

Boston University

Financial Statements
June 30, 2004 and 2003



Report of the Audit Committee

To the Trustees of Boston University:

The Audit Committee has received the report of the audit of the consolidated financial statements of the University from PricewaterhouseCoopers LLP, Independent Auditors, appointed to audit the books and records for the years ended June 30, 2004 and 2003, and has the report on file. Their report on the audit of the financial statements of the University as of June 30, 2004 and 2003, is submitted herewith.

Respectfully submitted,
Audit Committee

David M. Myers, *Chairman*

Edson D. de Castro

Patricia K. Donahoe

Sidney J. Feltenstein

Robert A. Knox

Melvin B. Miller

Richard C. Shipley

Robert E. Yellin

Boston, Massachusetts

September 22, 2004

Letter of Transmittal from the Treasurer

To the Board of Trustees of Boston University:

The annual financial report of Boston University for the fiscal years ended June 30, 2004 and 2003, is presented in the accompanying pages.

The financial statements of the University have been audited by PricewaterhouseCoopers LLP, Independent Auditors. Their report is made a part of this record.

Respectfully submitted,

Kenneth G. Condon

Treasurer, Trustees of Boston University

Boston, Massachusetts

August 25, 2004

Report of Independent Auditors

To the Board of Trustees of Boston University:

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of Boston University (the “University”) at June 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University’s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Boston, Massachusetts

August 25, 2004

BOSTON UNIVERSITY | CONSOLIDATED STATEMENTS
OF FINANCIAL POSITION

June 30, 2004 and 2003
(\$000)

	2004	2003
ASSETS		
Cash and cash equivalents (Note 1)	\$ 203,823	\$ 95,328
Cash and cash equivalents—restricted (Note 1)	29,795	130,917
Short-term investments (Notes 1 and 2)	18,295	14,357
Accounts receivable, net of allowance (Notes 1 and 3)	143,724	146,762
Pledges receivable, net of allowance (Note 3)	27,784	26,359
Prepaid expenses and other assets	81,651	70,849
Long-term investments (Notes 1 and 2)	576,588	574,893
Property, plant, and equipment, net (Notes 1 and 4)	1,454,908	1,299,324
Unamortized bond discount	2,818	2,404
Total assets	\$ 2,539,386	\$ 2,361,193
 LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued payroll and related expenses	\$ 98,352	\$ 91,676
Accounts payable and accrued expenses	204,047	208,661
Deferred income and student deposits	85,825	78,813
Annuities payable (Note 1)	11,787	11,122
Bonds, notes, and mortgages payable (Note 5)	933,194	875,159
Total liabilities	1,333,205	1,265,431
 Commitments and contingencies (Note 7)		
 Net assets (Note 1):		
Unrestricted:		
Allocated for designated purposes	729,895	669,537
Available for general purposes	12,799	12,606
Total unrestricted	742,694	682,143
Temporarily restricted	233,731	199,892
Permanently restricted	229,756	213,727
Total net assets	1,206,181	1,095,762
Total liabilities and net assets	\$ 2,539,386	\$ 2,361,193

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

BOSTON UNIVERSITY | CONSOLIDATED STATEMENTS OF ACTIVITIES

For the years ended June 30, 2004 and 2003
(\$000)

	2004			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Operating revenues (Note 1)				
Student tuition and fees	\$ 715,620	\$	\$	\$ 715,620
Student aid	(200,108)			(200,108)
Sponsored programs	182,123			182,123
Gifts	25,167	368		25,535
Sales and services	71,350			71,350
Spending formula amount and other investment income (Note 2)	6,361	16,512		22,873
Recovery of facilities and administrative costs	117,433			117,433
Sponsored program income for student aid	15,486			15,486
Other income	8,593			8,593
Auxiliary enterprises	172,204			172,204
Student aid	(2,171)			(2,171)
Net assets released from restrictions	16,512	(16,512)		
Total operating revenues	1,128,570	368		1,128,938
Operating expenses (Note 1)				
Instruction and departmental research	548,163			548,163
Educational support activities	89,830			89,830
Sponsored programs	182,123			182,123
Libraries	20,788			20,788
General and administrative	129,235			129,235
Student aid	13,130			13,130
Auxiliary enterprises	144,897			144,897
Total operating expenses	1,128,166			1,128,166
Net operating gain (loss)	404	368		772
Nonoperating revenues and (expenses)				
Gifts and changes in pledges, net (Note 1)	8,788	4,087	12,580	25,455
Spending formula amount and other investment income (Notes 1 and 2)	2,563	2,280	90	4,933
Excess (deficit) of investment return over spending formula amount (Note 2)	28,535	30,374	360	59,269
Net realized and unrealized gains (losses) on interest rate exchange agreements (Note 5)	20,856			20,856
Other additions (deductions), net	(595)	(3,270)	2,999	(866)
Net nonoperating income (loss)	60,147	33,471	16,029	109,647
Change in net assets	60,551	33,839	16,029	110,419
Beginning net assets	682,143	199,892	213,727	1,095,762
Ending net assets	\$ 742,694	\$ 233,731	\$ 229,756	\$ 1,206,181

