

Report of Independent Auditors

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, 2005 and 2004, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the management of the University. 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 financial statements present fairly, in all material respects, the financial position of the University as of August 31, 2005 and 2004, and the changes in its net assets and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

Chicago, Illinois

January 6, 2006

Consolidated Statements of Financial Position

As of August 31, 2005, and August 31, 2004

<i>(in thousands of dollars)</i>	2005	2004
Assets		
Cash and cash equivalents	\$266,246	\$225,679
Accounts receivable	195,613	233,040
Notes receivable	51,842	49,329
Contributions receivable	162,783	162,266
Collateral held for securities loaned	561,675	479,621
Investments	4,512,236	3,983,449
Land, buildings, and equipment	1,152,879	1,046,683
Bond proceeds held by trustees	126,699	50,448
Other assets	42,860	41,430
Total assets	\$7,072,833	\$6,271,945
Liabilities		
Accounts payable and accrued expenses	\$116,590	\$102,214
Deferred revenue	204,174	204,132
Payable under securities loan agreements	561,675	479,621
Actuarial liability of annuities payable and deposits payable	69,409	59,691
Reserves for self-insurance	80,306	79,454
Government advances for student loans	39,815	40,371
Bonds and notes payable	595,348	591,851
Total liabilities	1,667,317	1,557,334
Net assets		
Unrestricted	4,477,698	3,799,036
Temporarily restricted	165,150	163,283
Permanently restricted	762,668	752,292
Total net assets	5,405,516	4,714,611
Total liabilities and net assets	\$7,072,833	\$6,271,945

	2005			
Detail of net assets	Unrestricted	Temporarily restricted	Permanently restricted	
Operating funds	\$491,865	\$83,639		\$575,504
Invested in plant facilities	1,012,542	26,402		1,038,944
Annuity and life income funds	29,188	35,599	\$28,828	93,615
Endowment and similar funds	2,944,103	19,510	733,840	3,697,453
Total net assets	\$4,477,698	\$165,150	\$762,668	\$5,405,516

	2004			
Detail of net assets	Unrestricted	Temporarily restricted	Permanently restricted	
Operating funds	\$395,776	\$77,185		\$472,961
Invested in plant facilities	945,906	34,432		980,338
Annuity and life income funds	26,077	36,556	\$28,569	91,202
Endowment and similar funds	2,431,277	15,110	723,723	3,170,110
Total net assets	\$3,799,036	\$163,283	\$752,292	\$4,714,611

See Notes to the Consolidated Financial Statements, beginning on page 18.

Consolidated Statements of Activities

For the fiscal years ended August 31, 2005, and August 31, 2004

<i>(in thousands of dollars)</i>	2005	2004	
Changes in unrestricted net assets			
<i>Operating revenues</i>			
Tuition and fees	\$527,864	\$496,484	
(less scholarships and fellowships)	(153,205)	(145,171)	
Net tuition and fees	374,659	351,313	
Auxiliary services	63,579	65,626	
Grants and contracts	349,215	333,154	
Private gifts	68,561	18,869	
Investment return designated for operations	219,023	210,290	
Professional fees	27,735	27,502	
Sales and services	109,536	103,716	
Other income	5,372	5,144	
Total operating revenues	\$1,217,680	\$1,115,614	
<i>Operating expenses</i>			
Instruction	416,302	392,186	
Research	291,478	275,430	
Academic support	144,830	124,953	
Student services	94,891	82,998	
Institutional support	123,463	88,831	
Auxiliary services	98,692	99,191	
Total operating expenses	1,169,656	1,063,589	
Excess of operating revenues over expenses	48,024	52,025	
<i>Nonoperating</i>			
Private gifts and grants for buildings and equipment	30,826	28,751	
Investment gains reinvested	560,401	338,618	
Change in unrestricted net assets from nonoperating activities	591,227	367,369	
Net assets released from restrictions	39,411	50,331	
Change in unrestricted net assets	678,662	469,725	
Changes in temporarily restricted net assets			
Private gifts	40,503	10,293	
Net (loss) gain on annuity obligation	(1,410)	7,017	
Investment returns	2,185	41,278	2,126
Net assets released from restrictions	(39,411)	(50,331)	
Change in temporarily restricted net assets	1,867	(30,895)	
Changes in permanently restricted net assets			
Private gifts	10,297	38,998	
Net gain on annuity obligation	79	10,376	1,041
Change in permanently restricted net assets	10,376	40,039	
Change in net assets	690,905	478,869	
Beginning net assets	\$4,714,611	\$4,235,742	
Ending net assets	\$5,405,516	\$4,714,611	

See Notes to the Consolidated Financial Statements, beginning on page 18.

