations.

Income from temporarily restricted sources is reclassified as unrestricted income when the circumstances of the restriction have been fulfilled. Donor-restricted revenues whose restrictions are met within the same fiscal year are reported as unrestricted income. The expiration of a donor-imposed restriction on a contribution is recognized in the period in which the restriction expires. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with the donor's stipulations causes the release of the restriction.

Cash and Cash Equivalents
Cash reflects currency and deposits or other accounts with financial institutions that may be deposited or withdrawn without restriction or penalty. *Cash equivalents* represent short-term and highly liquid investments that convert readily to cash and carry little risk of change in value at maturity due to interest rate changes.

Investments

Investments are recorded at fair value, determined on the following basis:

- Equity securities with readily determinable fair values and debt securities are valued at the last sale price (if quotations are readily available) or at the closing bid price in the principal market in which such securities are normally traded (if no sale price is available). Certain fixed-income securities are valued based on dealer-supplied valuations.
- The estimated fair values of equity securities that do not have readily determined fair values, and of other investments, are based on estimates provided by external investment managers and are examined through a valuation review process performed by management. After this review, management may determine that an adjustment to the external managers' valuations is appropriate in recording the securities' fair value at August 31. The aggregate carrying value of these securities included within fixed income, high-yield credit, absolute return, private investments, and real assets was $3,725.5 million and $2,805.3 million at August 31, 2007, and 2006, respectively.

  During the examination process management reviewed the valuation policies for all partnerships in which Northwestern University is invested and deemed those policies appropriate. In addition to receiving the most recent available audited and unaudited financial statements from the external managers, management contacted the majority of general partners regarding the aggregate carrying value of the respective investments at August 31, 2007.

  A range of possible values exists for these partnership investments, and therefore the estimated values may differ from the values that would have been used had a ready market for these partnerships existed. In the absence of another basis, management has determined that cost represents an approximation of the fair value of such investments. A small number of investments within certain partnerships may have holdings at a carrying value of cost, and management has determined this to be appropriate for these specific investments.

The University continually monitors the difference between the cost and the estimated fair value of its investments. If any of the investments experiences a decline in value that the University believes is other than temporary, the University recognizes a realized loss in investment income in the consolidated statements of activities.

Investment income is recorded on the accrual basis, and purchases and sales of investment securities are reflected on a trade-date basis.

Derivative Financial Instruments

The University uses various financial instruments to hedge the risk of decline in fair value of certain equity securities. Equity options and equity-indexed options are used to reduce the primary market risk exposure (e.g., equity price risk) of the hedged item in conjunction with the specific hedged strategy; if applicable, these have a reference index (e.g., S&P 500) that is the same, or highly correlated with, the reference index of the hedged item. Similarly, the University also enters into swap agreements to hedge public real estate equity exposure and obtain S&P 500 equity index exposure, and it uses futures contracts on equity and bond indices. Such instruments are not designated as hedges for accounting purposes and are recorded at fair value. In fiscal year 2007, the University added a credit hedge transaction involving put options on the S&P 500 index, and used an interest rate swap agreement to hedge variable interest rate exposure. In fiscal year 2006, all swap agreements were liquidated.

Fair Values of Financial Instruments Other than Investments

The fair values of financial instruments other than investments are based on a variety of factors. In some cases, fair values represent quoted market prices for identical or comparable instruments. In other cases, fair values have been estimated based on assumptions about the amount and timing of estimated future cash flows and assumed discount rates reflecting varying degrees of risk. Accordingly, the fair values may not represent actual values that could have been realized at year-end or that will be realized in the future. At August 31, 2007, the fair value of the University's fixed rate debt of $354.6 million exceeded the carrying value of $350.6 million by $4 million. At August 31, 2006, the fair value of the University's fixed rate debt of $370.5 million exceeded the carrying value of $352.9 million by $17.6 million.

Accounts and Notes Receivable

Accounts receivable arising from tuition and fees are carried net of an allowance for doubtful accounts of $503,000 and $457,000 as of August 31, 2007, and 2006, respectively. Notes receivable resulting from student loans are carried net of an allowance for doubtful accounts of $417,000 and $279,000 as of August 31, 2007, and 2006, respectively.

Receivables from Northwestern Medical Faculty Foundation, a related party (see page 22), arose out of operational activities. They totaled $21.1 million and $13.9 million as of August 31, 2007, and 2006, respectively.

