State Auditor's Office

John Keel, CPA
State Auditor

Accreditation Reviews Fiscal Year 2007

March 2008
Report No. 08-344

Introduction

The State Auditor's Office completed accreditation reviews of seven higher education institutions' fiscal year 2007 financial statements:

- Sul Ross State University.

- The University of Houston.

- The University of Texas at Austin.

- The University of Texas at Brownsville.

- The University of Texas at Dallas.

- The University of Texas Health Science Center at San Antonio.

- The University of Texas Medical Branch at Galveston.

These reviews are performed to comply with the accreditation reaffirmation requirements of the Southern Association of Colleges and Schools. <u>The reports included in this document were prepared by the higher education institutions</u>, but they include the following documents issued by the State Auditor's Office:

- Auditor's Review Report.

- A management letter.

A review consists principally of inquiries of personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, the State Auditor's Office did not express such opinions.

SUL ROSS STATE UNIVERSITY

A Member of the Texas State University System

ALPINE, TEXAS

Southern Association of
Colleges and Schools
Review

For the Year Ended

August 31, 2007

SUL ROSS STATE UNIVERSITY

SACS Review

For the Year Ended August 31, 2007

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State Auditor

Auditor's Review Report

February 25, 2008

Dr. R. Vic Morgan, President
Sul Ross State University
SRSU Box C-114
East Highway 90
Alpine, Texas 79832

Dear Dr. Morgan:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of Sul Ross State University (University) as of and for the year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the University.

A review consists principally of inquiries of University personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the University. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The University has not presented a management's discussion and analysis section that the Governmental Accounting Standards Board has identified as required supplementary information that is not part of the basic financial statements.

This report is intended for use by the Board of Regents of the Texas State University System, management of the University, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

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SAO Report No. 08-339

Sul Ross State University

Statement of Net Assets

At August 31, 2007

(See Auditor's Review Report on page 1.)

ASSETS		
Current Assets		
Cash and Cash Equivalents (Note 3)	$	14,041,609
Restricted:		
Cash and Cash Equivalents (Note 3)		5,744,514
Short-Term Investments (Note 3)		198,000
Legislative Appropriations		4,232,172
Loans and Contracts		-
Receivables, Net of Allowances:		
Federal		755,523
Interest and Dividends		90,530
Accounts		3,398,222
Other		-
Due from Other State Entities (Note 7)		3,876
Consumable Inventories		170,477
Merchandise Inventories		33,599
Loans and Contracts		15,979
Other Current Assets		68,311
Total Current Assets	$	28,752,812
Non-Current Assets		
Investments (Note 3)	$	6,592,677
Loans and Contracts		763,706
Capital Assets (Note 2)		
Non-Depreciable		1,278,968
Depreciable		118,368,528
Less: Accumulated Depreciation		(54,976,391)
Total Non-Current Assets	$	72,027,488
Total Assets	$	100,780,300
LIABILITIES		
Current Liabilities		
Payables:		
Accounts	$	1,436,375
Payroll		1,290,549
Other		81,212
Due to Other State Entities (Note 7)		222,076
Deferred Revenue		5,647,169
Employees' Compensable Leave (Note 4)		507,262
Funds Held for Others		230,339
Other Current Liabilities		281,846

Total Current Liabilities	$	9,696,828
Non-Current Liabilities		
Employees' Compensable Leave (Note 4)	$	363,938
Total Non-Current Liabilities	$	363,938
Total Liabilities	$	10,060,766
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	$	64,671,105
Restricted for:		
Non-Expendable		
Permanent Funds, True Endowments, Annuities		13,672,706
Expendable		
Other		2,821,786
Unrestricted		9,553,937
Total Net Assets	$	90,719,534

The accompanying Notes to the Financial Statements are an integral part of this statement.

Sul Ross State University

Statement of Revenues, Expenses, and Changes in Net Assets

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

OPERATING REVENUES		
Tuition and Fees - Pledged		8,498,372
Discounts and Allowances		(1,745,721)
Auxiliary Enterprises - Pledged		4,252,462
Discounts and Allowances		(886,681)
Other Sales of Goods and Services - Non-Pledged		612,353
Federal Revenue		8,494,306
State Grant Revenue		1,356,132
Other Operating Grant Revenue		117,785
Other Operating Revenues		438,403
Total Operating Revenues	$	21,137,411
OPERATING EXPENSES		
Cost of Goods Sold	$	0
Salaries and Wages		20,200,416
Payroll Related Costs		5,641,491
Professional Fees and Services		356,130
Travel		1,025,476
Materials and Supplies		4,137,691
Communications and Utilities		2,125,182
Repairs and Maintenance		333,376
Rentals and Leases		1,163,584
Printing and Reproduction		269,798
Depreciation and Amortization		3,193,954
Bad Debt Expense		(33,771)
Scholarships		3,749,292
Other Operating Expenses		4,301,730
Total Operating Expenses	$	46,464,349
Operating Income (Loss)	$	(25,326,938)
NONOPERATING REVENUES (EXPENSES)		
Legislative Appropriations	$	23,774,672
Gifts		1,828,821
Interest and Investment Income (Loss)		709,432
Net Increase (Decrease) in Fair Value of Investments		219,037
Other Nonoperating Revenues (Expenses)		566,906
Total Nonoperating Revenues (Expenses)	$	27,098,868
Income (Loss) Before Other Revenues, Expenses, Gains (Losses), and Transfers	$	1,771,930

OTHER REVENUES, EXPENSES, GAINS (LOSSES), AND TRANSFERS		
Capital Contributions	$	399,281
Capital Appropriations (HEAF)		1,615,735
Transfers Out to Other State Entities (Note 7)		(1,438,816)
Legislative Transfers Out (Note 7)		(2,778,447)
Lapses		0
Total Other Revenues, Expenses, Gains (Losses), and Transfers	$	(2,202,247)
CHANGE IN NET ASSETS	$	(430,317)
Net Assets, September 1, 2006	$	91,171,401
Restatements (Note 13)		(21,550)
Net Assets, September 1, 2006, as Restated	$	91,149,851
NET ASSETS, August 31, 2007	$	90,719,534

The accompanying Notes to the Financial Statements are an integral part of this statement.

Sul Ross State University

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

CASH FLOWS FROM OPERATING ACTIVITIES		
Proceeds from Tuition and Fees	$	5,649,653
Receipts from Customers		609,889
Proceeds from Research Grants and Contracts		9,852,111
Proceeds from Loan Programs		975,847
Proceeds from Auxiliaries		3,761,450
Proceeds from Other Revenues		472,494
Payments to Suppliers for Goods and Services		(17,237,976)
Payments to Employees for Salaries		(19,916,591)
Payments to Employees for Benefits		(5,641,491)
Payments for Loans Provided		(967,096)
Payments for Other Expenses		(352)
Net Cash Provided (Used) by Operating Activities	$	(22,442,062)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Proceeds from Legislative Appropriations	$	25,489,446
Proceeds from Gifts		1,828,821
Proceeds from Endowments		168,468
Proceeds from Other Sources		8,307,848
Payments for Transfers to Other Entities		(1,438,816)
Payments for Other Uses		(7,853,069)
Net Cash Provided (Used) by Non-Capital Financing Activities	$	26,502,698
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from Disposal of Capital Assets		44,616
Proceeds from Federal Grants and Contracts		399,281
Payments for Additions to Capital Assets		(5,129,799)
Payments of Principal on Capital-Related Debt		(2,778,447)
Net Cash Provided (Used) by Capital and Related Financing Activities	$	(7,464,349)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales of Investments	$	31,925
Proceeds from Interest and Investment Income		924,872
Payments to Acquire Investments		(1,001,003)
Net Cash Provided (Used) by Investing Activities	$	(44,206)
Net Increase (Decrease) in Cash and Cash Equivalents	$	(3,447,919)

Cash and Cash Equivalents, September 1, 2006	$	23,234,042
Restatements		
Cash and Cash Equivalents, September 1, 2006, as restated	$	23,234,042
Cash and Cash Equivalents, August 31, 2007	$	19,786,123

Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities

Operating Income (Loss)	$	(25,326,938)
Adjustments:		
Depreciation and Amortization	$	3,193,954
Bad Debt Expense		(33,771)
Operating Income and Cash Flow Categories:		
Classification Differences		
Changes in Assets and Liabilities:		
(Increase) Decrease in Receivables		(882,517)
(Increase) Decrease in Due from Other Entities		
(Increase) Decrease in Inventories		(5,440)
(Increase) Decrease in Prepaid Expenses		(49,152)
(Increase) Decrease in Loans and Contracts		8,750
(Increase) Decrease in Other Assets		(350)
Increase (Decrease) in Payables		85,391
Increase (Decrease) in Due to Other Entities		
Increase (Decrease) in Deferred Revenue		93,165
Increase (Decrease) in Employees' Compensable Leave		102,707
Increase (Decrease) in Funds Held for Others		
Increase (Decrease) in Other Liabilities		372,139
Total Adjustments	$	2,884,876
Net Cash Provided (Used) by Operating Activities	$	(22,442,062)
Non-Cash Transactions		
Net Increase (Decrease) in Fair Value of Investments	$	219,037
Donated Capital Assets		10,975

The accompanying Notes to the Financial Statements are an integral part of this statement.

Sul Ross State University

Statement of Changes in Unrestricted Net Assets

For the Fiscal Year Ended August 31, 2007

	8/31/2007	8/31/2006	Difference
Reserved			
Encumbrances	$	$ 0	$ 0
Legislative Appropriations to be Lapsed			0
Accounts Receivable	2,029,259	783,474	1,245,785
Inventories			0
Self-Insurance Plans			0
Capital Projects			0
Retirement of Indebtedness			0
Higher Education Assistance Funds	1,524,159	1,274,271	249,888
Fees with Use Restricted by Statute:			
International Education Fees (54.5132)			0
Student Service Fees (54.503)			0
University Center Fee (54.527)			0
Permanent Health Fund Endowments			0
Advanced Research / Advanced Technology Programs		0	0
Notes Receivable			0
Deposits			0
Future Operating Budgets		0	0
Prepaid Expenses	10,800	11,271	(471)
Deferred Charges			0
Travel Advances			0
Petty Cash	25,773	83,284	(57,511)
Texas Public Education Grants			0
Unreserved			
Allocated			
Future Operating Budgets			0
Capital Projects			0
Service Department Operating Funds			0
Auxiliary Enterprises Operating Funds			0
Funds Functioning as Endowment - Unrestricted	0	0	0
Funds Functioning as Loans			0
Retirement of Indebtedness			0
Start-Up / Matching			0
Utilities Reserve			0
Student Fees	1,048,061	969,277	78,784
Other	4,915,885	6,177,819	(1,261,934)
Unallocated	0	(732,769)	732,769
Total Unrestricted Net Assets	$ 9,553,937	$ 8,566,627	$ 987,310

(See Auditor's Review Report on page 1.)

General Introduction
This report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of Sul Ross State University (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria the report also includes a Statement of Changes in Unrestricted Net Assets, and a management letter describing issues noted in the review.

Reporting Entity
The University is a component of the Texas State University System and an agency of the State of Texas. The University prepares financial statements that are included in the State's *Comprehensive Annual Financial Report*, which is audited by the Texas State Auditor's Office.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred. Operating items are distinguished from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the principle of ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair market value at the date of donation in the case of gifts. Livestock for educational purposes is recorded at estimated fair value. For equipment, the University capitalizes all items with a unit cost of $5,000 or more. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation is computed using the straight-line method over the estimated useful life of the asset, generally 40 to 50 years for buildings, 20 to 25 years for infrastructure and land improvements, and 3 to 7 years for equipment. Inexhaustible assets such as works of art and historical treasures are not depreciated.

Budget and Budgetary Accounting

The budget is prepared biennially and represents appropriations authorized by the legislature and approved by the Governor in accordance with the General Appropriations Act. Unencumbered appropriations are generally subject to lapse 60 days after the end of the fiscal year for which they were appropriated.

Assets, Liabilities, and Net Assets

Cash and Cash Equivalents: For purposes of the Statement of Cash Flows, the University considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Additionally, funds invested through the State Comptroller Cash Management Program are also considered cash equivalents.

Investments: The University accounts for its investments at fair value in accordance with GASB Statement No 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* Changes in unrealized gain (loss) on the carrying value of investments are reported in the statements of revenues, expenses, and changes in net assets.

Accounts Receivable: Accounts receivable consists of tuition and fees charged to students and auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also include amounts due from the Federal government, state and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts.

Inventories and Prepaid Items: Inventories are carried at the lower of cost or market or the average cost basis. The consumption method of accounting is used to account for inventories and prepaid items. The cost of these items is expensed when the items are consumed. Total cost of all inventories at August 31, 2007, totaled $204,076.

Deferred Revenue: Deferred revenues include amounts received from students and grant and contract sponsors that have not yet been earned. As of August 31, 2007, the amount of deferred revenues totaled $5,647,169.

Accounts Payable: Accounts payable represents the liability for the value of assets or services received as of the balance sheet for which payment is pending. As of August 31, 2007, accounts payable totaled $1,436,375.

Invested in Capital Assets, Net of Related Debt

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bond, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted Net Assets: Restricted assets include cash and investments that are externally restricted to make debt service payments, maintain sinking or reserve funds, or to purchase or construct capital or other non-current assets, or imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Assets

Unrestricted net assets consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified. When both restricted and unrestricted net assets are available for use, restricted resources are used first, then unrestricted resources are used as they are needed.

Note 2: Capital Assets

	Balance 9/1/2006	Adjustments	Completed Construction in Progress	Additions	Deductions	Balance 8/31/2007
Non-Depreciable Assets:						
Land and Land Improvements	929,918	$	$	$	$	929,918
Construction in Progress	34,516,733		(38,570,402)	4,145,019		91,350
Other Capital Assets	257,700					257,700
Total Non-Depreciable Assets	35,704,351	0	(38,570,402)	4,145,019	0	1,278,968
Depreciable Assets:						
Buildings and Building Improvements	64,007,918	$	38,570,402	$	$	102,578,320
Infrastructure	666,789					666,789
Facilities and Other Improvements	3,113,990			110,994		3,224,984
Furniture and Equipment	6,219,325			566,424	(265,195)	6,520,554
Vehicles, Boats, and Aircraft	1,225,955			19,679		1,245,634
Other Capital Assets	3,884,829			247,418		4,132,247
Total Depreciable Assets at Historical Cost	79,118,806	0	38,570,402	944,515	(265,195)	118,368,528
Less Accumulated Depreciation for:						
Buildings and Building Improvements	(40,569,469)	$	$	(2,435,955)	$	(43,005,424)
Infrastructure	(666,789)					(666,789)
Facilities and Other Improvements	(2,263,250)			(115,161)		(2,378,411)
Furniture and Equipment	(4,879,133)	36,497		(420,178)	265,195	(4,997,619)
Vehicles, Boats, and Aircraft	(839,727)	(14,947)		(80,132)		(934,806)
Other Capital Assets	(2,850,814)			(142,528)		(2,993,342)
Total Accumulated Depreciation	(52,069,182)	21,550	0	(3,193,954)	265,195	(54,976,391)
Depreciable Assets, Net	$ 27,049,624	$ 21,550	$ 38,570,402	$ (2,249,439)	$ 0	$ 63,392,137
Capital Assets, Net	$ 62,753,975	$ 21,550	$ 0	$ 1,895,580	$ 0	$ 64,671,105

Note 3: Deposits, Investments, and Repurchase Agreements

Authorized Investments

The University is authorized to invest in obligations and instruments as defined in the Public Funds Investment Act (Sec. 2256.001 Texas Governmental Code). Such investments include:

- Obligations of the United States or its agencies
- Direct Obligations of the State of Texas or its agencies
- Obligations of political subdivisions rated not less than A by a national investment rating firm
- Certificates of deposit
- Other instruments and obligations authorized by statute

Deposits

	Carrying Amount	Bank Balance
The carrying amount of Cash in Bank (including restricted assets) is	($1,506,039)	
At August 31, 2007, the actual balances on deposit with local banks were		$1,259,209

Cash on Hand	$	27,906
Cash in Bank		(1,506,039)
Reimbursement Due from Treasury		1,267,916
Cash in State Treasury		1,766,035
Cash Equivalents (Tex Pool)		18,230,305
Total Cash and Cash Equivalents	$	19,786,123
Current Assets Cash and Cash Equivalents	$	14,041,609
Current Assets Restricted Cash and Cash Equivalents		5,744,514
Total Cash and Cash Equivalents	$	19,786,123

Custodial credit risk for deposits is the risk that, in the event of the failure of the counterparty, Sul Ross State University will not be able to recover the value of its deposits that are in the possession of an outside party. As of August 31, 2007 Sul Ross State University did not have any deposits that were exposed to custodial credit risk.

Foreign currency risk for deposits is the risk that changes in exchange rate will adversely affect deposits. Sul Ross State University did not have any deposits exposed to foreign currency risk as of August 31, 2007.

Investments

The investments as of August 31, 2007, are stated at "Fair Market Value". To comply with the reporting requirements of GASB Statement No. 40, the University's investments are shown below to give an indication of credit risk assumed by the University at year-end.

Credit risk is the risk that another party to a investment transaction will not fulfill its obligations. This is not to be confused with market risk which is the risk that the market value of an investment or securities underlying a repurchase agreement will decline. Market risk is not depicted in this note.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, Sul Ross State University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Sul Ross State University's investment policy limits holding of securities by counterparties to those involved with securities lending. As of August 31, 2007 Sul Ross State University did not have any investments that were exposed to custodial credit risk.

Foreign currency risk for investments is the risk that changes in exchange rate will adversely affect the investment. Sul Ross State University's policy is to limit investments subject to foreign currency risk to 5% of total investments. Sul Ross State University did not have any investments exposed to foreign currency risk as of August 31, 2007.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Through its investment policy, Sul Ross State University manages its exposure to fair value losses arising from increasing interest rates by limiting the modified duration of its investments portfolio to one year.

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. Sul Ross State University did not have any investments in any one issuer that represent five percent or more of total investments as of August 31, 2007.

Investment Type	**AAA**	**AA**	**A-1**	**Not Rated**
US Govt Agency Obligation (TX Treasury Safekeeping)	$4,695,418			
Corporate Obligations (Tx Treasury Safekeeping)		$289,377		

INVESTMENTS

U. S. Government Agency Obligations (Ginnie Mae, Fannie Mae, Freddie Mac, Sallie Mae, etc.)	$	4,695,418
Corporate Obligations		289,377
Equity		1,548,976
Misc (e.g., guaranteed investment contract, political subdivision, bankers' acceptance, negotiable CD)		256,906
Total Investments	$	6,790,677
Current Assets – Short-Term Investments	$	198,000
Current Assets – Restricted Short-Term Investments		0
Non-Current Assets – Restricted Investments		0
Non-Current Assets – Investments		6,592,677
Total Investments	$	6,790,677

Securities Lending and Reverse Repurchase Agreements

The University does not participate in reverse repurchase agreements or a securities lending program and had no securities out on loan to brokers/dealers at August 31, 2007.

Derivative Investing

Derivatives are financial instruments (securities or contracts) whose value is linked to, or "derived" from, changes in interest rates, currency rates, and stock and commodity prices. Derivatives cover a broad range of financial instruments, such as forwards, futures, options, swaps, and mortgage derivatives. These mortgage derivatives are influenced by changes in interest rates, the current economic climate, and the geographic make-up of underlying mortgage loans. There are varying degrees of risk associated with mortgage derivatives. For example, Planned Amortization Class (PACs) and Collateralized Mortgage Obligations (CMOs) are considered a more conservative lower risk investment. In contrast, principal only and interest only strips are considered higher risk investments.

The University holds various forms of collateralized mortgage obligations such as fixed coupon, inverse floating rate and principal only. The University invested in these securities in part to maximize yields and in part to hedge against falling interest rates. These securities are reported at fair market value in the balance sheet. They are reported in aggregate as U.S. Government and Agency Securities in the disclosure of credit risk included in this note.

These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to pre-payments by mortgagees, which may result from a decline in interest rates. However, these investments do not pose a significant risk. The University's investments in derivatives comprise less than 1% of total investments as of August 31, 2007, and August 31, 2006, with a fair value of $5,120 and $6,511, respectively.

The majority of these investments were purchased prior to fiscal year 1995. In 1995, the Texas Legislature took steps to limit state entities' and local governments' ability to invest in high risk derivatives by amending the Public Funds Investment Act. These statutory limitations do not apply to certain institutions of higher education having total endowments of at least $95 million. The University is in compliance with the Public Funds Investment Act.

Note 4: Summary of Long-Term Liabilities

	Balance 9/1/2006	Additions	Deductions	Balance 8/31/2007	Amounts Due Within One Year
Employees' Compensable Leave	$ 768,492	$ 178,416	$ 75,708	$ 871,200	$ 507,262
Total	$ 768,492	$ 178,416	$ 75,708	$ 871,200	$ 507,262

Employees' Compensable Leave

Full-time University employees earn annual leave in the amount of eight to twenty one hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum of 532 hours for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements because experience indicates that the expense for sick leave will be minimal. Eligible part-time employees' sick leave accrual rate is proportional to the number of hours appointed to work.

