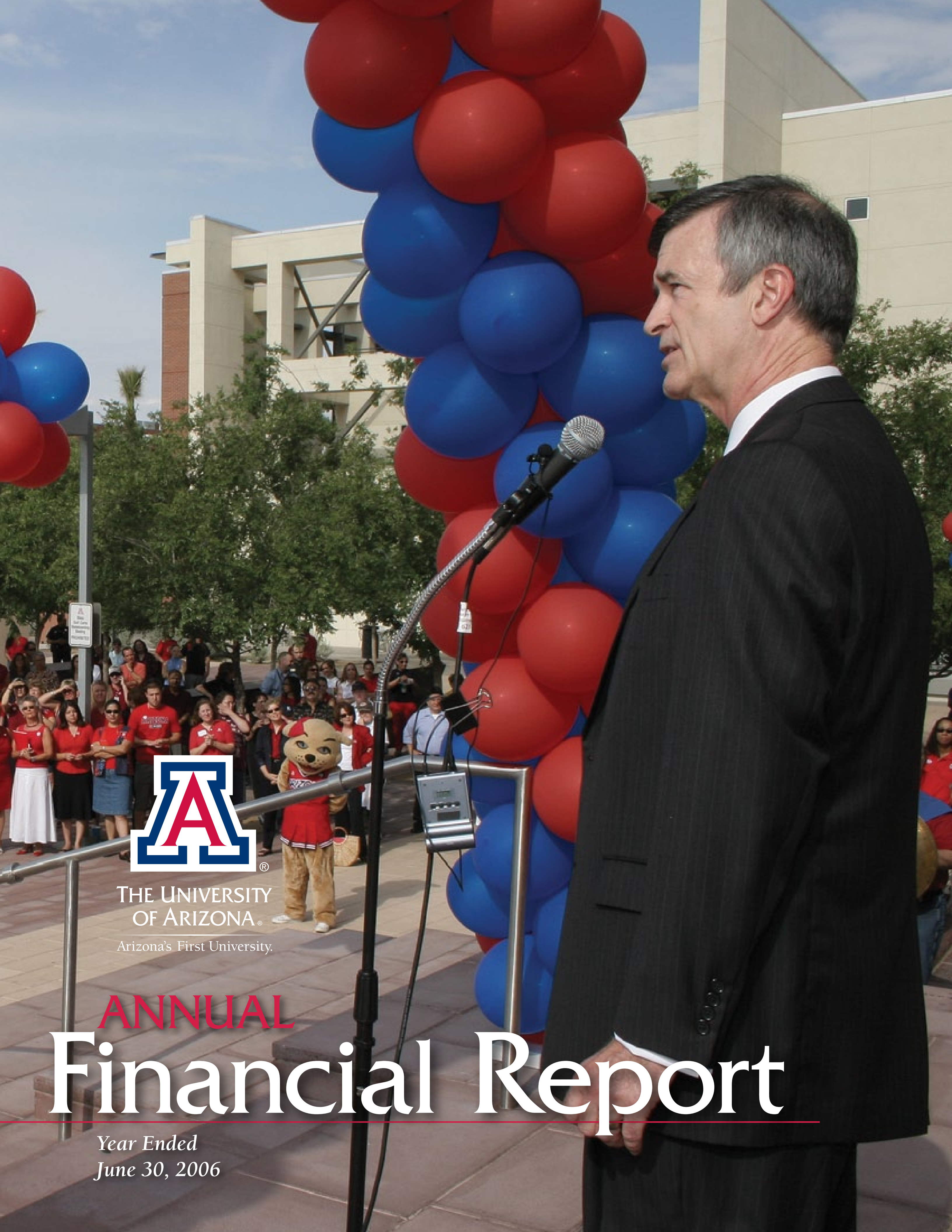
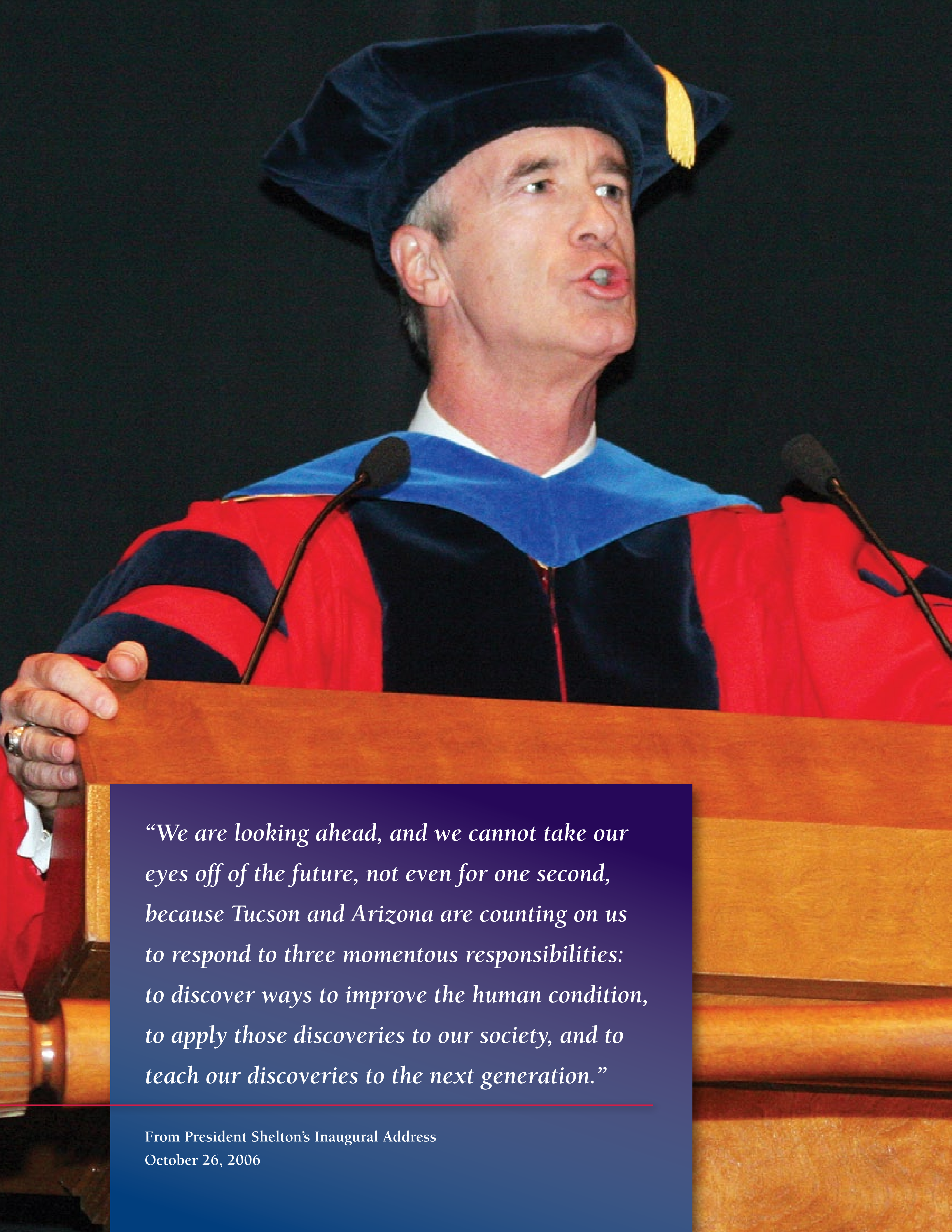


THE UNIVERSITY OF ARIZONA®

Arizona's First University.

ANNUAL Financial Report

Year Ended
June 30, 2006



"We are looking ahead, and we cannot take our eyes off of the future, not even for one second, because Tucson and Arizona are counting on us to respond to three momentous responsibilities: to discover ways to improve the human condition, to apply those discoveries to our society, and to teach our discoveries to the next generation."

From President Shelton's Inaugural Address
October 26, 2006

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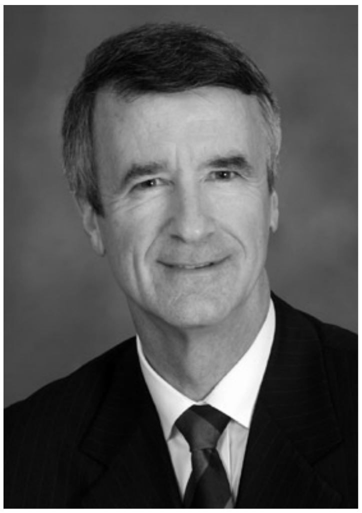
Martha Lochert Photography

A MESSAGE *from the* PRESIDENT



As I begin my tenure as the president of The University of Arizona, it gives me great pleasure to report that the overall finances of the University are very strong. The University's financial position has continued to improve through fiscal year 2006 with net assets increasing by $32.4 million. This is primarily the result of investments in capital assets, increased state appropriations, investment income and restricted gift donations. The University's operating revenues increased by $14.7 million with the primary source of this increase coming from tuition and fees by $11.7 million. State & local grants & contracts, sales and services of educational units, and auxiliary enterprises together provided the remainder. Our state appropriations grew from $355 to $378 million as the result of our governor and legislature providing funds towards faculty retention and staff merit along with dollars to assist in funding our ever increasing health insurance costs. Our investment income is on the road to recovery with growth in 2006 amounting to $2.4 million. Within this mix, it is important to note that our federal grants and contracts revenues declined by 4%. While this is important to note, it was primarily due to the reduced availability of funding from sponsors and the closure of some particularly large projects. In spite of this, our talented faculty continues to work diligently and successfully in the research arena.

The majority of images displayed in the annual report were taken at President Shelton's innauguration ceremony and celebration. The cover image portrays the welcoming celebration at President Shelton's first day on the job at The University of Arizona campus.

Portrait Photo: Margaret Hartshorn,
AHSC Biomedical Communications

Cover photos: Martha Lochert Photography

While our annual financial report and the detailed information therein is an important measure of our strength and progress, more important to me is our vast wealth of outstanding faculty, students, alumni, professionals and staff who work diligently and creatively in an effort to continually improve all facets of our mission. Our research university is on a very fast-moving cutting edge in a world defined not just by change, but by the ever-quickening pace of change. I plan to lead our university in such a way as to provide students with the high quality education they will need to advance our society through the mid-century. My focus will be to encourage and support efforts in keeping the engines of innovation firing, whether that means going to Mars, community interactions with students and faculty in music, dance and the theatre arts, showcasing our literary arts through our nationally renowned Poetry Center, advancing pharmaceutical research, pioneering artificial heart technology, or leading the optics revolution.

Woven into all of our goals for further achievement is our dedication to outreach to our Arizona citizens. We are very committed to our state community and are continually working towards making a positive impact and improving the state's ability to address the needs of our community. Dedication to our communities – sharing knowledge and pitching in to help with the great issues of the day – is what we will be actively pursuing as we move further into the 21st Century. I want Arizona always to believe in us, and I want it to expect great things from us. No matter how much change Arizona endures over the next century, the UA campus must always be the hallowed ground on which a bright future is built.

Robert Shelton
President

Institutional Profile

The University of Arizona was established as a land grant institution in 1885, 27 years before the Arizona Territory became a state. The years following World War II and the Korean War were a period of substantial growth for the University. In the late 1950s, enrollment greatly increased, with the University gaining an average of more than 1,200 additional students per year for 17 years. During this period, the foundation was laid for the development of a leading research institution. Today, the University serves about 37,000 students through 19 colleges offering 334 degree programs, and is ranked among the leading research universities in the country.

Enrollment Statistics
Academic Year 2005 – 2006

Undergraduate enrollment – Fall 2005	28,462
Graduate enrollment – Fall 2005	8,574
Degrees awarded – Bachelor's	5,749
Degrees awarded – Advanced	2,177
Tuition and fees for full-time student – Resident	$4,394
Tuition and fees for full-time student – Non-resident	$13,578

The University's 2,317 full time equivalent faculty and 1,334 full time equivalent graduate teaching and research assistants and associates educate a diverse student population. The student population is 53% female, 13.7% Hispanic, 5.5% Asian or Pacific Islander, 2.8% Black, and 2.1% Native American. It includes students from all fifty states, and 124 foreign countries. International students totaled 6.6% of the Fall 2005 enrollment, with the largest numbers of foreign students hailing from the People's Republic of China, India, Korea, Mexico and Japan.

Research Excellence

The University offers an unusually extensive and varied group of research, graduate and professional teaching programs. During the past 25 years the University has emerged as one of the top 26 universities in the nation (top 16 among public universities), according to the National Science Foundation. With its abundance of biological sciences, medical programs and interdisciplinary strengths, the University has tremendous potential for further research expansion.

The University was one of the original Carnegie Research I institutions. In 1985, the University was elected to membership in the Association of American Universities, a prestigious group limited to North America's preeminent public and private research universities.

Eminent research programs provide advances in applied and pure knowledge that fulfill the University's obligation to the State and the nation. Such programs attract truly distinguished faculty who serve the University's students through a comprehensive range of undergraduate and graduate programs.

High-quality research programs secure extensive federal and corporate funding that enriches instructional programs by providing tremendous education and research opportunities for the students, as well as helping to provide up-to-date facilities and equipment.

Strengths

A persistent theme in the University's history has been developing strengths based on its unique physical and cultural environment. Some examples follow:

- As Arizona's land grant institution, arid land agriculture, mining and geological studies became early focal points of a broad range of research, teaching and public service activities. The College of Agriculture and Life Sciences is dedicated to improving the quality of life for people in Arizona, the nation and the world. The Cooperative Extension Service has faculty and staff in all of Arizona's counties, on Indian Reservations, and in over 30 communities and research centers.

- The College of Agriculture received continued funding for a $9.7 million National Science Foundation award to map wild genomes of rice. This endeavor has broad implications for identifying disease resistant genes and improving the world's food supply.

- The Arizona Health Sciences Center (AHSC) is the State's only academic health sciences center, consisting of the Colleges of Medicine, Nursing, Pharmacy and Public Health. In conjunction with several independent non-profit health care organizations in Tucson (University Medical Center and University Physicians Healthcare), AHSC provides excellent education, research, and health care to the State and its people.

- In 2003, the National Cancer Institute (NCI) designated The University of Arizona Health Sciences Center's Arizona Cancer Center as a "comprehensive cancer center" and provided five years of increased funding. In 2006, U.S. News and World Report ranked the Arizona Cancer Center among the top 25 hospitals for cancer care in the nation. In the same report, Heart and Heart Surgery, Respiratory Disorders and Neurology/Neurosurgery reached the top 25 for care in those fields.

- AHSC serves as the core of a broad network of health services throughout the State with a focus on excellence in health promotion, health restoration and health maintenance. Ranked as the top program of its kind in the country, the Arizona Telemedicine Program provides faculty and other medical consultation to rural physicians and other health professionals through high-resolution video imaging.

- The clear skies of the Southwest have attracted generations of outstanding astronomers and planetary scientists and the telescopes they need. An assembly of major telescopes and facilities has helped to make the University a world center for astronomy and planetary sciences, with cooperative projects with Germany, Italy and the Vatican. This reputation will be enhanced by the international astrophysical observatory on Mt. Graham, and by recent international prominence gained from University designed and built instruments.

- The internationally-recognized College of Optical Sciences is a leader in science and engineering-related optics. Professor Roy J. Glauber, an adjunct professor in Optical Sciences, received the 2005 Nobel Prize in Physics with colleagues from Colorado and Germany. The Meinel Optical Sciences Center's expansion began in summer 2003 and will provide the campus with an improved optics instructional and research environment.

- Research of past cultures in Arizona has resulted in archaeological leadership in the Southwest setting. As an offshoot, this has led to leadership in the Classical and Middle East settings as well.

- The many Native American communities in the State have presented the University with opportunities not only to study and help preserve rich cultures, but also to assist these communities in their economic and educational development.

- Astronomy and archaeology provided the intellectual basis for development of a new science, dendrochronology. The study of tree rings as indicators of past environments is of increasing importance in identifying worldwide environmental trends.

- The location of the University, near the international boundary with Mexico, and the special social, economic, legal and political circumstances of the border zone provide outstanding educational, research and service opportunities in various Hispanic language, literature, and cultural programs.