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

2003				
Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
\$ 684,512	\$	\$	\$ 684,512	Operating revenues (Note 1)
(188,826)			(188,826)	Student tuition and fees
176,816			176,816	Student aid
20,346	427		20,773	Sponsored programs
70,266			70,266	Gifts
9,594	19,746		29,340	Sales and services
105,040			105,040	Spending formula amount and other investment income (Note 2)
14,536			14,536	Recovery of facilities and administrative costs
8,599			8,599	Sponsored program income for student aid
161,143			161,143	Other income
(2,145)			(2,145)	Auxiliary enterprises
19,746	(19,746)			Student aid
<u>1,079,627</u>	<u>427</u>		<u>1,080,054</u>	Net assets released from restrictions
				Total operating revenues
549,834			549,834	Operating expenses (Note 1)
93,219			93,219	Instruction and departmental research
176,816			176,816	Educational support activities
19,506			19,506	Sponsored programs
130,963			130,963	Libraries
11,074			11,074	General and administrative
128,608			128,608	Student aid
<u>1,110,020</u>			<u>1,110,020</u>	Auxiliary enterprises
				Total operating expenses
(30,393)	427		(29,966)	Net operating gain (loss)
				Nonoperating revenues and (expenses)
8,335	(2,209)	20,527	26,653	Gifts and changes in pledges, net (Note 1)
5,463	1,654	586	7,703	Spending formula amount and other investment income (Notes 1 and 2)
(5,930)	(7,334)	310	(12,954)	Excess (deficit) of investment return over spending formula amount (Note 2)
(47,766)			(47,766)	Net realized and unrealized gains (losses) on interest rate exchange agreements (Note 5)
(3,098)	(3,214)	2,402	(3,910)	Other additions (deductions), net
<u>(42,996)</u>	<u>(11,103)</u>	<u>23,825</u>	<u>(30,274)</u>	Net nonoperating income (loss)
(73,389)	(10,676)	23,825	(60,240)	Change in net assets
755,532	210,568	189,902	1,156,002	Beginning net assets
<u>\$ 682,143</u>	<u>\$ 199,892</u>	<u>\$ 213,727</u>	<u>\$ 1,095,762</u>	Ending net assets

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

BOSTON UNIVERSITY | CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended June 30, 2004 and 2003

(\$000)

	2004	2003
Cash flows from operating activities:		
Change in net assets	\$110,419	\$ (60,240)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	79,447	104,417
Gain on sale of property and equipment	(4,498)	
Unrealized (gains) losses on interest rate exchange agreements	(26,651)	42,374
Net realized and unrealized gains on investments	(75,304)	(10,281)
Provision for bad debts	(6,066)	(4,206)
Contributions restricted for investments	(12,580)	(20,527)
(Increase) decrease in unamortized bond discount	(414)	651
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	8,053	(5,837)
(Increase) decrease in pledges receivable	(374)	10,886
Increase in prepaid expenses and other assets	(10,802)	(7,778)
Increase in accounts payable and accrued expenses	22,037	10,815
Increase in accrued payroll and related expenses	6,676	5,010
Increase in deferred income and student deposits	7,012	177
Net cash provided by operating activities	<u>96,955</u>	<u>65,461</u>
Cash flows from investing activities:		
Purchases of investments	(257,602)	(284,265)
Proceeds from sales and maturities of investments	327,273	253,933
Proceeds from sale of property and equipment	8,955	
Purchases of property and equipment	(216,021)	(172,770)
Decrease in cash equivalents-restricted	<u>101,122</u>	<u>69,325</u>
Net cash used in investing activities	<u>(36,273)</u>	<u>(133,777)</u>
Cash flows from financing activities:		
Payment of bonds, notes, and mortgages	(30,432)	(13,947)
Increase in annuity obligations	665	2,099
Proceeds from bonds and notes payable	65,000	35,699
Contributions restricted for investments	<u>12,580</u>	<u>20,527</u>
Net cash provided by financing activities	<u>47,813</u>	<u>44,378</u>
Net increase (decrease) in cash and cash equivalents	108,495	(23,938)
Cash and cash equivalents beginning of year	95,328	119,266
Cash and cash equivalents end of year	<u>\$203,823</u>	<u>\$ 95,328</u>
Supplemental disclosure of non-cash information:		
Property and equipment acquired under capital lease obligations	\$ 23,467	\$ 30,853

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

For the years ended June 30, 2004 and 2003

1. Accounting Policies

The following is a summary of the significant accounting policies of the University.

Basis of Presentation:

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with the reporting principles of not-for-profit accounting.

Unrestricted net assets are free of donor-imposed restrictions. Unrestricted net assets include education and general, sponsored and departmental research, unexpended plant and debt service, investments in plant, long-term investments, and student loans. Contributions, gains, and investment income whose restrictions are met in the same reporting period are reported as unrestricted support.

Temporarily restricted net assets include gifts for which donor-imposed restrictions, as to time or purpose, have not been met (primarily future capital projects) and pledges receivable for which the ultimate purpose of the proceeds is not permanently restricted.

Permanently restricted net assets include gifts and pledges which require, by donor restriction, that the corpus be invested in perpetuity and only the income or a portion thereof be made available for spending in accordance with donor restrictions.

Nonoperating activities reflect transactions of a long-term investment or capital nature including contributions to be invested by the University to generate a return that will support future operations, contributions to be received in the future, contributions to be used for facilities and equipment, gains and losses on interest rate exchange agreements, and realized and unrealized investment gains or losses.

Sponsored Programs:

Revenues associated with contracts and grants are recognized as the related costs or capital expenditures are incurred. Grant revenue used for the construction or acquisitions of plant is recorded within nonoperating activities. The University records reimbursement of facilities and administrative costs relating to government contracts and grants based on predetermined rates through June 30, 2005.