Note 5: Bonded Indebtedness

The University receives proceeds from revenue bonds issued and held by the System to support capital projects of the System and its institutions. These proceeds are recorded as transfers from the System. The University disburses funds to the System for payments of principal and interest related to the University's share of bond proceeds. These disbursements are recorded as transfers to the System. At August 31, 2007, the System had outstanding bonds payable of $515,135,407. All bonds issued by the System are defined as revenue bonds. As such, the revenues of the System, including the University, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures' lack of specifically identifiable activities and separate accounting requirements imposed by an external party.

No amount of indebtedness related to these bonds has been recorded in the University's financial statements as the System is the party directly liable for these bonds. At August 31, 2007, however, the University's remaining unpaid share of the bond proceeds was $45,531,452.

Note 6: Operating Lease Obligations

Included in operating expenses is $187,660 rent paid or due under operating leases.

There are no future minimum lease rental payments under non-cancellable operating leases having an initial term in excess of one year.

Note 7: Interagency Balances / Activity

Interagency Activities and Balances include numerous transactions between the University and different agencies. At year-end, amounts to be received or paid are reported as follows:

DUE FROM/TO OTHER STATE ENTITIES

Entity		Due from Other State Entities		Due to Other State Entities	Purpose
TX DOT	$	3,876	$		Shared Costs
TSUS System Office				36,918	Shared Costs
USDA				185,158	Shared Costs
	$	3,876	$	222,076	

TRANSFERS IN FROM/OUT TO OTHER STATE ENTITIES

Entity		Transfers In from Other State Entities		Transfers Out to Other State Entities	Purpose
THECB	$		$	7,096	Be On Time Loan Set Aside
TSUS				1,431,720	Debt Service/Shared Costs
	$	0	$	1,438,816	

LEGISLATIVE TRANSFERS IN/OUT

Entity		Legislative Transfers In		Legislative Transfers Out	Purpose
TSUS-General Revenue	$		$	2,778,447	Debt Service
	$	0	$	2,778,447	

Note 8: Contingent Liabilities
At August 31, 2007, no lawsuits involving the University were pending.

Note 9: Risk Financing and Related Insurance
The State provides coverage for workers' compensation and unemployment compensation benefits from appropriations made to other State agencies for University employees. The current General Appropriations Act provides that the University must reimburse General Revenue Fund Consolidated, from University appropriations, one-half of the unemployment benefits paid and twenty-five percent of the workers' compensation benefits paid for former and current employees. The Comptroller of Public Accounts determines the proportionate amount to be reimbursed from each appropriated fund type. The University must reimburse the General Revenue Fund one-hundred percent of the cost for workers' compensation and unemployment compensation for any employee paid from funds held in local bank accounts. Workers' compensation and unemployment plans are on a pay-as-you-go basis, in which no assets are set aside to be accumulated for the payment of claims. No material outstanding claims are pending at August 31, 2007. The University has reserved funds for uninsured losses. At August 31, 2007, there were no claims liabilities.

The Texas Motor Vehicle Safety Responsibility Act requires that every non-governmental vehicle operated on a state highway be insured for minimum limits of liability in the amount of $20,000/$40,000 bodily injury and $15,000 property damage. All vehicles owned or leased by the University are covered by one of two commercial insurance policies specifically customized for the Texas State University System. Both policies provide coverage to the extent of $1,000,000 combined single liability. The coverage exceeds the extent of the waiver of state immunity in the Tort Claims Act.

The University maintains Fire and Extended Coverage and Boiler insurance on certain auxiliary buildings. There were no insurance claims made during the fiscal year ended August 31, 2007.

Note 10: Subsequent Events
There have been no subsequent events that would have a material effect on the University's financial statements for fiscal year ended August 31, 2007.

Note 11: Related Parties
There were no material transactions between the University and related parties during the fiscal year ended August 31, 2007.

Note 12: Stewardship, Compliance, and Accountability
Sul Ross State University has no material violations of finance related and contract provisions and no new component units are included in the financial report. Per the laws of the State of Texas, Sul Ross State University cannot spend amounts in excess of appropriations granted by the Texas Legislature and there are no deficits reported in net assets.

Note 13: Restatement of Net Assets
Net assets were restated by the State Comptroller in the amount of $21,550 as of August 31, 2006, to reflect the sale of a vehicle during fiscal year ending August 31, 2006.

Restatements:		
(a) Restatement by Texas State Comptroller	$	(21,550)
Total Restatements	$	(21,550)

Note 14: Employee Retirement Plans
The State of Texas has joint contributory retirement plans for substantially all of its employees. One of the primary plans in which the University participates is administered by the Teacher Retirement System of Texas (Retirement System). The contributory percentages currently provided by the State and by each participant are 6.0 percent and 6.4 percent, respectively, of annual compensation.

The Retirement System does not separately account for each of its component government agencies because the Retirement System itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. According to an independent actuarial valuation as of August 31, 2007, the present value of the Retirement System's actual and projected liabilities, including projected benefits payable to its retirees and active members and their beneficiaries, was more than the actuarial valuation of Retirement System assets. Further information regarding actuarial assumptions and conclusions, together with audited financial statements, are included in the Retirement System's annual financial report.

The State has also established an Optional Retirement Program for institutions of higher education. Participation in the Optional Retirement Program is in lieu of participation in the Retirement System. The Optional Retirement Program provides for the purchase of annuity contracts and mutual funds. The contributory percentages of participant salaries provided by the State and by each participant enrolled in the plan on or before August 31, 1995, are 8.5 percent and 6.65 percent, respectively. The 8.5 percent is composed of 6.0 percent contributed by the State and an additional 2.5 percent contributed by the University. For participants who enrolled after September 1, 1995, State and participant contributions are 6.0 and 6.65 percent, respectively. Because these are individual annuity contracts, the State has no additional or unfunded liability for this program, and the University bears no responsibility for retirement commitments beyond contributions.

The retirement expense to the University was $1,223,310 for the year ended August 31, 2007. Of this amount, $767,589 represents the portion of appropriations made by the State Legislature expended on behalf of the University and $455,721 represents the portion paid from the University's funds.

Note 15: Deferred Compensation Program
University employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. Deferred compensation plans are administered by the Employees Retirement System.

The State's 457 Plan complies with Internal Revenue Code, Section 457. This plan is referred to as the TexaSaver Deferred Compensation Plan and is available to all employees. Deductions, purchased investments, and earnings attributed to the 457 Plan are the property of the State and subject only to the claims of the State's general creditors. Participant rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the 457 account for each participant. The State has no liability under the 457 Plan, and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

The University also administers a Tax-Deferred Account Program, created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The Tax-Deferred Account Program is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be insurance companies, banks, or approved non-bank trustees such as mutual fund companies. The assets of this plan do not belong to the University, and thus it does not have a liability related to this plan.

Note 16: Donor Restricted Endowments

Nonexpendable restricted net assets consist of endowments in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income.

Donor Restricted Endowment	Amounts of Net Appreciation	Reported in Net Assets
True Endowments	$219,037	Restricted for Nonexpendable
	$219,037	

Note 17: Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health and life insurance benefits for retired employees, in accordance with state statutes. Substantially all of the employees may become eligible for the health and life insurance benefits if they reach normal retirement age while working for the State. Currently, there are 115 retirees who are eligible for these benefits. Similar benefits for active employees are provided through a self-funded plan and fully insured plans. Depending upon the status of the employee at the time of retirement, the State or the System recognizes the cost of providing these benefits. The cost of retiree post-employment benefits is recognized when paid. This contribution paid all of the "employee/retiree only" premiums and a portion of the premiums for those employees/retirees selecting dependent coverage. The employee/retiree was required to pay a portion of the cost of dependent coverage. For the fiscal year ended August 31, 2007 the cost of providing those benefits for the retirees was $560,796 for the State and $43,883 for the University.

In August 2004, the GASB issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, effective for the System in fiscal year 2008. GASB Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. The System is working with the State to determine the effect the GASB Statement No. 45 will have on the System's and University's financial statements.

Note 18: Disaggregation of Receivable and Payable Balances

Other Payables for the University at August 31, 2007, are as follows:

	2007
Funds Unapplied as of 8/31/07 held in clearing accounts:	$ 81,212

Federal Receivables at August 31, 2007 are comprised of the following:

Department of Agriculture	$ 344,818
Department of Education	$ 229,100
Department of the Interior	$ 29,903
Other Programs and Contracts	$ 151,702
Total	$ 755,523

Accounts Receivables

Installment plans	$1,633,677
Other receivables	$1,203,383
Returned Checks	$ 21,197
Grants receivable	$ 448,158
Travel Advances	$ 91,807
Total	$3,398,222

Accounts Payables

Grant Accruals	$ 79,944
Other payables	$1,356,431
	$1,436,375

State Auditor's Office
John Keel, CPA
State Auditor

February 25, 2008

Dr. R. Vic Morgan, President
Sul Ross State University
SRSU Box C-114
East Highway 90
Alpine, Texas 79832

Subject: Management Letter Resulting from a Review of the Sul Ross State University's Fiscal Year 2007 Financial Statements

Dear Dr. Morgan:

We offer this management letter in conjunction with our review of the financial statements of Sul Ross State University (University) for the fiscal year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

We appreciate the assistance provided during this review by the management of the University and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

Robert E. Johnson Building
1501 N. Congress Avenue
Austin, Texas 78701

P.O. Box 12067
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A Review of

University of Houston

A Report and Management Letter for the Southern Association of Colleges and Schools

February 2008

Contents

State Auditor's Office
John Keel, CPA
State Auditor

Auditor's Review Report

February 25, 2008

Dr. Renu Khator, Chancellor and President
University of Houston
Office of the Chancellor/President
212 Ezekiel Cullen Building
Houston, Texas 77204-2018

Dear Dr. Khator:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of the University of Houston (University) as of and for the fiscal year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the University.

A review consists principally of inquiries of University personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the University. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

This report is intended for use by the Board of Regents of the University of Houston System, management of the University, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

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SAO Report No. 08-341

Introduction

The following section of the University of Houston's Financial Report provides an overview of the activities and the financial position of the University of Houston for the fiscal year ended August 31, 2007. This Management's Discussion and Analysis is intended to offer a summary of significant current year activities, resulting changes, and currently known economic conditions and facts. This analysis should be read in conjunction with the University's basic financial statements and the notes to the statements.

The University of Houston (UH), located in the nation's fourth largest metropolitan area, is part of the state-supported system of higher education in Texas, serving over 35,000 students in nearly 300 undergraduate and graduate academic programs, and generating approximately $80 million in externally funded research awards annually. The University is the flagship institution of the University of Houston System, and is its principal doctoral degree-granting institution. As such, it has the traditional functions of a comprehensive research university including a full range of undergraduate through post-doctoral academic programs, nationally recognized quality in its programs and faculty, extensive externally funded basic and applied research, and diverse cultural and public service programs of benefit to the community and the state. The University is the largest provider of baccalaureate services for Houston and the Upper Texas Gulf Coast region. UH awards more than 6,500 degrees annually, and is proud to have nearly 200,000 alumni.

In addition to being an important source of new teachers in Texas, the UH has also developed many collaborative partnerships with public schools whereby teachers participate in professional development programs and students are provided with educational opportunities. The University is committed to the discovery, dissemination, and application of knowledge. Over the past several years, UH has built multi-disciplinary research programs in areas such as materials science, the biosciences, and the computational sciences, all of which align with major regional and state industries – energy, biotechnology, aerospace, and computers. In doing so, the University has created programs of international repute that contribute greatly to the regional and state economies.

Overview of the Financial Statements and Financial Analysis

The financial statements for fiscal year 2007 have been prepared in accordance with accounting pronouncements promulgated by the Governmental Accounting Standards Board (GASB). These include Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*. The requirements focus on the preparation of financial statements that present financial operations in the aggregate, rather than accountability by individual fund group.

Governmental Accounting Standards Board Statement No. 35 requires the University to include three financial statements in the financial report. They are (1) the Statement of Net Assets, (2) the Statement of Revenues, Expenses, and Changes in Net Assets, and (3) the Statement of Cash Flows. Additionally, in accordance with the Southern Association of Colleges and Schools' (SACS) Criteria for Accreditation, this report includes (4) the Statement of Changes in Unrestricted Net Assets.

The financial operations of the University of Houston are considered a business-type activity because the University charges a fee, in the form of tuition, to customers in order to pay for a majority of the cost of the services provided. Under this classification, the University's financial statements conform to the guidelines and presentation formats prescribed for Proprietary Funds.

As required by GASB reporting standards, the University reports accumulated depreciation on its capital assets. Additionally, the University recognizes a current year charge for depreciation expense. Revenues and expenses are classified as either operating or non-operating in the financial statements. The statements provide a measurement of entity-wide operations. Significant portions of the University's recurring resources are classified as non-operating by GASB Statement No. 35. Substantially all state appropriations are treated as non-operating revenues. Tuition and fee revenues are reported net of any scholarship discounts and allowances. A scholarship allowance is the difference between the stated charge for services provided by the University and the amount that is paid by the student or third parties making payments on behalf of the student. Funds received to satisfy student tuition and fee charges are reported as revenue only once.

Statement of Net Assets

The first schedule presented in this report is the Statement of Net Assets. The statement reflects the University's assets and liabilities using the full accrual basis of accounting, and represents financial position as of the conclusion of the fiscal year. This is a point in time financial presentation and presents a snapshot view of the financial status as of August 31, 2007. Assets and liabilities are presented as either current or non-current to provide an indication of their anticipated liquidation. Net Assets is equal to Assets minus Liabilities. Unrestricted Net Assets are available to the University for any lawful purpose. Unrestricted Net Assets often have constraints on resources, which are imposed by management, but can be removed or modified. On August 31, 2007, UH's Assets totaled $1,036 million, and Liabilities totaled $348 million, resulting in a Net Asset valuation of $688 million. This represents an increase in net assets of $54 million. This change reflects a modest increase in total net assets, and, as reflected in Table B, is consistent with the recent trend for change in net assets. The University's administration and management believes it exercises due care and diligence in balancing expenditures against available resources, while concurrently making provisions for future operating needs.

The Statement of Net Assets allows the reader of the financial statements to determine the assets available for use in the continuing operations of the University. Also, the reader will be able to determine the amounts owed to vendors, investors and lending institutions. Net Assets are presented in three major categories: invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The invested in capital assets category identifies the equity in property, plant, and equipment owned by the University. Restricted net assets are presented in two sub categories: non-expendable and expendable. Non-expendable restricted net assets are available only for endowed investment purposes. Expendable net assets are available for expenditure but must be expended for the purposes specified by the external donor/provider of the assets. Unrestricted net assets are available for any lawful purpose of the University. Although not subject to the stipulations of external requirements, a significant portion of the University's unrestricted net assets are committed to various future operating budgets related to academic, research, and capital programs and projects. These commitments, reservations, and allocations of net assets are reflected in the Statement of Changes in Unrestricted Net Assets. As indicated in this statement, adequate proportions of the University's net assets are not obligated by externally imposed restrictions, and have been designated by management to serve various University missions. The various restrictions, commitments, and other limitations of net assets do not significantly affect the availability of fund resources for future use.

The net asset position of the University at the end of the fiscal year is summarized in the following table (Table A). Financial data for the prior fiscal year is provided for comparative purposes.

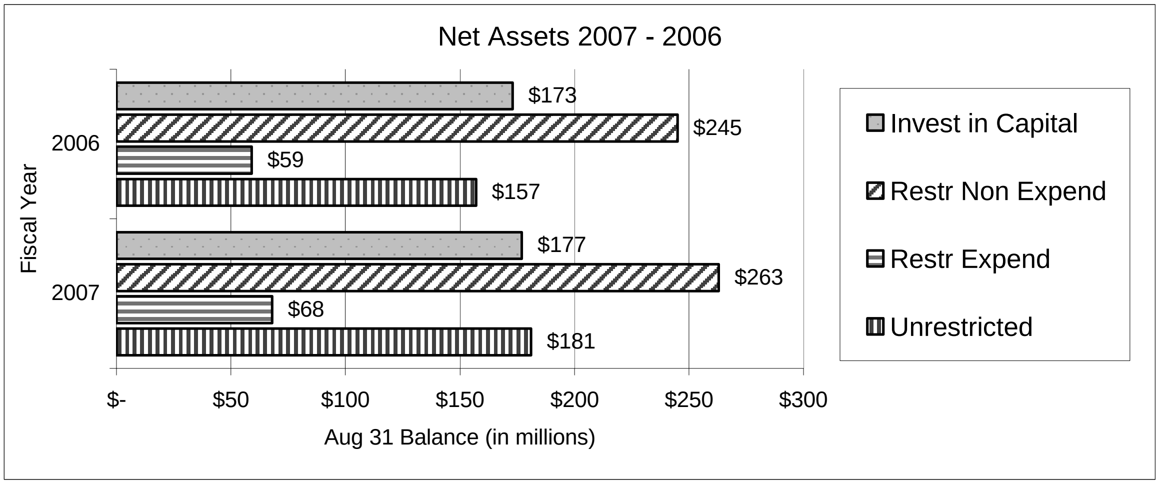
Table A

Statement of Net Assets
(amounts in thousands)

	2007	2006	% Change
Assets			
Current Assets	$ 334,940	$ 322,580	3.8%
Non-Current Assets	331,743	294,462	12.7%
Capital Assets, Net	369,097	371,870	-0.7%
Total Assets	$ 1,035,780	$ 988,912	4.7%
Liabilities			
Current Liabilities	$ 156,916	$ 150,247	4.4%
Non-Current Liabilities	190,898	204,731	-6.8%
Total Liabilities	$ 347,814	$ 354,978	-2.0%
Net Assets			
Invested in Capital Assets, Net of Related Debt	$ 176,515	$ 173,205	1.9%
Restricted			
Non-Expendable	263,220	244,557	7.6%
Expendable	67,547	58,932	14.6%
Unrestricted	180,684	157,240	14.9%
Total Net Assets	$ 687,966	$ 633,934	8.5%

The categories of net assets at the end of the fiscal year are compared in the following graphic (Chart 1) along with the prior year balances.

Chart 1



Statement of Revenues, Expenses, and Changes in Net Assets

The next statement comprising the primary financial statements is the Statement of Revenues, Expenses, and Changes in Net Assets. This schedule identifies operating and non-operating revenues received by the University. Additionally, both the operating and non-operating expenses incurred by the University during the fiscal year are displayed. Finally, any other gains and losses or other forms of revenue and expense are reported.

During the 2007 fiscal year, the University recognized operating revenues of $374 million and operating expenses of $590 million. After recognizing non-operating activities and other gains and losses, the University realized a current year net increase in net assets of $55 million.

Operating revenues are received and recognized as a result of providing services to the University’s customers. Operating expenses are the costs necessary to provide those services and to fulfill the mission of the University. Operating expenses are displayed in the Statement using the natural method of classification. The natural classification method presents operating expenses in a manner that categorizes the objects of expenditure in various cost centers. Non-operating revenues are those received for which no services are directly provided. State appropriations are classified as non-operating revenue because they are provided by the Legislature to the University without the Legislature directly receiving goods or services for those revenues. As previously mentioned, significant portions of the University’s recurring resources are classified as non-operating. Net resources from other than operating revenues totaled $301 million for fiscal year 2007.

The fiscal year changes in net assets for the University are summarized in the following table (Table B). Financial data for the prior fiscal year is provided for comparative purposes.

Table B

Statement of Revenues, Expenses, and Changes in Net Assets
(amounts in thousands)

	2007	2006	% Change
Operating Revenues			
Tuition and Fees, Net	$ 208,752	$ 188,760	10.6%
Federal Revenue	75,351	75,333	0.0%
All Other	89,508	85,728	4.4%
Total Operating Revenues	$ 373,611	$ 349,821	6.8%
Operating Expenses			
Salaries, Wages, and Benefits	$ 371,461	$ 359,537	3.3%
Professional Services	36,127	32,198	12.2%
Scholarships	31,658	27,821	13.8%
All Other	150,288	136,917	9.8%
Total Operating Expenses	$ 589,534	$ 556,473	5.9%
Operating Income (Loss)	$ (215,923)	$ (206,652)	4.5%
Non-operating Revenue			
Legislative appropriations	173,081	170,343	1.6%
Gifts	39,468	29,431	34.1%
All other	52,334	65,982	-20.7%
Total Non-operating Revenue	$ 264,883	$ 265,756	-0.3%
Non-operating (Expense)	(31,144)	(40,923)	-23.9%
Income(Loss) Before Other Revenues, Expenses, Gains Losses	$ 17,816	$ 18,181	-2.0%
Other Revenues, Expenses, Gains or Losses	37,522	37,799	-0.7%
Change in Net Assets	$ 55,338	$ 55,980	-1.1%
Net Assets, Beginning of Year	$ 633,934	$ 577,954	9.7%
Restatements	(1,306)		0.0%
Net Assets, As Restated	$ 632,628	$ 577,954	9.5%
Net Assets, End of Year	$ 687,966	$ 633,934	8.5%

The categories of operating expenses for the fiscal year are presented in the following graphic (Chart 2).