Contributions Receivable
Contributions receivable arising from unconditional promises to give are carried net of an allowance for uncollectible pledges that totaled $12.6 million and $9.5 million at August 31, 2007, and 2006, respectively. Additionally, unconditional promises expected to be collected in periods from more than one year are discounted to present value. The discount rates for pledges made in fiscal years 2007 and 2006 were 4.5 and 4.7 percent, respectively; the discount rate used on all pledges receivable prior to September 1, 2006, was 6.5 percent. Significant conditional promises to give totaled $25.8 million at August 31, 2007, and 2006.

Land, Buildings, and Equipment
The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair market value at the date of the gift. Significant renewals and replacements are capitalized. The cost of repairs and maintenance is expensed as incurred. Purchases of library books are also expensed.

Depreciation is calculated using the straight-line method over the useful lives of the buildings and equipment, which are estimated to be 3 to 20 years for equipment and a maximum of 40 years for buildings. The University follows SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The provisions under this statement include a requirement that long-lived assets be reviewed for impairment by comparing the future cash flows expected from the asset to the carrying value of the asset. If the carrying value of an asset exceeds the sum of estimated undiscounted future cash flows, an impairment loss is recognized for the difference between estimated fair value and carrying value. In management's opinion, no impairment existed as of August 31, 2007.

Charitable Remainder Trusts
Charitable remainder trusts are classified as permanently restricted net assets if, upon termination of the trust, the donor permanently restricts the remaining trust assets. If the remainder is temporarily restricted or unrestricted by the donor, the charitable remainder trust assets are recorded as temporarily restricted net assets.

Annuities Payable
Annuities payable consist of annuity payments currently due and the actuarial amount of annuities payable. The actuarial amount of annuities payable is the present value of the aggregate liability for annuity payments over the expected lives of the beneficiaries (based on the 90CM mortality tables in the Internal Revenue Code, Publication 1458, July 1999, and Publication 939, April 2003).

Self-Insurance Reserves
The University maintains a self-insurance program for general liability, professional liability, and certain employee and student insurance coverages. This program is supplemented with commercial excess insurance above the University's self-insurance retention.

Asset Retirement Obligations
In 2006, the University adopted the Financial Accounting Standards Board (FASB) Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—An Interpretation of FASB Statement No. 143" (FIN 47). FIN 47 clarifies the term *conditional asset retirement obligation* as it is used in SFAS No. 143, "Accounting for Asset Retirement Obligations," and requires a liability to be recorded if the fair value of the obligation to retire an asset can be reasonably estimated. Asset retirement obligations covered by FIN 47 include those for which an entity has a legal obligation to perform an asset retirement activity; however, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. In accordance with FIN 47, the University records all known asset retirement obligations for which the fair value of the liability can be reasonably estimated, including certain obligations relating to regulatory remediation.

Revenue Recognition
Revenues from tuition and fees are reported in the fiscal year in which educational programs are predominantly conducted. Fiscal year 2008 fall-quarter tuition and fees, billed in fiscal year 2007, are reported as deferred revenue in fiscal year 2007. Similarly, fiscal year 2007 fall-quarter tuition and fees, billed in fiscal year 2006, are reported as deferred revenue in fiscal year 2006.

Revenues from auxiliary services, such as residence and food services, represent fees for goods and services furnished to University students, faculty, and staff. Grants and contracts revenue is recognized as expenses are incurred on a project. Professional fees arise from faculty and department services provided to external institutions such as hospitals. Sales and services revenues represent fees for services and goods provided to external parties in the course of educational activities and also include revenues from the provision of physical plant services and goods to external institutions contiguous to the University campuses. Trademark and royalty revenues arise from licensing of innovative technologies, copyrights, and other intellectual property. Other income includes revenues not otherwise categorized, such as rental revenues from property not held for investment, reimbursements for goods and services, and sundry payments to the University.

Income Taxes

The University is exempt from income taxes under Section 501(c)(3) of the U.S. Internal Revenue Code, except with regard to unrelated business income, which is taxed at corporate income tax rates.

Related Parties

Northwestern Medical Faculty Foundation (NMFF) is a multispecialty physician organization committed to providing clinical care to patients and to supporting the research and academic endeavors of Northwestern's Feinberg School of Medicine. An independent not-for-profit organization, NMFF is governed by a board of directors. NMFF physicians are full-time faculty members or researchers at Feinberg and attending physicians at Northwestern Memorial Hospital. Under the terms of an agreement with Northwestern University, NMFF contributes a percentage of its revenue to a research and education fund, medical education programs, basic and applied biomedical research facilities and programs, and research and educational support services. NMFF also contributes funds to Feinberg's teaching and research activities on a discretionary basis. These contributions totaled $28.7 million in fiscal year 2007 and $25 million in fiscal year 2006.