Principles of Consolidation:

The consolidated financial statements include the University and its wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

Property, Plant, and Equipment:

Maintenance and repairs are expensed as incurred and improvements are capitalized. When assets are retired or disposed of, the cost and accumulated depreciation thereon is removed from the accounts, and gains and losses are included in operations in the statement of activities.

Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," requires that long-lived assets and certain intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. When such events or changes in circumstances indicate an asset may not be recoverable, an impairment loss is required to be recognized in an amount by which the asset's net book value exceeds its estimated fair value.

Gifts:

Gifts, including unconditional promises to give, are recorded upon receipt. Gifts other than cash are recorded at fair market value at the date of contribution. The University records gifts of patents that are accepted solely for future use in educational or scientific research at a nominal value. Gifts with donor-imposed restrictions, which are reported as temporarily restricted revenues, are reclassified to unrestricted net assets when an expense is incurred that satisfies the restriction.

Investment Income:

The major portion of net assets for long-term investments is pooled. Units in the pool are assigned on the basis of market value at the time net assets to be invested are received, and income is distributed quarterly thereafter on a per-unit basis.

For the years ended June 30, 2004 and 2003

Valuation of Investments:

Investments in marketable securities are stated at market value. Except as stated in Note 2, investments in closely held, unregistered and nonnegotiable securities, for which market quotations are not readily available, are valued by the general partnership or fund manager and are reviewed by management for reasonableness and approved by an advisory committee of the Board of Trustees. The average cost method is used for calculating realized gains. The investment portfolio is reflected on a trade-date basis.

Net gains and losses are classified as unrestricted net assets unless they are restricted by donor or the law. Net gains on permanently restricted gifts are classified as temporarily restricted until appropriated for spending by the University in accordance with Massachusetts law.

Real Estate Partnerships:

The University owns shares in certain real estate partnerships ranging from 20 to 50%, which have been accounted for using the equity method. The University's ownership interest in these partnerships has been recorded within long-term investments within the statement of financial position.

Cash and Cash Equivalents:

The University considers cash on hand, cash in banks, certificates of deposit, time deposits, and U.S. Government and other short-term securities with maturities of three months or less when purchased as cash and cash equivalents. Cash and cash equivalents-restricted represent funds held by the trustee associated with the Massachusetts Development Finance Agency Bond Issue Series R and Massachusetts Health and Educational Facilities Authority Bond Issue Series S, and will be drawn down to fund various construction projects.

Loans Receivable:

Notes and loans receivable are principally amounts due from students under federally sponsored programs which are subject to significant restrictions. Accordingly, it is not practical to determine the fair value of such amounts.

Student Aid:

Student aid of \$200,108,000 and \$188,826,000 for the years ended June 30, 2004 and 2003, respectively, has been classified as a reduction of student tuition and fees. In addition, student aid in the amount of \$2,171,000 and \$2,145,000 for the years ended June 30, 2004 and 2003, respectively, has been classified as a reduction of auxiliary enterprises (room and board) revenue.

Student aid in addition to tuition, fees, room and board in the amount of \$13,130,000 and \$11,074,000 for the years ended June 30, 2004 and 2003, respectively, has been classified as an operating expense.

Depreciation Policy:

All capital expenditures for, and gifts of, land, buildings, equipment, and library books are recorded as additions to unrestricted net assets when the assets are placed in service, and carried at cost at the date of the acquisition or fair value at the date of donation. Depreciation is computed on a straight-line basis over the remaining useful lives of assets as follows: buildings, 50 years; renovations and improvements, 20 years or lease term, if shorter; library books, 10 years; and equipment, 2–15 years.

Depreciation for the years ended June 30, 2004 and 2003 was \$79,447,000 and \$104,417,000, respectively.

Effective July 1, 2002, the University changed its method of computing depreciation for campus buildings used in sponsored research activities. The use of an overall useful life of 50 years or longer was replaced by use of distinct useful lives for each major building component ranging from 12 to 50 years. A change in accounting estimate was made to more accurately reflect the useful lives of building components. The change increased depreciation expense by \$54,100,000 for the year ended June 30, 2003.

For the years ended June 30, 2004 and 2003

Allocation of Expenses:

Certain expenses have been allocated to functional expenses in the statement of activities. These expenses are comprised of, in thousands of dollars:

	2004	2003
Operation and maintenance of plant	\$ 69,407	\$ 66,731
Interest on indebtedness	20,674	21,822
Depreciation expense	79,447	104,417

Collections:

The University's collections, which were acquired through purchases and contributions since the University's inception, are not recognized as assets on the statement of financial position. Purchases of collection items are recorded as decreases in unrestricted net assets in the year in which the items are acquired, or as releases from temporarily restricted net assets if the assets used to purchase the items are restricted by donors. Contributed collection items are not reflected in the financial statements. Proceeds from deaccessions or insurance recoveries are reflected as increases in the appropriate net asset classes.

The University's collections are made up of artifacts of historical significance, scientific specimens, and art objects that are held for educational, research, scientific, and curatorial purposes. Each of the items is cataloged, preserved, and cared for, and activities verifying their existence and assessing their condition are performed regularly. The collections are subject to a policy that requires proceeds from dispositions to be used to acquire other items for collections.