- Faculty in the College of Humanities are working to study, catalog, and preserve extinct and endangered languages through grants from the National Endowment for the Humanities and the National Science Foundation.

- The Student Union Memorial Center, currently the largest of its kind in the country, offers a host of services and amenities to enhance the campus experience. Other than residence halls currently under renovation, it completes the major student-related building additions that will be needed to meet the enrollment increases expected over the next few years.

- The College of Engineering is home to the Sustainability of Water Resources in Semi-Arid Regions (SAHRA) project sponsored by the National Science Foundation. The SAHRA project aims, through research and outreach, to manage water resource systems and contribute to sustainability of adequate water supplies in semi-arid regions of the world. The director of this project recently won the International Hydrology Prize, widely regarded as the most prestigious award in the field.

- During fiscal year 2006, the Office of Technology Transfer (OTT) generated approximately $1.7 million dollars in licensing income, a growth of 40% over fiscal year 2005. Continuing basic business execution, the OTT executed a total of 43 Major Agreements compared to 46 in fiscal year 2005 despite changes in personnel. The University received 88 technically and administratively complete Invention Disclosures from faculty and staff and 13 U.S. Patents were issued to ABOR on behalf of the University. The OTT and its Licensees filed 39 full U.S. Patent Applications including divisional, continuation and PCT applications along with an additional 71 U.S. Provisional Patent Applications to provide a one-year evaluation period for various technologies.

Opportunities and Challenges

The University has been meeting the needs of the people of the State through numerous programs in business, engineering, and natural and medical sciences. Given continuing increases in population and the potential for economic growth, the State will increasingly face challenges and opportunities in areas as diverse as water resource management, transportation, education, land use planning, technology development and transfer, and the provision of jobs for a growing population. The University has assisted in attracting corporations to the State and, through its faculty and graduates, has stimulated important business enterprises, especially in optics and biotechnology. The latter has unique potential now, based on the University's strong programs in medicine, agriculture and science, and on rapidly expanding federal funding for biotechnology research.

Management regards the University as well positioned to continue its strong financial condition and service to students, patients, the research community, citizens of Arizona and our country. Future successes are largely dependent upon cost containment, the ability to recruit and retain the highest quality students, faculty and staff, and ongoing financial and political support from the State government.

The University is increasing its competitiveness in obtaining sponsored research funds by the expansion of laboratory-oriented facilities and by pursuing organizational and programmatic initiatives (e.g. optics, biotechnology, and medicine).

For instructional purposes the University is dependent upon State appropriations and tuition and fees, with gifts providing some additional revenues, primarily for scholarships. The main revenue sources for government services, including public education, are State sales and income taxes. Consequently, as the State economy continues to improve (or the State alters the tax base that supports government services), appropriated funds may increase slowly or moderately. Since resident tuition continues to be among the lowest of the public universities in the nation, there are opportunities to increase tuition, as long as financial aid resources also increase.

Martha Lochert Photography

Private gift contributions are an important supplement to the fundamental support from the State of Arizona and are a significant factor in the growth of academic, research, and patient care units. Economic pressures affecting donors may also affect the future level of support afforded the University from corporate and individual giving. Recently, the University, along with The University of Arizona Foundation, concluded its eight-year capital campaign and raised over one billion dollars in pledges and contributions.

The State is projecting rapid growth in college enrollment over the next ten years, and the University is making every effort to meet those needs, while continuing to preserve our standards of excellence and maintaining a leadership position in higher education.

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited the accompanying financial statements of the business-type activities and aggregate discretely presented component units of the University of Arizona as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts for the aggregate discretely presented component units, is based solely on the reports of the other auditors.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinions.

As described in Note 1, the University's financial statements are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only those portions of the business-type activities, major fund, and aggregate discretely presented component units of the State of Arizona that are attributable to the University. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2006, and the changes in financial position and cash flows, where applicable, for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and aggregate discretely presented component units of the University of Arizona as of June 30, 2006, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 1, the University implemented the provisions of Governmental Accounting Standards Board Statement No. 46, *Net Assets Restricted by Enabling Legislation*, for the year ended June 30, 2006, which represents a change in accounting principle.

The information included in A Message from the President, Institutional Profile, and the Management's Discussion and Analysis sections listed in the table of contents has not been subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we express no opinion on such information.

Debbie Davenport
Auditor General

October 11, 2006

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Management's Discussion and Analysis

Introduction

The following discussion and analysis provides an overview of the financial position and activities of the University for the year ended June 30, 2006. Information for the year ended June 30, 2005, is also provided for comparative purposes. This discussion was prepared by management and is focused on the University. It should be read in conjunction with the financial statements and accompanying notes, which follow this section.

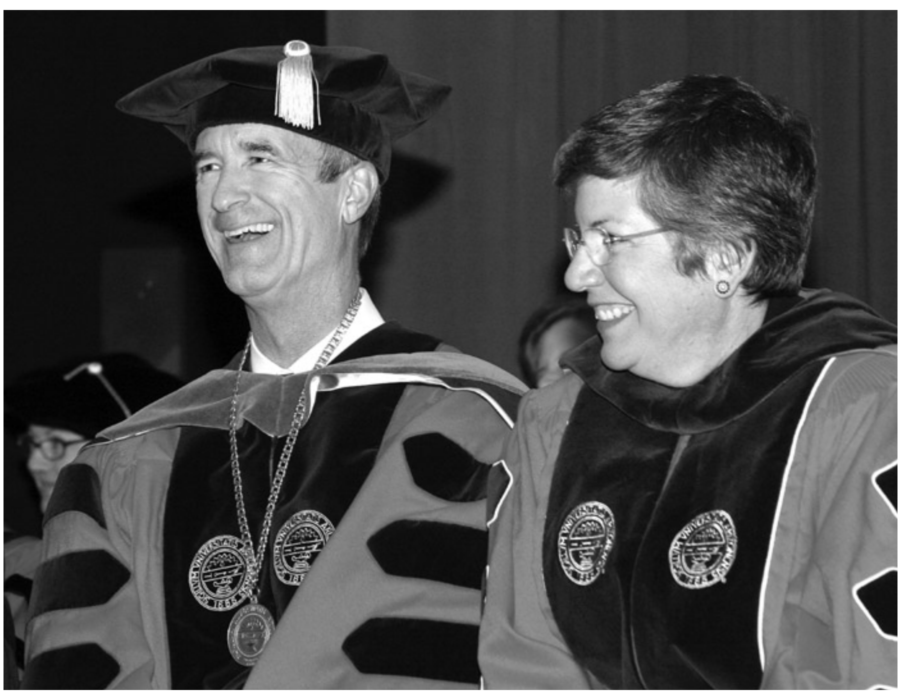
Using the Financial Statements

The University's financial report includes three statements: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows.

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. Assets and liabilities are classified as either current or noncurrent. Current liabilities are obligations that will be paid within one year of the statement date. Current assets are those resources available to satisfy current liabilities. The difference between total assets and total liabilities, referred to as net assets, is one indicator of the financial condition of the University. Generally, assets and liabilities are measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

The Statement of Revenues, Expenses and Changes in Net Assets provides information about the University's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and additions to endowments. Under the reporting standards, State appropriations, contributions and investment income are considered nonoperating revenues. As a result of these standards, the University typically will appear to operate at a loss. By comparison, the total change in net assets is a better indicator of whether the overall financial condition has improved or worsened during the year.

The Statement of Cash Flows reflects the inflows and outflows of cash and cash equivalents during the year. It shows the various cash activities by type, reconciling the beginning cash and cash equivalents amount to the ending cash and cash equivalents amount, which is shown on the Statement of Net Assets described above. In addition, this statement reconciles cash flows from operating activities to operating income/(loss) on the Statement of Revenues, Expenses and Changes in Net Assets described above.



Martha Lochert Photography

Condensed Financial Statement Information

STATEMENT OF NET ASSETS

A summarized comparison of the University's assets, liabilities and net assets (in thousands of dollars) at June 30, 2006, and at June 30, 2005, is as follows:

	2006	2005	% Change
Current assets	$ 336,074	$ 257,376	31%
Noncurrent assets other than capital assets	339,298	375,302	-10%
Capital assets	1,202,572	1,133,130	6%
Total assets	**$ 1,877,944**	**$ 1,765,808**	**6%**
Current liabilities	$ 195,355	$ 177,958	10%
Noncurrent liabilities other than debt	103,450	100,465	3%
Long-term debt	812,879	753,560	8%
Total liabilities	**$ 1,111,684**	**$ 1,031,983**	**8%**
Net assets			
Invested in capital assets, net of related debt	$ 388,472	$ 427,054	-9%
Restricted - nonexpendable	106,263	100,077	6%
Restricted - expendable	122,003	105,429	16%
Unrestricted	149,522	101,265	48%
Total net assets	**$ 766,260**	**$ 733,825**	**4%**

The University's financial position continued to improve in fiscal year 2006. Net assets increased by $32.4 million primarily due to gains on sales of land, increased state appropriations, investment income and restricted gift donations.

Current Assets and Current Liabilities

Current assets consist primarily of cash and cash equivalents, securities lending collateral, short-term investments and various receivables (primarily accounts receivable and government grants). Current liabilities consist primarily of trade accounts payable and accrued liabilities, securities lending obligations, deferred revenues, and the current portion of long-term debt payable. The University's 1.72:1 current ratio (current assets to current liabilities) reflects adequate liquidity and sufficient short-term ability to meet upcoming obligations.

During fiscal year 2006, the University continued to utilize a short-term hedge strategy, holding higher levels in cash and cash equivalents because of uncertain market conditions in other short-term investments. At the same time, the University continued to convert long-term fixed income investments into short-term fixed income investments to take advantage of the laddered short-term interest rate increases instituted by the Federal Reserve.

Net Assets

Restricted expendable net assets increased primarily due to increased lottery revenue distributions, gifts, and increased private grants for capital projects. The positive increase in restricted nonexpendable net assets is largely attributable to an increase in the fair market value of endowments and new gifts. Net investment in capital assets decreased as capital debt increased to support the University's mission. Unrestricted net assets increased primarily due to recognized gains on land sales.

Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the University's unrestricted net assets have been designated for various academic and research programs and initiatives, and for capital projects.

Office of University Communications, A. Espinoza

Martha Lochert Photography

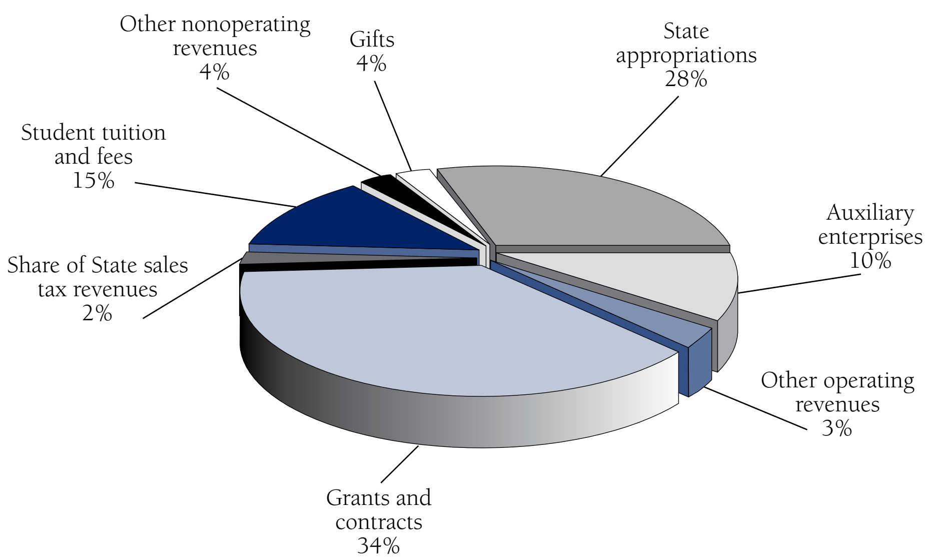
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

A summarized comparison of the University's operations (in thousands of dollars) for the year ended June 30, 2006, and for the year ended June 30, 2005, is as follows:

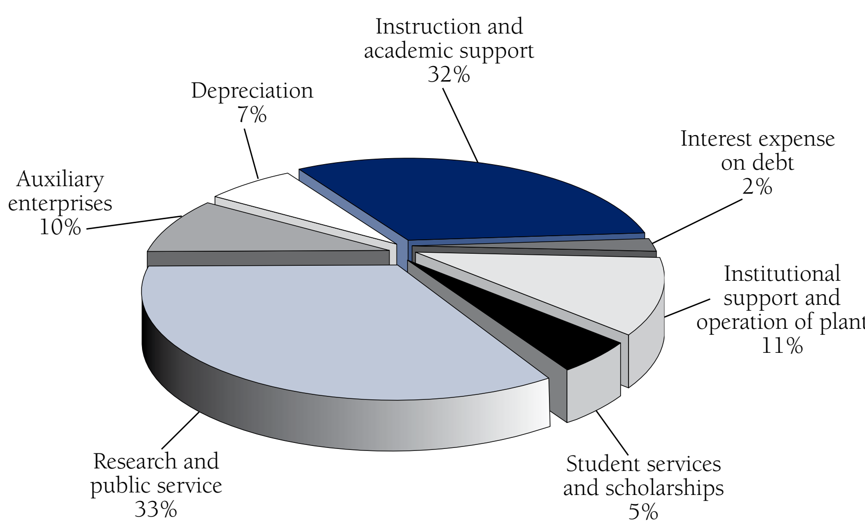
	2006	2005	% Change
Operating revenues			
Student tuition and fees	$ 193,498	$ 181,776	6%
Grants and contracts	425,189	437,818	-3%
Auxiliary enterprises	132,183	120,994	9%
Other operating revenues	33,823	29,365	15%
Total operating revenues	**$ 784,693**	**$ 769,953**	**2%**
Operating expenses			
Instruction and academic support	$ 398,517	$ 356,036	12%
Research and public service	416,134	415,203	0%
Student services and scholarships	63,513	71,409	-11%
Institutional support and operation of plant	145,880	130,154	12%
Auxiliary enterprises	122,042	113,629	7%
Depreciation	84,871	76,979	10%
Total operating expenses	**1,230,957**	**1,163,410**	**6%**
Operating loss	**$ (446,264)**	**$ (393,457)**	**13%**
Nonoperating revenues (expenses)			
State appropriations	$ 358,046	$ 333,692	7%
Share of State sales tax revenues	20,576	21,500	-4%
Gifts	51,111	42,156	21%
Investment income	25,742	23,301	10%
Interest expense on debt	(31,407)	(26,769)	17%
Other nonoperating revenues, net	28,958	3,233	796%
Net nonoperating revenues	**$ 453,026**	**$ 397,113**	**14%**
Income before capital and endowment additions	**$ 6,762**	**3,656**	**85%**
Capital and endowment additions	25,673	9,808	162%
Increase in net assets	**$ 32,435**	**$ 13,464**	**141%**
Net assets, beginning of year	**733,825**	**720,361**	**2%**
Net assets, end of year	**$ 766,260**	**$ 733,825**	**4%**

The following graphs illustrate operating and nonoperating revenues and expenses for the year ended June 30, 2006.