Uses of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the relevant period. Actual results could differ from those estimates.

At August 31, 2007, and 2006, reserves were established for uncollectible accounts, student loans, and pledges receivable. These reserves were estimated based on historical collection and allowance practices as well as on management's evaluation of current trends.

The reserves for self-insurance and postretirement medical and life insurance benefits were based on actuarial studies and management estimates.

The University believes that the methods and assumptions used in computing these reserves and liabilities are appropriate.

Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes," an interpretation of FASB Statement No. 109. In accordance with FASB Statement No. 109, "Accounting for Income Taxes," FIN 48 clarifies accounting for uncertainty in income taxes reported in the financial statements. It is effective for the University beginning in fiscal year 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, "Fair Value Measurements." SFAS No. 157 redefines fair value, provides a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. It is effective in fiscal year 2009 for the University.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115." The statement provides the option to report selected financial assets at fair value; it also includes presentation and disclosure requirements to facilitate comparisons between entities using different measurement attributes for similar kinds of assets and liabilities. SFAS No. 159 is effective in fiscal year 2009 for the University.

The University is evaluating the impact of implementation of these pronouncements on the consolidated financial statements.

2. Bonds and Notes Payable

Bonds and notes payable are as follows:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Demand revenue bonds		
IEFA–Series 1993	$20,495	$22,885
Less unamortized discount on IEFA–Series 1993	(511)	(584)
IEFA–Series 1997	—	145,000
IEFA–Series 2003	185,010	185,010
IFA–Series 2004	135,800	135,800
IFA–Series 2006	145,130	—
Plus unaccreted premium on IFA–Series 2006	5,459	—
Bonds payable subtotal	491,383	488,111
Commercial paper, taxable	119,500	100,000
Notes payable subtotal	119,500	100,000
Total bonds and notes payable	**$610,883**	**$588,111**

Bond issuance	**Interest rate mode**	**Interest rate**	**Maturity**
IEFA–Series 1993	Fixed	5.5%*	December 1, 2007, to December 1, 2013
IEFA–Series 2003	Fixed	5%*	December 1, 2014, to December 1, 2038
IFA–Series 2004	Variable, weekly rate	3.9% and 3.95%+	December 1, 2034
IFA–Series 2006	Fixed	5%*	December 1, 2042
Commercial paper, taxable	Fixed	5.3%*	September 13, 2007, to December 7, 2007

** Weighted average interest rate at August 31, 2007   + Weekly variable rate at August 31, 2007*

Total obligations including commercial paper at August 31, 2007, are scheduled to mature through August 31 of each period as follows:

(in thousands of dollars)	
2008	$122,059
2009	2,659
2010	2,754
2011	2,954
2012	3,149
2013–2017	18,637
2018–2022	24,558
2023–2027	758
2028–2032	758
Thereafter	432,597
Total	**$610,883**

Bonds Payable

The IEFA–Series 1993 Revenue Refunding Bonds operate in a fixed mode until maturity, bearing interest at fixed rates ranging from 3 percent to 5.55 percent. Proceeds of the refunding bonds were invested in United States government securities with a cost of $75.4 million and placed in escrow to satisfy scheduled payments of $66.4 million of the IEFA–Series 1985 bonds and related interest until maturity.

The IEFA–Series 1997 Adjustable Medium-Term Revenue Bonds operate in a fixed mode until maturity, bearing interest at fixed rates ranging from 4.7 percent to 5.25 percent. The weighted average interest rate at August 31, 2006, and October 2, 2006, was 5.08 percent. The 1997 issuance was structured as tendered bonds and scheduled to mature and be tendered between November 1, 2006, and November 1, 2015, at values between $5 million and $20 million. In October 2006 the bonds were refunded in total with the issuance of the IFA–Series 2006 revenue bonds.

The IEFA–Series 2003 Fixed-Rate Revenue Bonds were issued to acquire, construct, or renovate certain University facilities and to refund $35 million of the University's outstanding IEFA–Series 1993 bonds, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Facilities Authority.

The IFA–Series 2004 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects on both the Evanston and the Chicago campuses, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode. In fiscal year 2007, the revenue bonds operated in a weekly rate mode determined by the remarketing agents.

On October 3, 2006, the University legally defeased the IEFA–Series 1997 Adjustable Medium-Term Revenue Bonds with fixed-rate tax-exempt revenue bonds (Illinois Finance Authority Revenue Refunding Bonds Series 2006) totaling $145.1 million. The refunding bonds are subject to conditions set forth in a trust indenture and loan agreement between the University and the authority.