Split-Interest Agreements:

The University's split-interest agreements with donors consist of irrevocable charitable gift annuities and charitable remainder trusts held and administered by others. For annuity contracts, the contributed assets are included as part of investments at fair value. Contribution revenues are recognized as of the date the donated assets are transferred to the University, and liabilities are recorded for the present value of the estimated future payments to the donors and/or other beneficiaries. The liabilities are adjusted during the term of the annuities consistent with changes in the value of the assets and actuarial assumptions.

The present values of the estimated future cash receipts from the trusts are recognized as assets and contribution revenues as of the dates the trusts are established. Distributions from these trusts are recorded as contributions and the carrying value of the assets is adjusted for changes in the estimates of future receipts.

Related Party Transactions:

Under the University's conflict of interest policy, all business and financial relationships between the University and entities affiliated with trustees and officers are subject to the review and approval of the Audit Committee of the Board of Trustees. Transactions entered into with related parties are not considered material to the financial statements.

Income Taxes:

The University is exempt from federal income tax under Section 501(c)(3) of the U.S. Internal Revenue Code.

Use of Estimates:

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

Reclassifications:

Certain June 30, 2003 balances previously reported have been reclassified to conform to the June 30, 2004 presentation.

For the years ended June 30, 2004 and 2003

2. Investments

Total investments by type as of June 30, 2004 and 2003, in thousands of dollars, were as follows:

Summary by Type of Investment	2004		2003	
	Cost	Market or Estimated Fair Value	Cost	Market or Estimated Fair Value
Fixed income	\$ 41,124	\$ 46,897	\$ 70,902	\$ 77,635
Equities and convertibles	350,878	425,003	355,801	413,271
Closely held investments	149,010	122,983	121,376	98,344
Total	<u>\$ 541,012</u>	<u>\$ 594,883</u>	<u>\$ 548,079</u>	<u>\$ 589,250</u>

The following summarizes, in thousands of dollars, the investment return, as reflected in the statement of activities:

	Unrestricted	Temporarily Restricted	Permanently Restricted	2004 Total	2003 Total
Dividend and interest income . . .	\$ 3,866	\$ 7,815	\$ 90	\$ 11,771	\$ 13,808
Net realized and unrealized gains	33,593	41,351	360	75,304	10,281
Total return on investments	37,459	49,166	450	87,075	24,089
Less: Spending formula amount . .	(6,160)	(18,792)		(24,952)	(30,354)
Less: Other non-endowment income	(2,764)		(90)	(2,854)	(6,689)
	(8,924)	(18,792)	(90)	(27,806)	(37,043)
Excess (deficit) of investment return over spending formula amount . .	<u>\$ 28,535</u>	<u>\$ 30,374</u>	<u>\$ 360</u>	<u>\$ 59,269</u>	<u>\$ (12,954)</u>

The amounts distributed from the investment yield of pooled investments in any one year may include interest, dividends, and a portion of accumulated investment gains. The distribution is based on fixed quarterly amounts per unit. The return distributed is equivalent to an annual investment yield, using the average market value of pooled endowment funds for the five preceding quarters for the fiscal years ended June 30, 2004 and 2003, respectively. During the fiscal years ended June 30, 2004 and 2003, 5.2% and 6.0%, respectively, represented the distribution as a percentage of the ending market value of the total endowment fund.

Net losses of \$615,000 for the fiscal year ended June 30, 2003, on permanently restricted endowment funds were classified as a reduction in unrestricted net assets until such time as the market value equaled or exceeded book value. There were no such net losses on permanently restricted endowment funds as of June 30, 2004. Accordingly, the University has replenished \$615,000 to unrestricted net assets from temporary restricted net assets to account for the restoration of these losses in 2004.

As of June 30, 2004, investment commitments to venture capital limited partnerships total \$25,206,000 and are expected to be drawn down by the general partners over the next two to three years.

For the years ended June 30, 2004 and 2003

3. Receivables and Pledges

Accounts and loans receivable at June 30, 2004 and 2003, in thousands of dollars, consist of the following:

	2004	2003
Accounts receivable, net:		
Students	\$ 14,633	\$ 16,855
Less allowances	(6,046)	(6,334)
	<u>8,587</u>	<u>10,521</u>
Grants and contracts	48,177	48,027
Departmental sales, services, and other	24,418	32,013
Less allowances	(2,142)	(2,212)
	<u>70,453</u>	<u>77,828</u>
Student loans	63,954	63,452
Less allowances	(1,721)	(6,378)
	<u>62,233</u>	<u>57,074</u>
Receivables for investments sold	2,451	1,339
Total	<u>\$ 143,724</u>	<u>\$ 146,762</u>

Total allowances for doubtful accounts as of June 30, 2004 and 2003, are \$9,909,000 and \$14,924,000, respectively.

Included in accounts receivable at June 30, 2004 and 2003, is \$5,846,000 and \$9,600,000, respectively, related to the cash surrender value of split-dollar life insurance policies.

The University has outstanding notes, mortgages, and advances to certain employees bearing interest at rates up to 8% at June 30, 2004 and 2003. The aggregated amount as of June 30, 2004 and 2003, is \$213,000 and \$416,000, respectively.