Consolidated Statements of Cash Flows

For the fiscal years ended August 31, 2005, and August 31, 2004

<i>(in thousands of dollars)</i>	2005	2004
Cash flows from operating activities		
Change in net assets	\$690,905	\$478,869
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Depreciation	62,426	52,890
Loss on retirement of equipment	869	749
Net realized and unrealized gains on investments	(658,145)	(464,959)
Private gifts and grants for long-term investments	(30,826)	(28,751)
<i>Changes in assets and liabilities</i>		
Accounts receivable	37,422	(36,876)
Contributions receivable	(517)	30,118
Other assets	(1,430)	(6,284)
Accounts payable and accrued expenses	(6,607)	(7,777)
Deferred revenue	42	13,984
Reserves for self-insurance	852	18,064
Government advances for student loans	(556)	(731)
Net cash provided by operating activities	94,435	49,296
Cash flows from (used in) investing activities		
Purchases of investments	(1,907,909)	(1,830,837)
Proceeds from sales of investments	2,040,278	1,759,569
(Increase) decrease in trusts held by others	5	(22)
Increase in investments held for others	(3,011)	(3,385)
Acquisitions of land, buildings, and equipment	(148,508)	(139,906)
Student loans disbursed	(106,833)	(101,957)
Principal collected on student loans	104,320	102,571
Net cash used in investing activities	(21,658)	(213,967)
Cash flows from financing activities		
Net proceeds from issuance of notes payable and bonds payable	135,800	185,010
Net principal payments on notes and bonds payable	(132,377)	(48,332)
Amortization of discount on bonds payable	74	1,210
Increase in bond proceeds held by trustees	(76,251)	(48,687)
Proceeds from private gifts and grants for long-term investments	30,826	28,751
Increase in annuities and deposits payable	9,718	765
Net cash (used in) provided by financing activities	(32,210)	118,717
Increase (decrease) in cash and cash equivalents	40,567	(45,954)
Cash and cash equivalents at beginning of year	225,679	271,633
Cash and cash equivalents at end of year	\$266,246	\$225,679
Supplemental disclosure of cash flow information		
Accrued liabilities for construction in progress	\$20,983	\$19,174
Cash paid for interest	21,114	18,884

See Notes to the Consolidated Financial Statements, beginning on page 18.

Notes to the Consolidated Financial Statements

For the fiscal years ended August 31, 2005, and August 31, 2004

1. Summary of Significant Accounting Policies

Operations

Northwestern University is a major private research university with more than 17,000 students enrolled in 11 academic divisions on two lakefront campuses.

Basis of Accounting

The University maintains its accounts and prepares its consolidated financial statements on the accrual basis of accounting. These statements include all wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

The University prepares its financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 116, "Accounting for Contributions Received and Contributions Made," and SFAS No. 117, "Financial Statements of Not-for-Profit Organizations." SFAS No. 116 requires that contributions received, including unconditional promises to give (pledges), be recognized as revenues at their fair values. SFAS No. 117 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. This category includes gifts stipulated for student loans.

Nonoperating activities primarily reflect transactions of a long-term investment or capital nature, including contributions to be invested for the support of future operations, contributions to be used for facilities and equipment, and certain unrealized gains or losses.

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. 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.

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 such investments was \$2,062.2 million and \$1,951.8 million at August 31, 2005, and 2004, respectively. A range of possible values exists for these securities, and therefore the estimated values may differ from the values that would have been used had a ready market for these securities existed. In the absence of another basis, management has determined that cost represents an approximation of the fair value of such 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 an equity index. Such equity instruments are not designated as hedges for accounting purposes and are recorded at fair value.

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, 2005, the fair values of the University's fixed rate debt of \$385 million exceeded the carrying value of \$360 million by \$25 million. At August 31, 2004, the fair values of the University's fixed rate debt of \$384 million exceeded the carrying value of \$362 million by \$22 million.