On May 17, 2007, the University entered into an interest rate swap agreement to hedge variable interest rate exposure. The agreement effectively fixes the interest rate at 4.14 percent and expires on December 1, 2046. The notional value is $350 million through November 30, 2038, and reduces to $200 million effective December 1, 2038, through expiration. At August 31, 2007, the University recognized an unrealized gain on the swap investment totaling $4.2 million.

Notes Payable

The University places commercial paper under a $200 million Taxable Commercial Paper Note. On July 15, 2007, the University closed on two standby letters of credit: $100 million was issued to assure liquidity of short-term debt, and $50 million was issued to provide working capital as needed.

3. Contributions Receivable

Contributions receivable consisted of the following:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Unconditional promises expected to be collected in		
Less than one year	$99,993	$74,927
One year to five years	24,091	37,860
More than five years	496	1,181
Less discount to present value and other reserves		
Discount to present value	(6,609)	(8,163)
Other reserves	(12,628)	(9,500)
Total	**$105,343**	**$96,305**

4. Investments

The University's investments are overseen by the Investment Committee of the Board of Trustees. Guided by the policies established by the Investment Committee, the University's Investment Office or external equity investment managers, external and internal fixed-income and cash managers, and various limited partnership managers direct the investment of endowment and trust assets, certain working capital, temporarily invested expendable funds, and commercial real estate.

Substantially all of these assets are merged into internally managed investment pools on a market-value basis. Each holder of units in the investment pools subscribes to or disposes of units on the basis of the market value per unit at the beginning of each month.

Endowment Payout/Spending Guideline

The Board of Trustees adopted a revised guideline effective in fiscal year 2007 for the annual spending rate from the Long-Term Balanced Pool. The calculation blends market and spending elements for the total annual spending rate.

The market element is an amount equal to 4.35 percent of the market value of a unit in the pool, averaged for the 12 months ending October 31 of the prior fiscal year. It is weighted at 30 percent in determining the total. The spending element is an amount equal to the current fiscal year's spending amount increased by 1.5 percent, plus the actual rate of inflation. It is weighted at 70 percent in determining the total.

If endowment income received is not sufficient to support the total-return objective, the balance is provided from realized and unrealized gains. If income received is in excess of the objective, the balance is reinvested in the Long-Term Balanced Pool on behalf of the unit holders.

The University's policy is to allocate the current income of all other investment pools.

Investment Market Value

The following charts show the cost and estimated fair value of investments held by the University:

(in thousands of dollars)		*August 31, 2007*		*August 31, 2006*
	Cost	**Estimated fair value**	**Cost**	**Estimated fair value**
U.S. equity securities	$745,968	$974,009	$745,649	$867,498
International equity securities	792,143	979,251	634,690	845,471
Fixed income securities	682,187	703,387	651,749	645,157
High-yield credit	285,386	374,355	153,404	216,568
Absolute return	623,561	1,070,442	518,081	855,125
Private investments	1,335,354	1,320,975	1,078,319	958,022
Real assets	737,270	1,004,482	673,615	834,340
Other assets	50,369	69,764	34,222	50,531
Total investments	**$5,252,238**	**$6,496,665**	**$4,489,729**	**$5,272,712**

At August 31, 2007, the University was committed to making future capital contributions in other investments in the amount of $1,785 million, primarily in the next five years.

The carrying value of the University's investments (excluding intrauniversity investments, cash, and cash equivalents) is shown by investment pool in the following charts:

(in thousands of dollars)					*August 31, 2007*
	Operations and plant	**Quasi-endowment**	**Annuity and life-income**	**Permanent endowment**	**Total**
Long-Term Balanced Pool	$739,655	$1,951,227	$37,882	$2,864,212	$5,592,976
Intermediate-Term Bond Pool	671,542	35,702			707,244
Separately invested	543	57,917	57,888	7,300	123,648
Working capital	72,797				72,797
Total investments	**$1,484,537**	**$2,044,846**	**$95,770**	**$2,871,512**	**$6,496,665**

(in thousands of dollars)					*August 31, 2006*
	Operations and plant	**Quasi-endowment**	**Annuity and life-income**	**Permanent endowment**	**Total**
Long-Term Balanced Pool	$634,143	$1,524,387	$40,405	$2,363,652	$4,562,587
Intermediate-Term Bond Pool	547,784	32,601			580,385
Separately invested	161	13,597	60,186	4,527	78,471
Working capital	51,269				51,269
Total investments	**$1,233,357**	**$1,570,585**	**$100,591**	**$2,368,179**	**$5,272,712**

The following table is a summary of private investments in which cost basis exceeds fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position. Management regularly monitors unrealized gains and losses in this class of investments over the fiscal periods, noting trends and tracking performance compared with expectations. Private equity and international private equity categories consist of long-term partnerships that have predictable life cycles resulting in unrealized losses at the beginning and the ending of the cycle. In the early years of these partnerships, initial investments are made with the expectation of gains in future years; thus, fees and expenses cause a temporary impairment. In the late stages of these partnerships, realized gains have materially already occurred; thus, the remaining investments on the books are fairly valued at current prices below the original cost basis of these partnerships. Based on continuing analysis and evaluation, management has determined that declines in fair value are temporary and that these assets are not impaired at August 31, 2007.