Pledges, net of discounts and allowances, in the amount of \$27,784,000 and \$26,359,000, are recorded as receivables with the revenue assigned to the appropriate net asset category for fiscal years 2004 and 2003, respectively. Pledges consist of unconditional written promises to contribute to the University in the future. At June 30, 2004 and 2003, pledges, in thousands of dollars, are expected to be realized in the following time frame:

	2004	2003
In one year or less	\$ 8,361	\$ 9,256
Between one year and five years	22,898	24,323
More than five years	9,520	8,931
	<u>40,779</u>	<u>42,510</u>
Discount to present value	(2,799)	(4,905)
Less allowance for unfulfilled pledges	(10,196)	(11,246)
Pledges receivable	<u>\$ 27,784</u>	<u>\$ 26,359</u>

4. Property, Plant, and Equipment

Property, plant, and equipment and related accumulated depreciation at June 30, 2004 and 2003, in thousands of dollars, consist of the following:

	2004	2003
Land	\$ 93,441	\$ 80,426
Buildings and improvements	1,385,085	1,353,444
Construction in progress	285,666	117,206
Equipment	139,750	139,173
Library books	94,600	87,477
	<u>1,998,542</u>	<u>1,777,726</u>
Less accumulated depreciation	(543,634)	(478,402)
Property, plant, and equipment, net	<u>\$1,454,908</u>	<u>\$1,299,324</u>

For the years ended June 30, 2004 and 2003

Certain fully depreciated equipment amounting to approximately \$13,797,000 and \$7,878,000 was removed from the statement of financial position in 2004 and 2003 respectively.

Certain disposed property with a net book value of approximately \$5,041,000 was removed from the statement of financial position in 2004. In addition, certain buildings were sold during fiscal 2004. At the time they were sold, they had a net book value of \$4,457,000. In connection with the sale, a gain of \$4,498,000 was recorded.

On June 30, 1998, the University entered into a lease/lease back arrangement with a private investor relating to four properties. The lease terms range from 41 to 52 years and the total value of these properties was approximately \$222,000,000. The lease payments were prepaid to the University at the closing. The University's sublease terms range from 33 to 42 years and the University has an option to purchase the investor's leasehold interest in the properties on dates specific to each property between years 15 and 24. The University has prefunded both the required annual sublease payment obligations and the amounts necessary to exercise each specific lease buyout option.

5. Indebtedness

Debt at June 30, 2004, in thousands of dollars, consists of the following:

Maturity Date	Massachusetts Agency Bonds	Term Loans	Various Mortgages, Bonds, Notes, and Capital Lease Obligations	Total
2005	\$ 1,700	\$ 460	\$ 32,532	\$ 34,692
2006	1,800	478	2,645	4,923
2007	1,950	498	2,745	5,193
2008	2,000	6,547	2,905	11,452
2009	1,500	0	6,328	7,828
2010 and after	690,200	100,000	78,906	869,106
Total	<u>\$ 699,150</u>	<u>\$ 107,983</u>	<u>\$ 126,061</u>	<u>\$ 933,194</u>

Agency Bonds:

Massachusetts Health and Educational Facilities Authority Bond Issues:

Capital Asset Program Demand Revenue Bonds, Series E, principal outstanding is \$18,000,000 at a variable tax-exempt interest rate (1.00% at June 30, 2004). The bonds mature and are due in their entirety on April 1, 2011.

Boston University Demand Revenue Bonds, Series H, principal outstanding is \$69,000,000 at a variable tax-exempt interest rate (1.00% at June 30, 2004) which is currently in a weekly mode. The bonds mature in annual installments of \$17,250,000 from December 2026 through December 2029.

Boston University Revenue Bonds, Series N, principal outstanding \$135,650,000 at a variable taxable interest rate (1.40% at June 30, 2004), payable periodically through October 24, 2034. The bonds mature in annual installments ranging from \$300,000 to \$13,850,000 from October 1, 2004, through October 1, 2034. The Series N Loan and Trust Agreement allows Boston University to purchase portions of its outstanding Series N bonds at 35-day intervals.

Boston University Revenue Bonds, Series Q-1 and Q-2, principal outstanding \$44,700,000 for Series Q-1 and \$46,600,000 for Series Q-2 at variable tax-exempt interest rates of 1.08% and 1.07% respectively at June 30, 2004. The Series Q-1 and Series Q-2 bonds are currently in the weekly mode and mature in annual installments ranging from \$1,200,000 to \$6,100,000 from October 1, 2004, to October 1, 2031.

Boston University Revenue Bonds, Series S, principal outstanding \$35,000,000 at a tax-exempt fixed blended interest rate (4.71% at June 30, 2004), payable periodically through October 1, 2039. The bonds mature in annual installments ranging from \$5,695,000 to \$10,310,000 from October 1, 2035, through October 1, 2039.

For the years ended June 30, 2004 and 2003

Massachusetts Development Finance Agency Bond Issue:

Boston University Revenue Bonds, Series P, principal outstanding \$100,000,000 at a tax-exempt fixed blended interest rate (5.63% at June 30, 2004), payable periodically through May 15, 2059. The bonds mature in annual installments ranging from \$675,000 to \$3,100,000 from May 15, 2025, through May 15, 2039, and with a final payment of \$82,210,000 on May 15, 2059.

Boston University Revenue Bonds, Series R-1 through R-4, aggregate principal outstanding of \$250,200,000 (\$62,400,000 Series R-1; \$62,600,000 Series R-2; \$62,600,000 Series R-3; \$62,600,000 Series R-4) at a tax-exempt variable blended interest rate (1.05% at June 30, 2004). The bonds are being remarketed in the daily (Series R-2 and R-4) and the weekly (Series R-1 and R-3) modes. The Series R bonds mature in annual installments ranging from \$2,000,000 to \$100,000,000 from October 1, 2019, to October 1, 2043.