Accounts and Notes Receivable

Accounts receivable arising from tuition and fees are carried net of an allowance for doubtful accounts of \$332,000 and \$286,000 as of August 31, 2005, and 2004, respectively. Notes receivable resulting from student loans are carried net of an allowance for doubtful accounts of \$253,000 and \$271,000 as of August 31, 2005, and 2004, respectively.

Receivables from Northwestern Medical Faculty Foundation (NMFF), a related party (see next page), arising out of operational activities totaled \$15.6 million and \$25.7 million as of August 31, 2005, and 2004, respectively.

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, 2005.

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 mortality tables in the Internal Revenue Code, 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.

Revenue Recognition

Revenues from tuition and fees are reported in the fiscal year in which educational programs are predominantly conducted. Fiscal year 2006 fall-quarter tuition and fees, billed in fiscal year 2005, are reported as deferred revenue in fiscal year 2005. Similarly, fiscal year 2005 fall-quarter tuition and fees, billed in fiscal year 2004, are reported as deferred revenue in fiscal year 2004.

Grants and contracts revenue is recognized as expenses are incurred on the project. 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. The expiration of a donor-imposed restriction on a contribution is recognized in the period in which the restriction expires, and the related resources then are classified as unrestricted net assets.

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 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 \$25.9 million in fiscal year 2005 and \$21.9 million in fiscal year 2004.

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, 2005, and 2004, 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.

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

Accounting Pronouncements

In May 2003 the Financial Accounting Standards Board (FASB) issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS 150 modifies the accounting and financial statement disclosures for instruments with characteristics of both liabilities and equity that an issuer previously could account for as equity in its statement of financial position. In FASB Staff Position No. 150-3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150," issued November 2003, the FASB deferred the effective date of SFAS 150 for nonpublic entities until the first fiscal period beginning after December 15, 2004, or, for the University, for the fiscal year ending August 31, 2006. The University believes that the adoption of SFAS 150 during the fiscal year ending August 31, 2006, will not have a material effect on the consolidated financial statements.

In March 2005 the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations — an Interpretation of FASB Statement No. 143." FIN 47 clarifies that the term "conditional asset retirement obligation" used in SFAS No. 143 refers to an entity's legal obligation to perform an asset retirement activity whose timing and/or method of settlement depend on a future event the entity does not necessarily control. Accordingly, the entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. The fair value should be recognized when incurred — generally upon acquisition, construction, or development and/or through the normal operation of the asset.

FIN 47 will be effective for the 2006 fiscal year, and the University plans to adopt it then. The University is reviewing and analyzing the impact that adopting FIN 47 will have on the consolidated financial statements.

Reclassifications

Certain prior-year amounts have been reclassified to conform to current-year presentation of investments held by the University. In addition, the prior-year cash flow has been modified to reflect a change in the presentation of accrued liabilities for construction in progress. The amount reclassified, totaling \$19,174, is reflected as a decrease in net cash provided by operating activities and a decrease in net cash used in investing activities.

2. Bonds and Notes Payable

The University had \$100 million and \$135.8 million placed in commercial paper at August 31, 2005, and 2004, respectively.

Bonds payable are as follows:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
<i>Demand revenue bonds</i>		
IFA–Series 1985 varying adjustable interest rates	\$0	\$35,300
IFA–Series 1985 University Pooled Financing Program, variable rate	0	4,000
IFA–Series 1985 Cultural Pooled Financing Program, variable rate	0	9,992
IFA–Series 1988, variable rate	0	45,100
IFA–Series 1993, fixed rate	25,195	27,420
Less unamortized discount on IFA–Series 1993	(657)	(731)
IFA–Series 1997, fixed rate	150,000	150,000
IFA–Series 2003, fixed rate	185,010	185,010
IFA–Series 2004, variable rate	135,800	
Total	\$495,348	\$456,091

Total obligations including commercial paper at August 31, 2005, are scheduled to mature through August 31 of each period as follows:

<i>(in thousands of dollars)</i>	
2006	\$107,237
2007	12,317
2008	12,407
2009	17,507
2010	17,602
2011–2015	90,938
2016–2020	41,405
2021–2025	10,135
2026–2030	0
Thereafter	285,800
Total	\$595,348

In fiscal year 2005 the University elected to prepay the IFA–Series 1985 and 1988 Adjustable Demand Revenue Bonds in whole, without premium. The Series 1985 bond, whose principal amounted to \$35.3 million, was redeemed on September 25, 2004. The Series 1988 bond, whose principal amounted to \$45.1 million, was redeemed on September 10, 2004.