The unrealized losses of $250 million have been reflected in the consolidated financial statements in conjunction with the adjustment of all investments to fair market value.

(in thousands of dollars)						*August 31, 2007*
	Less than 12 months		**12 months or more**		**Total**	
	Fair value	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
Private equity securities	$16,804	($1,000)	$126,870	($74,031)	$143,674	($75,031)
International private equity securities	9,868	(566)	43,533	(8,110)	53,401	(8,676)
Venture capital	25,934	(1,974)	225,268	(164,416)	251,202	(166,390)
Separately invested			7,959	(173)	7,959	(173)
Total temporarily impaired securities	**$52,606**	**($3,540)**	**$403,630**	**($246,730)**	**$456,236**	**($250,270)**

Investment Return

The components of total investment return were as follows:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Investment income	$153,201	$112,741
Net realized gains	643,392	453,011
Change in net unrealized gains on investments reported at fair value	462,359	114,753
Total investment return	**$1,258,952**	**$680,505**

Investment return from operations is defined as the investment payout, according to the spending guideline for the Long-Term Balanced Pool and the actual investment income for all other investments. As reflected in the consolidated statements of activities, investment return was as follows:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Changes in unrestricted net assets		
Operating: investment return	$258,111	$232,407
Nonoperating: investment gains reinvested	997,366	446,082
Changes in temporarily restricted net assets		
Investment return	3,475	2,016
Total investment return	**$1,258,952**	**$680,505**

Derivative Financial Instruments

In fiscal year 2007, the University entered into a $1,000 million notional value credit hedge transaction. The net unrealized gain on the entire hedge transaction was $9 million at August 31, 2007. The University also entered into a hedging transaction via S&P 500 index over-the-counter put options. The net cost of these options was $2.7 million, and the options had an unrealized loss of $800,000 at August 31, 2007.

The University bought and sold futures contracts on 2-year and 10-year Treasury notes during fiscal years 2007 and 2006 and incurred realized gains of $253,000 and $153,000, respectively. At August 31, 2007, and 2006, respectively, the University had 250 and 145 10-year Treasury note contracts outstanding. These contracts had an underlying notional value of $27.3 million and $15.6 million, respectively; an unrealized loss of $23,000 at August 31, 2007; and an unrealized gain of $48,000 at August 31, 2006.

In addition, the University bought and sold futures contracts on a domestic equity index during fiscal years 2007 and 2006 and incurred realized gains of $3 million and $3.4 million, respectively, on the sale of S&P 500 equity index futures contracts. As of August 31, 2006, the University had 246 September S&P 500 index futures contracts outstanding with an underlying notional value of $80.3 million and an unrealized gain of $1.2 million.

Lastly, the University bought and sold futures contracts on international equity indices during 2007 and 2006 and incurred realized gains of $7.1 million and $1.8 million, respectively. As of August 31, 2006, the University had international equity index contracts representing a Europe, Australia, and Far East (EAFE) basket of securities. There were none outstanding at August 31, 2007. At August 31, 2006, this basket of contracts had an underlying notional value of $18.6 million and an unrealized gain of $290,000.

Such equity instruments are not designated as hedges for accounting purposes and are recorded at fair value and included in investments on the consolidated statements of financial position.

Credit exposure represents the University's potential loss if all the counterparties fail to perform under the terms of the contracts, and if all collateral, if any, becomes worthless. This exposure is measured by the fair value of the cash collateral held at the counterparties at the reporting date. The University manages its exposure to credit risk by using highly rated counterparties, establishing risk control limits, and obtaining collateral where appropriate. As a result, the University has limited credit risk. To date, the University has not incurred any losses on derivative financial instruments due to counterparty nonperformance.

The University regularly reviews the use of derivative financial instruments by each of the managers of alternative investment funds in which it participates. While these outside managers generally use such instruments for hedging purposes, derivative financial instruments are employed for trading purposes by 24 independent asset managers of the University funds totaling approximately $1,450 million and $1,002 million at August 31, 2007, and 2006, respectively.