Term Loans:

Boston University, Century Notes, Series A, principal outstanding \$100,000,000 at a taxable interest rate of 7.63% payable semiannually on January 15 and July 15 of each year. The principal is due in its entirety on July 15, 2097.

Boston University Loan from Citizens Bank of Massachusetts, principal outstanding \$7,982,000 at a taxable interest rate of 3.99% at June 30, 2004, payable in monthly installments based upon a 20-year level amortization schedule. The loan matures and is due in its entirety in October 2007.

Various Mortgages, Bonds, and Notes:

Boston University Bonds, Series 1999, principal outstanding \$21,950,000 at a variable taxable interest rate (1.70% at June 30, 2004), payable periodically through October 2019. The bonds mature in annual installments ranging from \$1,500,000 to \$2,950,000 from October 2010 through October 2019.

Boston University Aetna Senior Secured Note, Series A, principal outstanding \$8,088,000 at a taxable interest rate of 10.20%, payable on a semiannual basis from September 15, 2004, through September 15, 2018.

Boston University Aetna Senior Secured Note, Series B, principal outstanding \$4,044,000 at a taxable interest rate of 10.20%, payable on a semiannual basis from September 15, 2004, through September 15, 2008.

Sorbonne Limited (an entity owned 50% by the University) owns two dormitories in London, England, which are leased to the University pursuant to two capital leases. The University's capital lease obligation under these arrangements was \$53,508,000 at June 30, 2004 (see Note 8).

The University has various mortgages and notes payable of \$38,471,000 at taxable interest rates up to 7.00%, maturing in various years through 2022.

During fiscal 2004, a total of \$29,385,000 was paid for interest on debt including settlements on interest rate exchange agreements. Of this amount \$2,916,000 was capitalized.

In 1997, the University entered into two interest rate exchange agreements to exchange variable for fixed rate interest rate obligations without the exchange of the underlying principal amount as part of a liability management strategy. The agreements partially hedge variable interest rate exposure on certain debt issues. Under the first agreement, the counter party will pay the University a variable interest rate equal to the rate paid by the University on its taxable Revenue Bonds, Series N, on a notional amount of \$24,755,000, and the University will pay the counter party at a fixed interest rate of 6.79%. Under the second agreement, the counter party will pay the University a variable tax-exempt interest rate equal to the one-week Bond Market Association (BMA) Variable Rate Index on a notional amount of \$25,000,000, and the University will pay the counter party at a fixed interest rate of 5.28%.

In 2001, the University entered into two forward long-term interest rate exchange agreements having notional amounts of \$93,600,000 and \$10,700,000 respectively. These agreements hedge a portion of the University's variable interest rate exposure on certain debt issues. Under the terms of the \$93,600,000 notional interest rate exchange agreement, the counter party will pay the University a variable rate equal to 67% of the one-month London Interbank Offered Rate

For the years ended June 30, 2004 and 2003

(LIBOR) and the University will pay the counter party a fixed rate of 4.1% for a term of 30 years commencing October 30, 2001. With respect to the \$10,700,000 notional interest rate exchange agreement, the counter party will pay the University a variable rate equal to 67% of the one-month LIBOR and the University will pay the counter party a fixed rate of 4.16% for a term of 20 years commencing October 1, 2002.

In 2002, the University entered into four forward long-term interest rate exchange agreements having notional amounts of \$90,000,000, \$30,000,000, \$59,750,000, and \$59,750,000 respectively. These agreements will be utilized to hedge a portion of the University's variable interest rate exposure on certain debt issues. Under the terms of the \$90,000,000 and \$30,000,000 notional interest rate exchange agreements, the counter parties will pay the University a variable rate equal to the monthly weighted average of the one-week BMA Municipal Swap Index and the University will pay the counter party a fixed rate of 5.44% for a term of 34 years commencing July 1, 2008. With respect to the two \$59,750,000 notional interest rate exchange agreements, the counter parties will pay the University a variable rate equal to the monthly weighted average of the one-week BMA Municipal Swap Index and the University will pay the counter parties a fixed rate of 5.39% for a term of 34 years commencing July 1, 2008.

In 2004, the University entered into two interest rate exchange agreements having notional amounts of \$14,000,000 and \$21,000,000 respectively. Under the terms of these agreements, the counter parties will pay the University a fixed rate of 2.51% and the University will pay the counter parties a variable rate equal to the weighted average of the one-week BMA Municipal Swap Index for a term of three years commencing April 13, 2004. On April 13, 2007, a swaption agreement provides the counter parties with the option to extend the interest rate exchange agreements through April 13, 2011. The University will receive a fixed rate of 4.71% in place of 2.51% for the extended term if the swaption agreement is exercised.

The University implemented Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as of July 1, 2000. The interest rate exchange agreements are recorded at an estimated market value of \$(27,222,000) and \$(53,873,000) at June 30, 2004 and 2003, respectively, and the increase (decrease) in estimated market value of \$26,651,000 and \$(42,374,000) in 2004 and 2003, respectively, is included in nonoperating net realized and unrealized gains (losses) on interest rate exchange agreements. In addition to the unrealized gains (losses) related to the valuation of the exchange agreements, the University paid (net) \$5,795,000 and \$5,392,000 during the years ended June 30, 2004 and 2003, respectively, of settlement costs under the interest rate exchange agreements.