At the option of the University and upon compliance with certain conditions, the IFA–Series 1985 and 1988 Adjustable Demand Revenue Bonds may operate in one of four variable-interest-rate modes or may be converted to a fixed rate until maturity or earlier redemption. At September 8, 2004, \$35.3 million of the Series 1985 and all of the Series 1988 bonds operated in the weekly variable modes, under which the interest rate is adjusted weekly based on prevailing market rates for similar securities. The weekly interest rate at September 8, 2004, was 1.3 percent.

Also in fiscal year 2005, the University elected to prepay the IFA–Series 1985 Cultural Pooled Financing Program bond in whole, without premium; its promissory note; and the underabsorbed financing costs on September 15, 2004, which amounted to \$9.99 million in principal costs.

Under the IFA–Series 1985 Cultural Pooled Financing Program, the University assumed an additional liability representing its prorated share of underabsorbed financing costs that at September 2, 2004, amounted to \$255,000. The University Pooled Financing Program and Cultural Pooled Financing Program may operate in the weekly variable-interest-rate mode or may be converted to a fixed rate until maturity. The fixed-rate conversion requires the consent of all participants in the pools. At September 8, 2004, the bonds operated in the weekly variable mode and bore interest at 1.3 percent. The bonds are collateralized by certificates of deposit held by the trustee in amounts equal to 1.67 percent of the bonds outstanding.

The IFA-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 (weighted average rate at August 31, 2005, of 5.3 percent) and maturing from December 1, 2005, to December 1, 2013. 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 IFA-Series 1985 bonds and related interest until maturity. In 1993 this transaction was accounted for as an in-substance defeasance. In October 2003, \$35 million of the outstanding IFA-Series 1993 bonds were refunded with the issuance of the IFA-Series 2003 revenue bonds.

The IFA-Series 1976 and 1977 Demand Revenue Bonds were defeased on June 1 and July 1, 1996, respectively, through the issuance of commercial paper through the IFA-Series 1995 Pooled Financing Program. Principal payment on the 1985 demand revenue bond is also included in the program. The commercial paper, totaling \$35.8 million in aggregate principal, was prepaid in whole, without premium, on September 2, 2004. In addition, on July 15, 2005, the University began placing commercial paper under a new \$200 million commercial paper program.

The IFA-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 (weighted average rate at August 31, 2005, of 5.07 percent) and maturing from November 1, 2005, to November 1, 2015. The bonds are subject to mandatory tender at the stated dates and may be reissued in one of several permissible modes described in the agreements. The bonds will ultimately mature on November 1, 2032.

The IFA-Series 2003 Fixed-Rate Revenue Bonds totaling \$185 million were issued on October 29, 2003. The bonds were issued to acquire, construct, or renovate certain University facilities and to bring about the current refunding of \$35 million of the University's outstanding IFA-Series 1993 bonds, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Facilities Authority. The bonds were issued at a fixed rate of 5 percent and will mature from December 1, 2014, to December 1, 2038.

The IFA-Series 2004 Adjustable Rate Revenue Bonds, totaling \$135.8 million, were issued on September 9, 2004. The bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects on both the Evanston and Chicago campuses, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Facilities Authority. The bonds may operate in a daily, weekly, adjustable, or auction rate mode. In fiscal year 2005 the revenue bonds operated in a weekly rate mode, determined by the remarketing agents. The weekly interest rates at August 31, 2005, were 2.36 and 2.32 percent. The bonds will mature December 1, 2034.

The lending agreements covering the IFA demand revenue bond issues also provide that the third-party lender may purchase bonds, at a rate not exceeding the third-party lender's corporate base rate or prime rate (as defined), for which a demand has been made.

The lending agreements covering the demand revenue bond issues contain covenants that, among other things, require the University to maintain prescribed amounts of working capital (as defined). The covenants place certain limits on indebtedness and require holding investments in prescribed minimum amounts and maintaining certain financial ratios related to debt service, net assets to indebtedness, and assets to indebtedness. The University was in compliance with the covenants at August 31, 2005.