Valuation of Permanent Endowment Funds

The University monitors endowment accounts to identify any accounts for which historical cost was more than market value as of August 31, 2007. In fiscal 2007 market value exceeded historical costs for these accounts. In 2006 historical cost and market value totals for such accounts were approximately $4.2 million and $1.8 million, respectively. Associated unrealized losses are recorded in the unrestricted net assets classification.

5. Retirement Plans

The University maintains two contributory retirement plans for its eligible faculty and staff. The plans offer employees the choice of two investment company options, Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF), and the mutual funds offered by Fidelity Investments. The measurement date for plans is August 31. Participating employee and University contributions are immediately vested. The University contributed $35.9 million and $33.3 million to the two plans in 2007 and 2006, respectively. It expects to contribute $38.1 million to the two plans in 2008.

The University currently sponsors a health care plan permitting retirees to continue participation on a "pay-all" basis. The retiree contribution is based on the average per-capita cost of coverage for the plan's entire group of active employees and retirees rather than the per-capita cost for retirees only. Retirees are also eligible to participate in certain tuition reimbursement plans and may receive a payment for sick days accumulated at retirement. The accrued cost for postemployment benefits was $6.5 million and $6.6 million at August 31, 2007, and 2006, respectively, and is included in accounts payable and accrued expenses on the consolidated statements of financial position.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans." SFAS No. 158 amends FASB Statement No. 87, "Employers' Accounting for Pensions"; FASB Statement No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits"; FASB Statement No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions"; and FASB Statement No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits"; and other related accounting guidance.

SFAS No. 158 requires an employer sponsoring one or more single-employer defined benefit plans to recognize an asset or a liability in the statements of financial position for the plans' overfunded or underfunded status. The asset or liability is the difference between the fair value of plan assets and the related benefit obligation, defined as the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for other post-retirement benefit plans such as a retiree health care plan. SFAS No. 158 also requires an employer to recognize actuarial gains or losses and prior service costs or credits in the statements of activities that arise during the period but are not components of net periodic benefit cost pursuant to SFAS Nos. 87 and 106. In addition, an employer must measure defined benefit plan assets and obligations as of the date of its fiscal year-end and make specified disclosures for the upcoming fiscal year.

The implementation of SFAS No. 158 in fiscal year 2007 did not affect the University's consolidated financial statements.

The University funds the benefit costs as they are incurred. The accumulated postretirement benefit obligation (APBO) was as follows:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Active employees not yet eligible	$3,208	$3,285
Active employees eligible	4,060	3,895
Retirees	1,427	1,498
Total	**$8,695**	**$8,678**

The following table sets forth the plan's change in benefit obligation:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Benefit obligation at beginning of year	$8,678	$6,987
Service cost (benefits attributed to employee service during the year)	479	497
Interest cost on accumulated postretirement benefit obligation	474	346
Actuarial (gain) loss	(499)	990
Benefits paid	(874)	(1,203)
Contributions from participants	437	1,061
Benefit obligation at end of year	**$8,695**	**$8,678**

During fiscal year 2008, expected postretirement benefit payments (net of retirees' contributions) are approximately $453,000.

The following table sets forth the change in plan assets:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Fair value of plan assets at beginning of year	$0	$0
Employer contribution	436	143
Benefits paid	(436)	(143)
Fair value of plan assets at end of year	**$0**	**$0**

The accrued benefit cost recognized in the consolidated statements of financial position, which is included in accounts payable and accrued expenses, was $8.7 million at August 31, 2007, and 2006.

The components of the net periodic postretirement benefit cost were as follows:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Service cost (benefits attributed to employee service during the year)	$479	$497
Interest cost on accumulated postretirement benefit obligation	474	346
Amortization of prior service cost	109	109
Amortization of unrealized loss (gain)	117	(27)
Total	**$1,179**	**$925**

The following tables present key actuarial assumptions used in determining APBO as of August 31, 2007, and 2006.