Operating & Nonoperating Revenues



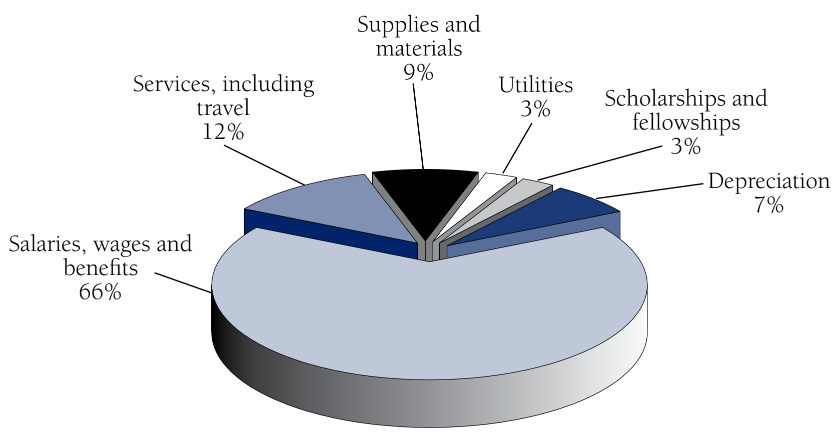
Operating & Nonoperating Expenses



In addition to programmatic (functional) classification of operating expenses, a summary of the University's expenses by natural classification (in thousands of dollars) for the years ended June 30, 2006, and 2005 follows:

Natural Classification of Operating Expenses:	**2006**	**2005**	**% Change**
Salaries, wages and benefits	$ 806,376	$ 739,880	9%
Supplies and materials	113,795	103,509	10%
Services, including travel	149,631	156,802	-5%
Utilities	39,761	38,925	2%
Scholarships and fellowships	36,523	47,315	-23%
Depreciation	84,871	76,979	10%
Total Operating Expenses	**$ 1,230,957**	**$ 1,163,410**	**6%**

Natural Classification of Operating Expenses for the year ended June 30, 2006



Operating revenues and expenses

Operating revenues: In fiscal year 2006, the University's operating revenues increased by $14.7 million, or 2%, over fiscal year 2005. The changes in revenues are as follows:

- **Student tuition and fees:** Tuition and fees rose by $11.7 million due to increased tuition rates. In-state undergraduate resident tuition and fees increased by $396, or 9.9%, to $4,394, while out-of-state undergraduate tuition and fees increased by $600, or 4.6%, to $13,578.

- **Federal grants and contracts:** Revenues declined 4% in fiscal year 2006. This decrease is directly related to the completion of large projects during the year. Revenues vary from year to year for many reasons, including the availability of funding from sponsors and the commencement or closure of particularly large projects.

- **State & local grants & contracts:** $15.1 million in state and local grants and contracts were received for the fiscal year, an increase of $1.6 million, or 11.9% from the previous year.

- **Nongovernmental grants & contracts:** Decreased by $0.6 million or 1% from the previous fiscal year.

- **Sales and services of educational units:** Increased from $22.1 million to $23.6 million. This was a 7% increase from 2005.

- **Auxiliary enterprises:** Increased from $120.9 million to $132.1 million. This was a 9% increase over the previous fiscal year.

Operating expenses: Operating expenses were $1.2 billion for the fiscal year ending June 30, 2006. This was an increase over the previous fiscal year of $67 million, or 6%. Expenses increased primarily due to increases in salaries and wages (3.9%), benefits (30.3%), supplies and materials (9.9%) and increased utility expenses (2%) driven by rising energy costs. Changes in the major categories of expense are as follows:

- **Total compensation** is comprised of academic and staff salaries, hourly compensation, and benefits. Compensation and benefits increased by 9% for the fiscal year, from $739 million to $806 million.
- **Scholarships & fellowships** decreased from $47 million to $36 million, a 23% reduction.
- **Utilities** had an increase of $0.8 million over the previous fiscal year, a 2% increase.
- **Supplies and materials** increased by 10% in 2006, from $103 million to $113 million.
- **Services, including travel** declined from $156 million to $149 million, a reduction of 5%.
- **Depreciation** expense of $84 million is $7.8 million more than 2005, an increase of 10%.

Nonoperating revenues and expenses

State appropriations: The appropriations, including the University's share of state sales taxes, rose from $355 million to $378 million, an increase of $23 million over the prior fiscal year. The increase of 6.5% in state appropriations and sales tax revenues is related to funding for enrollment growth, faculty retention, pay increases and higher health insurance costs.

Investment income: Fiscal year 2006 investment returns increased by $2.4 million over fiscal year 2005. This increase is attributable to pooled operating funds and capital projects funds with trustees, which are invested in short-term government debt instruments, coupled with measured increases in the Federal Funds Rate over the past year. Endowments are invested in a combination of externally managed equity and fixed income funds. Participation in these managed funds generated increased return and helped the Growth and Income Pool experience an annual return of 9.7% before administrative costs and payouts in fiscal year 2006. This represents an increase of 5.9% over last year's return. Investment returns by fund were as follows:

(in thousands of dollars)	2006	2005
Pooled operating funds	$ 8,613	$ 4,561
Deposits with trustees for capital projects	4,099	4,063
Endowments	13,030	14,677
Total investment income	$ 25,742	$ 23,301

Nonoperating expenses: Interest expense rose by 17% from $26.8 million in 2005 to $31.4 million in 2006 primarily due to the timing of initial interest payments on certificates of participation issued in fiscal years 2005 and 2006.

Other nonoperating revenues: Recognition of gains on sales of land contributed to the significant increase in other nonoperating revenues, which increased from $3.2 million to $28.9 million. This was a 796% increase over the previous fiscal year.

Capital and Debt Analysis

In fiscal year 2005-06, The University of Arizona completed construction of several high technology building projects for the research program and interdisciplinary academics. They were the Medical Research Building, Meinel Optical Science Center, Roy P. Drachman Hall Building, Chemistry Building, and the Agriculture Research Complex Shell Space Project. These new buildings provided relief to the University's space deficiency by adding approximately 281,000 gross square feet for research and 113,000 for interdisciplinary instruction. The total cost for constructing these facilities was $140.1 million, and the funding sources were from debt proceeds, gift funds, and University funds. Construction of the Medical Research Building and the Chemistry Building projects was made possible by the passage of House Bill 2529 into law in 2003. The State legislature made a commitment to invest in Universities research infrastructure, thereby approving funding debt service for research facilities constructed by the three Universities in the state.

The University administers construction projects and real estate acquisitions through a comprehensive Capital Improvement Plan (CIP) that is subject to annual approval by the Arizona Board of Regents. The Plan outlines the University's building inventory and capital improvement strategies for: addressing deficiencies in academic and research space; managing building renewal and deferred maintenance projects; and expanding student dormitory and parking capacities. New projects presented in the CIP would include project descriptions, justifications, and funding source(s) for the construction costs. A summary report of the University's debt capacity is also presented to demonstrate the ability to finance additional capital projects through debt instruments.

The University generally finances capital improvements and acquisitions through the issuance of debt with System Revenue Bonds (SRBs) and Certificates of Participation (COPs). Prior to the issuance of debt, a financing and funding plan must be submitted for review and approval by the State Joint Committee on Capital Review and the Arizona Board of Regents. The University must adhere to a debt ratio limit of 8% as defined by Arizona Revised Statutes §15-1683. The University's legislative debt ratio at the end of fiscal year 2005-06 was 2.9%.

During fiscal year 2005-06, the University issued System Revenue Bonds (bonds) Series 2005A for $35.6 million and Certificate of Participation Series 2006 for $17.8 million to finance the Architecture Building Expansion Project, the Poetry Center, Residence Life Building Renewal Phase II Project, Deferred Renovation and Building Renewal Project, and the Arizona Biomedical Collaborative facility in Phoenix. These projects will provide additional instructional and office space and enhanced building infrastructure for certain buildings and dormitories on campus. The estimated completion time for these projects is within two years. Detailed debt service information associated to these debt issues is available in Note 8 of the accompanying notes to the financial statements.

Economic Outlook

As the nation and State of Arizona continue to benefit from an improving economy, The University of Arizona continues to evaluate changes necessary to serve as a center for advanced graduate and professional studies while emphasizing research and providing excellence in undergraduate programs. University management continues to develop long and short term strategic plans to address this and other challenges to the financial health of the institution. At the same time, the Arizona Board of Regents and the three State universities are actively evaluating creative solutions to contain costs and generate new revenues in order to continue providing quality and affordable education.

Part of the strategic plan includes positioning the University for future expansion of externally sponsored research through capital improvements and additional facilities. The University plans to continue to improve its infrastructure in accordance with the Capital Improvement Plan discussed earlier. Ongoing planned projects include the Architecture Expansion and building renovations, Residence Life Building Renewal III, ICA Facilities, Medical Research Building (MRB), Institute of Biomedical & Biotechnology Science Building (IBBSB), Engineering Research Building – Phase I, Student Recreation Center Expansion & Renovation, Family and Consumer Sciences Bldg and the Arizona Biomedical Collaborative - Phoenix. At a time when other state legislatures were cutting appropriations and support to higher education, the Arizona State Legislature passed House Bill 2529 in support of expanded research infrastructure needs for each of the three State universities. This bill recognized the need for facilities to spur research activity and makes an investment in the future of The University of Arizona by providing needed long-term financing. The University is moving forward to create buildings that form the core of this new research infrastructure by completing the construction of the MRB and IBBSB facilities.

With current national trends in State appropriations continuing to decline, the University requested and received approval from the Arizona Board of Regents to increase tuition this past fiscal year. Due to increased financial needs to attract and retain talented faculty and staff, it is the intention of management to continue these requests until the University reaches the top of the bottom one third of the top fifty public institutions in tuition costs.

Since the University is ultimately subject to the same economic variables that affect other financial entities, it is not possible to predict future outcomes. Management is well aware of the challenges ahead and is working diligently to continue to provide quality instruction, research and public service to the State of Arizona and the nation.

Statement of Net Assets

June 30, 2006 (in thousands of dollars)

Assets

Current assets	
Cash and cash equivalents (Note 3)	$ 121,700
Securities lending cash collateral (Note 3)	27,916
Short-term investments (Note 3)	108,220
Receivables:	
Accounts receivable (net of allowances of $557)	19,262
Government grants receivable	47,079
Student loans (net of allowances of $185)	1,116
Inventories	8,606
Deferred expenses	2,175
Total current assets	**336,074**
Noncurrent assets	
Restricted cash and cash equivalents (Note 3)	20,163
Restricted investments with bond trustees (Note 3)	52,159
Long-term investments (Note 3)	33,315
Restricted investments held for others (Note 3)	32,696
Endowment investments (Note 3)	170,140
Student loans receivable (net of allowances of $1,388)	14,842
Long-term receivables	6,563
Deferred expenses	9,420
Capital assets, not being depreciated (Note 5)	154,153
Capital assets, being depreciated, net (Note 5)	1,048,419
Total noncurrent assets	**1,541,870**
Total Assets	**$ 1,877,944**

Liabilities

Current liabilities	
Accounts payable	$ 44,375
Accrued payroll and benefits	31,002
Accrued compensated absences (Note 7)	2,590
Obligations under securities lending (Note 3)	27,916
Deferred revenue and deposits (Note 6)	51,960
Funds held for others	8,003
Current portion of long-term debt (Note 8)	29,509
Total current liabilities	**195,355**
Noncurrent liabilities	
Deferred revenue and deposits (Note 6)	34,770
Accrued compensated absences (Note 7)	30,908
Funds held for others	37,772
Long-term debt (Note 8)	812,879
Total noncurrent liabilities	**916,329**
Total Liabilities	**$ 1,111,684**

Net Assets

Invested in capital assets, net of related debt	$ 388,472
Restricted for nonexpendable:	
Endowments	87,916
Student loans	18,347
Restricted for expendable:	
Scholarships and fellowships	29,560
Academic/departmental uses	78,282
Capital projects	5,938
Debt service	8,223
Unrestricted	149,522
Total Net Assets	**$ 766,260**

See Notes to Financial Statements

Statement of Financial Position - Component Units

June 30, 2006 (in thousands of dollars)

Assets

Cash and cash equivalents	$	66,958
Pledges receivable		58,675
Other receivables		3,066
Investments in marketable securities		312,053
Other investments		8,607
Property and equipment, net		14,667
Other assets		20,859
Total Assets	**$**	**484,885**

Liabilities and Net Assets

Liabilities

Accounts payable and accrued expenses	$	6,302
Annuities payable and other trust liabilities		20,246
Deferred revenue and deposits		3,844
Short-term and long-term debt		11,265
Other liabilities		301
Total Liabilities	**$**	**41,958**

Net Assets

Unrestricted	$	24,484
Temporarily restricted		148,316
Permanently restricted		270,127
Total Net Assets		**442,927**
Total Liabilities and Net Assets	**$**	**484,885**

See Notes to Financial Statements

Statement of Revenues, Expenses and Changes in Net Assets

Year Ended June 30, 2006 (in thousands of dollars)

Operating Revenues

Student tuition and fees, net of scholarship allowances of $76,190, pledged as security for long-term debt	$	193,498
Federal grants and contracts		346,275
State grants and contracts		12,523
Local grants and contracts		2,577
Nongovernment grants and contracts		63,814
Sales and services of educational departments, pledged as security for long-term debt		23,614
Auxiliary enterprises, net of scholarship allowances of $3,388, pledged as security for long-term debt		132,183
Other operating revenues, pledged as security for long-term debt		10,209
Total operating revenues	**$**	**784,693**

Operating Expenses

Educational and general		
Instruction	$	308,792
Research		352,409
Public service		63,725
Academic support		89,725
Student services		25,015
Institutional support		78,252
Operation and maintenance of plant		67,628
Scholarships and fellowships		38,498
Auxiliary enterprises		122,042
Depreciation (Note 5)		84,871
Total operating expense	**$**	**1,230,957**
Operating Loss	**$**	**(446,264)**

Nonoperating Revenues (Expenses)

State appropriations	$	358,046
Share of State sales tax revenues		20,576
Gifts		51,111
Investment income		25,742
Interest expense on debt		(31,407)
Other nonoperating revenues, net		28,958
Net nonoperating revenues	**$**	**453,026**
Income before Capital and Endowment Additions	**$**	**6,762**
Capital grants, gifts and conveyances	$	24,012
Additions to permanent endowments		1,661
Total capital and endowment additions	**$**	**25,673**
Increase in Net Assets	**$**	**32,435**

Net Assets

Net Assets - Beginning of year		733,825
Net Assets - End of year	**$**	**766,260**

See Notes to Financial Statements

Statement of Activities - Component Units

Year Ended June 30, 2006 (in thousands of dollars)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues				
Sales and services	$ 657			$ 657
Contributions	3,405	$ 30,087	$ 22,869	56,361
Rental revenues	7,331			7,331
Investment income	4,256	2,707	17,884	24,847
Net assets released from restriction	51,913	(42,833)	(9,080)	
Other income	9,477	4,568	84	14,129
Total revenues	**$ 77,039**	**$ (5,471)**	**$ 31,757**	**$ 103,325**
Expenses				
Program services:				
Leasing related expenses	$ 6,265			$ 6,265
Payments to the University	33,086			33,086
Payments on behalf of the University	22,361			22,361
Supporting services:				
Management and general	5,801			5,801
Fund raising	5,087			5,087
Other expenses	35			35
Total expenses	**$ 72,635**			**$ 72,635**
Increase/(decrease) in Net Assets	**$ 4,404**	**$ (5,471)**	**$ 31,757**	**$ 30,690**
Net Assets - Beginning of year	19,498	155,679	237,060	412,237
Transfers	582	(1,891)	1,309	
Net Assets - End of year	**$ 24,484**	**$ 148,317**	**$ 270,126**	**$ 442,927**

See Notes to Financial Statements

Statement of Cash Flows

Year Ended June 30, 2006 (in thousands of dollars)

Cash Flows from Operating Activities

Tuition and fees	$ 193,867
Grants and contracts	422,681
Payments for salaries, wages and benefits	(792,292)
Payments to suppliers	(286,402)
Payments for scholarships and fellowships	(42,021)
Loans issued to students	(33,543)
Collections on loans to students	32,871
Auxiliary enterprise receipts	133,135
Sales and services of educational departments	22,974
Other receipts	10,221
Net cash used for operating activities	**$ (338,509)**

Cash Flows from Noncapital Financing Activities

State appropriations	$ 363,932
Share of State sales tax receipts	24,643
Gifts and grants for other than capital purposes	52,424
Other nonoperating receipts	9,762
Federal Family Education Loans received	115,800
Federal Family Education Loans disbursed	(115,962)
Funds held for others received	74,170
Funds held for others disbursed	(68,731)
Net cash provided by noncapital financing activities	**$ 456,038**

Cash Flows from Capital and Related Financing Activities

Proceeds from issuance of capital debt, including premiums	$ 88,696
Capital grants and gifts received	15,100
Proceeds from sale of capital assets	21,850
Purchase of capital assets	(162,576)
Principal paid on capital debt and leases	(26,204)
Interest paid on capital debt and leases	(30,779)
Net cash used for capital and related financing activities	**$ (93,913)**

Cash Flows from Investing Activities

Proceeds from sales and maturities of investments	$ 455,751
Interest and dividends on investments	14,382
Purchase of investments	(439,233)
Net cash provided by investing activities	**$ 30,900**
Net Increase In Cash and Cash Equivalents	**$ 54,516**

Cash and Cash Equivalents

Cash and Cash Equivalents - Beginning of year	$ 87,347
Cash and Cash Equivalents - End of year	**$ 141,863**

See Notes to Financial Statements

Statement of Cash Flows (Concluded)

Year Ended June 30, 2006 (in thousands of dollars)

Reconciliation of Operating Loss to Net Cash Used for Operating Activities

Operating loss	$ (446,264)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation expense	84,871
Changes in assets and liabilities:	
Increase in:	
Receivables, net	(3,238)
Inventories	(1,469)
Deferred expenses	(1,003)
Accounts Payable	19,183
Accrued payroll and benefits and compensated absences	8,585
Deferred revenue and deposits	826
Net Cash Used For Operating Activities	**$ (338,509)**

Significant Noncash Transactions

Gifts and conveyances of capital assets	$ 3,027
Change in fair value of investments	(393)
Refunding of long-term debt (Note 8)	71,585
Amortization of bond discount and issuance costs	(1,902)
Amortization of bond premium	1,217
Net gain on disposal of capital assets with an original cost of $18,641, accumulated depreciation of $12,729 and cash proceeds of $20,133	14,221
Amortization of IBM deferred rent	4,900

See Notes to Financial Statements

Martha Lochert Photography

Notes to Financial Statements

NOTE 1. BASIS OF PRESENTATION & SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements include all activities that are directly controlled by the University. In addition, the financial statements include the financial position and activities of the University's discretely presented component units as described in Notes 2 and 14. Fiscal responsibility for the University remains with the State of Arizona; therefore, the University is considered part of the State's reporting entity for financial reporting purposes.