3. Contributions Receivable

Contributions receivable consisted of the following:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Unconditional promises expected to be collected in		
Less than one year	\$49,431	\$47,239
One year to five years	116,874	121,536
More than five years	43,986	47,285
Less discount to present value and other reserves		
Discount to present value	(40,842)	(43,698)
Other reserves	(6,666)	(10,096)
Total	\$162,783	\$162,266

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 manages the investment of endowment and trust assets, certain working capital, temporarily invested expendable funds, and commercial real estate. These assets are also managed either by Northwestern or by external equity investment managers, external and internal fixed-income and cash managers, and various limited partnership managers.

Substantially all 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 2005 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 4.1 percent of the market value of a unit in the pool, averaged for the latest 12 months. 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 5 percent. 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:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>		<i>August 31, 2004</i>	
	Cost	Estimated fair value	Cost	Estimated fair value
U.S. equity	\$639,974	\$791,726	\$606,498	\$696,255
International equity	517,303	693,679	421,014	525,356
Fixed income	677,507	692,771	741,219	758,561
High-yield credit	146,905	207,708	134,006	190,262
Absolute return	493,676	779,742	432,701	757,815
Private investments	901,322	763,817	773,365	582,238
Real estate	447,224	545,326	304,573	394,164
Other assets	23,510	37,467	59,796	78,798
Total investments	\$3,847,421	\$4,512,236	\$3,473,172	\$3,983,449

The University is committed to making future capital contributions in other investments in the amount of \$976 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:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>				
	Operations and plant	Quasi-endowment	Annuity and life-income	Permanent endowment	Total
Long-Term Balanced Pool	\$511,388	\$1,308,475	\$36,194	\$2,057,223	\$3,913,280
Intermediate-Term Bond Pool	435,345	21,190			456,535
Separately invested	160	14,248	87,523	4,989	106,920
Working capital	35,501				35,501
Total investments	\$982,394	\$1,343,913	\$123,717	\$2,062,212	\$4,512,236

<i>(in thousands of dollars)</i>	<i>August 31, 2004</i>				
	Operations and plant	Quasi-endowment	Annuity and life-income	Permanent endowment	Total
Long-Term Balanced Pool	\$357,750	\$1,153,010	\$32,931	\$1,776,046	\$3,319,737
Intermediate-Term Bond Pool	401,590	17,114			418,704
Separately invested	3,615	13,254	84,766	5,672	107,307
Working capital	137,701				137,701
Total investments	\$900,656	\$1,183,378	\$117,697	\$1,781,718	\$3,983,449

The following table is a summary of private investments where cost basis exceeds fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position. Based upon continuing analysis and evaluation, management has determined that declines in fair value are temporary and that these assets were not impaired at August 31, 2005.

	<i>August 31, 2005</i>					
	<i>(in thousands of dollars)</i>					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Private equity	\$17,891	\$437	\$112,125	\$71,761	\$130,016	\$72,198
International private equity	4,993	577	34,547	13,916	39,540	14,493
Venture capital	1,992	125	176,160	165,293	178,152	165,418
Separately invested			13,878	3,264	13,878	3,264
Total temporarily impaired securities	\$24,876	\$1,139	\$336,710	\$254,234	\$361,586	\$255,373

Investment Return

The components of total investment return were as follows:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>		<i>August 31, 2004</i>
Investment income		\$123,469	\$86,053
Net realized gains		507,015	308,686
Change in net unrealized gains on investments reported at fair value		151,125	156,295
Total investment return		\$781,609	\$551,034

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:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>		<i>August 31, 2004</i>
Changes in unrestricted net assets			
Operating: investment return		\$219,023	\$210,290
Nonoperating: investment gains reinvested		560,401	338,618
Changes in temporarily restricted net assets			
Investment return		2,185	2,126
Total investment return		\$781,609	\$551,034

Derivative Financial Instruments

The University used a swap agreement to hedge public real estate equity exposure and obtain S&P 500 equity index exposure. The market value of the underlying real estate assets hedged by the swap was \$9.4 million at August 31, 2005. In addition, the University had \$9.6 million S&P 500 equity index exposure related to the swap as of August 31, 2005. The swaps outstanding at August 31, 2005, had an unrealized loss of \$254,000. The swap settlements during 2005 resulted in a realized loss of \$1.5 million. At August 31, 2004, the market value of the underlying equity assets hedged by the swap was \$23.3 million. In addition, the University had \$22.7 million S&P 500 equity index exposure related to the swap as of August 31, 2004. The swaps outstanding at August 31, 2004, had an unrealized loss of \$763,000. The swap settlements during 2004 resulted in a realized loss of \$4.1 million.