Chart 2

Statement of Cash Flows

The third primary statement included in the financial statements is the Statement of Cash Flows. This schedule explains the change during the fiscal year in cash and cash equivalents, regardless of whether there are restrictions on their use. The Statement of Cash Flows should be used in conjunction with related disclosures and information in the other financial statements. The statement can provide relevant information about an entity, such as the ability to generate future net cash flows, the ability to meet obligations when due, or reasons for differences between operating income and associated cash receipts and payments. The statement is comprised of five sections. The first section recognizes the cash flows from operating activities as well as the net cash used by operating activities. The second section identifies the cash flows from non-capital financing activities. The third section reflects the cash flows from capital and related financing activities. The next section details the cash flows from investing activities. The final section reconciles net cash used by operating activities to the operating loss or income reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

The cash and cash equivalents balance at the conclusion of the fiscal year totaled $117 million, which reflected a net increase in cash of $19 million.

The fiscal year changes in cash and cash equivalents for the University are summarized in the following table (Table C). Financial data for the prior fiscal year is provided for comparative purposes.

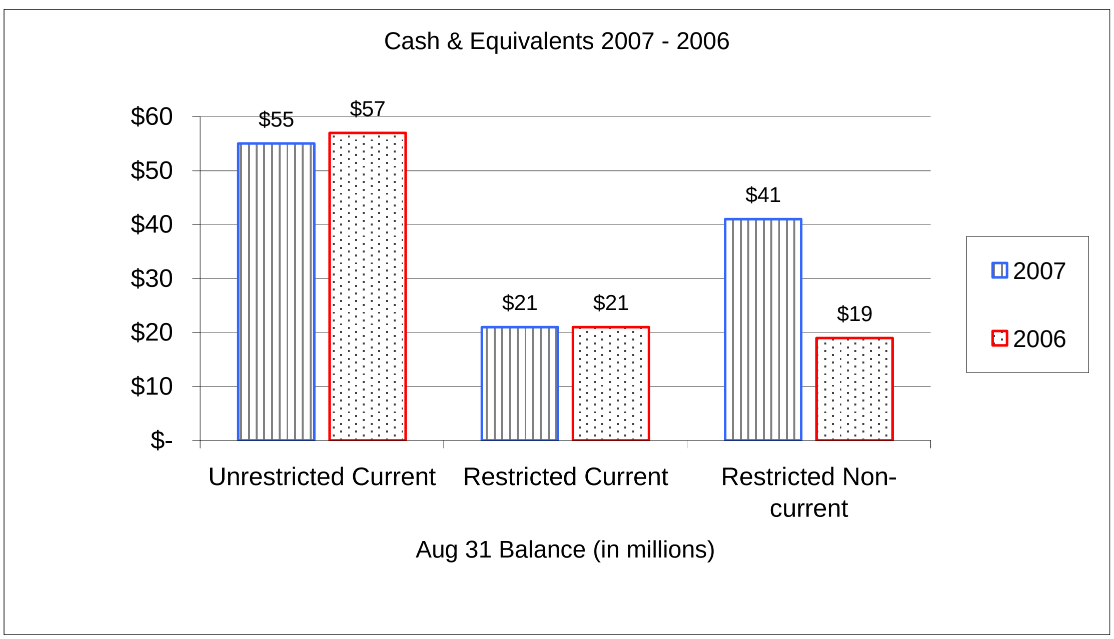
Table C

Statement of Cash Flows
(amounts in thousands)

	2007	2006	% Change
Cash Provided (Used) By			
Operating Activities	$ (197,400)	$ (184,251)	7.1%
Non-capital Financing Activities	212,774	188,572	12.8%
Capital & Related Financing Activities	(17,667)	(17,164)	2.9%
Investing Activities	21,692	39,215	-44.7%
Net Change in Cash	$ 19,399	$ 26,372	-26.4%
Cash, Beginning of Year	97,153	70,781	37.3%
Cash, End of Year	$ 116,552	$ 97,153	20.0%

The classifications of cash and cash equivalent balances at fiscal year end are presented in the following graphic (Chart 3).

Chart 3



Capital Asset and Debt Administration

Critical to maintaining the quality of academic, research, and service programs, as well as residential life, is the development and renewal of the University's capital assets. The University continues the implementation of its long-range capital plan, with a prudent combination of renovation and modernization of older facilities, along with new construction.

As of the end of the 2007 fiscal year, the University had $369 million of capital assets, net of accumulated depreciation. These assets included land, buildings, infrastructure and improvements, furniture and equipment, library books, and works of art. Several major capital construction projects are in various stages of completion, and the cumulative investment in these assets is reported as construction in progress. Capital assets, net of accumulated depreciation, at August 31, 2006, totaled $372 million.

Construction has been completed on the renovation and expansion of the M.D. Anderson Library, which nearly doubled the size of the building. Additionally, the project provides the Honors College, housed within the library, with new and expanded classroom, seminar, and student spaces. Also completed is the initial construction phase of the Science and Engineering Research and Classroom Complex (SERCC). The structure, which was designed by internationally renowned architect Cesar Pelli, will facilitate collaborative research among scientists, engineers, and physicians. Much of the University's joint research with the Texas Medical Center – including bionanotechnology, drug design, and synthetic medicinal chemistry – will be conducted at the SERCC. The multifunctional parking garage, one of several new garages planned for the campus was placed in service during the spring of 2006. The facility serves as the home of the University's new Welcome Center, as well as retail outlets and dining establishments. The Welcome Center provides convenient parking, easier access to student services, and a spirited place to welcome prospective students, their parents, and returning alumni. Completion of each of these projects will provide enhanced and significant benefits to the University's students and other constituencies.

The University's new Framework Master Plan, which was unveiled during the 2006 fiscal year, lays a framework for a vision of growth and expansion of services. By the year 2020, the campus will have a greater number of housing facilities, improved academic buildings, with an increased amount of square footage, and new lifestyle facilities, including stores, restaurants, social and gathering places, and enhanced transportation facilities. The construction of UH's graduate and professional lofts on Calhoun Road is the first major project to be launched as part of the campus master plan. The 552,000 square foot facility will house more than 700 loft apartments and 10,000 square feet of ground-level retail space. This facility will be the University's first campus housing designed exclusively for graduate and professional students, which is appropriate since UH's enrollment has the highest proportion of graduate students of any University in the state. UH has $233 million in projects planned over the next five years. The plan will continue to evolve over the coming years and will help guide UH's future growth. The University maintains a goal of improving the physical condition of the campus and its various facilities, while at the same time, preserving their condition and maximizing their utilization.

The University believes that the prudent use of debt to finance capital projects is an effective tool in the management of its financial resources. Detailed information concerning the University's long-term debt is found in Note 5 in the Notes to the Financial Statements.

The University of Houston is authorized by statute to issue long-term debt in the form of revenue bonds. Each series of revenue bonds issued is backed by a pledged revenue source specified in the bond resolution. Additionally, each issue is designed to be self supporting from the primary revenue source. At August 31, 2007, UH had $196 million of long-term bonded debt outstanding, $14 million of which will be retired during the 2008 fiscal year. No additional bonded indebtedness was issued during the current fiscal year.

Economic Outlook and Significant Events

The University of Houston is strongly committed to undergraduate education and moving students from matriculation to graduation while maintaining rigorous academic standards. As the demands and requirements of our population and economic/industrial base increase, a citizenry educated through the baccalaureate has become imperative for the future success of our state. Houston and the Upper Gulf Coast region are critical to this success, and as the region's largest provider of baccalaureate services, the University of Houston's responsibility is significant. Part of this responsibility includes ensuring access to all qualified students regardless of cultural/ethnic background or economic position – factors that have stood as roadblocks to participation in higher education in the past. If we do not create an environment hospitable to all people, we will not have done our job as educators, and the potential of Texas citizens will not be maximized. Part of this responsibility is also to ensure that students have the support they need to complete their degrees in a timely manner. Currently, the University of Houston is implementing a major student retention and graduation initiative, through which we are increasing the number of academic advisors on campus and the availability of financial aid. We have also created a four-year graduation pledge and scholarship reward program for freshmen who complete at least 30 credit hours per year.

In addition to its instructional goals, the University of Houston is committed to the discovery, dissemination, and application of knowledge. In this regard, UH is unique among state research institutions because of its location in Houston – one of the most ethnically diverse, economically dynamic, and culturally rich areas of the nation. In fact, the University of Houston is the most ethnically diverse research university in the United States. Of fundamental importance to the University is its ability to capitalize on the city's resources to improve its academic programs, the research experience of its faculty and students, and the cultural and economic development of the city, state, nation, and world. Over the past several years, the University of Houston has built multi-disciplinary research programs in areas such as materials science, the biosciences, and the computational sciences, all of which align with major regional and state industries – energy, biotechnology, aerospace, and computers. In doing so, we have created programs of international reputation that contribute greatly to the regional and state economies.

As we look to fiscal years 2008 and 2009, becoming the state's third top-tier research university will remain the University of Houston's highest institutional priority. Over the past several years, much progress has been made in accomplishing this goal. First, the University of Houston is becoming an institution of choice for more students. UH serves more students than any other institution in the state other than the University of Texas at Austin and Texas A&M University. Second, growth in research funding has been outstanding. The General Appropriations Act adopted by the 80th Texas Legislature in May, 2007, resulted in overall increased funding for the 2008-2009 biennium, ranging from resources for capital improvements to support for twenty-first century research. As valuable as state support is to the University, an ever-increasing percentage of the UH budget, however, comes from sources other than state funding. These sources include tuition and fees, federal research dollars, and gifts from individuals, foundations, and corporations. The UH Board of Regents and the University’s administrators exercise every effort to maintain tuition rates as low as realistically possible, which consequently means that the University must rely on community partners and their philanthropy for the extra margin of excellence in everything that is done.

In November 2007, the Board of Regents unanimously appointed Dr. Renu Khator president of the University of Houston and chancellor of the UH System. Dr. Khator, who had been serving as provost and senior vice president at the University of South Florida, assumed the office in January 2008. She is the third person to hold the dual title of UH System chancellor and UH president. She follows Arthur Smith, who retired in 2003, and Jay Gogue, who became president of Auburn University, his alma mater, during the summer of 2007.

The University is not aware of any known facts, decisions, or conditions that are expected to have a significant effect on the financial position or results of operations during the 2008 fiscal year. Although it is not possible to predict ultimate results, management believes the University of Houston’s financial condition and position are strong. The University’s administrative and management teams realize that universities must be good stewards of the dollars with which they are entrusted. The University of Houston is committed to this principle. Accomplishing the University’s goals and mission is predicated on the effective management of resources, which the University of Houston strives to achieve.

University of Houston

Statement of Net Assets

At August 31, 2007

(See Auditor's Review Report on page 1.)

ASSETS		
Current Assets		
Cash and Cash Equivalents (Note 3)	$	55,121,569
Short-Term Investments (Note 3)		110,199,417
Restricted:		
Cash and Cash Equivalents (Note 3)		20,886,047
Short-Term Investments (Note 3)		970,469
Legislative Appropriations		44,668,282
Receivables, Net of Allowances:		
Federal (Note 19)		23,808,279
Other Intergovernmental		35,443,206
Interest and Dividends		108,807
Accounts		8,559,757
Gifts		6,196,520
Other		220,534
Due from Other State Entities (Note 7)		793,079
Consumable Inventories		482,077
Merchandise Inventories		2,498,331
Prepaid Expenses		18,976,131
Loans and Contracts		6,007,303
Total Current Assets	$	334,939,808
Non-Current Assets		
Restricted:		
Cash and Cash Equivalents (Note 3)	$	40,544,469
Investments (Note 3)		275,670,034
Loans and Contracts		9,470,300
Gifts Receivable		5,808,364
Investments (Note 3)		229,361
Capital Assets (Note 2)		
Non-Depreciable		55,178,657
Depreciable		869,715,268
Less: Accumulated Depreciation		(555,797,093)
Other Non-Current Assets		20,527
Total Non-Current Assets	$	700,839,887
Total Assets	$	1,035,779,695

University of Houston

Statement of Net Assets

At August 31, 2007

(See Auditor's Review Report on page 1.)

LIABILITIES		
Current Liabilities		
Payables:		
Accounts	$	14,911,171
Accrued Liabilities		5,258,236
Payroll		23,902,821
Federal		222,242
Other		2,730,392
Due to Other State Entities (Note 7)		5,978
Deferred Revenue		85,999,573
Claims and Judgments (Note 4)		208,489
Employees' Compensable Leave (Note 4)		6,841,279
Notes and Loans Payable		26,775
Accrued Bond Interest Payable		372,357
Revenue Bonds Payable (Notes 4,5)		13,530,288
Funds Held for Others		2,905,960
Total Current Liabilities	$	156,915,561
Non-Current Liabilities		
Claims and Judgments (Note 4)	$	13,794
Employees' Compensable Leave (Note 4)		7,918,762
Revenue Bonds Payable (Notes 4, 5)		182,965,599
Total Non-Current Liabilities	$	190,898,155
Total Liabilities	$	347,813,716
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	$	176,514,722
Restricted for:		
Non-Expendable		
Permanent Funds, True Endowments, Annuities		263,219,753
Expendable		
Debt Retirement		23,512
Capital Projects		586,629
Term Endowments		256,218
Other		66,680,653
Unrestricted		180,684,492
Total Net Assets	$	687,965,979

The accompanying Notes to the Financial Statements are an integral part of this statement.

University of Houston

Statement of Revenues, Expenses, and Changes in Net Assets

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

OPERATING REVENUES	
Tuition and Fees - Non-Pledged	$ 248,455,546
Discounts and Allowances	(39,703,541)
Auxiliary Enterprises - Non-Pledged	39,515,536
Other Sales of Goods and Services - Non-Pledged	17,679,211
Federal Revenue	75,350,861
State Grant Revenue	19,126,459
Other Operating Grant Revenue	12,351,162
Other Operating Revenues	835,528
Total Operating Revenues	$ 373,610,762
OPERATING EXPENSES	
Cost of Goods Sold	$ 2,878,116
Salaries and Wages	305,579,336
Payroll Related Costs	65,881,707
Professional Fees and Services	36,126,543
Travel	10,663,671
Materials and Supplies	24,766,571
Communications and Utilities	34,604,291
Repairs and Maintenance	6,394,922
Rentals and Leases	11,844,968
Printing and Reproduction	3,751,422
Depreciation and Amortization	30,443,815
Interest Expense	1,619,063
Scholarships	31,658,463
Claims and Judgments	617,276
Other Operating Expenses	22,704,162
Total Operating Expenses	$ 589,534,326
Operating Income (Loss)	$ (215,923,564)

University of Houston

Statement of Revenues, Expenses, and Changes in Net Assets

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

NONOPERATING REVENUES (EXPENSES)		
Legislative Appropriations	$	173,081,014
Gifts		39,467,494
Interest and Investment Income (Loss)		37,783,842
Net Increase (Decrease) in Fair Value of Investments		489,307
Interest Expense and Fiscal Charges		(8,706,185)
Other Nonoperating Revenues - Non-Pledged		14,061,218
Other Nonoperating Expenses		(22,437,355)
Total Nonoperating Revenues (Expenses)	$	233,739,335
Income (Loss) Before Other Revenues, Expenses, Gains (Losses), and Transfers	$	17,815,771
OTHER REVENUES, EXPENSES, GAINS (LOSSES), AND TRANSFERS		
Capital Appropriations (HEAF)	$	23,517,427
Additions to Permanent and Term Endowments		8,350,354
Transfers In from Other State Entities (Note 7)		12,520,505
Transfers Out to Other State Entities (Note 7)		(6,981,931)
Legislative Transfers In (Note 7)		207,812
Legislative Transfers Out (Note 7)		(76,996)
Legislative Appropriations Lapsed		(15,114)
Total Other Revenues, Expenses, Gains (Losses), and Transfers	$	37,522,057
CHANGE IN NET ASSETS	$	55,337,828
Net Assets, September 1, 2006	$	633,934,374
Restatements (Note 14)		(1,306,223)
Net Assets, September 1, 2006, as Restated	$	632,628,151
NET ASSETS, August 31, 2007	$	687,965,979

The accompanying Notes to the Financial Statements are an integral part of this statement.

University of Houston

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

CASH FLOWS FROM OPERATING ACTIVITIES	
Proceeds from Tuition and Fees	$ 209,660,064
Receipts from Customers	23,540,839
Proceeds from Research Grants and Contracts	95,475,717
Proceeds from Loan Programs	4,030,433
Proceeds from Auxiliaries	37,909,319
Payments to Suppliers for Goods and Services	(127,847,708)
Payments to Employees for Salaries	(303,952,224)
Payments to Employees for Benefits	(65,843,329)
Payments for Loans Provided	(3,301,534)
Payments for Other Expenses	(67,070,944)
Net Cash Provided (Used) by Operating Activities	$ (197,399,367)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Proceeds from Legislative Appropriations	$ 174,072,663
Proceeds from Gifts	25,806,490
Proceeds from Endowments	22,002,716
Proceeds from Other Sources	4,013,244
Payments for Other Uses	(13,121,268)
Net Cash Provided (Used) by Non-Capital Financing Activities	$ 212,773,845
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from Capital Contributions	$ 29,580,457
Proceeds from Disposal of Capital Assets	1,185,066
Payments for Additions to Capital Assets	(26,015,084)
Payments of Principal on Capital-Related Debt	(13,456,297)
Payments of Interest on Capital-Related Debt	(8,706,184)
Payments of Other Costs of Capital-Related Debt	(255,079)
Net Cash Provided (Used) by Capital and Related Financing Activities	$ (17,667,121)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales of Investments	$ 2,668,635
Proceeds from Interest and Investment Income	37,790,084
Payments to Acquire Investments	(18,766,746)
Net Cash Provided (Used) by Investing Activities	$ 21,691,973
Net Increase (Decrease) in Cash and Cash Equivalents	$ 19,399,330
Cash and Cash Equivalents, September 1, 2006	$ 97,152,755
Restatements	
Cash and Cash Equivalents, September 1, 2006, as restated	$ 97,152,755
Cash and Cash Equivalents, August 31, 2007	$ 116,552,085

University of Houston

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities

Operating Income (Loss)	$ (215,923,564)
Adjustments:	
Depreciation and Amortization	30,443,815
Changes in Assets and Liabilities:	
(Increase) Decrease in Receivables	(14,441,135)
(Increase) Decrease in Inventories	(688,383)
(Increase) Decrease in Prepaid Expenses	(4,086,236)
(Increase) Decrease in Loans and Contracts	728,900
Increase (Decrease) in Payables	(263,382)
Increase (Decrease) in Deferred Revenue	7,525,063
Increase (Decrease) in Employees' Compensable Leave	789,935
Increase (Decrease) in Other Liabilities	(1,484,380)
Total Adjustments	$ 18,524,197
Net Cash Provided (Used) by Operating Activities	$ (197,399,367)
Non-Cash Transactions	
Net Increase (Decrease) in Fair Value of Investments	$ 489,307
Amortization of Investment Premiums (Discounts)	1,782,975
Donation of Non-Cash Investment	14,261,338
Disposal of Capital Assets	(18,939,479)
Depreciation	30,443,815

The accompanying Notes to the Financial Statements are an integral part of this statement.

University of Houston

Statement of Changes in Unrestricted Net Assets

For the Fiscal Year Ended August 31, 2007

	8/31/2007	8/31/2006	Difference
Unrestricted Net Assets:			
Unrestricted			
Reserved			
Encumbrances	$ 10,240,495	$ 15,621,175	$ (5,380,680)
Accounts Receivable	18,911,667	18,356,605	555,062
Inventories	2,980,408	2,292,025	688,383
Self-Insurance Plans	2,214,733	1,298,028	916,705
Higher Education Assistance Funds	27,538,131	29,950,838	(2,412,707)
Fees with Use Restricted by Statute:			
International Education Fees (54.5132)	69,553	48,649	20,904
Student Service Fees (54.503)	1,466,987	762,152	704,835
University Center Fee (54.527)	524,797	15,000	509,797
Advanced Research / Advanced Technology Programs	720,284	615,240	105,044
Future Operating Budgets	29,169,768	9,435,050	19,734,718
Prepaid Expenses	5,507,835	1,557,676	3,950,159
Travel Advances	110,650	140,034	(29,384)
Petty Cash	128,618	122,358	6,260
Texas Public Education Grants	395,819	6,801	389,018
Unreserved			
Allocated			
Capital Projects	(3,449,564)		(3,449,564)
Service Department Operating Funds	3,022,495	963,791	2,058,704
Auxiliary Enterprises Operating Funds	(1,295,720)	(6,484,363)	5,188,643
Funds Functioning as Endowment – Unrestricted	12,194,063	13,239,932	(1,045,869)
Funds Functioning as Loans	10,708,491	10,040,252	668,239
Retirement of Indebtedness	(4,141,005)	(4,433,722)	292,717
Student Fees	16,656,880	12,557,676	4,099,204
Unallocated	47,009,107	51,135,373	(4,126,266)
Total Unrestricted Net Assets	$ 180,684,492	$ 157,240,570	$ 23,443,922

(See Auditor's Review Report on page 1.)