The financial statements are presented in accordance with U. S. generally accepted accounting principles (GAAP) applicable to governmental colleges and universities engaged in business-type activities as adopted by the Governmental Accounting Standards Board (GASB). The University follows Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, Accounting Principles Board Opinions, and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements. The University has chosen the option not to follow FASB Statements and Interpretations issued after November 30, 1989.

The component units are legally separate private nonprofit organizations that report under FASB standards. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the component units' financial information included in the University's financial report. Accordingly, those financial statements have been reported on separate pages following the respective counterpart financial statements of the University.

During the year ended June 30, 2006, the University implemented the provisions of GASB Statement No. 46 – *Net Assets Restricted by Enabling Legislation,* an amendment of GASB Statement No. 34. Statement No. 46 requires that net assets at the end of the reporting period that are restricted by enabling legislation be disclosed in the notes to financial statements. The implementation of Statement No. 46 had no effect on the reported amounts for the University's net assets.

The financial statements include a Statement of Net Assets; a Statement of Revenues, Expenses and Changes in Net Assets; and a Statement of Cash Flows.

- The Statement of Net Assets provides information about the assets, liabilities, and net assets of the University at June 30. Assets and liabilities are classified as either current or noncurrent. Current liabilities are obligations that will be paid within one year of the statement date and current assets are those resources available to satisfy current liabilities. Net assets are the residual amounts and are classified according to external donor restrictions and availability of assets to satisfy University obligations. Invested in capital assets, net of related debt, represents capital assets less accumulated depreciation and the amount of related outstanding debt for those assets. Nonexpendable restricted net assets are gifts received for endowment purposes and revolving student loan funds, the corpus of which cannot be expended. Expendable restricted net assets represent grants, contracts, gifts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.

- The Statement of Revenues, Expenses and Changes in Net Assets provides information about the University's financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported, including capital contributions and additions to endowments. Operating revenues and expenses generally result from providing instructional, research, public, and auxiliary services, which are consistent with the University's mission. Accordingly, revenues generated by the University for instruction, research and other activities are considered to be operating revenues. Other revenues, such as State appropriations and gifts, are not generated from operations and are reported as nonoperating revenues. Operating expenses include the cost of sales and services, administrative expenses, and depreciation of capital assets. Other expenses, such as interest expense on debt, are considered to be nonoperating expenses.

- The Statement of Cash Flows provides information about the University's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, noncapital financing, capital and related financing, or investing activities.

The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. The University eliminates all internal activity.

Significant Accounting Policies

The methods of applying GAAP that materially affect financial presentation are summarized below:

Cash and Investments

- Cash equivalents include all highly liquid investments with an original maturity of 90 days or less.

- Investments are stated at fair value at June 30. Fair value typically is the quoted market price for securities.

- Investment income includes interest and dividend earnings and changes in fair value of investments during the fiscal year from the investment of endowment, operating and trustee funds.

Endowment Spending Rate Policy – Arizona State law permits the University to expend the entire net appreciation of endowment fund investments. When determining the spending rate for endowment funds, the Investment Committee and University administration consider long- and short-term needs, total investment return and price level trends, and general economic conditions. For fiscal year 2006, the expendable rate was established at 4% of the three year average market value ending December 31, 2004. Donor restricted endowments that are available for expenditure are reported as restricted and expendable on the Statement of Net Assets.

Inventories – Inventories consist primarily of bookstore items and resale supplies. They are stated at the lower of cost (determined by the first-in, first-out or the weighted average method) or market.

Capital Assets, Special Collections and Historical Treasures

- Capital assets are stated at cost at the date of acquisition or, if donated, at fair market value at date received.

- The University maintains special collections and historical treasures for educational purposes and public exhibition. These special collections include Kress, Pfiefer, and Gallagher artwork, Ansel Adams, Richard Avedon, and Edward Westin photography collections, American Indians of the Southwest archeological collection, pottery whole vessel collection, and several medical and law book collections. They are not subject to disposal for financial gain or encumbrance. Accordingly, such collections are not capitalized for financial statement purposes but are inventoried for property control purposes.

- Interest incurred during the construction phase of projects is capitalized, net of interest earned on the invested proceeds over the same period.

- Capital assets, other than land and construction in progress, are depreciated over their estimated useful lives using the straight line method. The capitalization thresholds and estimated useful lives for capital assets of the University are as follows:

Asset Category	Capitalization Threshold ($)	Estimated Useful Life (yrs)
Infrastructure	100,000	20 - 100
Buildings and improvements	100,000	20 - 50
Equipment	5,000	3 - 25
Library materials	1	10
Land	1	n/a
Construction in progress	5,000	n/a

Scholarship Allowances – A scholarship allowance is the difference between the stated charge for tuition and fees and the amount paid by the student or third parties making payments on behalf of the student. Accordingly, some types of student financial aid such as fee waivers, Pell grants, and scholarship awards are considered to be scholarship allowances if used to pay tuition and residence fees. These allowances are netted against tuition and auxiliary revenues in the Statement of Revenues, Expenses and Changes in Net Assets.

Restricted and Unrestricted Resources – The University has both restricted and unrestricted resources available for most programs. Restricted resources are externally restricted for a specific purpose and primarily include sponsored research grants and contracts and gifts. The University's policy regarding whether to first apply restricted or unrestricted resources is made on a case-by-case basis. Restricted resources remain classified as such until spent.

Net Assets Restricted by Enabling Legislation – At June 30, 2006, the University reported restricted net assets of $228,266,000, of which $34,845,000 is restricted by enabling legislation.

NOTE 2. COMPONENT UNITS

The financial statements of the University include the operations of The University of Arizona Foundation, Inc., The University of Arizona Alumni Association, the Law College Association of The University of Arizona and the Campus Research Corporation, all discretely presented component units. For financial reporting purposes, only the statement of financial position and statement of activities are included in the University's financial statements as required by U.S. generally accepted accounting principles for public colleges and universities. Discretely presented component units are reported on separate pages following the University's respective counterpart financial statements because those component unit financial statements are prepared in accordance with non-governmental U.S. generally accepted accounting principles (i.e., FASB). Each discretely presented component unit discussed below has a June 30 year-end with the exception of the Law College Association which has a May 31 year-end.

Component units can be defined as legally separate entities for which the University is considered to be financially accountable. GASB Statement No. 14 – *The Financial Reporting Entity* has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the University to impose its will on that organization; or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the University. GASB Statement No. 39 – *Determining Whether Certain Organizations Are Component Units* provides additional criteria for determining whether certain organizations are component units. Organizations that are legally separate, tax-exempt entities and that meet all of the following criteria should also be considered component units, with discrete presentation. These criteria are (1) the economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the University, its component units, or its constituents; (2) the University or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization; and (3) the economic resources received or held by an individual organization that the University, or its component units, is entitled to, or has the ability to otherwise access, are significant to the University.

Discretely Presented Component Units

The University of Arizona Foundation, Inc. (Foundation) is a legally separate, nonprofit, tax-exempt organization controlled by a separate Board of Directors. The principal goals of the Foundation are to support the University through various fund-raising activities, and to contribute funds to the University in support of various programs. Although the University does not control the timing or amount of receipts from the Foundation, the Foundation's restricted resources are significant to the University and can only be used by, or for the benefit of, the University or its constituents. As the University is also entitled to these resources, the Foundation is considered a component unit of the University and is discretely presented in the University's financial statements. The Foundation's financial statements are not publicly available. For information regarding the Foundation's financial statements, contact The University of Arizona Comptroller at the following address: University of Arizona, Financial Services, P.O. Box 3310, Tucson, Arizona 85722-3310.

The University of Arizona Alumni Association (Alumni Association) is a legally separate, tax-exempt, nonprofit corporation governed by a separate Board of Directors and was established to serve the University and its graduates, former students, and friends by attracting, organizing and encouraging them to advance the University's missions – teaching, research, and public service. There is an Administrative Service Agreement between the Alumni Association and the University whereby the University provides staff, facilities and services to the Alumni Association and the Alumni Association agrees to provide an organizational framework for volunteer service and other activities to benefit and promote the University. As the economic resources held by the Alumni Association are significant to the University and are entirely or almost entirely for the direct benefit of the University, and as the University is entitled to a majority of the economic resources received or held by the Alumni Association, it is considered a component unit of the University and is discretely presented in the University's financial statements. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the Alumni Association at the following address: Alumni Association, University of Arizona, P.O. Box 210109, Tucson, Arizona 85721-0109.

The Law College Association of The University of Arizona (Law Association) is a legally separate, tax-exempt, nonprofit corporation governed by a separate Board of Directors and was established to provide support and financial assistance to the College of Law at The University of Arizona. The Law Association funds provide support to the College on many levels, from endowed student scholarships to named faculty professorships. The funds also provide support for various academic programs. As the economic resources held by the Law Association are significant to the University and are entirely or almost entirely for the direct benefit of the University, and as the University is entitled to a majority of the economic resources received or held by the Law Association, it is considered a component unit of the University and is discretely presented in the University's financial statements. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the Law Association at the following address: Law College Association, University of Arizona, P.O. Box 210176, Tucson, Arizona 85721-0176.

Campus Research Corporation (CRC) is a legally separate, tax-exempt, nonprofit corporation governed by a separate Board of Directors and was established to assist the University in the acquisition, improvement, and operation of the UA Science and Technology Park (Park) and related properties. CRC currently leases from the University the remaining 32% of building space of the Park not leased to the Arizona Research Park Authority. CRC is responsible for assisting in the development of the presently undeveloped portions of the Park and for subleasing unoccupied space, newly developed space, and space now occupied by IBM or its subtenants once the current subleases expire. The University is responsible for payment of the operational expenses associated with the space occupied by University departments, offices, and programs. All income received by CRC from its activities, after payment of expenses and financial reserves, will be distributed to the University. During fiscal year 2006, no funds were distributed to the University. As the University approves CRC's budget, fiscal dependency exists between the entities, making CRC a component unit. As CRC provides services to all tenants of the Park, not just the University, by acting as the property management company, CRC is presented as a discrete component unit in the University's financial statements. Complete copies of the financial statements of the aforementioned component unit can be obtained by contacting the Chief Financial Officer at the following address: University of Arizona Science and Technology Park, 9040 South Rita Road, Suite 1400, Tucson, Arizona 85747.

NOTE 3. DEPOSITS & INVESTMENTS

A. General

At year end, the University's deposits totaled $43,133,000, while investments had a fair value of $495,260,000. In addition, under securities lending arrangements, the University held cash collateral investments of $27,916,000. These balances are considered in our analysis of deposit and investment risk. The required disclosures are included in sections B and C of this footnote. Note that where the University has engaged in securities lending, the footnote disclosures include the cash collateral investments, while excluding the securities lent. Further required disclosures related to the University's securities lending activities are presented separately in section D of this footnote.

Included in the University's deposits and investments are capital project funds totaling $67,592,000, which are held in trust by various commercial banks. Of this amount, $52,159,000 is available for future construction costs, and $15,433,000 is from bond proceed earnings for unrestricted purposes. Trust funds are invested in accordance with the Board's authorizing resolutions, as disclosed in section B of this footnote.

In addition, endowment funds make up a portion of the deposits and investments. These funds are primarily invested in the Consolidated Endowment Growth/Income Pool. Included within the pool are balances invested on behalf of the Arizona Student Financial Aid Trust (ASFAT). The University currently invests all funds for ASFAT, which was established by the Arizona Board of Regents and is funded by the Arizona State Legislature and student fees. Funds invested for other universities are recorded as investments held for others and include the following at fair value: Arizona State University - $23,482,000 and Northern Arizona University - $9,214,000. The University's ASFAT funds are recorded as endowment investments at $17,004,000.

Also included within the endowment funds are certain endowments held by external trustees. At June 30, 2006, University endowments totaling $17,657,000 are held and invested by bank trustees according to donor specifications. These externally held endowments are further discussed in the custodial credit risk disclosure in section C of this footnote.

B. Statutory and Board of Regents' Policies

Arizona Revised Statutes require that deposits of the University, not covered by federal deposit insurance, be secured by government bonds or by a safekeeping receipt of the institution accepting the deposit. Further policy regarding deposits is provided by the Arizona Board of Regents. According to Board policy, deposits can be made only at depository banks approved by the Board.

The Statutes do not specifically address the investment policy of the University; rather Board of Regents' policy governs in this area. Board policy requires that the University arrange for the safekeeping of securities by a bank or other financial institution approved by the Board. Also under Board policy, the University is limited to investing its pooled operating funds and capital projects funds in collateralized certificates of deposit and repurchase agreements with commercial banks, United States Treasury securities and other Federal agency securities or in the government investment pool administered by the State Treasurer's Office.

With regard to endowments, Board of Regents' policy dictates that these funds are to be invested under the direction of an investment committee designated by the president of each university. At The University of Arizona, the investment committee is responsible for defining, developing, and implementing investment objectives, policies, and restrictions. However, if donors restrict investments, Board policy requires that the University invest those funds separately as directed by the donor, and the individual endowments bear all changes in value.

Neither the Statutes nor Board policies include any specific requirements for concentration of credit risk, interest rate risk, or foreign currency risk for investments of the universities.

C. Deposit & Investment Risk

Custodial Credit Risk:
University policy requires collateralization for all certificates of deposit, repurchase agreements and cash balances held in the controller's demand deposit account. Beyond this requirement and those established by Statute or the Board, the University does not have a policy that specifically addresses custodial credit risk. At June 30, 2006, $17,657,000 of the University's total deposits and investments is exposed to custodial credit risk as follows: some of the University's endowment funds are held by trustees. These deposits and securities are held by the counterparties in the names of the individual donors as irrevocable trusts for the benefit of the University.