The University also used a swap agreement to hedge small-cap equity exposure and obtain S&P 500 equity index exposure. The market value of the underlying small-cap equity assets hedged by the swap was \$23.2 million at August 31, 2005. In addition, the University had \$21.3 million S&P 500 equity index exposure related to the swap as of August 31, 2005. The swap settlements during 2005 resulted in a realized loss of \$2 million.

The University bought and sold futures contracts on a domestic equity index during 2005 and 2004 and incurred realized gains of \$3.1 million and \$4.7 million, respectively, on the purchase and sale of S&P 500 equity index futures contracts. As of August 31, 2005, and 2004, respectively, the University had 325 and 287 September S&P 500 index futures contracts outstanding. These contracts had an underlying notional value of \$99.2 million

and \$81.4 million, respectively; an unrealized gain of \$777,000 at August 31, 2005; and an unrealized loss of \$2.1 million at August 31, 2004.

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 contracts with a positive fair value at the reporting date.

The University manages its exposure to credit risk by utilizing 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 11 independent asset managers of Northwestern University funds totaling approximately \$520 million and \$362 million at August 31, 2005, and 2004, respectively.

Valuation of Permanent Endowment Funds

The University is monitoring endowment accounts in which historical cost was more than market value as of August 31, 2005. Historical cost and market value totals for these accounts were approximately \$3.9 million and \$2.2 million, respectively. In 2004 historical cost and market value totals for these accounts were approximately \$83 million and \$65.7 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. Participating employee and University contributions are immediately vested. The University contributed \$32.2 million and \$30.1 million to the two plans in 2005 and 2004, respectively. It expects to contribute \$34.2 million to the two plans in 2006.

The University currently sponsors a health care plan permitting retirees to continue participation on a "pay-all" basis, which requires a retiree contribution based on the average per capita cost of coverage for the entire plan 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 \$8.7 million and \$6.1 million at August 31, 2005, and 2004, respectively, and is included in accounts payable and accrued expenses on the consolidated statements of financial position.

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

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Active employees not yet eligible	\$3,299	\$2,767
Active employees eligible	3,149	2,506
Retirees	539	676
Total	\$6,987	\$5,949

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

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Benefit obligation at beginning of year	\$5,949	\$8,035
Service cost (benefits attributed to employee service during the year)	412	469
Interest cost on accumulated postretirement benefit obligation	352	517
Actuarial loss (gain)	437	(2,716)
Benefits paid	(1,138)	(1,308)
Contributions from participants	975	952
Benefit obligation at end of year	\$6,987	\$5,949

During fiscal year 2005 postretirement benefit payments (net of retirees' contributions) were approximately \$163,000.

The following table sets forth the plan's funded status:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Funded status	(\$5,771)	(\$5,061)
Unrecognized net actuarial loss	(505)	(68)
Unrecognized prior service cost	(711)	(820)
Total	(\$6,987)	(\$5,949)

The accrued benefit cost recognized in the consolidated statements of financial position, which is included in accounts payable and accrued expenses, was \$7 million and \$5.9 million at August 31, 2005, and 2004, respectively.

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

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Service cost (benefits attributed to employee service during the year)	\$412	\$469
Interest cost on accumulated postretirement benefit obligation	352	517
Amortization of prior service cost	109	109
Amortization of unrealized loss	0	195
Total	\$873	\$1,290

The discount rate used in determining the APBO was 5 percent and 6 percent as of August 31, 2005, and 2004, respectively. The assumed health care cost trend rate used in measuring the APBO in 2005 and 2004 was a graded table starting at 9 and 10 percent, respectively, and decreasing 1 percent each year to an ultimate rate of 5 percent.