General Introduction

This report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of the University of Houston (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria or Governmental Accounting Standards Board requirements, the report also includes a Management's Discussion and Analysis section, a Statement of Changes in Unrestricted Net Assets, and a management letter describing issues noted in the review.

Reporting Entity

The University is a component of the University of Houston System (System) and an agency of the State of Texas. The University prepares financial statements that are included in the State's *Comprehensive Annual Financial Report*, which is audited by the Texas State Auditor's Office.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred. Operating items are distinguished from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the principle of ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets.

Cash and Cash Equivalents

Included in this category are demand deposits in banks, local funds held by the state, state reimbursements in transit, and deposits in TexPool, the state's governmental investment pool.

For the purpose of financial statement reporting, cash equivalents are short-term, highly liquid investments with an original maturity of three months or less.

Investments

The University accounts for its investments at fair market value, as determined by quoted market prices, in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Changes in unrealized gain (loss) on the carrying value of the investments are reported as a component of net change in fair value of investments in the Statement of Revenues, Expenses, and Changes in Net Assets.

Restricted Assets

Restricted assets include monies or other resources restricted by legal or contractual requirements. These assets include proceeds of revenue bonds and revenues set aside for statutory or contractual requirements.

Receivables

Accounts receivable and student receivables consist of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty, and staff. Accounts receivable are recorded net of estimated uncollectible amounts.

Federal receivables include amounts due from the federal government or private sources, in connection with reimbursement of allowable expenditures disbursed by the University's grants and contracts department.

Gift receivables are accounted for at their estimated net realizable value. The estimated net realizable value consists of the present value of long-term pledges and a reduction for any allowance for uncollectible pledges. Pledges vary from one to ten years and are used to support specifically identified University programs and initiatives.

Interest and income receivable consists of amounts due from investment holdings, cash management pools, and cash invested in various short-term investment items.

Inventories

Inventories include both merchandise inventories on hand for sale and consumable inventories such as maintenance supplies, housing supplies, janitorial supplies, office supplies, and telecommunications supplies. Inventories are valued at cost, generally utilizing the last-in, first-out method.

Prepaid Expenses

Disbursements for insurance, subscriptions, postage, travel costs, and similar services paid in the current or prior fiscal years and benefiting more than one accounting period are allocated among accounting periods.

Loans and Notes Receivable

These receivables are student loans receivable that consist of amounts due from the Federal Perkins Loan Program and from other loans administered by the University.

Capital Assets

Furniture, equipment, and vehicles with a cost of more than $5,000 and an estimated useful life in excess of one year are capitalized. Capitalization thresholds for buildings, building improvements, facilities, and other improvements are $100,000. The capitalization threshold for infrastructure is $500,000. These assets are capitalized at cost. Donated assets are reported at fair market value as of the acquisition date. Routine repairs and maintenance and capital assets acquired for less than the threshold amounts are charged to operating expenses in the year in which the expense was incurred. All land, land improvements, library books and materials, and works of art are capitalized. Assets are depreciated over their estimated useful lives using the straight-line method.

Accounts Payable

Accounts payable represent the liability for the value of assets or services received at the Statement of Net Assets date for which payment is pending.

Deferred Revenues

Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year but related to the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

Employees' Compensable Leave

The employees' compensable leave represents the liability that becomes due upon the occurrence of relevant events such as resignations, retirements, and uses of leave balances by covered employees. Liabilities are reported separately as either current or non-current in the Statement of Net Assets.

Notes Payable

Notes payable represents amounts owed to lenders and evidenced by contractual agreements. This balance also includes amounts owed for commercial paper that was issued during the current accounting period.

Revenue Bonds Payable

Revenue bonds are reported at par, less unamortized discount or plus unamortized premium. Interest expense is reported on the accrual basis, with amortization of discount or premium. Payables are reported separately as either current or noncurrent in the Statement of Net Assets.

Funds Held for Others

Current balances in funds held for others result from the University acting as an agent or fiduciary for students and student organizations.

Net Assets

Net assets are the difference between assets and liabilities. The University has classified resources into the following three net asset categories:

Invested in Capital Assets, Net of Related Debt

This category consists of capital assets net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted Net Assets

Restricted Net Assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Assets

Net assets that are not subject to externally imposed stipulations are reported as Unrestricted Net Assets. These balances may be designated for special purposes by action of University management or the UH System Board of Regents, or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the university addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation. Generally, the University's policy is to first apply the expense towards restricted resources and then towards unrestricted resources.

Revenues and Expenses

Operating revenues include activities such as student tuition and fees, net of scholarship allowances; sales and services of auxiliary enterprises; most federal, state, and local grants, and contracts; and interest on student loans. Operating expenses include salaries and wages, payroll related costs, materials and supplies, depreciation, scholarships and fellowships, and impairment losses and insurance recoveries received in the same year as the associated loss in accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. In addition, all changes to incurred but not reported liabilities related to insurance programs are reflected as operating. Nonoperating revenues include activities such as gifts and contributions, insurance recoveries received in years subsequent to the associated loss, State appropriations, investment income, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*, GASB Statement No. 34, and GASB

Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Nonoperating expenses include activities such as interest expense on capital asset financings, and other expenses that are defined as nonoperating expenses by GASB Statement Nos. 9, 34, and 42.

Scholarship Allowances and Student Aid

Financial aid to students is reported in the financial statements as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid (student loans, funds provided to students as awarded by third parties, and Federal Direct Lending) is accounted for as third party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expense or scholarship allowances, which reduce revenues. The amount reported as operating expense represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed on an entity-wide basis by allocating cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third party aid.

Note 2: Capital Assets

A summary of changes in Capital Assets for the year ended August 31, 2007, is presented in Table 2.

Table 2
Capital Assets

	Balance 9-1-2006	Adjustments	Completed CIP	Additions	Deletions	Balance 8-31-07
Non-Depreciable						
Land & land improvements	$ 36,576,591	$	$	$	$	$ 36,576,591
Construction in progress	4,169,697	(71,619)		14,503,988		18,602,066
Other capital assets						
Total Non-Depreciable	$ 40,746,288	$ (71,619)	$	$ 14,503,988	$	$ 55,178,657
Depreciable						
Buildings & bldg imprvmnt	$539,555,125	$	$	$	$	$ 539,555,125
Infrastructure	34,575,129					34,575,129
Facilities & oth imprvmnt	66,272,493					66,272,493
Furniture & equipment	138,285,299	(1,118,275)		9,000,037	(4,568,695)	141,598,366
Vehicles, boats, aircraft	2,332,899			221,750	(42,489)	2,512,160
Other capital assets	79,704,525			5,596,617	(99,147)	85,201,995
Total Depreciable	$860,725,470	$(1,118,275)	$	$ 14,818,404	$(4,710,331)	$ 869,715,268
Less Accumulated Depreciation For						
Buildings & bldg imprvmnt	$(322,085,762)	$ (72,800)	$	$(15,483,276)	$	$(337,641,838)
Infrastructure	(27,251,827)			(549,924)		(27,801,751)
Facilities & oth imprvmnt	(32,574,590)			(1,824,874)		(34,399,464)
Furniture & equipment	(104,068,333)	(43,529)		(7,775,933)	4,321,457	(107,566,338)
Vehicles, boats, aircraft	(1,713,590)			(190,289)	42,489	(1,861,390)
Other capital assets	(41,907,747)			(4,619,519)	954	(46,526,312)
Total Accumulated Depreciation	$(529,601,849)	$ (116,329)	$	$(30,443,815)	$ 4,364,900	$(555,797,093)
Depreciable Assets, Net	$ 331,123,621	$(1,234,604)	$	$(15,625,411)	$ (345,431)	$ 313,918,175
Capital Assets, Net	$ 371,869,909	$(1,306,223)	$	$ (1,121,423)	$ (345,431)	$ 369,096,832

Note 3: Deposits, Investments, and Repurchase Agreements

Deposits of Cash in Bank

As of August 31, 2007, the carrying amount of deposits was $(2,800,424) as presented below.

Table 3.1
Cash In Bank Deposits

Cash in bank – Carrying value	$ (2,800,424)
Cash in bank per financial report	$ (2,800,424)

This balance consists of the carrying amount of all cash on deposit in local banks. The amount is included on the Statement of Net Assets as part of the "Cash and Cash Equivalents" accounts.

As of August 31, 2007, the total bank balance was as follows.

Table 3.2
Bank Balances

Balance per bank	$ 1,735,868
Total cash in bank per bank	$ 1,735,868

As of August 31, 2007, the total Cash and Cash Equivalents balance was as follows.

Table 3.3
Cash & Cash Equivalents Balances

Cash on hand	$ 129,118
Cash in bank	(2,800,424)
Reimbursement due from Treasury	2,165
Cash in State Treasury	11,179,083
Cash equivalents	108,042,143
Total cash & cash equivalents	$ 116,552,085

Table 3.4
Cash & Cash Equivalents By Classification

Current assets	$ 55,121,569
Current assets, restricted	20,886,047
Non-current assets restricted	40,544,469
Total cash & cash equivalents	$ 116,552,085

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the University will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. To the extent there are funds held on deposit, with financial institutions, that exceed the limits of coverage of the Federal Deposit Insurance Corporation (FDIC), the institutions have pledged securities to protect the University's deposits. These securities are held in safekeeping, with the Federal Reserve serving as custodian. The University has no deposits that are at risk of recovery with the failure of a depository financial institution.

Foreign currency risk for deposits is the risk that changes in exchange rates will adversely affect the deposit. Foreign bank accounts were liquidated in 2007. Therefore, there is no exposure to foreign currency risk as of August 31, 2007.

Investments

As of August 31, 2007, the fair value of investments is as presented below.

Table 3.6
Investments Balances

Fixed income money market & bond mutual funds	$ 385,415,793
Other comingled funds	1,653,488
Total investments	$ 387,069,281

Table 3.7
Investments By Classification

Current assets – short term investments	$ 110,199,417
Current assets, restricted – short term investments	970,469
Non-current assets, restricted – investments	275,670,034
Non-current assets - investments	229,361
Total investments	$ 387,069,281

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The general investment policy of the University limits investments in debt securities that are not in the top three investment grade ratings issued by nationally recognized statistical rating organizations to 5% of total investments. As of August 31, 2007, the University had no investment securities with credit risk exposure. Below is a schedule of credit risk related to the University's investments.

Table 3.8
Investments Credit Risk
(As rated by Standard & Poor's)

	Not Rated
Fixed income money market & bond mutual funds	$ 385,415,793
Total investment types	$ 385,415,793

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. As of August 31, 2007, the agency's concentration of credit risk in any single issuer did not exceed five percent of total investment assets as reported on the Statement of Net Assets.

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. Interest rate risk inherent in the University investments is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the University's investments to changes in interest rates. UH has no specific policy statement limitations with respect to its overall modified duration. The University manages its exposure to fair value losses arising from increasing interest rates by limiting the modified duration of its investment portfolio.

The University of Houston has no investments that are subject to custodial credit risk. The University has no investments that are subject to foreign currency risk.

Reverse Repurchase Agreements

The University, by statute, is authorized to enter into reverse repurchase agreements. During the fiscal year, the University had no investments in reverse repurchase agreements.

Securities Lending

The University does not participate in a security-lending program.

Derivative Investing

The University did not hold any collateralized mortgage obligations at fiscal year-end. The University does not enter into forward-exchange contracts to manage exposure of foreign portfolio holdings to changes in foreign currency exchange rates.

Note 4: Summary of Long-Term Liabilities

During the year ended August 31, 2007, the following changes, presented in Table 4.1, occurred in liabilities.

Non-debt liability obligations are usually paid from the same funding source from which the employee's salary or wage compensation was paid.

Table 4
Long-Term Liabilities

	Balance 9-1-2006	Additions	Reductions	Balance 8-31-07	Amounts Due Within 1 Yr
Claims & judgments	$ 312,927	$ 960,334	$ 1,050,978	$ 222,283	$ 208,489
Employees' compensable leave	13,970,105	6,961,929	6,171,993	14,760,041	6,841,279
Revenue bonds payable	210,219,182		13,723,295	196,495,887	13,530,288
Total Long-Term Liabilities	$ 224,502,214	$ 7,922,263	$20,946,266	$ 211,478,211	$20,580,056

Claims and Judgments

At August 31, 2007, various lawsuits and claims involving the University were pending. While the ultimate liability, if any, with respect to litigation and other claims asserted against the University cannot be reasonably estimated at this time, such liability, to the extent not provided for by insurance or otherwise, is not expected to have a material effect on University accounts.

Additionally, obligations may arise from future workers' compensation and unemployment claims. As discussed in Note 9, an estimated liability of $222,283 has been recognized for any such obligations.

Employees' Compensable Leave

Substantially all full-time University employees earn annual leave in the amount of 8 to 21 hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum of 532 hours for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements because experience indicates that the expense for sick leave will be minimal. Eligible part-time employees' sick leave accrual rate is proportional to the number of hours appointed to work.

Note 5: Bonded Indebtedness

The University receives proceeds from revenue bonds issued by UH System to support capital projects of the institution. At August 31, 2007, the University had outstanding bonds payable of $196,495,887 (consisting of $192,727,240 of bond liability and $3,768,647 of unamortized bond premium). All bonds currently outstanding are defined as revenue bonds. As such, the revenues of the University, including certain revenues of the UH System, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures' lack of specifically identifiable activities and separate accounting requirements imposed by an external party.

Information concerning each of the University's outstanding bond issues is itemized below.

Revenue Bonds

- **Consolidated Revenue Bonds, Series 1998**
  - Purpose – To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, building, structure, activity, service, operation, or facility of the University of Houston, specifically energy conservation projects.
  - Issued 1-1-98.
  - $14,565,000; all bonds authorized have been issued.
  - Interest rates – 4.1% - 5.5%.
  - Maturity date range – 2000 - 2009.
  - First call date – 8-15-07.
  - Source of revenue for debt service – Tuition, state appropriations, and various other revenues and balances that may be legally available for payment of debt obligations.

- **Consolidated Revenue Bonds, Series 1999**
  - Purpose – To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, building, structure, activity, service, operation, or facility of the University of Houston System, including the University of Houston.
  - Issued 1-1-99.
  - $33,350,000 ($12,002,665, University of Houston; $21,347,335, other UH System institutions); all bonds authorized have been issued.
  - Interest rates – 4.5% - 5.0%.
  - Maturity date range – 2000 - 2019.
  - First call date – 2-15-09.
  - Source of revenue for debt service – Tuition and various other revenues and balances that may be legally available for payment of debt obligations (funding for fiscal year 2007 from Legislative appropriation).

- **Consolidated Revenue Bonds, Series 2000**
  - Purpose – To construct a recreation and wellness facility at the University of Houston.
  - Issued 9-1-00.
  - Interest rates – 5.25% - 7.0%.
  - Maturity date range – 2003 - 2030.
  - First call date – 2-15-10.
  - $52,070,000; all bonds authorized have been issued.
  - Source of revenue for debt service – Tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations.

- **Consolidated Revenue Bonds, Series 2002-A**
  - Purpose – To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, building, structure, activity, service, operation, or facility of the University of Houston System, including the University of Houston.
  - Issued 9-1-02.
  - Interest rates – 2.5% - 4.75%.
  - Maturity date range – 2003 - 2022.
  - First call date – 2-15-12.
  - $130,955,000 ($74,000,000, University of Houston; $56,955,000, other UH System institutions); all bonds authorized have been issued.
  - Source of revenue for debt service – Tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations (funding for fiscal year 2007, partially from Legislative appropriation).

- **Consolidated Revenue Variable Rate Demand Bonds, Series 2004**
  - Purpose – To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, buildings, structures, facilities, roads, or related infrastructure for the University of Houston System, including the individual campuses of the System.
  - Issued 6-16-04.
  - Interest rates – variable, rates reset weekly.
  - Maturity date range – 2006 - 2024.
  - First call date – 8-15-04.
  - $25,000,000: all bonds authorized have been issued.
  - Source of revenue for debt service – Tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations (funding for fiscal year 2007, from Legislative appropriation).

- **Consolidated Revenue Bonds, Series 2005**
  - Purpose – To construct a parking garage facility at the University of Houston.
  - Issued 4-01-05.
  - Interest rates – 4.0% - 5.0%.
  - Maturity date range – 2006 - 2025.
  - First call date – 2-15-15.
  - $25,800,000; all bonds authorized have been issued.
  - Source of revenue for debt service – Tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations.

Refunding Bonds

- **Consolidated Revenue Refunding Bonds, Series 2002-B**
  - Purpose – To refund $27,415,000 of Consolidated Revenue Refunding Bonds, Series 1993 and $19,385,000 of Consolidated Revenue Bonds, Series 1993-A (both University of Houston).
  - Issued 11-1-02.
  - Interest rates – 3.0% - 5.25%.
  - Maturity date range – 2003 - 2018.
  - First call date – 2-15-12.
  - $45,425,000; all bonds authorized have been issued.
  - Source of revenue for debt service - Designated tuition and various other revenues and balances that may be legally available for payment of debt obligations.
  - Average rate of bonds refunded - 5.4% (1993) and 5.5% (1993-A).
  - Net proceeds from refunding series - $47,871,000, after receipt of bond premium of $2,888,998 and payment of $442,998 in underwriting fees, insurance, and other issuance costs.

- Funds were used to purchase state and local government securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt payments on the 1993 and 1993-A series bonds, when the bonds were called for early redemption on 2-15-03.
- The 1993 and 1993-A series bonds are considered fully defeased, and the liability for those bonds has been removed from the accounts of the University.

- **Consolidated Revenue Refunding Bonds, Series 2006**
  - Purpose – To refund $44,430,000 of Consolidated Revenue Bonds, Series 2000 (University of Houston), and $3,295,000 of other Consolidated Revenue Bonds at other University of Houston System institutions.
  - Issued 2-1-06.
  - Interest rates – 3.5% - 5.0%.
  - Maturity date range – 2007 - 2030.
  - First call date – 2-15-15.
  - $48,450,000 ($45,240,000, University of Houston; $3,210,000, UH System institutions); all bonds authorized have been issued.
  - Source of revenue for debt service – Tuition, designated tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations (funding for fiscal year 2007, partially from Legislative appropriation).
  - Average rate of UH 2000 series bonds refunded - 5.45%.
  - Net proceeds from refunding series - $49,799,345, after receipt of bond premium of $1,823,210 and payment of $473,865 in underwriting fees, insurance, and other issuance costs.
  - Funds were used to purchase state and local government securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt payments on the refunded 2000 series bonds. The refunded 2000 series bonds will be called for early redemption on 2-15-10.
  - The 2000 series bonds maturing subsequent to 2-15-10 are considered fully defeased, and the liability for those bonds has been removed from the accounts of the University.

Defeased Bonds Outstanding

- **Consolidated Revenue Bonds, Series 2000**
  - Refunded 2-1-06.
  - Par value refunded – $44,430,000.
  - Par value outstanding – $44,430,000.

General Obligation Bonds

At August 31, 2007, the University had no bonds payable classified as general obligation bonds.

Debt Service Requirements

The future debt service requirements, as of August 31, 2007, for the University's outstanding bonds are as follows.

Table 5
Revenue Bonds Payable
Debt Service Requirements

	Total Principal	Total Interest	Total
2008	$ 13,263,449	$ 8,530,378	$ 21,793,827
2009	14,615,442	7,848,919	22,464,361
2010	8,222,434	7,300,354	15,522,788
2011	8,602,627	6,921,303	15,523,930
2012	8,986,419	6,536,519	15,522,938
2013 - 2017	51,644,760	26,117,922	77,762,682
2018 – 2022	54,662,109	13,827,285	68,489,394
2023 – 2027	22,995,000	4,435,441	27,430,441
2028 - 2032	9,735,000	670,388	10,405,388
Total Debt Service	$192,727,240	$ 82,188,509	$274,915,749

Commercial Paper Program

During October 2006, the UH System established a commercial paper program that permits the issuance of commercial paper notes which may not exceed, in the aggregate, the principal amount of $50,000,000 at any one time. It is anticipated that commercial paper will be issued to provide interim financing for the costs of various capital projects within the System, including the University of Houston. The maximum maturity for the commercial paper is 270 days and will be issued at tax exempt interest rates. As of August 31, 2007, the UH System had not issued any commercial paper and had no outstanding commercial paper liabilities. It is anticipated that the System might issue some commercial paper during the 2008 fiscal year, to provide interim construction financing for several planned projects at UH. Ultimate financing is anticipated to be provided by future Consolidated Revenue Bonds, which have been approved by the state legislature, and whose debt service has also been partially provided for by appropriated funds.

Future Revenue Bonds

No additional bonded indebtedness was authorized or issued during the 2007 fiscal year. The state legislature appropriated additional funds to pay debt service during the 2008-2009 biennium for planned Consolidated Revenue Bonds. Authorization and issuance of additional long-term debt is anticipated to occur during the fourth quarter of the 2008 fiscal year.