Credit Risk:
With regard to credit risk, University policy mirrors that of the Board in that it restricts investment of the operating and capital projects funds to collateralized certificates of deposit and repurchase agreements, United States Treasury securities and other Federal agency securities or the State Treasurer's investment pool. University policy also dictates that government debt securities must be used to collateralize certificates of deposit and repurchase agreements to conform to Statute. When investing endowment funds, University policy requires corporate bonds and notes to be of investment grade quality, rated Baa or higher by Moody's Investor Service, at the time of purchase. The Moody's credit quality ratings for the University's investments in debt securities at June 30, 2006, are disclosed in the following table:

			Moody's					
Investment Type	**Fair Value**	**Not Rated**	**AAA**	**AA**	**A**	**BAA**	**BA**	**B**
State Treasurer's Pool	$ 922,000	922,000						
Securities Lending Pool	21,567,000	21,567,000						
Federal Agency Securities	128,200,000		128,200,000					
Indexed Treasury Bond Fund	1,220,000		1,220,000					
Money Market Mutual Funds	70,550,000	70,550,000						
Corporate Bonds	31,591,000	1,628,000	5,100,000	9,223,000	12,836,000	2,599,000	205,000	
International Fixed Income Fund	8,443,000		6,713,000	168,000	768,000	401,000	234,000	159,000
Corporate Bond Funds	1,368,000			1,368,000				
Municipal Bonds	1,679,000		1,369,000	310,000				
Other Investments	152,000	152,000						
Totals	**$265,692,000**	**94,819,000**	**142,602,000**	**11,069,000**	**13,604,000**	**3,000,000**	**439,000**	**159,000**

Concentration of Credit Risk:
Other than United States Treasury securities and other Federal agency securities, which can represent greater than 5% of total investments, University policy limits investment in a single issuer to 5% or less of the fair value of the total portfolio. Save for those issuers allowed by policy, the University does not have an investment in any single issuer that exceeds 5% of the overall portfolio. At June 30, 2006, the University had investments in FNMA, FHLB, and FHLMC agency securities with a fair value of $61,204,000, $34,899,000 and $27,142,000 or 11%, 6.5% and 5% of total investments, respectively.

Interest Rate Risk:
The University's investment policy for the operating funds limits a significant proportion, although not a fixed percentage, of the portfolio to authorized securities with maturities of one year or less. Also, the maximum maturity of any fixed rate issue may not exceed three years and the final maturity of any floating rate issue may not exceed five years. The capital projects and endowment funds portfolios have no such limitation. The following chart presents the interest rate risk for the University's debt investments at June 30, 2006, utilizing the segmented time distribution method:

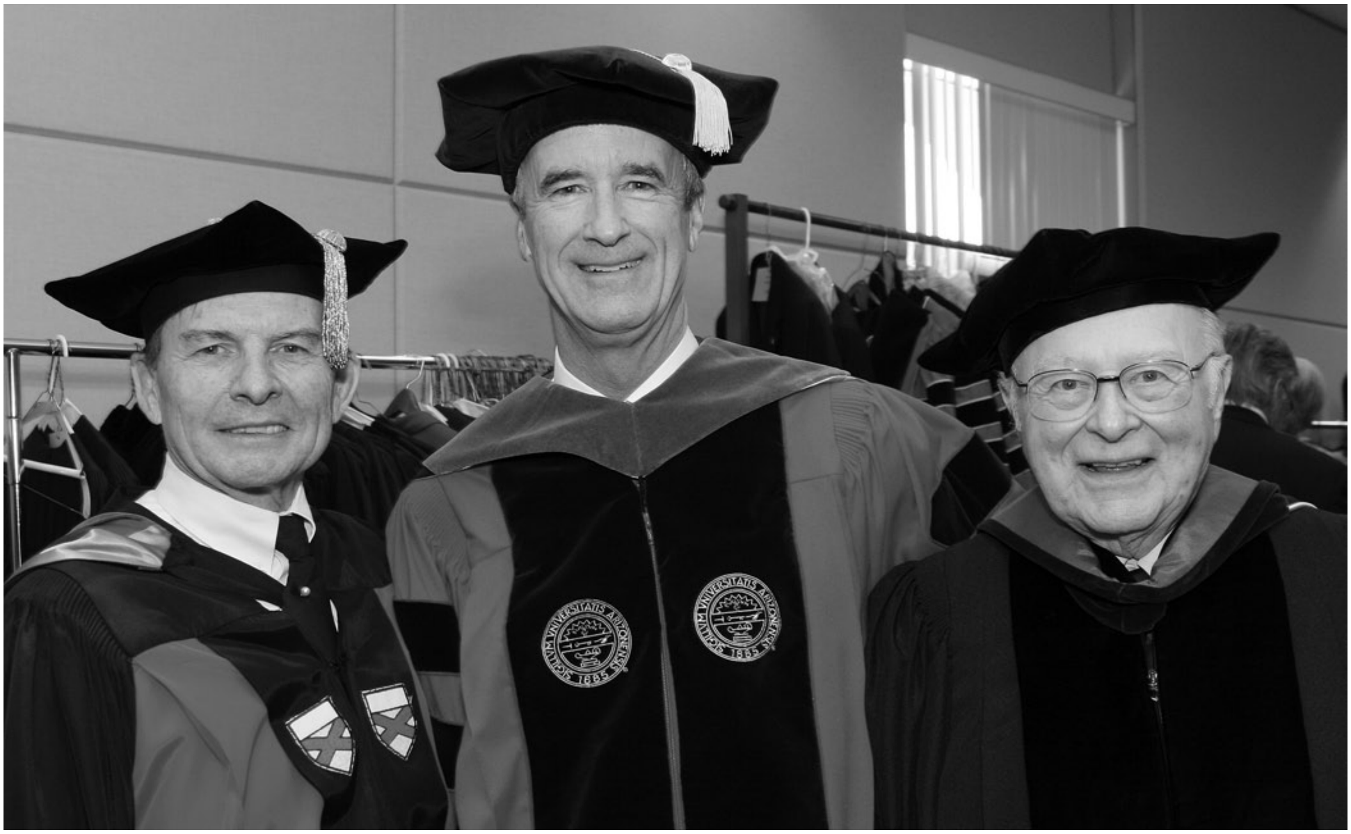
			Maturity Date			
Investment Type		**Fair Value**	**<1 Year**	**1-5 Years**	**6-10 Years**	**> 10 Years**
State Treasurer's Pool	$	922,000		922,000		
Securities Lending Pool		21,567,000	21,567,000			
US Treasury Securities		459,000		83,000	65,000	311,000
Repurchase Agreements		94,202,000	94,202,000			
Money Market Mutual Funds		70,550,000	70,550,000			
Federal Agency Securities		128,200,000	109,027,000	15,697,000	1,462,000	2,014,000
Indexed Treasury Bond Fund		1,220,000				1,220,000
Corporate Bonds		31,591,000	4,230,000	19,511,000	7,140,000	710,000
International Fixed Income Fund		8,443,000	2,406,000	2,438,000	1,996,000	1,603,000
Corporate Bond Funds		1,368,000		855,000	384,000	129,000
Municipal Bonds		1,679,000		149,000	311,000	1,219,000
Other Investments		339,000	152,000	108,000	74,000	5,000
Totals	**$**	**360,540,000**	**302,134,000**	**39,763,000**	**11,432,000**	**7,211,000**

At June 30, 2006, the University held $128,200,000 or 24% of investments in Federal agency securities, including FNMA, FHLB, FFCB, and FHLMC, which may be considered to be highly sensitive to interest rate fluctuations. However, most of the balance for these securities, $109,027,000 or 20% of total investments, had a maturity of less than one year, limiting the University's exposure to interest rate risk.

Foreign Currency Risk:
University policy allows no more than 20% of the endowment fund portfolio to be invested in foreign-based companies. Other funds may not be invested in international securities. At June 30, 2006, the University held investments in two international mutual funds, Julius Baer Institutional International Equity Strategy Fund and Brandywine International Opportunistic Fixed Income Portfolio, for $25,042,000 (13%) and $8,350,000 (4%) of the endowment portfolio, respectively.

D. Securities Lending

During the fiscal year, the University engaged in securities lending transactions within the endowment funds, as authorized by the Board of Regents. The University entered into an agreement with Wells Fargo, the University's custodial bank, to carry out these transactions. The custodial bank enters into agreements with brokers to loan securities and have the same securities returned at a later date. It is the policy of Wells Fargo to receive as collateral at least 102% of the market value of the loaned securities and accrued interest, and maintain collateral at no less than 100% for the duration of the loan. At year end, the University has no credit risk to borrowers because the University was holding more collateral than the amount of loaned securities outstanding. The University records the collateral received as an asset, which is offset by an obligation recorded under securities lending. During the fiscal year ended June 30, 2006, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses. Wells Fargo does indemnify the University against losses due to borrower defaults. Collateral can be received in the form of U.S. Government securities, letters of credit, or cash. As of June 30, 2006, the custodial bank has received only cash collateral. This collateral may be invested in United States Treasury and sponsored agency obligations, repurchase agreements, bankers' acceptances, commercial



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paper, mortgage-backed securities, municipal securities, and corporate bonds or in a cash collateral investment pool, which invests in similar securities. At June 30, 2006, cash collateral received from borrowers was invested in the cash collateral investment pool and corporate bonds, which had a weighted average maturity of 3 days and 377 days, respectively, and represented 78% and 22% of cash collateral investments, respectively. The relationship between the maturities of the cash collateral investment pool and the University's securities loans is affected by the maturities of the securities loans made by other entities that use the custodial bank's pool, which the University cannot determine. However, the University or the borrower can terminate securities loans on demand. Other cash collateral investments are made such that their maturities will match those of the related securities loans. Such matching existed at year-end. At June 30, 2006, cash collateral investments totaled $27,916,000 while the market value of securities on loan was $27,270,000. Securities lent for cash collateral included corporate stocks and bonds, and U.S. government and agency notes and bonds. The University cannot sell or pledge any securities received as collateral unless the borrower defaults. The University earns a negotiated fee for participating in securities lending activities.

NOTE 4. JOINT VENTURE

The University is a participant in the Large Binocular Telescope Corporation (LBT). LBT was formally incorporated as a nonprofit corporation in August 1992 pursuant to a Memorandum of Understanding, as amended, executed on February 24, 1989, between the University and Arcetri Astrophysical Observatory in Florence, Italy (Arcetri). The purpose of the joint venture is to design, develop, construct, own, operate, and maintain a binocular telescope currently being constructed in Arizona. The current members of LBT are the University, Arcetri, Research Corporation, Ohio State University, and LBT Beteiligungsgesellschaft (LBTB).

The University has committed resources equivalent to 25% of LBT's construction costs and annual operating costs. As of June 30, 2006, the University has made cash contributions of $18,159,000 toward the project's construction costs. The University's financial interest represents future viewing/observation rights. Upon completion of construction, these rights will be divided among the participants in proportion to their contributions. According to the audited financial statements of LBT for the year ended December 31, 2005, assets, liabilities, revenues, and expenses totaled $109 million, $2 million, $10 million, and $3 million, respectively.

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006, was as follows:

	Beginning Balance July 1, 2005	Additions	Retirements	Transfers/ Reclasses	Ending Balance June 30, 2006
Land	$ 52,368,000	$ 2,833,000	$ (399,000)	$ 114,000	$ 54,916,000
Construction in progress	136,716,000	120,289,000	(72,000)	$ (157,696,000)	99,237,000
Total non-depreciable capital assets	$ 189,084,000	$ 123,122,000	$ (471,000)	$ (157,582,000)	$ 154,153,000
Buildings and improvements	$ 1,153,060,000	$ 1,806,000	$ (3,958,000)	$ 151,404,000	$ 1,302,312,000
Infrastructure	146,222,000	122,000	(598,000)	6,178,000	151,924,000
Equipment	363,222,000	24,986,000	(10,706,000)		377,502,000
Library materials	195,800,000	10,189,000	(2,908,000)		203,081,000
Total depreciable capital assets	$ 1,858,304,000	$ 37,103,000	$ (18,170,000)	$ 157,582,000	$ 2,034,819,000
Less: accumulated depreciation					
Buildings and improvements	$ 492,121,000	$ 42,148,000	$ (1,302,000)		$ 532,967,000
Infrastructure	41,841,000	5,945,000	(521,000)		47,265,000
Equipment	229,179,000	27,169,000	(7,998,000)		248,350,000
Library materials	151,117,000	9,609,000	(2,908,000)		157,818,000
Total accumulated depreciation	$ 914,258,000	$ 84,871,000	$ (12,729,000)		$ 986,400,000
Depreciable capital assets, net	$ 944,046,000	$ (47,768,000)	$ (5,441,000)	$ 157,582,000	$ 1,048,419,000
Capital assets, net	$ 1,133,130,000	$ 75,354,000	$ (5,912,000)	$ 0	$ 1,202,572,000

In addition to expenditures through June 30, 2006, it is estimated that $135,948,000 will be required to complete projects under construction or planned for construction. Of that amount, $37,904,000 is contractually encumbered.

NOTE 6. DEFERRED REVENUE AND DEPOSITS

Deferred revenue consists primarily of amounts received from grants and contract sponsors which have not yet been earned under the terms of the agreements and the unamortized portion of the IBM lease (see discussion below) related to the acquisition of The University of Arizona Science and Technology Park. Deferred revenue also includes amounts received in advance of an event, such as advance ticket sales for sporting events.

Arizona Research Park Authority (ARPA) was established under the State's industrial development authority statute to assist in the acquisition, improvement and operation of university research parks and related properties. In August 1994, ARPA sold $98 million of transferable special revenue bonds to International Business Machines Corporation (IBM) to enable the University to acquire from IBM a 345-acre developed industrial site near Tucson, Arizona, together with 1,000 acres of adjacent unimproved land (collectively, The University of Arizona Science and Technology Park or the "Park"). The bonds are payable solely from lease rentals paid by IBM. If IBM defaults or cancels its lease, the bonds must be surrendered and discharged. Title to the entire Park resides with the University and neither the Park nor any payments by the University secures ARPA's bonds. Since the original transaction, IBM has reduced its leasehold to 68% of the building space for periods up to the remaining term of 8 years. The University has recorded the value of the Park as a capital asset and is amortizing the associated deferred revenue over a 20 year period.

Deferred revenue and deposits at June 30, 2006, consist of the following:

Current Deferred Revenue and Deposits	
Unexpended cash advances received for sponsored programs	$ 31,138,000
Auxiliary sales and services	5,985,000
IBM lease related to the acquisition of the Park	4,900,000
Tuition and fees	4,681,000
Other deferred revenues	3,759,000
Deposits	1,497,000
Total current deferred revenue and deposits	$ 51,960,000
Noncurrent Deferred Revenue and Deposits	
IBM lease related to the acquisition of the Park	$ 34,770,000

NOTE 7. ACCRUED COMPENSATED ABSENCES

The University accrues vacation when earned. At fiscal year-end, the University accrued up to the maximum 22 days allowed by University policy for which an employee can be paid upon termination of employment. The University does not accrue sick time. Upon retirement, employees with a minimum of 500 hours of accumulated sick time are paid a formulated amount from the Retiree Accumulated Sick Leave (RASL) fund administered by the Arizona State Department of Administration. The University pays a percentage of its payroll to RASL annually and does not have further liability. Accrued compensated vacation for the year ended June 30, 2006, is displayed to the right:

Beginning balance	$ 29,962,000
Additions	39,725,000
Reductions	(36,189,000)
Ending balance	$ 33,498,000
Current portion	$ 2,590,000

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NOTE 8: LONG-TERM DEBT & LEASE OBLIGATIONS

Long-term debt activity for the year ended June 30, 2006, was as follows:

	Beginning Balance July 1, 2005	Additions	Reductions	Ending Balance June 30, 2006	Due Within One Year
Bonds payable	$ 242,585,000	$ 53,215,000	$(12,355,000)	$ 283,445,000	$ 17,440,000
Certificates of participation	493,419,000	106,517,000	(79,050,000)	520,886,000	8,540,000
Capitalized lease obligations	40,665,000		(6,503,000)	34,162,000	3,619,000
Subtotal long-term debt	$ 776,669,000	$ 159,732,000	$(97,908,000)	$ 838,493,000	$ 29,599,000
Premium on sale of debt	16,613,000	3,961,000	(1,218,000)	19,356,000	1,363,000
Discount on sale of debt		(502,000)	9,000	(493,000)	(31,000)
Deferred costs of refundings	(14,834,000)	(1,492,000)	1,358,000	(14,968,000)	(1,422,000)
Total long-term debt	$ 778,448,000	$ 161,699,000	$(97,759,000)	$ 842,388,000	$ 29,509,000

Bonds – The University's bonded debt consists of various issues of system revenue bonds that are generally callable with interest payable semi-annually. Bond proceeds are used to pay for acquiring or constructing capital facilities and infrastructure. Bond proceeds are also used for refunding obligations from previously issued bonds. Payment of principal and interest on bonds is secured by a pledge of tuition and fees, sales and services, auxiliary enterprises, and other charges.