	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Health care cost trend rate assumed	9%	10%
Rate to which the cost trend rate is assumed to ultimately decline	5%	5%
Year that rate will reach the ultimate trend rate	2009	2009

A one percentage point change in assumed health care cost trend rates would have had the following effects in fiscal year 2005:

	<i>1% increase</i>	<i>1% decrease</i>
Increase (decrease) in total of service and interest cost	\$114	(\$98)
Increase (decrease) in postretirement benefit obligation	614	(523)

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

<i>(in thousands of dollars)</i>	
2006	\$143
2007	214
2008	302
2009	350
2010	437
2011–2015	3,308
Total	\$4,754

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.

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." This FASB staff position 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. Measures of the APBO or net periodic postretirement benefit cost do not reflect any amount associated with the subsidy because the University does not expect to qualify. In the future, should the University qualify, it may elect to pursue the subsidy.

6. Land, Buildings, and Equipment

Land, buildings, and equipment consisted of the following:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Land and improvements	\$27,950	\$27,951
Buildings	1,480,270	1,337,525
Equipment	220,634	199,270
Accumulated depreciation	(575,975)	(518,063)
Total	\$1,152,879	\$1,046,683

At August 31, 2005, the University had under construction buildings that will cost approximately \$209.7 million. The estimated cost to complete this construction is \$100.3 million. Costs incurred through August 31, 2005, of \$109.4 million are included in land, buildings, and equipment. These buildings are being funded by loans, gifts (received or pledged), and grants.

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, 2005, and 2004. Those expenses have been distributed to the functional areas of the University as follows:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>		
	Depreciation	Plant maintenance	Interest on indebtedness
Instruction	\$9,114	\$14,984	\$3,083
Research	12,797	21,040	4,328
Academic support	13,796	22,682	4,666
Student services	5,806	9,545	1,964
Institutional support	3,870	6,363	1,309
Auxiliary services	17,043	28,018	5,764
Total	\$62,426	\$102,632	\$21,114

<i>(in thousands of dollars)</i>	<i>August 31, 2004</i>		
	Depreciation	Plant maintenance	Interest on indebtedness
Instruction	\$8,568	\$14,573	\$3,059
Research	11,160	18,981	3,985
Academic support	8,357	14,213	2,984
Student services	4,972	8,456	1,775
Institutional support	3,967	6,747	1,416
Auxiliary services	15,866	26,987	5,665
Total	\$52,890	\$89,957	\$18,884

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 \$80.3 million and \$79.5 million at August 31, 2005, and 2004, 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 2005 and 2004. 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 in excess of or less than the amounts provided.

Under an agreement between the University and Northwestern Medical Faculty Foundation, a proportionate share of professional liability insurance costs 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. NMFF has agreed to continue to bear a proportionate share of the primary medical professional liability costs that arise out of events prior to November 1, 2004. As of August 31, 2005, and 2004, accounts receivable from NMFF related to professional liability insurance costs totaled \$2.9 million and \$18.6 million, respectively.

The University has borrowed 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, and proceeds are applied to retire the debt amount. Additionally, the University has contracted to service these loans, which totaled \$228.6 million at August 31, 2005. Service revenues are the excess of the actual interest collected above a guaranteed rate of return 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 May 31, 2006, the University guarantees these loans against default up to 10 percent of the original loan portfolio amount. The maximum future total payments are \$22.9 million as of August 31, 2005. At August 31, 2005, and 2004, \$549,000 and \$541,000, 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 2005 and 2004.

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, 2005, and 2004, were as follows:

<i>(in thousands of dollars)</i>	<i>August 31, 2005</i>	<i>August 31, 2004</i>
Salaries, wages, and benefits	\$623,417	\$585,293
Services and professional fees	154,007	142,509
Supplies	64,365	59,880
Travel and promotion	54,275	50,545
Other expenses	73,815	46,713
Maintenance, utilities, and equipment	116,237	106,875
Interest on indebtedness	21,114	18,884
Depreciation	62,426	52,890
Total	\$1,169,656	\$1,063,589

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 specified that the custodian was responsible for lending of securities and obtaining adequate collateral from the borrower. Collateral was limited to cash, government securities, and irrevocable letters of credit. At August 31, 2005, and 2004, investment securities with an aggregate market value of \$654.9 million and \$539.9 million, respectively, were loaned to various brokers and were returnable on demand. In exchange, the University received cash collateral of \$561.7 million and noncash collateral of \$105 million at August 31, 2005, and cash collateral of \$479.6 million and noncash collateral of \$70.9 million at August 31, 2004. 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.

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