First, the assumptions used to determine benefit obligations:

	August 31, 2007	*August 31, 2006*
Discount rate	6.2%	5.6%
Rate of increase in compensation levels	4%	4%

Next, the assumptions used to define net periodic benefit cost:

	August 31, 2007	*August 31, 2006*
Discount rate	5.6%	5%
Weighted average rate of increase in future compensation levels	4%	4%
Current pre-65 health cost trend rate	10%	9%
Current post-64 health cost trend rate	10%	9%
Ultimate health care cost trend rate	5%	5%
Year when trend rate will reach ultimate trend rate	2011	2009

A one-percentage-point change in assumed health care cost trend rates would have had the following effects in fiscal year 2007:

(in thousands of dollars)	*1% increase*	*1% decrease*
Increase (decrease) in total of service and interest cost	$79	($68)
Increase (decrease) in postretirement benefit obligation	560	(491)

Estimated future benefit payments reflecting anticipated service, as appropriate, are expected to be paid as follows:

(in thousands of dollars)	
2009	$475
2010	556
2011	646
2012	732
2013–2017	4,785
Total	**$7,194**

The University offers a deferred compensation plan under Internal Revenue Code 457(b) to a select group of management and highly compensated employees. There is no University contribution related to this deferred compensation plan. The University has recorded both an asset and a liability related to the deferred compensation plan that totaled $14.2 million and $9.8 million in fiscal years 2007 and 2006, respectively.

In May 2004, the FASB issued FASB Staff Position SFAS No. 106-2, "Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvements, and Modernization Act of 2003." It requires that the University disclose, effective with the year ended August 31, 2005, the effects of the act and assess the impact of the Medicare Part D subsidy on the accumulated postretirement benefit obligation and net periodic postretirement benefit cost. Since in fiscal years 2007 and 2006 the University chose not to pursue the subsidy, measures of the APBO or net periodic postretirement benefit cost do not reflect any amount associated with it.

6. Land, Buildings, and Equipment

Land, buildings, and equipment consisted of the following:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Land	$27,355	$27,355
Construction in progress	75,479	38,908
Buildings and leasehold improvements	1,577,749	1,528,261
Equipment	291,904	254,447
Accumulated depreciation	(722,394)	(657,717)
Total	**$1,250,093**	**$1,191,254**

The estimated cost to complete construction in progress at August 31, 2007, is $218.7 million. Costs included in construction in progress are future leasehold improvements and building and equipment capitalizations. Building costs are funded by loans, gifts (received or pledged), grants, and unrestricted funds.

Under Northwestern's interest capitalization policy, actual interest expense incurred during the period of construction of an asset for University use is capitalized until that asset is substantially completed and ready for use. The capitalized cost is reflected in the total cost of the asset and depreciated over the useful life of the asset. Assets may include buildings and major equipment.

Asset Retirement Obligations

As a result of adopting FIN 47 at the beginning of fiscal year 2006, the University recorded a cumulative effect of change in accounting principle of $84.1 million and a liability for asset retirement obligations of $98.5 million, and it increased the carrying value of the related assets by $14.3 million, net of accumulated depreciation of $15.2 million. The depreciation and accretion expenses at August 31, 2006, were $497,000 and $5.1 million, respectively. At August 31, 2006, asset retirement obligations totaled $103.6 million. At August 31, 2007, the depreciation and accretion expenses were $508,000 and $5.3 million, respectively.

Asset retirement obligations at August 31, 2006, were adjusted during 2007 as follows:

(in thousands of dollars)	*August 31, 2007*
Balance at beginning of year	$103,596
Accretion expense	5,330
Balance at end of year	**$108,926**

Lease Obligations

The University is obligated under numerous operating leases to pay base rent through the lease expiration dates. Operating leases consist primarily of leases for the use of real property and have terms expiring in various years through fiscal year 2022. Noncancelable real estate lease expenses totaled $5.9 million at August 31, 2007, and $4.7 million at August 31, 2006. The future minimum lease payments under noncancelable operating leases were allocated on a straight-line basis over the term of the lease. These payments through August 31 of each period are as follows:

(in thousands of dollars)	
2008	$5,747
2009	5,571
2010	5,431
2011	4,532
2012 and thereafter	16,188
Total	**$37,469**

7. Allocation of Expenses

The University allocated depreciation, plant maintenance expenditures, and interest on indebtedness to the various functional expense categories in the consolidated statements of activities for the fiscal years ended August 31, 2007, and 2006. Those expenses have been distributed to the functional areas of the University as follows:

(in thousands of dollars)				*August 31, 2007*
	Accretion for ARO	**Depreciation**	**Plant maintenance**	**Interest on bond indebtedness**
Instruction	$839	$12,068	$21,187	$3,562
Research	1,302	18,724	32,871	5,526
Academic support	1,003	14,421	25,317	4,256
Student services	491	7,061	12,396	2,084
Institutional support	299	4,296	7,542	1,268
Auxiliary services	1,396	20,073	35,238	5,923
Total	**$5,330**	**$76,643**	**$134,551**	**$22,619**

(in thousands of dollars)				*August 31, 2006*
	Accretion for ARO	**Depreciation**	**Plant maintenance**	**Interest on bond indebtedness**
Instruction	$717	$9,866	$16,318	$3,115
Research	1,208	16,631	27,508	5,250
Academic support	1,070	14,728	24,361	4,650
Student services	445	6,131	10,141	1,935
Institutional support	312	4,299	7,110	1,357
Auxiliary services	1,366	18,816	31,120	5,940
Total	**$5,118**	**$70,471**	**$116,558**	**$22,247**

The allocations were based on the functional use of space on the University's campus.