On September 13, 2005, the University sold System Revenue Bonds Series 2005A (2005A Bonds) for $35,570,000 dated September 1, 2005. The 2005A Bonds include $25,255,000 of serial bonds with interest rates ranging from 3.00% to 5.00% and maturity dates ranging from 2007 to 2025. The 2005A Bonds also include two term bonds consisting of $4,785,000 with an interest rate of 5.00% due June 1, 2028, and $5,530,000 with an interest rate of 5.00% due June 1, 2031. The 2005A Bonds with maturity on or after June 1, 2016, are subject to optional redemption without premium. The 2005A Bonds with maturity on June 1, 2028 and June 1, 2031, are subject to mandatory sinking fund redemption without premium pursuant to the debt documents. The 2005A Bonds sold at a premium of $1,372,000 and had accrued interest of $119,000. The University realized net proceeds of $36,647,000 after payment of $414,000 for issuance costs, underwriter discounts and bond insurance. The net proceeds were used to finance the Architecture Building Expansion Project, the Poetry Center Project, the Residence Life Building Renewal Phase II Project, the Deferred Renovation - Building Renewal and Infrastructure Project and to pay the December 1, 2005 interest payments on the University's System Revenue Bonds Series 1992A, 1998, 2002, 2003, 2004A, and 2004B. The interest payments from the net proceeds provided budget relief to assist the University with implementing a budget stabilization plan.

On May 9, 2006, the University sold System Revenue Bonds Series 2006A (2006A Bonds) for $17,645,000 dated May 1, 2006. The 2006A Bonds include $17,645,000 of serial bonds with an interest rate of 5.00% and maturity dates ranging from 2016 to 2020. The 2006A Bonds with maturity on or after June 1, 2017, are subject to optional redemption without premium. The 2006A Bonds sold at a premium of $993,000. The University realized net proceeds of $18,477,000 after payment of $303,000 for issuance costs, underwriter discounts and bond insurance and a University Contribution of $142,000. The net proceeds were used to pay the June 1, 2006 principal and interest payments on the University's System Revenue Bonds Series 1992A, 1998, 2002, 2003, 2004A, and 2004B. This provided budget relief to assist the University with implementing a budget stabilization plan.

In fiscal year 2003, the University refunded, in advance of maturity, a portion of outstanding System Revenue Bonds Series 2000A. At June 30, 2006, the outstanding principal balance of the refunded bonds was $4,330,000, which will be paid by investments held in an irrevocable trust with a fair value of $4,364,000. Accordingly, the trust account assets and liability for these defeased bonds are not included in the University's financial statements.

In fiscal year 2005, the University refunded, in advance of maturity, a portion of outstanding System Revenue Bonds Series 1998 and the remaining portion of System Revenue Bonds Series 2000A. At June 30, 2006, the total outstanding principal balance of the refunded bonds was $28,285,000, which will be paid by investments held in an irrevocable trust with a total fair value of $29,859,000. Accordingly, the trust account assets and liability for these defeased bonds are not included in the University's financial statements.

The following schedule details outstanding bonds payable at June 30, 2006:

Issue	Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1992A – System Revenue Refunding Bonds	$ 55,490,000	2016	5.90-6.20%	$ 50,895,000
1998 – System Revenue Bonds	54,270,000	2018	4.375-5.25%	24,390,000
2002 – System Revenue Refunding Bonds	93,080,000	2011	3.55-5.25%	56,945,000
2003 – System Revenue Refunding Bonds	30,805,000	2024	3.50-5.00%	30,805,000
2004A – System Revenue Bonds	17,780,000	2029	3.25-5.00%	16,930,000
2004B – System Revenue Bonds	50,265,000	2034	3.00-5.00%	50,265,000
2005A – System Revenue Bonds	35,570,000	2031	3.00-5.00%	35,570,000
2006A – System Revenue Refunding Bonds	17,645,000	2020	5.00%	17,645,000
Total	$ 354,905,000			$ 283,445,000

The following schedule details debt service requirements to maturity for System Revenue Bonds payable at June 30, 2006:

Year	Principal	Interest
2007	$ 17,440,000	$ 14,166,000
2008	20,535,000	13,291,000
2009	21,565,000	12,282,000
2010	22,600,000	11,209,000
2011	23,430,000	10,097,000
2012-16	72,090,000	37,133,000
2017-21	55,875,000	19,205,000
2022-26	28,790,000	8,652,000
2027-31	17,360,000	3,416,000
2032-34	3,760,000	382,000
Total	$ 283,445,000	$ 129,833,000

Certificates of Participation - The University utilizes Certificates of Participation and various capital leases to acquire buildings, equipment and land. The Certificates are generally callable, and the capital leases are subject to prepayment.

On November 16, 2005, the University issued Refunding Certificates of Participation Series 2005D, 2005E, 2005F, 2005G, 2005H, and 2005I (2005D-I Certificates) dated November 1, 2005 at a net premium of $202,000 as described below:

Series	Amount	Description	Interest Rate Range	Maturity Date Ranges
2005D	$6,655,000	Serial Certificates	4.125% to 5.00%	2012 to 2020
2005E	$3,555,000	Serial Certificates	3.25% to 4.25%	2008 to 2014
2005F	$14,915,000	Serial Certificates	3.25% to 4.50%	2006 to 2025
2005G	$2,245,000	Serial Certificates	4.125% to 4.375%	2016 to 2020
2005H	$770,000	Serial Certificates	4.125% to 4.375%	2016 to 2020
2005I	$1,320,000	Serial Certificates	4.125% to 4.375%	2016 to 2020

The 2005D-I Certificates maturing on or after June 1, 2016, are subject to optional redemption prior to maturity without premium and there are also extraordinary redemption dates pursuant to the debt documents.

The University realized net proceeds from the 2005D-I Certificates of $29,147,000 after payment of $515,000 for issuance costs, underwriters discount and bond insurance. These net proceeds were used for the following:

- Pay the December 1, 2005 debt service interest payments on the Certificates of Participation Series 1999A, 1999B, 1999, 2000A, 2001A, 2001B, 2002A, 2002B, 2003A, 2003B, and 2004A, which provided budget relief to assist the University with implementing a budget stabilization plan.

- Current-refund a $14,070,000 principal portion of the variable rate Certificates of Participation Series 2000A. At the time of the refunding, the effective rate of the refunded 2000A variable rate Certificates was 3.05 percent and the maximum annual interest rate could not exceed 12 percent. Depending on what the future changes might have been in the variable rates of the refunded 2000A Certificates, the difference in debt service payments resulting from changes in variable interest rates compared to the 2005F Certificates' average fixed interest rate of 4.3% over the next 19 years is ($2,130,000) to $15,417,000. The difference between the present values of the old and new debt service payments results in a range of an economic loss of $135,000 to an economic gain of $974,000. The current refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $209,000. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being amortized to interest expense through the year 2025 using the straight-line method.

- Refund in advance a $6,555,000 principal portion of the Certificates of Participation Series 1999A and the $3,290,000 principal balance of the Series 1999. The advance-refunding generated a combined net present value economic gain of $437,000 (difference between the present values of the old debt and new debt service payments) for the University. The advance-refunding decreases the University's debt service by $260,000 in year one, $43,000 in year two, and by an average of $27,000 in years three through nine when the annual debt service increases by an average of $4,000 from years ten through fifteen. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $654,000. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being amortized to interest expense through the year 2020 using the straight-line method. The refunded Certificates of Participation Series 1999A and 1999 will be paid by investments held in an irrevocable trust with a combined fair value of $9,969,000. Accordingly, the trust account assets and liability for these defeased bonds are not included in the University's financial statements.

On May 9, 2006, the University issued Refunding Certificates of Participation Series 2006A, 2006B, 2006C, 2006D, and 2006E (2006A-E Certificates) at a net premium of $996,000, dated May 1, 2006, as described below:

Series	Amount	Description	Interest Rate Range	Maturity Date Ranges
2006A	$35,785,000	Serial Certificates	3.875% to 5.00%	2013 to 2024
2006B	$12,395,000	Serial Certificates	3.60% to 4.50%	2007 to 2025
2006C	$6,100,000	Serial Certificates	4.25% to 4.375%	2016 to 2020
2006D	$1,285,000	Serial Certificates	4.25% to 4.375%	2016 to 2020
2006E	$3,085,000	Serial Certificates	4.25% to 4.375%	2016 to 2020

The 2006A-E Certificates maturing on or after June 1, 2017, are subject to optional redemption prior to maturity without premium, and there are also extraordinary redemption dates pursuant to the debt documents.

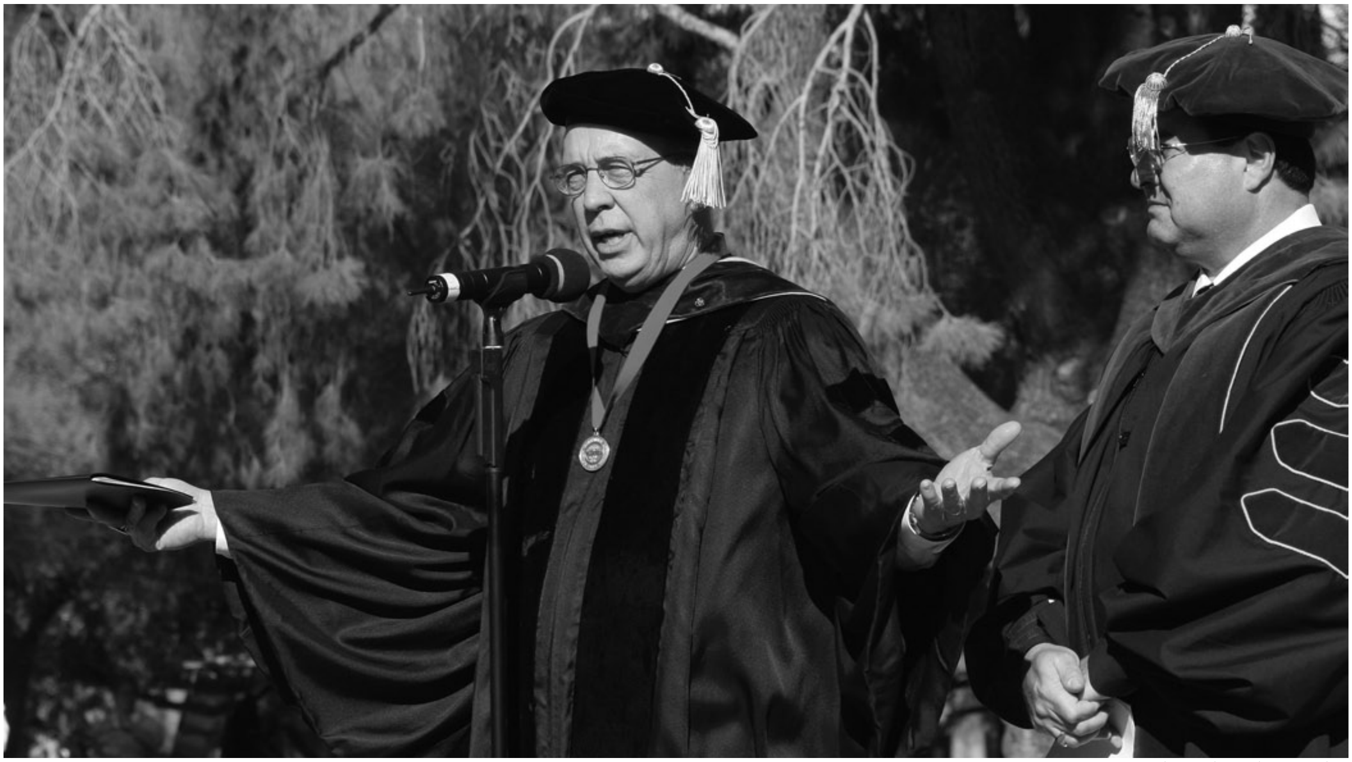
The University realized net proceeds from the 2006A-E Certificates of $58,824,000 after payment of $913,000 for issuance costs, underwriters discount and bond insurance and a University Contribution of $91,000. The net proceeds were used for the following:

- Pay the June 1, 2006 debt service principal and interest payments on the Certificates of Participation Series 1999A, 2000A, 2001A, 2001B, 2002A, 2002B, 2003A, 2003B, and 2004A.

- Current-refund the variable rate Certificates of Participation Series 1999B and the remaining portion of the variable rate Certificates of Participation Series 2000A, with outstanding principal balances of $36,500,000 and $11,530,000 respectively. At the time of the refunding, the effective rate of the refunded 1999B and 2000A variable rate Certificates was 3.60 percent and the maximum annual interest rate could not exceed 12 percent. Depending on what the future changes might have been in the variable rates of the refunded 1999B and 2000A Certificates, the difference in the combined debt service payments resulting from changes in variable interest rates compared to the 2006A Certificates' average fixed interest rate of 4.9% over the next 18 years is ($7,290,000) to $45,871,000. The difference between the present values of the old and new debt service payments results in a range of an economic loss of $486,000 to an economic gain of $3,058,000. The current refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $629,000. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being amortized to interest expense through the year 2025 using the straight-line method.

On June 6, 2006, the University issued Certificates of Participation Series 2006 for $18,240,000 at a discount of $104,000, dated June 1, 2006. The 2006 Certificates include two term certificates consisting of $3,780,000 with an interest rate of 4.50% due June 1, 2028, and $6,320,000 with an interest rate of 4.50% due June 1, 2031. The 2006 Certificates with maturity on or after June 1, 2017, are subject to optional redemption without premium. The 2006 Certificates with maturity on June 1, 2028 and June 1, 2031, are subject to mandatory sinking fund redemption without premium pursuant to the debt documents. There are also extraordinary redemption dates pursuant to the debt documents. The University realized net proceeds of $17,807,000 after payment of $329,000 for issuance costs, underwriter discounts and bond insurance. The net proceeds were used to finance the Arizona Biomedical Research Collaborative Building construction project.

The University has outstanding at June 30, 2006, variable rate Certificates of Participation, Series 2004B, totaling $41,400,000. These certificates bear interest at a weekly rate, determined by J.P. Morgan Securities as remarketing agents, with a final maturity date of June 1, 2031. These certificates are subject to conversion, at the option of the Arizona Board of Regents, to an adjustable rate, an annual rate, or a term rate pursuant to the debt documents. If not converted, the 2004B certificates will bear interest at a weekly rate not to exceed 12 percent per annum determined under prevailing market conditions by the remarketing agent. The variable rate Certificates of Participation are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days' notice and delivery to the remarketing agents. If the remarketing agents are unable to resell the demand certificates, the University has



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Standby Purchase Agreements with Bayerische Landesbank to extend credit through the purchase of the un-marketed certificates. Assuming all of the $41,400,000 Certificates of Participation are not resold within 90 days, the University would be responsible to make annual installment principal payments of $8,280,000 over a five-year period, plus interest to be calculated as established in the Standby Purchase Agreements. Bayerische Landesbank charges the University an annual Standby Purchase Agreement commitment fee on the outstanding principal for the Certificates of Participation for the Series 2004B. The fee is 0.19%. The Standby Purchase Agreement is valid through November 30, 2015.