These financial instruments necessarily involve counter party credit exposure. The counter parties for these interest rate exchange transactions are major financial institutions that meet the University's criteria for financial stability and credit-worthiness. The estimated market value of the interest rate exchange agreements was computed by a third party financial intermediary using the net present value of fixed and floating future cash flows, with floating future flows estimated through the use of forward interest rate yield curves.

The University has outstanding variable rate debt of \$640,108,000, which approximates fair value in the accompanying financial statements since the interest rates vary with changes in market rates. In addition, there is \$293,086,000 of fixed rate debt outstanding which also approximates fair value.

Plant property with a book value before depreciation of \$222,369,000 as of June 30, 2004, as well as tuition revenues, are pledged as collateral for certain obligations. Indebtedness agreements contain tests for unrestricted revenues, net of expenditures and debt payments and certain restrictions on the amount of additional indebtedness. The University is required to maintain a total of cash and investments which is equal to or greater than 60% of its total liabilities.

6. Pension and Other Employee Benefits

403(b) Plan:

The University makes retirement plan contributions to Teachers Insurance and Annuity Association (TIAA), College Retirement Equities Fund (CREF), and Fidelity Investments for faculty and staff. This program is a defined contribution plan available to all employees who work at least 50% of a full-time schedule, and have an appointment or an expected assignment duration of

BOSTON UNIVERSITY | NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS *continued*

For the years ended June 30, 2004 and 2003

at least nine months. The expenses for this program amounted to \$38,007,000 in fiscal year 2004 and \$36,211,000 in fiscal year 2003.

Pension and other Postretirement Benefit Plans:

The University maintains a qualified defined benefit pension plan that covers certain retirees and eligible employees who elected to participate before December 31, 1986. As of December 31, 1986, the plan was closed to any new participants as well as to additional employee contributions. Due to the funded status of the plan, no University contributions were required for the fiscal period ended June 30, 2004.

The University offers subsidized health care coverage to employees that retire from the University after age 55 until age 65, provided they have at least ten consecutive years of participation in the plan at the time they retire. The University also provides minimal life insurance benefits to retirees.

Pension and other Postretirement Benefit Plans at June 30, 2004 and 2003, in thousands of dollars:

	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
Change in Benefit Obligation				
Benefit obligation at beginning of year . . .	\$ 17,162	\$ 16,680	\$ 20,818	\$ 16,085
Service cost			1,714	1,397
Interest cost	931	1,097	1,286	1,258
Amendments	1,068			
Actuarial loss (gain)	(341)	1,285	(516)	2,833
Benefits paid	(1,839)	(1,900)	(1,091)	(755)
Benefit obligation at end of year	<u>16,981</u>	<u>17,162</u>	<u>22,211</u>	<u>20,818</u>
Change in Plan Assets				
Fair value of plan assets at beginning of year	18,312	21,302		
Actual return on plan assets	876	(1,090)		
Benefits paid	(1,839)	(1,900)		
Fair value of plan assets at end of year . . .	<u>17,349</u>	<u>18,312</u>		
Funded status	368	1,150	(22,211)	(20,818)
Unrecognized actuarial loss	5,380	5,508	2,737	3,423
Unrecognized prior service cost	1,928	1,121		
Unrecognized net transition obligation (asset)	(10)	(21)		
Prepaid (accrued) benefit cost	<u>\$ 7,666</u>	<u>\$ 7,758</u>	<u>\$ (19,474)</u>	<u>\$ (17,395)</u>
Weighted-average Assumptions as of June 30				
Discount rate	6.25%	5.75%	6.25%	5.75%
Rate of compensation increase	N/A	N/A	N/A	N/A
Expected return on plan assets	8.50%	8.50%		
Initial health care trend			9.00%	10.00%
Ultimate health care trend			5.00%	5.00%
Years to reach ultimate			4	5

For measurement purposes, a 9% and 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2004 and 2003, respectively, decreasing at 1% per year thereafter until an ultimate rate of 5% in 2008.

BOSTON UNIVERSITY | NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS *continued*

For the years ended June 30, 2004 and 2003

	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
Components of Net Periodic Benefit Cost				
Service cost	\$	\$	\$ 1,714	\$ 1,397
Interest cost	931	1,097	1,286	1,258
Expected return on plan assets	(1,474)	(1,725)		
Amortization of prior service cost	260	260		
Amortization of initial transition obligation	(11)	(10)		
Recognized actuarial loss	385		170	
Net periodic benefit cost	\$ 91	\$ (378)	\$ 3,170	\$ 2,655

Assumed health care cost trends have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in the assumed health care cost trend rates would have the following effects.

	1% Point Increase	1% Point Decrease
Effect on total of service and interest cost components	\$ 301	\$ (269)
Effect on postretirement benefit obligation	1,348	(1,231)

The accumulated benefit obligation at the end of fiscal year 2004 and 2003 was \$16,981,000 and \$17,162,000, respectively.

Plan Assets

The pension plan weighted average asset allocations as of June 30, 2004 and 2003, respectively, are as follows:

Asset Category	Plan Assets	
	Fiscal Year Ending 2004	2003
Equity securities	78%	81%
Fixed income	22%	19%

The expected long-term rate of return assumption represents the expected average rate of earnings on the funds invested or to be invested to provide for the benefits included in the benefit obligations. The long-term rate of return assumption is determined based on a number of factors, including historical market index returns, the anticipated long-term asset allocation of the plans, historical plan return data, plan expenses, and the potential to outperform market index returns.