8. Self-Insurance Reserves and Other Contingencies

Reserves for losses under the University's self-insurance program, aggregating $51.6 million and $65.5 million at August 31, 2007, and 2006, respectively, include reserves for known losses and for losses incurred but not yet reported. A portion of the reserves pertaining to professional liability has been determined on a discounted present-value basis. The discount rate was 7.5 percent in fiscal years 2007 and 2006. Self-insurance reserves are based on estimates of historical loss experience, and while management believes that the reserves are adequate, the ultimate liabilities may be more or less than the amounts provided.

Under an agreement between the University and Northwestern Medical Faculty Foundation, a proportionate share of primary medical professional liability costs that arise out of events prior to November 1, 2004, is borne by NMFF. As of November 1, 2004, NMFF obtained excess medical liability coverage through another institution for all events after October 1, 2002, and reported after November 1, 2004. As of August 31, 2007, and 2006, there were no accounts receivable from NMFF related to professional liability insurance costs.

The University may borrow under an agreement whereby monies are advanced for the purpose of originating student loans. These loans, when fully disbursed, are sold to the lending agency. Additionally, the University has contracted to service these loans, which totaled $256.7 million at August 31, 2007.

Service revenues are the excess of the actual interest collected above the agreed-upon warehouse fees on the serviced loans. The University manages the program to break even and generates no servicing assets or liabilities through these activities. Under the agreement in effect through June 30, 2008, the University guarantees these loans against default up to 10 percent of the original domestic loan portfolio and 30 percent of the original international amounts. The maximum future total payments are $30.5 million as of August 31, 2007. At August 31, 2007, and 2006, $514,000 and $506,000, respectively, were reserved in anticipation of future defaults. Notes receivable on the consolidated statements of position are shown net of these reserves in fiscal years 2007 and 2006.

From time to time, various claims and suits generally incidental to the conduct of normal business are pending or may arise against the University. It is the opinion of management of the University, after taking into account insurance coverage, that any losses from the resolution of pending litigation should not have a material effect on the University's financial position or results of operations.

All funds expended in connection with government grants and contracts are subject to audit by government agencies. While any ultimate liability from audits of government grants and contracts by government agencies cannot be determined at present, management believes that it should not have a material effect on the University's financial position or results of operations.

9. Natural Classification of Expenses

Operating expenses incurred in the fiscal years ended August 31, 2007, and 2006, were as follows:

(in thousands of dollars)	*August 31, 2007*	*August 31, 2006*
Salaries, wages, and benefits	$719,091	$672,010
Services and professional fees	190,709	163,601
Supplies	74,432	69,034
Travel and promotion	65,382	62,286
Trademark and royalty fees	20,861	10,076
Other expenses	62,372	59,163
Maintenance, utilities, and equipment	114,125	111,023
Accretion for asset retirement obligations	5,330	5,118
Interest on bond indebtedness	22,619	22,247
Depreciation	76,643	70,471
Total	**$1,351,564**	**$1,245,029**

10. Securities Lending

The University has had an agreement with its investment custodian to lend University securities to approved brokers in exchange for a fee. Among other provisions that limit the University's risk, the securities lending agreement specifies that the custodian is responsible for lending securities and obtaining adequate collateral from the borrower. Collateral is limited to cash, government securities, and irrevocable letters of credit. At August 31, 2007, and 2006, investment securities with an aggregate market value of $512.3 million and $509.5 million, respectively, were loaned to various brokers and were returnable on demand. In exchange, the University received cash collateral of $470.7 million and noncash collateral of $52.5 million at August 31, 2007, and cash collateral of $509 million and noncash collateral of $14.1 million at August 31, 2006. In accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," the cash collateral is shown as both an asset and a liability on the consolidated statements of financial position.

11. Subsequent Event

On November 27, 2007, the University entered into a sale without recourse of a portion of a royalty interest under a license agreement with a manufacturer. Upon the settlement date, in return for a one-half portion of its royalty interest, the University received a cash payment of $700 million. Under the terms of a corollary intellectual property agreement, the University will continue to distribute an agreed-upon portion of royalty interest to the inventors of the product.