In fiscal year 2003, the University refunded, in advance of maturity, a portion of outstanding Certificates of Participation Series 2001B. At June 30, 2006, the outstanding principal balance for the Certificates of Participation Series 2001B was $5,465,000, which will be paid by investments held in an irrevocable trust with a fair market value of $5,437,000. Accordingly, the trust account assets and liability for these defeased bonds are not included in the University's financial statements.

In fiscal year 2005, the University refunded, in advance of maturity, a portion of outstanding Certificates of Participation Series 1999A, 1999 and 2001A. At June 30, 2006, the total outstanding principal balance for the Certificates of Participation Series 1999A, 1999 and 2001A was $41,935,000, which will be paid by investments held in an irrevocable trust with a fair value of $43,283,000. Accordingly, the trust account assets and liability for these defeased bonds are not included in the University's financial statements.

The following schedule details outstanding Certificates of Participation payable at June 30, 2006:

Issue	Original Amount	Year of Final Maturity	Interest Rates	Outstanding Principal
1999A Fixed Student Union Certificates	$ 21,607,000	2020	5.125-5.30%	$ 3,601,000
1999 Parking Garage, Res. Life Certificates	18,635,000	2009	4.85-5.00%	505,000
2001A Park Std. Union, Learning Svcs., 6th Street Garage, TEP Bldg.	31,695,000	2025	3.875-5.50%	15,165,000
2001B Gittings Bldg., Highland Infra., Life Sciences	21,425,000	2022	4.00-5.125%	13,385,000
2002A Student Housing, Health Bldg., UA North	76,965,000	2022	4.125-5.50%	64,400,000
2002B Meinel Bldg., Refund COPS 1994B	29,845,000	2023	3.00-5.125%	28,845,000
2003A Refund COPS 1997 & Portion of COPS 2001B	10,615,000	2022	3.50-5.00%	10,615,000
2003B Medical Research Bldg., Biomedical Sciences & Biotech Bldg., Technology Infrastructure	153,960,000	2031	2.00-5.25%	152,360,000
2004A Chemistry Bldg. Expansion, Res. Life Phase I, Highland Pkg. Garage, Refund COPS 1994A	42,020,000	2029	3.50-5.25%	40,895,000
2004B Chemistry Bldg. Expansion	41,400,000	2031	Variable	41,400,000
2005A Refund COPS 1999A	12,660,000	2024	4.00-5.00%	12,660,000
2005B Refund COPS 1999	14,825,000	2024	5.00%	14,825,000
2005C Refund COPS 2001A	16,330,000	2022	4.125-5.00%	16,330,000
2005D Refund COPS 1999A & B	6,655,000	2020	4.125-5.00%	6,655,000
2005E Refund COPS 1999	3,555,000	2014	3.25-4.136%	3,555,000
2005F Refund COPS 2000A & 2001A	14,915,000	2025	3.25-4.50%	14,465,000
2005G Refund COPS 2001B, 2002A, & 2003A	2,245,000	2020	4.125-4.375%	2,245,000
2005H Refund COPS 2002B	770,000	2020	4.125-4.375%	770,000
2005I Refund COPS 2003B, 2004A	1,320,000	2020	4.125-4.375%	1,320,000
2006A Refund COPS 1999A & 1999B	35,785,000	2024	3.875-5.00%	35,785,000
2006B Refund COPS 2000A & 2001A	12,395,000	2025	3.60-4.50%	12,395,000
2006C Refund COPS 2001B, 2002A, & 2003A	6,100,000	2020	4.25-4.375%	6,100,000
2006D Refund COPS 2002B	1,285,000	2020	4.25-4.375%	1,285,000
2006E Refund COPS 2003B & 2004A	3,085,000	2020	4.25-4.375%	3,085,000
2006 Arizona Biomedical Research Collaborative Building Project	18,240,000	2031	4.00-5.00%	18,240,000
Total	$ 598,332,000			$ 520,886,000

The following schedule details debt service requirements to maturity for Certificates of Participation payable at June 30, 2006:

Year	Principal	Interest
2007	$ 8,540,000	$ 24,515,000
2008	13,470,000	24,190,000
2009	14,005,000	23,676,000
2010	14,430,000	23,044,000
2011	15,355,000	22,431,000
2012-16	119,210,000	99,796,000
2017-21	161,831,000	65,540,000
2022-26	108,015,000	28,853,000
2027-31	66,030,000	9,428,000
Total	$ 520,886,000	$ 321,473,000

The following schedule details debt service requirements to maturity for capital leases payable at June 30, 2006:

Year	Capital Lease Payments
2007	$ 5,136,000
2008	5,047,000
2009	4,620,000
2010	3,415,000
2011	3,352,000
2012-16	11,668,000
2017-21	5,349,000
2022-26	4,419,000
2027-31	4,420,000
2032	887,000
Total minimum lease payments	48,313,000
Less: interest	(14,151,000)
Present value of net minimum lease payments	$ 34,162,000

Capital Leases – The University has entered into various long-term leases to acquire equipment and enhance fixtures and infrastructure. These leases are classified as capital leases since they provide a bargain purchase option, a transfer of ownership by the end of the lease term, or comply with other accounting criteria. There were no major capital leases entered into this fiscal year.

Following is a summary of capital assets financed by certificates of participation and capital leases at June 30, 2006:

Land	$ 6,812,000
Construction in progress	68,566,000
Buildings and improvements	408,225,000
Infrastructure	56,793,000
Equipment	23,077,000
Total cost of assets	563,473,000
Less: accumulated depreciation	(71,583,000)
Carrying value of assets	$ 491,890,000

Operating Leases - The University has entered into certain operating leases, generally with options for annual renewal, and other rental agreements for real property and equipment. For fiscal year 2006, rent expenses totaled $20,045,000.

The following schedule details future operating lease payments to maturity:

Year	Operating Lease Payments
2007	$ 2,637,000
2008	1,971,000
2009	888,000
2010	462,000
2011	227,000
Total	$ 6,185,000

NOTE 9. SELF-INSURANCE PROGRAM

The University is exposed to various risks of loss related to: torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The University participates in a self-insurance program administered by the State of Arizona Department of Administration, Risk Management Section. Arizona Revised Statutes §41-621 *et seq* provides that losses eligible for coverage and not covered by insurance will be paid by the State from the self-insurance program or by a future appropriation from the State Legislature. Loss risks not covered by Risk Management and for which the University has no insurance coverage are losses that arise from contractual breaches, or are directly attributable to an act or omission determined to be a felony by a court of law. With this exception, the University has no significant risk of loss beyond adjustments to future years' premium payments to the State's self-insurance program. All estimated losses for unsettled claims and actions of the State are determined on an actuarial basis and are included in the State of Arizona Comprehensive Annual Financial Report.

NOTE 10. RETIREMENT PLANS

The University participates in one cost-sharing multiple-employer defined benefit pension plan and six defined contribution pension plans.

A. Defined Benefit Plan

Plan Description. The Arizona State Retirement System (ASRS) administers a cost-sharing multiple-employer defined benefit pension plan that covers employees of the University. Benefits are established by State statute and provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of ARS Title 38, Chapter 5, Article 2. The ASRS issues a publicly available comprehensive annual financial report that includes its financial statements and required supplementary information. That report may be obtained by writing to the ASRS, 3300 North Central Avenue, PO Box 33910, Phoenix, Arizona 85067-3910, or by calling (602) 240-2000 or (800) 621-3778.

Funding Policy. For the year ended June 30, 2006, active ASRS members and the University were each required to contribute 7.4 percent (6.9 percent retirement and .5 percent long term disability) of the members' annual covered payroll. The University's portion of contributions to the ASRS for the years ended June 30, 2006, 2005, and 2004, was $19,527,000, $14,293,000, and $13,330,000, respectively, which equaled the required contributions for the year. The Arizona State Legislature establishes and may amend active plan members' and the University's contribution rates.

B. Defined Contribution Plans

Plan Description. In accordance with ARS §15-1628, University faculty, academic professionals, and administrative officers have the option to participate in defined contribution pension plans. For the year ended June 30, 2006, plans offered by the Teachers Insurance Annuity Association/College Retirement Equities Fund (TIAA/CREF), Variable Annuity Life Insurance Company (VALIC), Fidelity Investments Tax-Exempt Services Company (Fidelity), AETNA Life Insurance and Annuity Company (AETNA), and The Vanguard Group (Vanguard) were approved by the Arizona Board of Regents. (Note that as of December 31, 2005, Vanguard and AETNA were removed as Board approved companies.) In addition, employees hired before July 1, 1972, have the option to participate in the defined contribution plan administered by the ASRS. Benefits under these plans depend solely on the contributed amounts and the returns earned on investments of those contributions. Contributions made by members

Contributions to the defined contribution plans for the year ended June 30, 2006, were as follows:

Plan	University Contributions	Member Contributions	Total Contributions
TIAA/CREF	$ 13,021,000	$ 13,021,000	$26,042,000
VALIC	784,000	784,000	1,568,000
Fidelity	4,462,000	4,462,000	8,924,000
AETNA	75,000	75,000	150,000
Vanguard	617,000	617,000	1,234,000
ASRS	108,000	93,000	201,000

vest immediately; University contributions vest after five years of full-time employment. Member and University contributions and associated returns earned on investments may be withdrawn upon termination of employment, death, or retirement. The distribution of member contributions and associated investment earnings are made in accordance with the member's contract with the applicable insurance and annuity company.

Funding Policy. The Arizona State Legislature establishes the contribution rates for active plan members and the University. For the year ended June 30, 2006, plan members and the University were each required by statute to contribute an amount equal to 7 percent of a member's compensation, except for an 8.13 percent University contribution for the ASRS plan.

NOTE 11. OPERATING EXPENSES BY NATURAL CLASSIFICATION

Operating expenses by natural classification for the year ended June 30, 2006, consist of the following:

Category	
Salaries and wages	$ 623,112,000
Benefits	183,264,000
Supplies and materials	113,795,000
Services, including travel	149,631,000
Utilities	39,761,000
Scholarships and fellowships	36,523,000
Depreciation	84,871,000
Total operating expenses	$ 1,230,957,000

NOTE 12. CONTINGENT LIABILITIES

In August 2003, four University of Arizona students filed a lawsuit against the Arizona Board of Regents and the State of Arizona in Pima County (Arizona) Superior Court. The complaint alleged that the tuition increase approved by the Board for the 2003-04 academic year violates the State's constitution. The plaintiffs requested that the suit be certified as a class action on behalf of all students at the three universities governed by the Board. The complaint also asserted that the State has not provided funding to the three universities governed by the Board at the level required by the State Constitution. The complaint sought (i) a declaratory judgment that the actions of each of the defendants violate the State Constitution, (ii) preliminary and permanent injunctive relief to prevent the Board from imposing the tuition increase and to compel repayment of any amounts already collected, and (iii) preliminary and injunctive relief ordering the State to set in place a plan to provide increased funding for maintenance, operation and improvement of the State's universities. In March 2004, the Superior Court granted the Board's and the State's motion to dismiss the case. In the related minute entry, the court held that in the exercise of its legislative and administrative function, which includes setting tuition levels for the State's three universities, the Board is absolutely immune from suit and that the conduct of the business of the State Legislature is absolutely immune from suit. The plaintiffs have filed a notice of appeal with the Arizona Court of Appeals. The plaintiffs have filed their opening brief and the Board and the State have filed their answering brief in the appeal, and oral arguments took place on February 15, 2005. To date the Court of Appeals has not issued a decision in the case. The Board intends to vigorously defend the appeal. Management believes that the claim can be adequately and successfully defended, but is not able to predict at this time what the ultimate outcome of the case will be or how the case may affect the financial condition of the University. An adverse judgment in the litigation described above would be covered by the statutory self-insurance program under the Risk Management Section of the State of Arizona Department of Administration.

In February 2004, two cases were filed arising from the same set of circumstances that lists a variety of causes of action based upon alleged violations of cultural and religious privacy and violations of human subjects research protocols. The complaints allege that, from 1990 through 1994, Arizona State University (ASU) researchers collected blood samples from individual members of the Havasupai Tribe for research purposes. The ASU Human Subjects Institutional Review Board approved the research to study the causes of various medical and behavioral disorders. In 1999, the principal investigator on the project moved to The University of Arizona (University). At that time, she transported the blood samples from the project and the related documentation to the University. In February 2003, the dissertation of an ASU student raised concerns that Havasupai blood samples had been used for purposes beyond the consent granted by participants. The plaintiffs in one case consist of 52 individual members of the Havasupai Tribe while the other case consists of the Havasupai Tribe. The complaints seek compensatory and punitive damages of $75,000,000. The Universities (ABOR) are being defended in these matters by the Arizona Attorney General's Office. In May 2005, the Federal District Court transferred both cases back to State Court. On July 11, 2005, the two cases were consolidated by the State Court, and on August 4, 2005, the defendants' motion to transfer the case to the Maricopa County Superior Court (from Coconino County) was granted. Management believes that the claim can be adequately and successfully defended, but is not able to predict at this time what the ultimate outcome of the case will be or how the case may affect the financial condition of the University. An adverse judgment in the litigation described above would be covered by the statutory self-insurance program under the Risk Management Section of the State of Arizona Department of Administration.

In September 2004, an action was filed by Kaman Aerospace Corporation (Kaman) alleging counts of breach of contract, negligent misrepresentation, unjust enrichment and quantum merit. This action arises out of a $35 million contract between the University and a large aerospace technology company for the production of an optical collimator apparatus. Under the contract, the University subcontracted $12.8 million of the work to Kaman. A number of disputes subsequently arose between Kaman and the University related to the scope of Kaman's work. Thereafter, Kaman abandoned its performance of the subcontract and initiated a lawsuit against the University in Arizona Superior Court seeking approximately $6 million for extra work claimed. The University retained outside counsel, answered the lawsuit, and counterclaimed against Kaman for breach of contract and for the delivery of the parts already produced by Kaman. The Superior Court judge agreed with the University's position and ordered Kaman to deliver the parts to the University. The University anticipates completing the rest of the work originally subcontracted to Kaman with its own personnel. A jury trial resulted in a verdict for plaintiff with no damages awarded. At this time, the University is unable to predict with accuracy what the ultimate outcome of the case will be or how the case may affect the financial condition of the University, but through the appeal that has been filed intends to continue to pursue its defense and counterclaim. An adverse judgment in the litigation described above would not be covered by the statutory self-insurance program under the Risk Management Section of the State of Arizona Department of Administration.

NOTE 13. SUBSEQUENT EVENTS

In fiscal year 2005, The University of Arizona and KB Home Incorporated entered into an equal value land exchange agreement in which the University will transfer approximately 124 acres of land located at the UA Science and Technology Park valued at $12,424,000 to KB Home. In return, the University will receive the following: approximately 53.5 acres of land located near Interstate I-10 and Kino Parkway valued at $8,739,000; an exemption on the University's share of the construction costs (estimated to be $3,416,000) associated with a new arterial roadway and certain infrastructure improvements in the Science and Technology Park; a cash payment of $269,000; and an option to purchase an additional 11.5 acres for $1,879,000. The title transfers for this transaction are expected to be finalized in February 2007. The University intends to use the newly acquired property to develop a second research park to facilitate commercialization of the University's biosciences technology. Associated with this land exchange agreement, the University and KB Home entered into a Pre-annexation and Development Agreement and Intergovernmental Agreement with the City of Tucson for the annexation of a portion of the Science and Technology Park. As a component of the annexation agreement, the University will provide a 5.5-acre parcel to the City of Tucson for location of a fire station and water facilities at the Science and Technology Park.

NOTE 14. DISCRETELY PRESENTED COMPONENT UNIT DISCLOSURES

A. Summary of Significant Accounting Policies

University of Arizona Foundation

Basis of Accounting

For financial reporting purposes, three net asset categories are utilized to reflect resources according to the existence or lack thereof of externally (donor) imposed restrictions. A description of the three net asset categories follows.