Note 6: Operating Lease Obligations

Included in the expenditures reported in the financial statements are the following amounts of rent paid or due under operating leases:

Table 6.1
Operating Leases

Lease & rental payments	$ 4,021,170
Total lease & rental payments	$ 4,021,170

Future minimum lease rental payments under non-cancelable operating leases having an initial term in excess of one year are as follows:

Table 6.2
Future Operating Lease Payments

2008	$ 3,239,078
2009	2,430,050
2010	1,608,097
2011	804,234
2012	401,932
2013 - 2017	201,059
2018 – 2022	100,529
Total lease & rental payments	$ 8,784,979

Note 7: Interagency Balances / Activity

During the fiscal year there are numerous transactions between funds and state agencies and entities. At year end, amounts to be received or paid are reported as:

1. Due From Other Agencies or Due To Other Agencies
2. Transfers In From Other Agencies or Transfers Out To Other Agencies
3. Legislative Transfers In or Legislative Transfers Out

The University experienced routine transfers with other State agencies, which were consistent with the activities of the entity making the transfer. Repayment of any interagency balances occurs within one year from the date of the financial statement.

Individual balances and activity at August 31, 2007, are shown in the following tables.

Table 7.1
Due From / To
Other State Entities

Entity	Due From Other State Entities	Due To Other State Entities	Purpose
Texas Department of Transportation	$ 2,836	$	License plate scholarships
Texas Higher Education Coordinating Board	431,134		Pass-through grant
Texas Dept of Protective & Family Services	148,934		Pass-through grant
Texas Education Agency	210,175		Pass-through grant
Prairie View A&M University		5,978	Pass-through grant
Total	$ 793,079	$ 5,978	

Table 7.2
Transfers In From / Out
To Other State Entities

Entity	Transfers In From Other State Entities	Transfers Out To Other State Entities	Purpose
UHS Components	$ 12,520,505	$	Intercampus operational activities
UHS Components		5,216,832	Intercampus operational activities
Texas Comptroller of Public Accounts		1,765,099	Tuition set-aside programs
Total	$ 12,520,505	$ 6,981,931	

Table 7.3
Legislative Transfers
In / Out

Entity	Legislative Transfers In	Legislative Transfers Out	Purpose
UH – Clear Lake	$	$ 76,996	Space exploration partnership
UH – Clear Lake	207,812		Environmental studies partnership
Total	$ 207,812	$ 76,996	

Note 8: Contingent Liabilities

As mentioned in Note 4, various lawsuits and claims involving the University were pending. While the ultimate liability, if any, remains uncertain, management does not expect any possible adverse ruling to have a material effect on University accounts.

The University has received several federal grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to a request for reimbursements to grantor agencies for expenditures disallowed under the terms of the grant. Based on prior experience, management believes such disallowances, if any, will be immaterial.

The University has several contractual agreements with various external housing management entities to construct, maintain, and manage off-campus student housing complexes. Under certain circumstances, the University may have contingent liabilities to these entities. Based on prior experience, previous years' liabilities have been immaterial, and management believes no such liabilities currently exist. Additional information is provided in Note 11.

Note 9: Risk Financing and Related Insurance

The University is exposed to a variety of civil claims resulting from the performance of its duties. It is University policy to periodically assess the proper combination of commercial insurance and retention of risk to cover losses to which it may be exposed.

The University assumes substantially all risks associated with tort and liability claims due to the performance of its duties. Currently there is the purchase of some commercial insurance, and the University is not involved in any risk pools with other government entities.

The University's liabilities are reported when it is both probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Liabilities are reevaluated periodically to consider current settlements, frequency of claims, past experience and economic factors.

Liabilities include an amount for estimated future workers' compensation and unemployment claims that have been incurred as of the fiscal year end, but that have not been reported. Additional information about claims and judgments payable is provided in Note 4 and in the following table.

Table 9
Claims & judgments

	Balance 9-1-2006	Additions	Reductions	Balance 8-31-07	Amounts Due Within 1 Yr
Workers' compensation claims	$ 160,617	$ 809,237	$ 831,913	$ 137,941	$ 124,147
Unemployment claims	152,310	151,097	219,065	84,342	84,342
Total claims & judgments	$ 312,927	$ 960,334	$ 1,050,978	$ 222,283	$ 208,489

Note 10: Subsequent Events

On July 16, 2007, University of Houston System Chancellor/President Dr. Jay Gogue resigned to accept the position of President at Auburn University in Auburn, Alabama. Dr. John Rudley, Vice Chancellor/Vice President of Administration and Finance was appointed Interim Chancellor/President. On November 5, 2007, Dr. Renu Kator, who had previously served in the position of Provost and Senior Vice President at the University of South Florida, was appointed by the Board of Regents as the succeeding Chancellor/President of the University of Houston System.

As of the date this report was issued, there have been no occurrences since August 31, 2007 that have had a significant financial impact on the University.

Note 11: Related Parties

The University of Houston is affiliated with several foundations and organizations that have been created to benefit certain operations of the University. Those which have a significant relationship with the University are described below. The assets, liabilities, and equities of the various foundations and organizations are not contained in the financial statements of the University.

- **University of Houston Foundation**

The stated purpose of the University of Houston Foundation is for the advancement of the general welfare of the University of Houston, Houston, Texas, as a whole, including, without limitation, all of the colleges and branches or divisions, thereof, wheresoever located, as well as all of the facilities and activities thereof now or hereafter existing or created, not inconsistent with the objectives, operation and management of the University of Houston. The Foundation's Board of Trustees consists of nine members. The Foundation remitted $2,901,154 of direct support and $306,327 of indirect support to the University of Houston during the year ended August 31, 2007.

- **UH College of Business Administration Foundation**

The stated purpose of the University of Houston College of Business Administration Foundation is to solicit, receive, or otherwise acquire real or personal property with the primary objective of improving the quality of education provided by the College of Business Administration; to assist in developing and increasing the facilities of the College for broader educational opportunities; to apply funds and other resources in procuring quality personnel, materials, and equipment; and to foster professional zeal among the faculty of the College and to promote the general educational interests of such faculty. The Foundation's Board of Trustees consists of fourteen members. The Foundation remitted $915,835 of direct support to the University during the year and $563,776 of indirect support for the year ended August 31, 2007.

- **University of Houston Law Foundation**

The stated purpose of the University of Houston Law Foundation is to complement legal education and assist in the orderly development of law and legal institutions through basic and applied research, service and cooperative effort for the benefit of the Law Program, and other programs and schools now or hereafter existing in related fields, of the University of Houston. The Foundation's Board of Trustees consists of fifteen members. The Foundation remitted $914,914 of direct support to the University during the year and $1,826,954 of indirect support during the year ended August 31, 2007.

- **University of Houston Alumni Organization**

The stated purpose of the University of Houston Alumni Organization is to promote the aims, ideals, and purposes of the founders, officers, and faculty of the University of Houston. The Organization's Board of Trustees consists of fifteen officers and twenty-one at large directors. The Organization remitted no direct support to the University during the year ended August 31, 2007.

- **University of Houston Athletics Foundation, Inc.**

The stated purpose of the Houston Athletics Foundation, Inc. is to assist in the development and implementation of a strategic plan for athletics development including annual fund, major gifts, leadership gifts, and endowments for the University of Houston in compliance with rules and regulations set forth by the National Collegiate Athletic Association and the Board of Regents of the University of Houston System. The Foundation's Board of Directors consists of one officer and twenty eight directors. The Foundation remitted $280,000 of direct support to the University during the year ended August 31, 2007.

- **Association for Community Broadcasting**

The stated purpose of the Association for Community Broadcasting (ACB) is to engage in co-operating to sustain and continue a public cultural educational television and radio dedicated to bring the KUHT (Public Television Station Channel 8) and KUHF (FM Radio Station 88.7) service area excellence in operation and programming and to further mutual goals for KUHT, KUHF, and ACB, by providing various and substantial support to KUHT, KUHF, and the University of Houston. The organization remitted $2,856,000 of direct support to the University during the year and $1,648,560 of indirect support for the year ended August 31, 2007.

- **The Foundation for Education and Research in Vision**

The stated purpose of The Foundation for Education and Research in Vision (FERV) is to improve the quality of life for others through promoting education in the field of vision, as well as releasing pertinent information to the public concerning vision needs and care. The organization also seeks to encourage and foster the study of human vision and related fields by providing resources for student scholarships and loans, research and state-of-the-art equipment. The foundation remitted $56,502 of direct support to the University during the year ended August 31, 2007.

- **Privatized Student Housing Facilities**

Several student housing facility projects have been constructed by private external entities in order to enhance the residential life experience of students at various System campuses. The participating entities have financed and constructed housing complexes on System owned property adjacent to the University campus. These facilities are operated under grounded leases and management agreements with the System for extended time periods. Under the terms of the agreements, cash revenues from rental income, net of operating expenses, are shared with the University. If cash revenues do not attain certain contractually defined thresholds, the University may be liable to the external management entity for the deficiency. In previous fiscal years, contingent liability payments were made for $55,850 in 2005 and $138,405 in 2006, both in relation to the Bayou Oaks facility. During the 2007 fiscal year, net cash flows were sufficiently adequate, so as not to generate a liability payment. University management believes that current financial and occupancy performance indicates that future years' net cash flows will be sufficient and that future contingent liabilities will not occur. Repayment of project financing is serviced from revenues generated by the housing projects, and is the sole responsibility of the external entity. The related loans and bonds are not liabilities of the System or component universities, and are not contained in the financial statements of the University. American Campus Communities operates the Bayou Oaks and Cullen Oaks residential facilities at the University of Houston. Century Development operates the Cambridge Oaks facility at the University of Houston campus.

Note 12: Stewardship, Compliance, and Accountability

There were no significant violations of finance-related, legal, or contractual provisions, nor any borrower or lending agent default losses during the year. There were no recoveries of prior-period losses. The University had no violations of bond or note covenants. Per State law, the System cannot spend amounts in excess of appropriations granted by the Texas Legislature. A negative Change in Net Assets did not occur in the proprietary operations (business-type activities) of the University for the fiscal year.

Note 13: The Financial Reporting Entity

The University of Houston is an agency of the State of Texas, and its financial records reflect compliance with applicable state statutes and regulations. The University of Houston is a component of the University of Houston System, was established by House Bill No. 188, Sixty-Fifth Legislature, Regular Session, effective September 1, 1977. Components of the System and their date of legislative creation are System Administration (1977), University of Houston (1963), Clear Lake (1973), Downtown (1974), and Victoria (1973). The System is governed by an appointed nine member Board of Regents.

Although the University is affiliated with several separate legal entities, as previously disclosed, these organizations are not considered component units as defined by generally accepted accounting principles. Therefore, the account balances and financial transactions of these organizations are not included in the University's financial statements.

Note 14: Restatement of Net Assets

During fiscal year 2007, a restatement of the prior year's net assets balance was required. The restatements represent prior period adjustments to beginning net assets related to capital assets and accumulated depreciation changes. See also, the adjustments column in the table in Note 2.

Table 14
Restatement of Net Assets

Description		
Restatements		
Capital assets valuation correction	$ (1,189,894)	
Accumulated depreciation correction	(116,329)	
Total Restatements		$ (1,306,223)

Note 15: Employee Retirement Plans

The State of Texas has joint contributory retirement plans for substantially all of its employees. One of the primary plans in which the University participates is administered by the Teacher Retirement System of Texas (Retirement System). The contributory percentages currently provided by the State and by each participant, for the 2007 fiscal year are 6.0 percent and 6.4 percent, respectively, of annual compensation. Certain contributory percentages will change for fiscal year 2008, effective September 1, 2007. The contributory percentage provided by the State will increase to 6.58 percent, while the participant contributory percentage will remain 6.4 percent.

The Retirement System does not separately account for each of its component government agencies because the Retirement System itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. According to an independent actuarial valuation as of August 31, 2007, the present value of the Retirement System's actual and projected liabilities, including projected benefits payable to its retirees and active members and their beneficiaries, was more than the actuarial valuation of Retirement System assets. However, the actuary projected that such assets, augmented by projected future contributions and earnings, would be sufficient to amortize the unfunded difference over a period of 27.4 years. Further information regarding actuarial assumptions and conclusions, together with audited financial statements, are included in the Retirement System's annual financial report.

The State has also established an Optional Retirement Program for institutions of higher education. Participation in the Optional Retirement Program is in lieu of participation in the Retirement System. The Optional Retirement Program provides for the purchase of annuity contracts and mutual funds. The contributory percentages of participant salaries provided by the State and by each participant enrolled in the plan on or before August 31, 1995, are 8.5 percent and 6.65 percent, respectively. The 8.5 percent is composed of 6.0 percent contributed by the State and an additional 2.5 percent contributed by the University. For participants who enrolled after September 1, 1995, State and participant contributions are 6.0 percent and 6.65 percent, respectively. Because these are individual annuity contracts, the State has no additional or unfunded liability for this program, and the University bears no responsibility for retirement commitments beyond contributions. Certain contributory percentages will change for fiscal year 2008, effective September 1, 2007. The contributory percentages of participant salaries provided by the State and by each participant enrolled in the plan on or before August 31, 1995, will continue to be 8.5 percent and 6.65 percent, respectively. The 8.5 percent will be composed of 6.58 percent contributed by the State and an additional 1.92 percent contributed by the University. For participants who enrolled after September 1, 1995, State and participant contributions will be 6.58 percent and 6.65 percent, respectively.

The retirement expense to the University was $17,174,496 for the year ended August 31, 2007. Of this amount, $11,941,089 represents the portion of appropriations made by the State Legislature expended on behalf of the University and $5,233,407 represents the portion paid from the University's funds.

Note 16: Deferred Compensation Program

University employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. Deferred compensation plans are administered by the Employees Retirement System.

The State's 457 Plan complies with Internal Revenue Code, Section 457. This plan is referred to as the TexaSaver Deferred Compensation Plan and is available to all employees. Deductions, purchased investments, and earnings attributed to the 457 Plan are the property of the State and subject only to the claims of the State's general creditors. Participant rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the 457 account for each participant. The State has no liability under the 457 Plan, and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

The University also administers a Tax-Deferred Account Program, created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The Tax-Deferred Account Program is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be insurance companies, banks, or approved non-bank trustees such as mutual fund companies. The assets of this plan do not belong to the University, and thus it does not have a liability related to this plan.

Note 17: Donor Restricted Endowments

Expenditure of endowed funds is not permitted without the express consent of the donor. The majority of UH's endowments are held in perpetuity. In many cases, endowment earnings are expendable for student financial assistance or other purposes as specified by the donor. In other cases, endowment earnings are reinvested. Amounts reported as net appreciation on investments of donor-restricted endowments that are available for authorization for expenditure are disclosed in Table 17. Chapter 163 of the Texas Property Code (also cited as the Uniform Prudent Management of Institutional Funds Act) grants the University the authority to spend net appreciation. Effective September 1, 1995, the Board of Regents adopted an endowment income payout policy whereby the payout rate is based on a percentage of the fiscal year end market value averaged over rolling three year periods. If an endowment were in existence less than three years, the average is based on the number of years in existence. The following table displays the net appreciation to the endowments for the year ended August 31, 2007.

Table 17
Endowments

Donor Restricted	Amount of Net Appreciation / (Depreciation)	Reported in Net Assets
True Endowments	$ 12,930,296	Restricted Expendable
Term Endowments	17,446	Restricted Expendable
Total donor restricted	$ 12,947,742	

Note 18: Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health and life insurance benefits for retired employees, in accordance with state statutes. Substantially all of the employees may become eligible for the health and life insurance benefits if they reach normal retirement age while working for the State. Currently, there are 1,025 University retirees who are eligible for these benefits. Similar benefits for active employees are provided through a self-funded plan and fully insured plans. Depending upon the status of the employee at the time of retirement, the State or the University recognizes the cost of providing these benefits. The cost of retiree post-employment benefits is recognized when paid. This contribution paid all of the “employee/retiree only” premiums and a portion of the premiums for those employees/retirees selecting dependent coverage. The employee/retiree was required to pay a portion of the cost of dependent coverage. For the fiscal year ended August 31, 2007, the cost of providing those benefits for the retirees was $5,092,873 for the State.

In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the System in fiscal year 2008. GASB Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees’ years of service, along with the related liability, net of any plan assets. The System is working with the State to determine the effect the GASB Statement No. 45 will have on the System’s and University’s financial statements.

Note 19: Disaggregation of Receivable and Payable Balances

Balances of receivables and payables reported on the Statement of Net Assets may be aggregations of different components. GASB Statement 38, *Certain Financial Statement Note Disclosures*, requires that the University provide details in the notes to the financial statements when significant components have been obscured by aggregation. The Statement of Net Assets is presented in the classified format, and therefore the current and non-current portions of receivables and payables are separately disclosed. Significant balances in various classifications of receivables and payables are disclosed below.

Federal Receivable

Balances by category type for Federal Receivable are shown in the table below.

Table 19
Federal Receivable

Department of Agriculture	$ 146,261
Department of Commerce	357,780
Department of Defense	6,056,028
Department of Education	1,467,417
Department of Energy	2,620,416
Department of Health & Human Services	5,705,625
Department of Homeland Security	635,534
Department of Justice	43,362
Department of Labor	56,228
Department of the Interior	166,259
Department of Transportation	53,577
Department of Veterans Affairs	48,604
Environmental Protection Agency	454,691
National Aeronautics & Space Administration	2,003,335
National Foundation for the Arts & Humanities	358,675
National Science Foundation	3,343,353
Securities & Exchange Commission	164,474
Small Business Administration	119,573
U.S. Agency for International Development	7,087
Total federal receivable	$ 23,808,279

Other Receivables - Current
There are no reportable balances for this classification.

Other Payables - Current

There are no reportable balances for this classification.

Note 20: Termination Benefits

The University has no retiring members of the Employees Retirement System of Texas (ERS) eligible for a temporary retirement incentive payment.

State Auditor's Office
John Keel, CPA
State Auditor

February 25, 2008

Dr. Renu Khator, Chancellor and President
University of Houston
Office of the Chancellor/President
212 Ezekiel Cullen Building
Houston, Texas 77204-2018

Subject: Management Letter Resulting from a Review of the University of Houston's Fiscal Year 2007 Financial Statements

Dear Dr. Khator:

We offer this management letter in conjunction with our review of the financial statements of the University of Houston (University) for the fiscal year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

We appreciate the assistance provided during this review by the management of the University and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

Robert E. Johnson Building
1501 N. Congress Avenue
Austin, Texas 78701

P.O. Box 12067
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SAO Report No. 08-342

The University of Texas at Austin

A Review of

The University of Texas at Austin

A Report and Management Letter for the Southern Association of Colleges and Schools

January 2008

Contents

State Auditor's Office
John Keel, CPA
State Auditor

Auditor's Review Report

January 31, 2008

Mr. William C. Powers, Jr., President
The University of Texas at Austin
Main Building, Room 400 (G3400)
PO Box T
Austin, Texas 78713-8920

Dear Mr. Powers:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of the University of Texas at Austin (University) as of and for the fiscal year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the University.

A review consists principally of inquiries of University personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the University. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The University has not presented a management's discussion and analysis section that the Governmental Accounting Standards Board has identified as required supplementary information that is not part of the basic financial statements. However, such required supplementary information for the University of Texas System (System) is presented in the System's consolidated annual financial report.

This report is intended for use by the Board of Regents of the System, management of the University, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

SAO Report No. 08-322

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The University of Texas at Austin
Statement of Net Assets
At August 31, 2007
(See Auditor's Review Report on page 1.)

ASSETS

Current Assets:		
Cash & Cash Equivalents	$	117,912,839
Restricted Cash & Cash Equivalents		41,566,152
Balance in State Appropriations		713,111
Accounts Receivable:		
Federal Receivables		58,221,962
Other Intergovernmental Receivables		9,972,674
Student Receivables (net of allowance of $1,476,774)		83,020,067
Interest and Dividends		5,630,383
Contributions Receivable (net of allowance of $336,799)		8,623,663
Other Receivables (net of allowance of $469,466)		15,337,815
Due From Other Agencies		262,737,328
Inventories		8,061,020
Loans and Contracts		10,812,429
Other Current Assets		47,703,806
Total Current Assets		670,313,249
Non-Current Assets:		
Restricted:		
Investments		3,090,338,359
Loans, Contracts and Other (net of allowance of $7,755,661)		55,349,801
Contributions Receivable (net of allowance of $275,756)		17,071,406
Investments		513,901,594
Other Non-Current Assets/Held in Trust		1,346,336
Capital Assets-Depreciable		2,868,358,501
Less Accumulated Depreciation		(1,537,155,515)
Capital Assets-Non-depreciable		527,889,321
Total Non-Current Assets		5,537,099,803
TOTAL ASSETS	**$**	**6,207,413,052**

The University of Texas at Austin

Statement of Net Assets

At August 31, 2007

(See Auditor's Review Report on page 1.)

LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities	$	98,889,331
Due to Other Agencies		11,698,598
Deferred Revenue		377,384,506
Employees' Compensable Leave		23,770,429
Notes, Loans and Leases Payable		1,989,467
Payable From Restricted Assets		19,771,009
Other Current Liabilities		4,683,352
Total Current Liabilities		538,186,692
Non-Current Liabilities:		
Employees' Compensable Leave		21,305,616
Assets Held for Others		20,723,761
Liabilities to Beneficiaries		11,361,619
Notes, Loans and Leases Payable		20,270,957
Total Non-Current Liabilities		73,661,953
TOTAL LIABILITIES		611,848,645
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		1,836,831,883
Restricted for:		
Nonexpendable		
True and Other Endowments, and Annuities		1,310,113,302
Expendable		
Capital Projects		183,669,255
Funds Functioning as Endowment - Restricted		122,923,983
Other Expendable		1,702,027,133
Unrestricted		439,998,851
TOTAL NET ASSETS		**5,595,564,407**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Austin

Statement of Revenues, Expenses, and Changes in Net Assets

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

OPERATING REVENUES:		
Student Tuition and Fees	$	464,364,708
Discounts and Allowances		(92,466,577)
Federal Sponsored Programs		348,542,834
State Sponsored Programs		48,631,177
Local Sponsored Programs		2,685,915
Private Sponsored Programs		66,293,693
Sales and Services of Educational Activities		152,804,711
Discounts and Allowances		(1,255)
Auxiliary Enterprises		172,493,597
Discounts and Allowances		(8,629,705)
Other Operating Revenues		3,403,127
Total Operating Revenues		**1,158,122,225**
OPERATING EXPENSES:		
Salaries and Wages		898,414,149
Payroll Related Costs		215,362,849
Professional Fees and Services		21,575,812
Travel		37,452,592
Material and Supplies		105,461,227
Utilities		41,316,168
Telecommunications		9,288,979
Repairs and Maintenance		26,826,492
Rentals and Leases		11,629,807
Printing and Reproduction		6,528,802
Scholarships and Fellowships		87,832,321
Depreciation and Amortization		135,227,783
Other Expenses		149,729,981
Total Operating Expenses		**1,746,646,962**
Operating Income (Loss)		**(588,524,737)**

The University of Texas at Austin

Statement of Revenues, Expenses, and Changes in Net Assets

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

NONOPERATING REVENUES (EXPENSES):		
State Appropriations	$	301,768,872
Gift Contributions for Operations		95,688,355
Net Investment Income		146,792,797
Net Increase (Decrease) in Fair Value of Investments		363,516,012
Interest Expense on Capital Asset Financings		(1,517,935)
Gain/(Loss) on Sale of Capital Assets		(7,114,734)
Other Nonoperating Revenues		6,214,709
Other Nonoperating (Expenses)		(2,498,616)
Net Nonoperating Revenues (Expenses)		**902,849,460**
Income/(Loss) Before Other Rev., Exp., Gains/(Losses) & Transfers		**314,324,723**
Gifts and Sponsored Programs for Capital Acquisitions		44,991,783
Additions to Permanent Endowments		44,556,746
Transfers From Other State Agencies		441,515,514
Transfers to Other State Agencies		(49,565,172)
Change in Net Assets		**795,823,594**
Beginning Net Assets		4,799,740,813
Ending Net Assets	**$**	**5,595,564,407**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Austin

Statement of Cash Flows

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

Cash Flows from Operating Activities:	
Proceeds from Tuition and Fees	$ 366,739,146
Proceeds from Sponsored Programs	470,857,776
Proceeds from Auxiliaries	170,094,524
Proceeds from Other Revenues	159,258,307
Payments to Suppliers	(500,460,015)
Payments to Employees	(1,106,573,485)
Payments for Loans Provided	(43,637,874)
Proceeds from Loan Programs	39,388,823
Net Cash Used by Operating Activities	(444,332,798)
Cash Flows from Noncapital Financing Activities:	
Proceeds from State Appropriations	302,932,707
Proceeds from Operating Gifts	86,724,715
Proceeds from Private Gifts for Endowment and Annuity Life Purposes	44,556,746
Proceeds from Other Nonoperating Revenues	6,214,709
Payments/Receipts for Transfers to/from Other Agencies	100,854,935
Payments for Other Uses	(2,498,615)
Net Cash Provided by Noncapital Financing Activities	538,785,197
Cash Flows from Capital and Related Financing Activities:	
Proceeds from Capital Debt Transferred from System	244,311,986
Proceeds from Capital Appropriations, Grants and Gifts	12,466,349
Proceeds from Sale of Capital Assets	65,527
Payments for Additions to Capital Assets	(361,170,959)
Payments of Principal on Capital Related Debt	(931,176)
Transfers to System for Capital Related Debt Service	(45,308,577)
Payments of Interest on Capital Related Debt	(1,517,935)
Net Cash Used by Capital & Related Financing Activities	(152,084,785)
Cash Flows from Investing Activities:	
Proceeds from Interest and Investment Income	150,324,694
Proceeds from Sales of Investments	2,216,564
Payments to Acquire Investments	(91,490,385)
Net Cash Provided by Investing Activities	61,050,873
Net Increase in Cash	3,418,487
Cash and Cash Equivalents - Beginning of the Year	156,060,504
Cash and Cash Equivalents - End of the Year	**$ 159,478,991**

The University of Texas at Austin

Statement of Cash Flows

For the Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

Reconciliation of Net Operating Revenues (Expenses) to Net Cash Used by Operating Activities:		
Operating Loss	$	(588,524,737)
Adjustments to Reconcile Operating Loss to Net Cash:		
Depreciation and Amortization Expense		135,227,783
Bad Debt Expense		214,523
Changes in Assets and Liabilities:		
Accounts Receivable		13,192,993
Inventories		(647,796)
Loans and Contracts		(4,249,051)
Other Current and Noncurrent Assets		(1,758,422)
Accounts Payable		2,481,162
Due to System		733,160
Deferred Revenue		(7,541,545)
Employees' Compensable Leave		3,761,986
Other Current and Noncurrent Liabilities		2,777,146
Total Adjustments		144,191,939
Net Cash Used by Operating Activities	**$**	**(444,332,798)**
Non Cash Transactions		
Net Increase in Fair Value of Investments		363,516,012
Donated Capital Assets		32,525,434
Capital Assets Acquired Under Capital Lease Purchases		755,624
Miscellaneous Noncash Transactions		(4,657,985)

The University of Texas at Austin

Statement of Changes in Unrestricted Net Assets

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

		August 31, 2007	August 31, 2006	Difference
Unrestricted Net Assets:				
Unrestricted				
Reserved				
Encumbrances	$	190,044,727	133,934,465	56,110,262
Accounts Receivable (less deferred revenue)		10,185,082	7,682,832	2,502,250
Inventories		8,060,714	7,412,918	647,796
Other Specific Purposes:				
ARP/ATP		506,911	1,217,935	(711,024)
Prepaid Expenses		39,172,122	39,906,386	(734,264)
Imprest Funds		196,940	198,115	(1,175)
Unreserved				
Allocated				
Funds Functioning as Endowments - Unrestricted		43,147,996	38,685,738	4,462,258
Provision for FY 2008 Operating Budgets		3,000,000	3,000,000	-
Capital Projects		-	27,626,928	(27,626,928)
Start-up/Matching		11,951,746	17,202,905	(5,251,159)
Utilities Reserve		1,804,916	3,070,963	(1,266,047)
Research Enhancement and Support		23,693,589	21,576,273	2,117,316
Market Adjustments		22,699,749	3,840,650	18,859,099
Student Fees		16,554,526	18,271,887	(1,717,361)
Texas Tomorrow Fund Shortfall		8,000,000	7,500,000	500,000
Instructional Program Support		40,383,915	32,714,869	7,669,046
Self-Supporting Enterprises		19,597,334	18,308,622	1,288,712
Unallocated		998,584	1,000,000	(1,416)
Total Unrestricted Net Assets	**$**	**439,998,851**	**383,151,486**	**56,847,365**

(See Auditor's Review Report on page 1.)

General Information

This report is prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of The University of Texas at Austin (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria, the report also includes a Statement of Changes in Unrestricted Net Assets and a Management Letter describing issues noted in the review.

Reporting Entity

The University is an institution within The University of Texas System (System). The System is reported as a business-type activity in the State of Texas' *Comprehensive Annual Financial Report* and reflects compliance with applicable state statutes and GASB pronouncements. The System is governed by a board of regents, composed of nine members who are appointed by the Governor and confirmed by the Senate. Terms are scheduled for six years each and staggered so that three members' terms usually expire on February 1 of odd-numbered years.

Founded in 1883, the University has grown from a single building, eight teachers, two departments and 221 students to a 350-acre main campus with 21,000 faculty and staff, 16 colleges and schools, and almost 50,000 students. The University's reach goes far beyond the borders of the main campus with satellite campuses and research centers across Texas, including the J.J. Pickle Research Campus, the Marine Science Institute, the McDonald Observatory, the Montopolis Research Center, and the Brackenridge tract.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The basis of accounting determines when revenues and expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, the University's financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred. Operating items are distinguished from nonoperating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the principle of ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets.

The financial statements of the University have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. The University applies all GASB pronouncements and applicable Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, except FASB statements that conflict with a GASB pronouncement.

Cash and Cash Equivalents

Cash and cash equivalents are maintained for the purpose of meeting short-term expense requirements. Highly liquid investments with maturities of three months or less at the time of purchase are included as cash and cash equivalents.

Due from Other Agencies

Due from Other Agencies is mainly accounts receivable from proceeds of System debt issuances and the University's share of deposits in funds managed by the System, with investment horizons of less than one year.

Investments

Investments of the University are managed by The University of Texas Investment Management Company (UTIMCO), a private investment corporation that provides services exclusively to the System. All investments are reported as noncurrent, as these funds have an investment horizon extending beyond one year. The investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the System are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes, and internal pricing matrices.

Equity security market values are based on the New York Stock Exchange composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded. If a closing price is not available, the average of the last reported bid and ask price is used.

The audited financial statements of the funds managed by UTIMCO may be found on UTIMCO's web site, and inquiries may be directed to UTIMCO via www.utimco.org.

Endowments

The University's endowments are used to support operations, which require the simultaneous achievement of two seemingly contradictory objectives of generating a predictable stream of annual revenue at a rate at least equal to the average rate of inflation for current needs and of increasing the purchasing power of the funds (after annual distributions) at a rate at least equal to the average rate of inflation for future periods.

Funds are subject to restrictions of endowment and trust instruments, requiring that principal be maintained and that only the income be utilized. Funds may include endowments, term endowments, and funds functioning as endowments. Funds functioning as endowments consist of amounts that have been internally dedicated by the System for long-term investment purposes.

Contributions Receivable

Current and noncurrent contributions receivable are amounts pledged to the University by donors, net of allowances.

Inventories

Inventories, consisting primarily of supplies and merchandise for resale, are valued at cost based on the specific identification method.

Restricted Assets

Restricted assets include funds restricted by legal or contractual requirements, including those related to sponsored programs, donors, constitutional restrictions, bond covenants, and loan agreements.

Loans and Contracts

Current and noncurrent loans and contracts are receivables, net of allowances, related to student loans.

Capital Assets

Capital assets are recorded at cost at the date of acquisition or at fair value at the date of donation in the case of gifts. The University follows the State's capitalization policy with a cost equal to or greater than $5,000 for equipment items; $100,000 for buildings, building improvements, and improvements other than buildings; and $500,000 for infrastructure items with an estimated useful life of greater than one year. Purchases of library books are capitalized. Renovations to buildings, infrastructure, and land improvements that increase the value by at least 25 percent or extend the useful life by at least 25 percent are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expenses are incurred. Outlays for construction in progress are capitalized as incurred. Interest expense related to construction is capitalized net of interest income earned on the resources reserved for this purpose.

The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research, and public service. These collections are protected and preserved.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 2 to 15 years for equipment items, 15 years for library books, 10 to 50 years for buildings and their components, and 15 to 40 years for infrastructure elements.

Other Current Assets

Other current assets consist of prepaid scholarships of $41,753,231, and miscellaneous prepaid expenses of $5,950,575.

Accounts Payable and Accrued Liabilities

Accounts Payable and Accrued Liabilities represent amounts owed to vendors for goods and services, and salaries and wages paid to employees on September 1, 2007.

Deferred Revenue

Deferred revenue represents revenues collected but not earned as of August 31, such as tuition received in August for the fall semester and payments received in advance for sponsored programs.

Liability to Beneficiaries – Held by System

The System holds numerous irrevocable charitable remainder trusts for the University and a pooled income fund. Together, these assets are reflected in the accompanying financial statements within restricted investments.

The charitable remainder trusts designate the System Board of Regents as both trustee and remainder beneficiary. Donors (or other donor-designated income beneficiaries) are paid either a fixed amount or the lesser of a fixed percentage of the fair value of the trusts' assets or the trusts' income during the beneficiaries' lives. Trust assets are measured at fair value when received and monthly thereafter. A corresponding liability to beneficiaries is measured at the present value of expected future cash flows to be paid to the beneficiaries based upon the applicable federal rate on the gift date. Upon the deaths of the income beneficiaries, substantially all of the principal balance passes to the University to be used in accordance with the donors' wishes.

The pooled income fund was formed with contributions from several donors. The contributed assets are invested and managed by UTIMCO. Donors (or designated beneficiaries) periodically receive, during their lives, a share of the income earned on the fund proportionate to the value of their contributions to the fund. Upon the deaths of the income beneficiaries, substantially all of the principal balance passes to the University to be used in accordance with the donors' wishes. Contribution revenue is measured at the fair value of the assets received, discounted for a term equal to the life expectancies of the beneficiaries.

Net Assets

The University has classified resources into the following three net asset categories:

Invested in Capital Assets, Net of Related Debt
Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted:

Nonexpendable
Net assets subject to externally imposed stipulations that require the amounts to be maintained in perpetuity by the University or the System. Such assets include the University's permanent endowment funds.

Expendable
Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire with the passage of time.

Unrestricted
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for special purposes by action of management or the System Board of Regents. Substantially all unrestricted net assets are designated for academic and research programs and initiatives and for capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation. Generally, the University's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.

Revenues and Expenses

Operating revenues include student tuition and fees, net of scholarship allowances; sales and services of auxiliary enterprises; most federal, state, and local grants and contracts and federal appropriations; and interest on student loans. Operating expenses include salaries and wages, payroll related costs, materials and supplies, depreciation, and scholarships and fellowships.

Nonoperating revenues include activities such as gifts, contributions, State appropriations, investment income, increases in the fair market value of investments, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. Nonoperating expenses include activities such as interest expense on capital asset financings and other expenses that are defined as nonoperating expenses by GASB Statement Nos. 9 and 34.

Scholarship Allowances and Student Aid

Financial aid to students is reported in the financial statements as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid (student loans, funds provided to students as awarded by third parties, and Federal Direct Lending) is accounted for as third-party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expense or scholarship allowances, which reduce revenues. The amount reported as operating expense represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed on an entity-wide basis by allocating cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third-party aid.

Use of Estimates

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

Note 2: Capital Assets

A summary of changes in capital assets is shown below:

	Balance 9/1/2006	Completed Construction in Progress	Additions	Deductions	Balance 8/31/2007
Nondepreciable Assets:					
Land	60,094,399		22,196,982		82,291,381
Construction in Progress	175,989,482	(224,113,331)	302,431,741	(2,417,461)	251,890,431
Other Capital Assets	186,595,530		7,123,635	(11,656)	193,707,509
Total Nondepreciable Assets	$422,679,411	($224,113,331)	$331,752,358	($2,429,117)	$527,889,321
Depreciable Assets:					
Buildings	1,621,241,378	137,257,714	19,912,483		1,778,411,575
Infrastructure	42,025,902	8,606,628			50,632,530
Facilities and Other Improvements	232,127,362	75,908,962	132,117	(11,300,000)	296,868,441
Equipment	464,955,128	2,340,027	43,640,848	(30,334,822)	480,601,181
Vehicles and Aircraft	14,236,644		1,450,649	(607,558)	15,079,735
Other Capital Assets	236,680,973		10,084,066		246,765,039
Total Depreciable Assets at Historical Cost	$2,611,267,387	$224,113,331	$75,220,163	($42,242,380)	$2,868,358,501
Less accumulated depreciation for:					
Buildings	(804,724,179)		(70,783,082)		(875,507,261)
Infrastructure	(30,572,051)		(1,377,583)		(31,949,634)
Facilities and Other Improvements	(77,891,466)		(10,580,161)		(88,471,627)
Equipment	(332,322,783)		(42,433,674)	23,225,394	(351,531,063)
Vehicles and Aircraft	(10,578,385)		(1,117,328)	548,381	(11,147,332)
Other Capital Assets	(169,541,154)		(9,007,444)		(178,548,598)
Total Accumulated Depreciation	($1,425,630,018)	$0	($135,299,272)	$23,773,775	($1,537,155,515)
Depreciable Assets, Net	$1,185,637,369	$224,113,331	($60,079,109)	($18,468,605)	$1,331,202,986
Capital Assets, Net	$1,608,316,780	$0	$271,673,249	($20,897,722)	$1,859,092,307

Note 3: Deposits and Investments

Deposits

University bank information as of August 31, 2007, is presented below:

Carrying Amount	Bank Balance
$ (54,378,334)	$ 4,898,974

Cash Deposits	$ (54,378,334)
Cash in State Treasury	33,127,761
Cash Equivalents	176,479,048
Other	4,250,516
Total Cash and Cash Equivalents	$ 159,478,991
Current Assets Cash and Cash Equivalents	$ 117,912,839
Current Assets Restricted Cash and Cash Equivalents	41,566,152
Total Cash and Cash Equivalents	$ 159,478,991

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the University will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The University maintains depository relationships with various banking institutions. The University's policy is that all deposits are governed by a bank depository agreement between the University and the respective banking institution. This agreement provides that the University's deposits, to the extent such deposits exceed the maximum insured limit under deposit insurance provided by the Federal Deposit Insurance Corporation, shall at all times be collateralized with either government securities or a surety bond issued by an insurer rated "AAA" or its equivalent by a nationally recognized rating organization or a combination thereof.

Investments

At the direction of the System Board of Regents, University investments and cash equivalents are pooled at the System level with UTIMCO. The System is responsible for disclosure of all information on the pooled investments and has included these disclosures in its annual financial report.

The University does not have an investment risk policy. As of August 31, 2007, the fair value of the University's share of investments is presented below:

Investments Held by System in:	
Intermediate Term Fund	$ 756,893,641
General Endowment Fund	2,847,331,312
Other Investments	15,000
Total Investments	$3,604,239,953
Noncurrent Assets Investments	$ 513,901,594

Noncurrent Assets Restricted Investments	3,090,338,359
Total Investments	$3,604,239,953

(A) *Credit Risk* – Article VII, Section 11b, of the Texas Constitution authorizes the System Board of Regents, subject to procedures and restrictions it establishes, to invest System funds in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System's investment policies limit investments in U.S. domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, Baa3 or better by Moody's Investor Services; BBB- or better, by Standard & Poor's Corporation, or BBB- or better by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below-investment-grade bonds. Per GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. GASB 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk.

(B) *Concentrations of Credit Risk* – The System's investment policy statements contain the limitation that no more than 5 percent of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer. At August 31, 2007, the System did not hold any direct investments in any one issuer of corporate or municipal bonds that were five percent or more of the market value of the System's domestic fixed income investments.

(C) *Custodial Credit Risk* – Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas statutes and the System's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. At August 31, 2007, the System did not have any deposits or investments that were exposed to custodial credit risk.

(D) *Interest Rate Risk* – Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Interest rate risk inherent in the System investments is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the System's investments to changes in interest rates. The System has no specific policy statement limitations with respect to its overall modified duration.

(E) *Investments with Fair Values that Are Highly Sensitive to Interest Rate Changes* – In accordance with the System's investment policy statements, the System may invest in various mortgage-backed securities, such as collateralized mortgage-backed obligations. The System also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds, and stripped Treasury and Agency securities created from coupon securities. As of August 31, 2007, the System's investments include the following investments that are highly sensitive to interest rate changes:

- Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Mortgage-backed securities that are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Asset-backed securities that are backed by home equity loans, auto loans, equipment loans, and credit card receivables. Prepayments by the obligees of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received.

- Step-up notes that grant the issuer the option to call the note on certain specified dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at the inception of the note. The call feature embedded within a step-up note causes the fair value of the instrument to be considered highly sensitive to interest rate changes.

(F) *Foreign Currency Risk* – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the System's non-U.S. dollar investments. The System's investment policy statement limits investments in non-U.S. denominated bonds to 50 percent of the System's total fixed income exposure.

Securities Lending

In accordance with the prudent investor investment standards, the System participates in a securities lending program. The System began the program, under a contract with the System's lending agent, on September 1, 1995. The lending agent is authorized to lend any securities held by the System's custodian except those securities which the policy guidelines prohibit lending. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In securities lending transactions, the System transfers its securities to brokers/dealers for collateral, which may be cash, securities issued or guaranteed by the U.S. government or its agencies, and irrevocable bank letters of credit, and simultaneously agrees to return the collateral for the same securities in the future.