Expected Cash Flows

Information about the expected cash flows for the pension and other postretirement benefit plans are as follows:

	Pension Benefits	Other Benefits
Employer contributions		
2005 (Expected)	\$	\$
Expected benefit payments		
2005	2,013	1,328
2006	1,895	1,559
2007	1,795	1,755
2008	1,698	1,944
2009	1,601	2,143
2010–2014	6,810	13,948

For the years ended June 30, 2004 and 2003

7. Commitments and Contingencies

As of June 30, 2004, approximately \$184,345,000 is committed principally on open construction contracts and acquisitions. This amount will be financed from operations, federal government grants, private donations, and borrowings.

The University has also formally agreed to support the Huntington Theatre, Inc., a nonprofit theatre production company, during the next year in the amount of \$510,000.

The University is committed to minimum annual rent payments under several capital and long-term noncancelable operating leases through the year 2030, for the use of educational facilities and office space, as follows:

	Operating	Capital
2005	\$ 28,514,000	\$ 4,762,000
2006	26,333,000	4,762,000
2007	24,109,000	4,762,000
2008	20,332,000	4,762,000
2009	18,619,000	4,762,000
Thereafter	208,008,000	74,958,000
	\$ 325,915,000	\$ 98,768,000
Less: Amounts representing interest		45,260,000
Capital lease obligation		\$ 53,508,000

Rent expense for educational facilities and office space amounted to \$26,596,000 and \$28,182,000 during the years ended 2004 and 2003, respectively. Certain of these leases provide for an option to purchase these properties at fair value.

In fiscal 1993 the University commenced leasing a 180,000-square-foot medical research building under a 25-year noncancelable lease requiring minimum annual lease payments of approximately \$3,276,000, which are included in the table above. The building was constructed at a cost of \$41,500,000 by a trust of which the University is a 50% beneficiary. The trust had outstanding debt of \$28,827,000 at June 30, 2004.

In fiscal 2000, the University commenced leasing a portion of a 171,000-square-foot biomedical research facility. The 30-year noncancelable master lease of 69,000 square feet of space requires minimum annual lease payments of approximately \$2,043,000, which are included in the table above. The University has subleased 23,000 square feet of the space under the master lease. The building was constructed at a cost of \$52,132,000 by a trust of which the University is a 50% beneficiary. As of June 30, 2004, the trust had outstanding debt of approximately \$20,619,000.

In fiscal 2000, the University commenced leasing a 1,000-space parking garage under a 20-year noncancelable lease requiring minimum annual lease payments of \$778,000, which are included in the table above. The garage was constructed at a cost of \$18,187,000 by a nonprofit corporation of which the University has a 50% interest. As of June 30, 2004, the corporation had outstanding debt of approximately \$15,400,000.

The University has leased certain properties under noncancelable leases ranging in terms from 10 to 15 years with minimum annual lease payments of \$2,000,000, which are included in the table above. The buildings were constructed at a cost of approximately \$22,200,000 by certain real estate partnerships of which the University owns shares ranging from 45 to 50% (see Note 1). As of June 30, 2004, the real estate partnerships had outstanding debt of approximately \$11,400,000.

On July 1, 1996, the University entered into a Support Agreement with the Boston Medical Center Corporation which was formed from the merger of Boston City Hospital and Boston University Medical Center Hospital. The University agreed to continue to pay a percentage portion of the Boston Medical Center Corporation's clinical department budget. Management believes the commitment for fiscal year 2005 approximates \$8,000,000.

For the years ended June 30, 2004 and 2003

During fiscal 2004, the University signed a lease agreement to occupy approximately 52,000 square feet of office and research space currently under construction. Construction started in April 2004, with occupancy planned for fiscal 2006. Future minimum lease payments under this agreement amount to approximately \$41,368,000, to be paid over the 15-year initial term. Future rental commitments on this lease are not included in the five-year payout schedule. The obligation and asset associated with this capital lease will not be recorded in the financial statements until occupancy commences.

On August 20, 2003, The Hillel House at Boston University, an unrelated not-for-profit organization, entered into a six-year Term and Construction Loan Agreement with Fleet National Bank ("Fleet Bank") to finance the construction of a new building, with a total construction budget of \$15 million exclusive of land acquisition costs. In conjunction with the financing, the University entered into a put agreement with Fleet Bank, whereby Fleet Bank has the option to put the balance of any amounts outstanding under the loan to the University in the event of a default by The Hillel House. The maximum amount of the loan is \$11 million of which \$3.8 million had been drawn by The Hillel House and was outstanding as of June 30, 2004. In the event of a default, the University would become the new lender with all lender rights and responsibilities under the loan agreement, including a security interest in the property.

Audits of specific contracts and grants by the Department of Health and Human Services have been conducted on a periodic basis. The University believes that adverse determinations, if any, from audits by the Department of Health and Human Services or other agencies will not be material to the financial statements.

The University is a defendant in various legal actions arising out of the normal course of its operations. Although the final outcome of such actions cannot currently be determined, the University believes that eventual liability, if any, will not have a material effect on the University's financial position.

8. Subsequent Event

Subsequent to year end, the University dissolved the Sorbonne Limited partnership, an entity in which it was a 50% beneficiary. In connection with this transaction, the University terminated its capital leases and took ownership of the two dormitories in London, England.

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Suzanne Cutler
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Dexter A. Dodge

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