- Unrestricted net assets – include assets and contributions that are not restricted by donors or for which such restrictions have expired.
- Temporarily restricted net assets – include contributions for which donor imposed restrictions have not been met (either by the passage of time or by actions of the Foundation), charitable remainder unitrusts, pooled income funds, gift annuities, and pledges receivable for which the ultimate purpose of the proceeds is not permanently restricted. Donor-restricted contributions are classified as temporarily restricted even if restrictions are satisfied in the same reporting period in which the contributions are received.
- Permanently restricted net assets – include contributions, charitable remainder unitrusts, pooled income funds, gift annuities, and pledges receivable which require by donor restriction that the corpus be invested in perpetuity. Included in permanently restricted net assets is the Foundation's Endowment, which is invested in accordance with the policies of the Foundation as established from time to time by its Board of Directors. Realized and unrealized gains and losses on endowment assets are classified as permanently restricted, as Management believes such classification is consistent with either the explicit or implicit wishes of the donors.

The Endowment Payout, a percentage (4% of the average fair value at the calendar year-end of the three previous years at June 30, 2006) of the fair value of the Endowment as determined from time to time by the Foundation's Board, is made available to support the purposes of the individual accounts comprising the Endowment as specified by the donors. The Foundation charges a fee, a percentage (1.5% at June 30, 2006, 1.25% thereafter) of the fair value of the Endowment as determined from time to time by the Foundation's Board, which is paid from the Endowment to defray the Foundation's costs of holding and managing the Endowment, including costs for safeguarding, investing and accounting for such funds. The Foundation has historically made the Payout available whether or not the fair value of an individual account exceeded its historic gift value, as management believed such policy was consistent with the wishes of the donor. Management is currently formalizing its understanding of donor wishes in this matter, and has reduced or eliminated the Payout for certain accounts as a result. The total deficiency of the Endowment accounts (for which donor consent is still in process of completion) where the historic gift value exceeds the fair value is approximately $2,826,000 as of June 30, 2006.

Cash and Cash Equivalents

Cash and cash equivalents includes monies held in certificates of deposit, overnight money market accounts, and money market funds. Cash equivalents are stated at cost which approximates fair value.

Investments in Securities

Investments in securities are stated at fair value in the statement of financial position. Investments in domestic and international equity securities and mutual funds, U.S. government and agency obligations and mutual funds, corporate bonds, REIT funds, international fixed income mutual funds, and commodity mutual funds are valued based on quoted market prices. Investments in real estate and timber partnerships are recorded at fair value as determined by the General Partner based on the appraised value of the Partnerships' assets. Absolute return limited partnership interests are recorded at fair value based on quoted market prices (where the underlying investment is a mutual fund) or as determined by the fund manager. Private capital and commodity limited partnership interests are recorded at fair value as determined by the fund manager. Investment income or loss comprises the sum of realized and unrealized gains and losses on investments and interest and dividends, less an investment management fee.

Annuities Payable and Other Trust Liabilities

Annuities payable and other trust liabilities of $20,245,000 at June 30, 2006 are stated at the actuarially computed present value of future payments to the annuitants. The excess of the fair values of assets received (classified according to their nature in the statement of financial position) pursuant to annuity agreements over the actuarially computed annuities payable (using market rates in effect on the contribution date) is recorded as contributions in the year received. The fair values of such assets held in trust at June 30, 2006 total $38,545,000, of which $2,894,000 were unrestricted, $15,068,000 were temporarily restricted and $20,583,000 were permanently restricted.

Net Assets Released From Restriction

Expenses are not incurred in the temporarily restricted or permanently restricted net asset categories. As the restrictions on these net assets are met, the assets are reclassified to unrestricted net assets. The total assets reclassified are reported as net assets released from restriction in the accompanying statement of activities.

Campus Research Corporation

Property, Equipment and Depreciation

Property and equipment are stated at cost and depreciation is provided for using the straight-line method over the estimated useful lives of the assets. Expenditures for major improvements to property are capitalized and expenditures for repairs and maintenance are expensed as incurred. The Organization has recorded in the financial statements a building and related debt for which the ABOR/UA holds the title to the building, under the requirements of a lease.

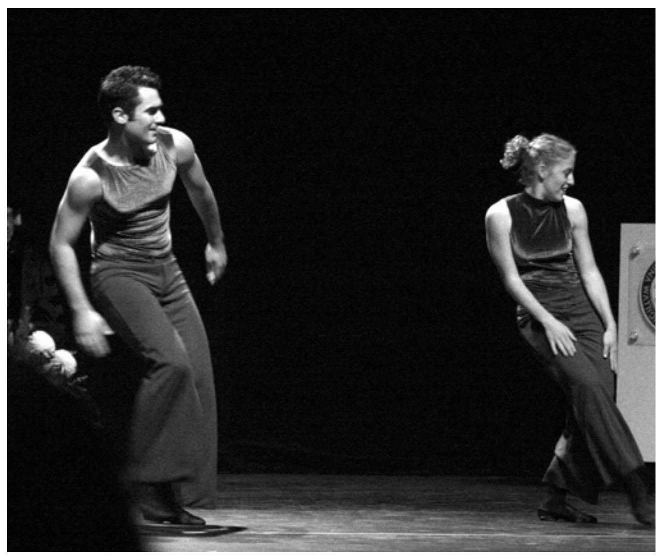
B. Investments

University of Arizona Foundation

Investments are comprised of the following amounts at June 30, 2006:

	Fair Value	Cost
Domestic/international equity securities and mutual funds	$ 137,966,000	$ 121,434,000
U.S. fixed income obligations and mutual funds	69,428,000	71,017,000
Absolute return limited partnerships and funds	64,628,000	58,603,000
REIT fund, real estate and timber partnerships	14,818,000	13,411,000
International fixed income mutual funds	9,992,000	10,237,000
Private capital and commodity limited partnerships and mutual funds	6,806,000	6,482,000
	$ 303,638,000	$ 281,184,000

The Foundation participates in a securities lending program established by Wells Fargo Bank, the custodian of the majority of the Foundation's investment assets (the "Program"). Under the Program, the custodian makes the Foundation's securities available for loan to selected brokerage firms and other borrowing organizations. Each loan is required to be collateralized in an amount equal to at least 102% of the market value of the loaned security and accrued interest thereon. Each loaned security is marked to market daily, and the custodian is required to ensure that collateralization remains at an amount of at least 102% on a daily basis. Collateral may take the form of U.S. government obligations, letters of credit or cash. At June 30, 2006, $5,086,000 in equity securities were in use under the Program.



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C. Pledges Receivable

University of Arizona Foundation

Unconditional promises are included in the financial statements as pledges receivable and revenue of the appropriate net asset category. Unconditional promises are recorded at their net realizable value using yields on U.S. Treasury obligations of equivalent maturity dates at the end of the fiscal year in which they were received. Unconditional promises at June 30, 2006 totaled $29,230,000.

Law College Association

At May 31, 2006, the Association had unconditional promises to give, pledged for future support. Net of present value discounts and allowances for doubtful pledges, these unconditional promises totaled $29,445,000. Note that 95% of the Association's gross pledges receivable come from an individual donor.

D. Property and Equipment

Campus Research Corporation

Property and equipment consisted of the following as of June 30, 2006:

Building and infrastructure improvements	$ 12,571,000
Furniture, equipment and other property	627,000
Total	13,198,000
Less accumulated depreciation	(1,820,000)
Property and equipment, net	$ 11,378,000

E. Long-Term Debt

Campus Research Corporation

Bonds payable, Series A, payable in scheduled monthly installments of principal plus interest at the floating taxable bond rate (remarketed weekly) through May 2013, with a lump sum payment of $6,491,000 due in June 2013.	$ 7,719,000
Noninterest bearing note payable, Arizona Commerce and Economic Development Commission, payable in monthly principal installments of $2,000 beginning May 2007 through April 2016.	200,000
Notes payable, bank	3,157,000
Total long-term debt	$ 11,076,000

The bonds are collateralized by leasehold interests in real property and an assignment of rents and require the Organization to be in compliance with certain financial and nonfinancial covenants. At June 30, 2006, the Organization was in violation of certain financial covenants, which the bank has subsequently waived.

Wells Fargo Bank Arizona issued an $11,400,000 letter of credit to enhance the sale of the bonds and the Organization entered into a reimbursement agreement with the bank, which provides real property as collateral to the bank. The letter of credit is renewed annually in July at the outstanding bond amount plus 45 days of interest.

The Series A and Series B bonds payable bear interest at a market rate of interest as stated above. However, the Organization entered into two separate interest rate swap contracts with Wells Fargo that effectively convert the interest rate on the Series A and Series B notes to 6.3% and 4.77%. Under the swap contracts, the Organization pays interest at the fixed rate and receives interest at LIBOR (proxy rate), which was 5.48% at June 30, 2006. The notional amount under the swaps decreases as principal payments are made on the bonds so that the notional amount equals the principal outstanding under the bonds. The swaps are designed to hedge the risk of changes in interest payments on the bonds. The swap agreement related to the Series B bonds matured in December 2005 upon the receipt of final payment on those bonds.

Martha Lochert Photography

The swaps were issued at market terms so that they had no fair value at inception. As required by generally accepted accounting principles, the carrying amount of the swaps has been adjusted to fair value at June 30, 2006 which, because of changes forecasted in levels of LIBOR, resulted in reporting a liability for the fair value of the future net payments forecasted under the swaps. The change in fair value is recorded as a component of the change in net assets for 2006 and the liability is included in the balance sheet at June 30, 2006.

F. Project Operation Agreement (POA):

Campus Research Corporation

The Organization has an agreement with IBM whereby all common services at the Park are to be provided by the Managing Operator, which is currently IBM. Common services consist of the operation, maintenance and repair of the central utility system, project fire and security services, and the common areas. The term of the agreement coincides with the IBM master lease agreement that expires in August 2014. Exercise of the contractual extensions contained within the IBM master lease agreement will extend the POA according to the terms of the lease agreement.

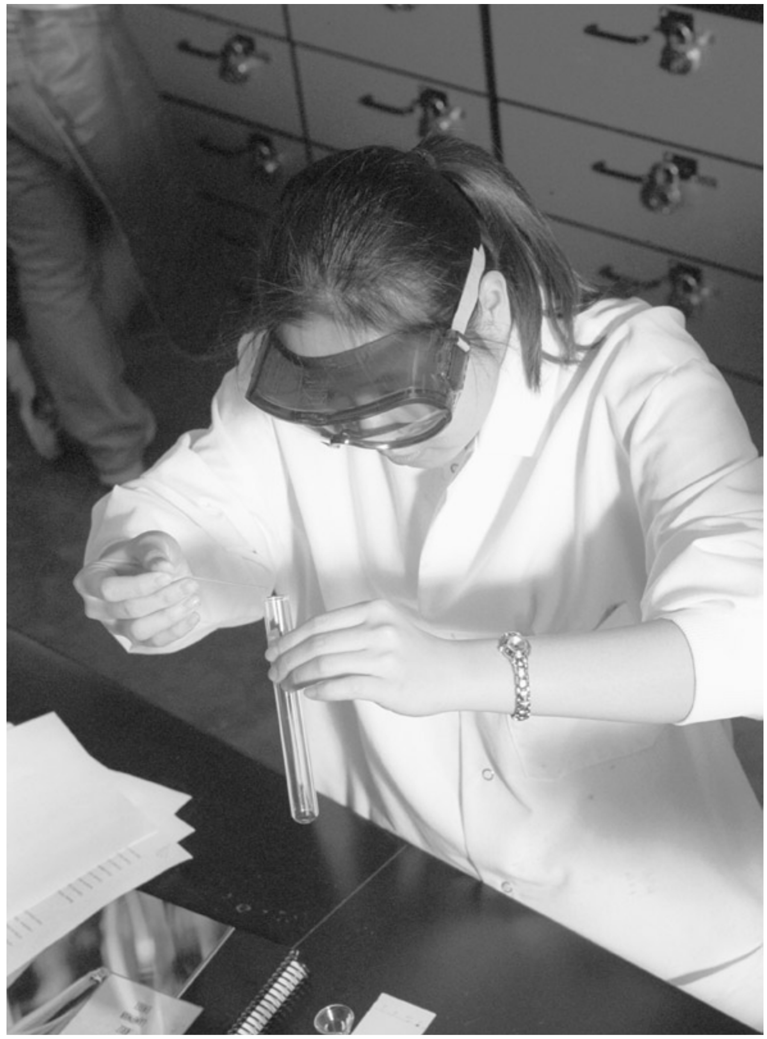
In October 2004, the Organization issued a notice of default to IBM asserting that IBM is not complying with the terms of the POA in its responsibility to maintain the Park. The lack of maintenance has caused a significant increase in the Organization's repairs and maintenance costs necessary to maintain the building systems and infrastructure at a minimum acceptable level. The incurrence of such costs has contributed to the Organization's overall decrease in net assets during 2006 and has placed at risk the Organization's ability to attract new tenants and retain existing tenants. Furthermore, IBM is in default with an additional term of the POA that requires IBM to provide evidence of insurance coverage for the structures to all lessees of the Park. Accordingly, the Organization and the Parks' tenants do not know if the current insurance coverage is sufficient in the event of a loss.

The Organization's management continues to communicate with IBM regarding its obligations and the Organization's expectation. No legal proceedings have yet commenced. However, should IBM not commit to meet the requirements set forth in the POA, management intends to proceed with legal action to enforce the provisions of the POA.

G. Condensed Financial Statements of Major Component Units

Major Component Units Statement of Financial Position June 30, 2006	University of Arizona Foundation	Other Component Units	Total
Assets			
Cash, cash equivalents and investments	$ 373,415,000	$ 14,203,000	$ 387,618,000
Pledges receivable	29,230,000	29,445,000	58,675,000
Property and equipment, net	3,111,000	11,556,000	14,667,000
Other assets	16,045,000	7,880,000	23,925,000
Total Assets	**$ 421,801,000**	**$ 63,084,000**	**$ 484,885,000**
Liabilities and Net Assets			
Liabilities			
Annuities payable and other trust liabilities	$ 20,246,000		$ 20,246,000
Short-term and long-term debt	160,000	$ 11,105,000	11,265,000
Other liabilities	5,141,000	5,306,000	10,447,000
Total Liabilities	**$ 25,547,000**	**$ 16,411,000**	**$ 41,958,000**
Net Assets			
Unrestricted	$ 12,944,000	$ 11,540,000	$ 24,484,000
Temporarily restricted	116,235,000	32,081,000	148,316,000
Permanently restricted	267,075,000	3,052,000	270,127,000
Total Net Assets	**$ 396,254,000**	**$ 46,673,000**	**$ 442,927,000**
Total Liabilities and Net Assets	**$ 421,801,000**	**$ 63,084,000**	**$ 484,885,000**

Major Component Units Statement of Activities Year Ended June 30, 2006	University of Arizona Foundation	Other Component Units	Total
Revenues			
Contributions	$ 53,345,000	$ 3,016,000	$ 56,361,000
Rental revenues		7,331,000	7,331,000
Investment income	24,058,000	789,000	24,847,000
Other income	10,525,000	4,261,000	14,786,000
Total revenues	**$ 87,928,000**	**$ 15,397,000**	**$ 103,325,000**
Expenses			
Program services:			
Leasing related expenses		$ 6,265,000	$ 6,265,000
Payments to the University	$ 33,086,000		33,086,000
Payments on behalf of the University	14,345,000	8,016,000	22,361,000
Supporting services:			
Management and general	3,813,000	1,988,000	5,801,000
Fund raising	4,798,000	289,000	5,087,000
Other expenses		35,000	35,000
Total expenses	**$ 56,042,000**	**$ 16,593,000**	**$ 72,635,000**
Increase in Net Assets	**$ 31,886,000**	**$ (1,196,000)**	**$ 30,690,000**
Net Assets - Beginning of year	**364,368,000**	**47,869,000**	**412,237,000**
Net Assets - End of year	**$ 396,254,000**	**$ 46,673,000**	**$ 442,927,000**



Upper left: A. Espinoza, Office of University Communications. *Bottom left:* David A. Harvey Photography. *Upper right:* Robert Walker, UA Photo Service.
Bottom right: Margaret Hartshorn, AHSC Biomedical Communications.

Martha Lochert Photography

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