Cash collateral received by the lending agent on behalf of the System is invested and reinvested in a non-commingled pool exclusively for the benefit of the System. The pool is managed in accordance with investment guidelines established by the System and as stated in the securities lending contract. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent. On August 31, 2007, the System was collateralized 102 percent for securities on loan collateralized by cash.

Collateral pool investments are uninsured and are held by the securities lending agent, in its name, on behalf of the System, except for the investments in repurchase agreements, which are held in the securities lending agent's name by a third party custodian not affiliated with the System or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties's trust department or agent.

Lending income is earned if the returns on those investments exceed the "rebate" paid to borrowers of the securities. The income is then shared with the lending agent based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from the System's resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a "loan premium or fee" for the securities loan. This income is split with the same ratio as the earnings for cash collateral. The collateral pledged to the System by the borrower is custodied by the lending agent or through a third-party arrangement. These securities held as collateral are not available to the System for selling or pledging unless the borrower is in default of the loan. On August 31, 2007, the System was collateralized 102 percent for securities on loan which were collateralized by securities.

The collateral received will have a fair value of 102 percent of the loaned securities of U.S. issuers. If the fair value of the collateral held in connection with loans of securities of U.S. issuers is less than 100 percent at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102 percent of the fair value.

For non-U.S. issuers, the collateral should remain at 105 percent of the fair value of the loaned securities at the close of any business day. If it falls below 105 percent, the borrower must deliver additional collateral by the close of the following business day. On August 31, 2007, the System was collateralized 105 percent for international loans.

In the event of default, where the borrower is unable to return the securities loaned, the System has authorized the lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the lending agent has indemnified the System from any loss due to borrower default.

At August 31, 2007, the System had no credit risk exposure to borrowers because the amounts the System owed to borrowers exceeded the amounts the borrowers owed the System.

There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Derivative Financial Instruments

Derivatives are financial instruments (securities or contracts) with values linked to, or "derived" from, changes in interest rates, currency rates, and stock and commodity prices. Derivatives cover a broad range of financial instruments, such as forwards, futures, options, swaps, and mortgage derivatives.

(A) *Mortgage Derivatives* – Mortgage derivatives are used to manage portfolio duration and to enhance portfolio yield, and are influenced by changes in interest rates, the current economic climate, and the geographic make-up of underlying mortgage loans. There are varying degrees of risk associated with mortgage derivatives. For example, certain Collateralized Mortgage Obligations (CMOs) such as Planned Amortization Class (PACs) are considered a more conservative lower risk investment. In contrast, principal only and interest only strips are considered higher risk investments. The System's investment in CMOs at August 31, 2007, was composed almost exclusively of the lower risk investment class.

(B) *Futures Contracts* – Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. The net liability is included in payables from restricted assets. Futures contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss difference is referred to as the daily variation margin, which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The System executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the manager's various trading and credit monitoring techniques.

(C) *Foreign Currency Exchange Contracts* – The System enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward currency contract, the System agrees to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the System's net equity therein, representing unrealized gain or loss on the contracts, as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date, is included in other receivables. Realized and unrealized gains and losses are included in the statement of revenues, expenses, and changes in net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the statement of net assets. Risks arise from the possible inability of counterparties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(D) *Written Options* – Written options are used to alter the market (systematic) exposure without trading the underlying cash market securities and to hedge and control risks so that the actual risk/return profile is more closely aligned with the target risk/return profile.

(E) *Swaps* – Swaps are used to adjust interest rate and yield curve exposures. During the year, the System entered into interest rate, inflation, credit default, total return, and commodity swap contracts. They are included in other receivables and payables from restricted assets.

(F) *Investment Funds* – The System's investment funds include exchange-traded funds, index funds, Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures, which are generally unrated and may be unregulated.

Marketable alternatives investment pools are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private market funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments, domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk and investment manager risk.

Public market funds are invested in exchange traded funds, index funds and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the funds. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are investment manager risk, market risk and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market and public market funds include investments in private placement vehicles that are subject to risk, which could result in the loss of invested capital. The risks include the following:

- *Non-regulation risk* – Some of these funds are not registered with the Securities and Exchange Commission, and therefore are not subject to regulatory controls.
- *Key personnel risk* – The success of certain funds is substantially dependent upon key investment managers and the loss of those individuals may adversely impact the fund's performance.
- *Liquidity risk* – Many of the System's investment funds may impose lock-up periods, which would cause the System to incur penalties to redeem its units or prevent the System from redeeming its shares until a certain period of time has elapsed.
- *Limited transparency* – As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
- *Investment strategy risk* – These funds often employ sophisticated investment strategies and may use leverage, which could result in the loss of invested capital.

(G) Securities Sold Short – The System may sell securities it does not own in anticipation of a decline in the fair value of that security or as means to adjust the duration of certain fixed income portfolios. When the System sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The securities sold short as of August 31, 2007, are commitments to sell U.S. Treasury securities that do not require cash deposit. As of August 31, 2007 there was no Deposit with Broker for Securities Sold Short. The System must pay dividends or interest on the securities sold short. Until the System covers it shorts sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold short at prices, which may be significantly higher than the market value reflected in the statements of fiduciary net assets.

Repurchase Agreements

The System, by statute, is authorized to enter into repurchase agreements. A repurchase agreement is made when a holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate the buyer for this. During the year ended August 31, 2007, the System participated in repurchase agreements.

Note 4: Summary of Long-Term Liabilities

	Balance 9/1/2006	Additions	Reductions	Balance 8/31/2007	Amounts Due Within One Year
Notes, Loans and Leases Payable	$ 22,435,976	$ 755,624	$ 931,176	$ 22,260,424	$ 1,989,467
Employees' Compensable Leave	41,314,059	29,313,400	25,551,414	45,076,045	23,770,429
Total	$ 63,750,035	$ 30,069,024	$ 26,482,590	$ 67,336,469	$ 25,759,896

Employees' Compensable Leave

Substantially all full-time University employees earn annual leave in the amount of 8 to twenty-one hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum of 532 hours for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements since experience indicates the expense for sick leave to be minimal. Eligible part-time employees' sick leave accrual rate is proportional to the number of hours appointed to work.

Notes and Loans Payable

Notes and loans payable includes:

- Note payable issue name: Charitable Remainder Trust
  Purpose: Fine Arts Foundation (a blended component unit) purchase of the Suida Manning Art Collection
  Issue Date: January 4, 1999
  Authorized Amount: $12,000,000
  Source of Revenue for Debt Service: Gift
  Terms: January 4, 1999 through April 17, 2016

- Note payable issue name: Charitable Lead Trust
  Purpose: Fine Arts Foundation (a blended component unit) purchase of the Suida Manning Art Collection
  Issue Date: January 4, 1999
  Authorized Amount: $10,713,200
  Source of Revenue for Debt Service: Gift
  Terms: January 4, 1999 through April 17, 2016

Notes and loans payable obligations are due in annual installments through 2016. General information related to notes and loans payable at August 31, 2007, which in substance are not bonds, is summarized as follows:

Fiscal Year	Principal	Interest	Total
2008	$ 1,099,217	$ 1,118,397	$ 2,217,614
2009	850,000	1,070,618	1,920,618
2010	850,000	1,021,056	1,871,056
2011	850,000	971,970	1,821,970
2012	850,000	923,370	1,773,370
2013-2016	15,314,957	3,216,963	18,531,920
Total Requirements	$ 19,814,174	$ 8,322,374	$ 28,136,548

Note 5: Bonded Indebtedness

The University receives proceeds from revenue bonds issued and held by the System to support capital projects of the System and its institutions. These proceeds are recorded as transfers from the System. The University disburses funds to the System for payments of principal and interest related to the University's share of bond proceeds. These disbursements are recorded as transfers to the System. At August 31, 2007, the System had outstanding bonds payable of $3,755,040,000. All bonds issued by the System are defined as revenue bonds. As such, the revenues of the System, including the University, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures' lack of specifically identifiable activities and separate accounting requirements imposed by an external party.

No amount of indebtedness related to bonds has been recorded in the University's financial statements as the System is the party directly liable for these bonds. At August 31, 2007, however, the University's remaining unpaid share of the bond proceeds was $835,118,000.

Note 6: Capital Lease Obligations

Certain leases to finance the purchase of property are capitalized at the present value of future minimum lease payments. The original capitalized cost of all such property under capital lease as of August 31, 2007, is as follows:

Museums and Art Collections	$ 2,742,808
Total	$ 2,742,808

Capital lease obligations are due in annual installments through 2011. The following is a schedule of the future minimum lease payments for leased property and the present value of the net minimum lease payments at August 31, 2007.

Fiscal Year	Principal	Interest	Total
2008	$ 890,250	$ 69,375	$ 959,625

2009	677,375	54,375	731,750
2010	455,125	33,750	488,875
2011	423,500	15,000	438,500
Total Minimum Lease Payments	$ 2,446,250	$ 172,500	$ 2,618,750
Less: Interest			(172,500)
Present Value of Net Minimum Lease Payments			$ 2,446,250

Note 7: Operating Leases

The University has entered into various operating leases for buildings, equipment and land. Rental expenses for operating leases were $2,063,631 in 2007. Future minimum lease rental payments under noncancelable operating leases having an initial term in excess of one year as of August 31, 2007, were as follows:

Fiscal Year	Lease Payments
2008	$2,733,243
2009	2,501,456
2010	1,653,242
2011	1,395,140
2012	715,184
2013 -2017	382,083
Total Minimum Future Payments	$9,380,348

The University has also leased buildings, equipment, and land to outside parties under various operating leases. The cost, carrying value, and accumulated depreciation of these leased assets as of August 31, 2007, were as follows:

Assets Leased	August 31, 2007
Buildings:	
Cost	$960,883
Less Accumulated Depreciation	(294,008)
Carrying Value of Buildings	666,875
Land	529,545
Total Carrying Value	$1,196,420

Minimum future lease income under noncancelable operating leases as of August 31, 2007, was as follows:

Fiscal Year	Lease Income
2008	$4,035,689
2009	4,035,689
2010	4,035,689
2011	4,035,689
2012	4,035,689
Total	$20,178,445

Note 8: Interagency Balances/Activity

The University has numerous transactions with Other Agencies. At year-end, amounts to be received or paid are reported as Due from Other Agencies or Due to Other Agencies.

	Due from Other Agencies	Due to Other Agencies	Purpose
The University of Texas System Administration	$ 2,134,527		Payroll related and telecom
The University of Texas System Administration	69,272,828		Payroll, construction in progress
The University of Texas System Administration	1,386,745		Misc. expenses from gift sources
The University of Texas System Administration	189,414,858		Construction in progress financing

The University of Texas System Administration		$ 11,698,598	Payroll-related insurance premiums
Texas Higher Education Coordinating Board	528,235		Scholarships, Technology Workforce Development awards
Totals	$ 262,737,328	$ 11,698,598	

Interagency transfers made during the fiscal year are presented below:

	Transfers from Other Agencies	Transfers to Other Agencies	Purpose
The University of Texas System Administration	$ 2,414,525	$	Library books, servers, computers
The University of Texas System Administration	432,364,907		Bond proceeds
The University of Texas System Administration		45,308,577	Debt service
The University of Texas System Administration	6,693,858		Anticipated proceeds from debt
UT Health Science Center at Houston	18,762		Computer equipment
UT San Antonio	5,967		Computer equipment
Texas Cooperative Extension	5,858		Water tank
Texas Department of Transportation	11,637		Vehicle
Texas Higher Education Coordinating Board		4,256,595	Tuition set-asides
Totals	$441,515,514	$ 49,565,172	

Note 9: Contingent Liabilities

As of August 31, 2007, University management was not aware of any significant contingent liabilities.

Note 10: Risk Financing and Related Insurance

All risk financing and related insurance for the University is part of coverage provided by the System. The System has seven funded self-insurance plans providing coverage in the following areas: employee health and dental, unemployment compensation, workers' compensation, property protection, directors and officers/employment practices liability, and construction contractor insurance.

Employee and Retiree Insurance Benefits

The System Employee Benefits program provides health, dental, vision, life, long-term disability, short-term disability, long-term care, and flexible spending account coverage to all benefits-eligible employees and retirees of the System and its fifteen institutions. These insurance benefits are provided through both self-funded and fully insured arrangements. A portion of the System's cost of providing group health and basic life insurance is paid by the State as specified in the General Appropriations Act. The System's Office of Employee Benefits (OEB) is responsible for the overall administration of the insurance plans. OEB was established by Chapter 1601 of the *Texas Insurance Code* and complies with state laws and statutes pertinent to employee benefits for the System.

Effective January 1, 2006, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 established prescription drug coverage for Medicare beneficiaries under Medicare

Part D. Medicare Part D provides sponsors of postemployment healthcare plans up to 28 percent of the amount of eligible prescription drug benefit costs of retirees who are eligible for, but not enrolled in, Medicare Part D, if the sponsor's plan provides a prescription drug benefit that is actuarially equivalent to the Medicare Part D benefit.

Unemployment Compensation Insurance

The General Appropriations Act requires the System to reimburse the Texas Workforce Commission (TWC) for 50% of the unemployment benefits paid to former employees that were paid from general revenue funds. The System reimburses the TWC 100% of the unemployment benefits paid to former employees that were paid from local funds.

Workers' Compensation Insurance

The University of Texas System Workers' Compensation Insurance (WCI) program provides coverage to all employees of the System and its fifteen institutions. Under the oversight of the System's Office of Risk Management (ORM), the System self-insures and administers the program. The WCI staff is responsible for administering all aspects of the system-wide program, which provides income and medical benefits to all employees who have sustained job-related injuries or occupational diseases. The program's statutory authority is embodied in Chapter 503 of the *Texas Labor Code.*

Comprehensive Property Protection Program

The property protection plan consists of two programs. The first covers fire and other perils and includes commercial coverage for claims exceeding a per occurrence deductible of $7.5 million or an annual aggregate deductible of $20 million. The policy covers all UT System buildings, personal property and business income reported by the institutions. The maximum reimbursement under this policy is $1 billion per occurrence.

The second program provides coverage for physical damage resulting from Named Windstorms and catastrophic flood losses up to $50 million. Insurance policies providing underlying limits ($1-2 million per building and contents) are purchased through the Texas Windstorm Insurance Association and the National Flood Insurance Program on several facilities in the Tier 1 wind zone and other flood prone areas to provide a primary layer of insurance. The self-insurance component of the program participates in losses that exceed the coverage available under these primary policies or in cases where there is no underlying insurance.

To fund the self-insurance portion of both property programs, the institutions make annual contributions to the loss reserve funds in addition to paying insurance premiums.

Directors and Officers/Employment Practices Liability Self-Insurance Plan

The Directors and Officers Liability (D&O) and Employment Practices Liability (EPL) Self-Insurance Plan (the "Plan") provides coverage for claims arising from actual or alleged wrongful acts performed by the plan beneficiaries. The plan also provides coverage for EPL claims, such as wrongful termination, failure to promote and wrongful discipline. In 2003, the UT System Board of Regents allocated $3.7 million from the Available University Fund to establish the D&O/EPL loss reserve fund. Institutions make annual premium contributions to this fund.

Coverage applies to individual board members, employees, faculty, etc., as well as to the System itself. The limit of liability is a $10 million annual aggregate (Coverages A, B and C combined), except for $5 million annual aggregate sublimit for Coverage C. Coverage A applies to individuals and it has no deductible. Coverage B applies to a UT institution that is required to indemnify a covered individual with deductibles of $100,000 per individual and $300,000 per occurrence. Coverage C applies to a UT institution and related entities with a $300,000 deductible. An excess coverage commercial insurance policy provides $10 million of excess coverage after the Plan's liability limits have been exhausted.

Rolling Owner Controlled Insurance Program

The Rolling Owner Controlled Insurance Program (ROCIP) was established for the centralized purchase of construction contractor insurance on various capital projects. This program provides workers' compensation and general liability insurance for all contractors enrolled on projects participating in the program. The insurance carries a $250,000 per occurrence basket deductible, which is paid through the program's self-insurance fund.

Incurred But Not Reported Self-Insurance Claims

Insurance claims that were Incurred But Not Reported (IBNR) were actuarially determined for the employee's health and dental, workers' compensation, directors and officers/employment practices liability, and rolling owner controlled self-insurance plans. IBNR figures for the workers' compensation, directors and officers/employment practices liability, and rolling owner controlled self-insurance plans include liabilities for unpaid reported claims and are reported on an undiscounted basis. The IBNR liability for the property protection self-insurance plan is not actuarially determined but rather estimated based on unpaid reported claims. Since an annual accrual is recorded for the third quarter TWC billing, no IBNR liability is recorded for Unemployment Compensation Insurance. No settlements exceeded insurance coverage in the past three fiscal years.

Note 11: Subsequent Events

University management is not aware of any significant subsequent events.

Note 12: Stewardship, Compliance, and Accountability

Per State law, the University cannot spend amounts in excess of appropriations granted by the Texas Legislature. There are no deficits in net assets.

Note 13: The Financial Reporting Entity

In addition to the main campus in downtown Austin, the University has satellite campuses and research centers across Texas, including the J.J. Pickle Research Campus, the Marine Science Institute, the McDonald Observatory, the Montopolis Research Center, and the Brackenridge tract.

The University of Texas Fine Arts Foundation is included in these financial statements as a blended component unit because it is governed by a three-member board appointed by the University. Financial information on the Foundation is available on request at UT Austin, Main Building, P.O. Box T, Austin, Texas 78713. The Foundation's fiscal year-end is December 31.

There are not other entities which warrant disclosure as component units for the fiscal year ended August 31, 2007.

Note 14: Employees' Retirement Plans

Teacher Retirement System

The State of Texas has joint contributory retirement plans for substantially all of its employees. One of the primary plans in which the System participates is a cost-sharing, multi-employer, public employee retirement system administered by the Teacher Retirement System of Texas (TRS). TRS is primarily funded through State and employee contributions. Depending upon the source of funding for a participant's salary, the System may be required to make contributions in lieu of the State.

All System personnel employed in a position on a half-time or greater basis for at least 4 ½ months are eligible for membership in the TRS retirement plan. Members with at least five years of service at age 65, or any combination of age plus years of service which equals 80, have a vested right to retirement benefits. Additionally, reduced benefits are available at age 55 with at least 5 years of service or at any age below 50 with 30 years of service. Members are fully vested after five years of service and are entitled to any benefits for which the eligibility requirements have been met.

TRS contribution rates for both employers and employees are not actuarially determined but are legally established by the State Legislature. Contributions by employees are 6.4 percent of gross earnings. Depending upon the source of funding for the employee's compensation, the State or the University contributes a percentage of participant salaries totaling 6 percent of annual compensation. The University's contributions to TRS for the year ended August 31, 2007, were $22,412,515, which equaled the amount of the required contributions for the year.

TRS does not separately account for each of its component government agencies since TRS itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. Further information regarding actuarial assumptions and conclusions, together with audited financial statements are included in TRS's annual financial report, which may be found on the TRS Web site at www.trs.state.tx.us.

Optional Retirement Program

The State has also established an optional retirement program for institutions of higher education. Participation in the ORP is in lieu of participation in the TRS and is available to certain eligible employees. The ORP provides for the purchase of annuity contracts and mutual funds. Participants are vested in the employer contributions after one year and one day of service. The contributory percentages of participant salaries currently provided by the State and each participant are 6 percent and 6.65 percent, respectively. Depending upon the source of funding for the employee's compensation, the System may be required to make the employer contributions in lieu of the State. Additionally, the State or the System must make additional contributions above 6 percent depending upon the employee's date of hire. Since these are individual annuity contracts, the State and the System have no additional or unfunded liability for this program.

The University's contributions for the year ended August 31, 2007, were $23,016,879 for 2,862 participating employees.

The University of Texas System Governmental Retirement Arrangement (UTGRA)

The University of Texas System Governmental Retirement Arrangement (UTGRA) is a defined contribution pension plan established by the System to provide certain participants in the ORP that portion of their benefits that would otherwise be payable under the ORP except for the $45,000 limit on contributions imposed by Section 415 of the Internal Revenue Code (IRC). At August 31, 2007, there were 19 plan members. Persons employed by the University prior to September 1, 1996, whose compensation exceeds the limit set by IRC Section 401(a)(17) and whose ORP contribution is limited by the $45,000 cap under IRC Section 415(c), defer 6.65 percent of their excess compensation while the University contributes between 6 percent and 8.5 percent depending upon the institution and the date of employment. The University contributed $143,726 for the year ended August 31, 2007. Plan provisions are established and may be amended at any time by the UT System Board of Regents.

Plan assets are valued at fair value and are invested in contracts and accounts in a similar manner to the ORP. Participants are immediately vested in the plan, both for the employee deferrals and the employer contributions. However, deferrals, contributions, purchased investments and earnings attributable to the plan are the property of the System and subject only to the claims of the System's general creditors. Participant's rights under the plan are equal to those of the general creditors of the System in an amount equal to the fair value of the participant's account balance. The System has no liability under the UTGRA that would exceed the aggregate value of the investments, and it is unlikely that any of UTGRA's assets will be used to satisfy the claims of general creditors in the future.

Note 15: Deferred Compensation

University employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. The deferred compensation plan is administered by the System.

The System administers the UTSaver Deferred Compensation Program (DCP), created in accordance with IRC Section 457(b). All employees are eligible to participate. Deductions, purchased investments and earnings attributed to the UTSaver DCP are the property of the System subject only to the claims of the System's general creditors. Participants' rights under the plan are equal to those of the general creditors of the System in an amount equal to the fair market value of the UTSaver DCP account for each participant. The System has no liability under the UTSaver DCP and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

In addition, some employees contribute to a deferred compensation plan administered by the State, through the Employees' Retirement System (ERS). The State's 457 plan complied with the IRC Section 457. This State plan was referred to as the Texa$aver Deferred Compensation Plan and was only available to employees who were contributing prior to the establishment of the UTSaver DCP. Deductions, purchased investments and earnings attributed to the 457 plan are the property of the State subject only to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair value of the 457 account for each participant. The State has no liability under the 457 plan and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

The System also administers the UTSaver Tax-Sheltered Annuity Program (TSA), created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The UTSaver TSA is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be insurance companies, banks, or approved non-bank trustees such as mutual fund companies. The assets of this plan do not belong to the System or the State. Therefore, neither the System nor the State has a liability related to this plan.

Note 16: Donor-Restricted Endowments

Donor-restricted endowments are invested by System's UTIMCO. Net appreciation on investments of donor-restricted endowments are available for authorization for expenditure by the UT System Board of Regents. Pursuant to the Uniform Management of Institutional Funds Act, as adopted by Texas, the UT System Board of Regents may distribute net appreciation, realized and unrealized, in the fair market value of the assets of endowment holdings over the historic dollar value of the gifts, to the extent prudent. Net appreciation of $1,702,027,133 is reported as Restricted, Expendable, Other Expendable net assets. The System's policy is to retain all undistributed net realized and unrealized appreciation within the endowment funds.

Note 17: Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health and life insurance benefits for retired employees, in accordance with State statutes. Many employees may become eligible for the health and life insurance benefits as a retired employee if they meet certain age and service requirements as defined by the State. Similar benefits for active employees are provided through the same self-funded plan and fully-insured plans. For the year ended August 31, 2007, the contributions for the self-funded plan by the State per full-time retired employee are shown in the following table. The retiree contributes any premium over and above the State contributions.

Retiree Only	$ 348.35
Retiree/Spouse	530.82
Retiree/Children	465.09
Retiree/Family	648.65

The monthly contribution per full-time retiree participating in the fully-insured programs (HMO's) ranged from $339.21 to $746.06 in fiscal year 2007, depending upon the region and level of coverage selected.

The State recognizes the cost of providing these benefits to eligible retired employees. The cost of retired employee benefits is recognized when paid. The number of retired University employees who were eligible for these benefits, as well as the cost of providing the benefits for the year ended August 31, 2007, were 4,158 and $18,754,351, respectively.

In August 2004, the GASB issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, effective for the System in fiscal year 2008. GASB Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. For the System, this will result in increased expenses and a related liability which will be significant. The System and its actuaries are evaluating the effect the GASB Statement No. 45 will have on the System's and University's financial statements.

Note 18: Extraordinary Items

During the fiscal year ended August 31, 2007, there were no extraordinary items that warrant disclosure.

Note 19: Disaggregation of Receivable Balances

Other receivables as reported on the Statement of Net Assets are detailed by type as follows:

Net Other Receivables	
Receivables related to Gifts, Grants, and Sponsored Programs	$ 6,411,785
Receivables related to Conferences	360,742
Receivables related to Auxiliary Enterprises	2,681,370
Receivables related to Payroll	3,048,880
Receivables related to Printing and Reproduction Services	386,318
Receivables related to Loan Funds and Financial Aid	218,407
Receivables related to Agency Funds	596
Receivables related to Other Activities	2,229,717
Total	$ 15,337,815

Note 20: Termination Benefits

During the fiscal year ended August 31, 2007, the University had no voluntary or involuntary termination arrangements that involved a substantial number of individual employees or group of employees and met the criteria for liability recognition.

State Auditor's Office
John Keel, CPA
State Auditor

January 31, 2008

Mr. William C. Powers, Jr., President
The University of Texas at Austin
Main Building, Room 400 (G3400)
PO Box T
Austin, Texas 78713-8920

Subject: Management Letter Resulting from a Review of the University of Texas at Austin's Fiscal Year 2007 Financial Statements

Dear Mr. Powers:

We offer this management letter in conjunction with our review of the financial statements of the University of Texas at Austin (University) for the fiscal year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

We appreciate the assistance provided during this review by the management of the University and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

Robert E. Johnson Building
1501 N. Congress Avenue
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P.O. Box 12067
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SAO Report No. 08-323

The University of Texas at Brownsville

Financial Statements and Auditors' Review Report
as of August 31, 2007 and for the Year Then Ended

Contents

State Auditor's Office
John Keel, CPA
State Auditor

Auditor's Review Report

February 15, 2008

Dr. Juliet V. Garcia, President
The University of Texas at Brownsville
80 Fort Brown
Brownsville, Texas 78520

Dear Dr. Garcia:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of the University of Texas at Brownsville (University) as of and for the year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the University.

A review consists principally of inquiries of University personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the University. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The University has not presented a management's discussion and analysis section that the Governmental Accounting Standards Board has identified as required supplementary information that is not part of the basic financial statements. However, such required supplementary information for the University of Texas System (System) is presented in the System's consolidated annual financial report.

This report is intended for use by the Board of Regents of the System, management of the University, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

SAO Report No. 08-337

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The University of Texas at Brownsville

Statement of Net Assets

At August 31, 2007

(See Auditor's Review Report on page 1.)

ASSETS		
Current Assets		
Cash and Cash Equivalents (Note 3)	$	25,010,857
Restricted:		
Cash and Cash Equivalents (Note 3)		140,524
Legislative Appropriations		6,217,617
Receivables, Net of Allowances:		
Federal		4,219,393
Other Intergovernmental		573,750
Interest and Dividends		91,973
Student Accounts		4,462,521
Texas Southmost College Contract		5,201,699
Other		204,238
Due from Other State Entities (Note 6)		801,800
Loans and Contracts		1,815,575
Funds Held in Custody		7,857,766
Other Current Assets		1,758,164
Total Current Assets	$	58,355,877
Non-Current Assets		
Restricted:		
Investments (Note 3)	$	11,801,257
Investments (Note 3)		10,668,527
Capital Assets (Note 2):		
Non-Depreciable		2,485,971
Depreciable		99,146,563
Less: Accumulated Depreciation		(28,088,982)
Total Non-Current Assets	$	96,013,336
Total Assets	$	154,369,213
LIABILITIES		
Current Liabilities		
Payables:		
Accounts	$	18,026,312
Accrued Liabilities		3,991,869
Payroll		1,414,047
Federal		32,084
Other		254,281
Due to Other State Entities (Note 6)		668,311
Deferred Revenue		7,221,379
Employees' Compensable Leave (Note 4)		942,051
Liabilities Payable from Restricted Assets		312,263
Funds Held for Others		8,691,510
Other Current Liabilities		43,883
Total Current Liabilities	$	41,597,990

The University of Texas at Brownsville

Statement of Net Assets

At August 31, 2007

Non-Current Liabilities		
Employees' Compensable Leave (Note 4)	$	1,315,333
Total Non-Current Liabilities	$	1,315,333
Total Liabilities	$	42,913,323
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	$	73,543,552
Restricted for:		
Non-Expendable		
Permanent Funds, True Endowments, Annuities		5,100,493
Expendable		
Capital Projects		1,212,126
Funds Functioning as Endowments		2,100,731
Other		4,359,791
Unrestricted		25,139,197
Total Net Assets	$	111,455,890

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Brownsville

Statement of Revenues, Expenses, and Changes in Net Assets

For the Fiscal Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

OPERATING REVENUES		
Tuition and Fees	$	14,974,440
Discounts and Allowances		(2,437,304)
Auxiliary Enterprises		930,439
Discounts and Allowances		(117,807)
Other Sales of Goods and Services		1,057,365
Federal Revenue		34,245,292
State Grant Revenue		3,744,933
Other Operating Grant Revenue		50,670,732
Other Operating Revenues		137,510
Total Operating Revenues	$	103,205,600
OPERATING EXPENSES		
Salaries and Wages	$	57,016,561
Payroll Related Costs		13,835,071
Professional Fees and Services		1,950,536
Travel		1,293,735
Materials and Supplies		5,320,351
Communications and Utilities		5,011,487
Repairs and Maintenance		1,006,069
Rentals and Leases		1,941,905
Printing and Reproduction		395,505
Depreciation and Amortization		5,402,826
Bad Debt Expense		106,920
Scholarships		33,442,843
Other Operating Expenses		7,293,871
Total Operating Expenses	$	134,017,680
Operating Income (Loss)	$	(30,812,080)
NONOPERATING REVENUES (EXPENSES)		
Legislative Appropriations	$	28,612,438
Gifts		269,836
Interest and Investment Income (Loss)		1,452,649
Net Increase (Decrease) in Fair Value of Investments		2,182,252
Gain (Loss) on Sale of Capital Assets		626
Total Nonoperating Revenues (Expenses)	$	32,517,801
Income (Loss) Before Other Revenues, Expenses, Gains (Losses), and Transfers	$	1,705,721

The University of Texas at Brownsville
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended August 31, 2007

OTHER REVENUES, EXPENSES, GAINS (LOSSES), AND TRANSFERS		
Capital Contributions	$	101,715
Capital Appropriations (HEAF)		2,791,194
Additions to Permanent and Term Endowments		244,943
Transfers In from Other State Entities (Note 6)		3,261,146
Transfers Out to Other State Entities (Note 6)		(4,317,365)
Total Other Revenues, Expenses, Gains (Losses), and Transfers	$	2,081,633
CHANGE IN NET ASSETS	$	3,787,354
Net Assets, September 1, 2006	$	107,668,536
Restatements		
Net Assets, September 1, 2006, as Restated	$	107,668,536
NET ASSETS, August 31, 2007	$	111,455,890

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Brownsville

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

CASH FLOWS FROM OPERATING ACTIVITIES	
Proceeds from Tuition and Fees	$ 11,953,937
Proceeds from Grants and Contracts	87,502,695
Proceeds from Loan Programs	2,276,233
Proceeds from Auxiliaries	797,242
Proceeds from Other Revenues	120,203
Payments to Suppliers for Goods and Services	(55,414,050)
Payments to Employees for Salaries	(70,663,840)
Payments for Loans Provided	(2,723,741)
Net Cash Used by Operating Activities	$ (26,151,321)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Proceeds from Legislative Appropriations	$ 28,813,227
Proceeds from Gifts	269,836
Proceeds from Endowments	244,943
Proceeds of Transfers from Other Entities	90,146
Payments for Other Uses	(20,901)
Net Cash Provided by Non-Capital Financing Activities	$ 29,397,251
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from State Appropriations (HEAF)	$ 2,587,256
Proceeds of Transfers from Other Entities	3,881,233
Payments for Additions to Capital Assets	(4,673,130)
Payments for Transfers to Other Entities	(4,317,365)
Net Cash Used by Capital and Related Financing Activities	$ (2,522,006)
CASH FLOWS FROM INVESTING ACTIVITIES	
Payments for Purchases of Investments	$ (24,848,766)
Proceeds from Sales of Investments	28,433,153
Proceeds from Interest and Investment Income	1,407,706
Net Cash Provided by Investing Activities	$ 4,992,093
Net Increase in Cash and Cash Equivalents	$ 5,716,017
Cash and Cash Equivalents, September 1, 2006	$ 19,435,364
Restatements	
Cash and Cash Equivalents, September 1, 2006, as restated	$ 19,435,364
Cash and Cash Equivalents, August 31, 2007	$ 25,151,381

The University of Texas at Brownsville

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007

**Reconciliation of Operating Loss to
Net Cash Used by Operating Activities**

Operating Loss	$	(30,812,080)
Adjustments:		
Depreciation and Amortization	$	5,402,826
Bad Debt Expense		106,920
Changes in Assets and Liabilities:		
Decrease in Receivables		(3,708,931)
Increase in Deposits		271,968
Decrease in Loans and Contracts		(447,508)
Decrease in Other Current Assets		(442,241)
Increase in Payables		2,184,553
Increase in Due to Other Entities		57,699
Increase in Deferred Revenue		1,003,798
Increase in Employees' Compensable Leave		187,792
Increase in Other Liabilities		43,883
Total Adjustments	$	4,660,759
Net Cash Used by Operating Activities	$	(26,151,321)
Non-Cash Transactions		
Net Increase in Fair Value of Investments	$	2,182,252
Donated Capital Assets		101,715
Gain(Loss) on Sale of Capital Assets		626

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Brownsville
Statement of Changes in Unrestricted Net Assets
For the Fiscal Year Ended August 31, 2007

	8/31/2007	8/31/2006	Difference
Reserved			
Encumbrances	$ 1,753,121	$ 1,921,364	$ (168,243)
Accounts Receivable	5,302,202	2,271,022	3,031,180
Higher Education Assistance Funds	2,983,957	2,790,019	193,938
Future Operating Budgets	0	91,778	(91,778)
Prepaid Expenses	1,114,860	1,024,906	89,954
Unreserved			
Allocated			
Future Operating Budgets	725,000	857,859	(132,859)
Capital Projects	3,879,943	7,430,388	(3,550,445)
Self Supporting Enterprises	854,675	547,902	306,773
Funds Functioning as Endowment - Unrestricted	125,621	266,288	(140,667)
Research Enhancement and Support	1,242,947	776,465	466,482
Utilities Reserve	397,083	346,006	51,077
Student Fees	3,415,441	3,875,805	(460,364)
Instructional Program Support	3,344,347	950,710	2,393,637
Unallocated	0	0	0
Total Unrestricted Net Assets	$ 25,139,197	$ 23,150,512	$ 1,988,685

General Introduction

This report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of The University of Texas at Brownsville (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria, the report also includes a Statement of Changes in Unrestricted Net Assets, and a management letter describing issues noted in the review.

Reporting Entity

The University is a component of the University of Texas System (the System), which was established by the Texas Constitution of 1876. The System is reported as a business-type activity in the State of Texas' *Comprehensive Annual Financial Report* which is audited by the Texas State Auditor's Office and reflects compliance with applicable state statutes and Governmental Accounting Standards Board (GASB) pronouncements. The System is governed by a Board of Regents, composed of nine members who are appointed by the Governor and confirmed by the Senate. Terms are scheduled for six years each and staggered so that three members' terms will usually expire on February 1 of odd-numbered years.

In 1991, the Regents of the University of Texas System and the Texas Southmost College Board of Trustees signed a historic, one of a kind agreement. The union brought together the best of both institutions for the benefit of the community and students. Texas Governor Ann Richards signed Senate Bill 1050 into law and created The University of Texas at Brownsville. The agreement combines the strengths of the community college and those of a university by increasing student access and eliminating inter-institutional barriers while fulfilling the distinctive responsibilities of each type of institution. The University of Texas at Brownsville and Texas Southmost College (UTB/TSC) offers Certificates, Associate, Baccalaureate, Graduate and Doctoral degrees in liberal arts, the sciences, and professional programs designed to meet student demand as well as regional, national, and international needs.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements present the financial position and operations of the University using the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. Operating revenues and expenses result from providing services or producing and delivering goods in connection with ongoing operations. Operating expenses include the cost of goods and services, administrative expenses, and depreciation on capital assets. The University reports as a business-type activity, as defined by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*.

The financial statements of the University have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. The University applies all GASB pronouncements and applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

Cash and Cash Equivalents

Cash and cash equivalents are maintained for the purpose of meeting short-term expense requirements. Highly liquid investments with maturities of three months or less at the time of purchase are included as cash and cash equivalents.

Balance in State Appropriations

Balance in State Appropriations consists of amount due from the State for reimbursements of expenditures from Appropriations for the fiscal year ended August 31, 2007.

Investments
Investments of the University are managed by The University of Texas Investment Management Company (UTIMCO), a private investment corporation that provides services entirely to the System. All investments are reported as noncurrent as these funds have an investment horizon extending beyond one year. The System's investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the System are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes and internal pricing matrices.

Equity security market values are based on the New York Stock Exchange composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded (if a closing price is not available, the average of the last reported bid and ask price is used).

The audited financial statements of the funds managed by UTIMCO may be found on UTIMCO's website and inquiries may be directed to UTIMCO via www.utimco.org.

Endowments
The University's endowments are used to support operations, which require the simultaneous achievement of two contradictory objectives of generating a predictable stream of annual revenue at a rate at least equal to the average rate of inflation for current needs and of increasing the purchasing power of the funds (at annual distribution) at a rate at least equal to the average rate of inflation for future periods.

Funds are subject to restrictions of endowment and trust instruments, requiring that principal be maintained and that only the income be utilized. Funds may include endowments, term endowments and funds functioning as endowments. Funds functioning as endowments consist of amounts that have been internally dedicated by the System for long-term investment purposes.

Restricted Assets
Restricted assets include funds restricted by legal or contractual requirements, including those related to sponsored programs, donors, constitutional restrictions, bond covenants, and loan agreements.

Loans and Contracts
Current and noncurrent loans and contracts are receivables, net of allowances, related to student loans.

Capital Assets
Capital assets are recorded at cost at the date of acquisition or fair value at the date of donation in the case of gifts. The University and the System follow the State's capitalization policy with a cost equal to or greater than $5,000 for equipment items, $100,000 for buildings, building improvements and improvements other than buildings, and $500,000 for infrastructure items, and an estimated useful life of greater than one year. Purchases of library books are capitalized. Renovations to buildings, infrastructure and land improvements that increase the value by at least 25 percent or extend the useful life by at least 25 percent of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred. Outlays for construction in progress are capitalized as incurred. Interest expense related to construction is capitalized net of interest income earned on the resources reserved for this purpose.

The University capitalizes, but does not depreciate works of art and historical treasures that are held for exhibition, education, research and public service. These collections are protected and preserved.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 2 to 15 years for equipment items, 15 years for library books, 10 to 50 years for buildings and their components and 15 to 40 years for infrastructure elements.

Other Assets
Included in other current assets are prepaids which occurred in August for the fall semester.

Deferred Revenue
Deferred revenue represents revenues collected but not earned as of August 31, such as tuition receipts from students received in August for the fall semester and payments received in advance for sponsored programs.

Assets Held for Others
Assets held for others represent funds held by the University as custodial or fiscal agent for students, faculty members, and others.

Net Assets
The University has classified resources into the following three net asset categories:

Invested in Capital Assets, Net of Related Debt
Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets

Restricted:

Nonexpendable
Net assets subject to externally imposed stipulations that require the amounts to be maintained in perpetuity by the University or the System. Such assets include the University's permanent endowment funds.

Expendable
Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire with the passage of time.

Unrestricted
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for special purposes by action of management or the UT System Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation. Generally, the University's policy is to first apply the expense towards restricted resources and then towards unrestricted resources.

Revenues and Expenses
Operating revenues include activities such as student tuition and fees, net of scholarship allowances; sales and services of auxiliary enterprises; most federal, state and local grants and contracts and federal appropriations. Operating expenses include salaries and wages, payroll related costs, materials and supplies, depreciation and scholarships and fellowships.

Non-operating revenues include activities such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flow of Proprietary and Nonexpendable Trust Funds and Government Entities That Used Proprietary Fund Accounting,* GASB Statement No. 34, such as State appropriations and investment income. Nonoperating expenses include activities such as interest expense on capital asset financings and other expenses that are defined as nonoperating expenses by GASB Statement Nos. 9, 34 and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.*

Scholarship Allowances and Student Aid
Financial aid to students is reported in the financial statements as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid (student loans, funds provided to students as awarded by third parties and Federal Direct Lending) is accounted for as third party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expense or scholarship allowances, which reduce revenues. The amount reported as operating expense represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed on an entity-wide basis by allocating cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third party aid.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make prudent and conservative 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2: Capital Assets

A summary of changes in capital assets is shown below:

	Balance 9/1/2006	Additions	Deductions	Balance 8/31/2007
Non-Depreciable Assets:				
Land and Land Improvements	$ 354,891	$ 2,126,080	$	$ 2,480,971
Other Capital Assets	5,000			5,000
Total Non-Depreciable Assets	$ 359,891	$ 2,126,080	$ 0	$ 2,485,971
Depreciable Assets:				
Buildings and Building Improvements	$ 71,059,873	$	$	$ 71,059,873
Infrastructure	1,660,100			1,660,100
Facilities and Other Improvements	1,823,076			1,823,076
Furniture and Equipment	16,004,515	2,719,722	(53,045)	18,671,192
Vehicles, Boats, and Aircraft	1,247,862	32,374		1,280,236
Other Capital Assets	4,207,192	444,894		4,652,086
Total Depreciable Assets at Historical Cost	$ 96,002,618	$ 3,196,990	$ (53,045)	$ 99,146,563
Less Accumulated Depreciation for:				
Buildings and Building Improvements	$ (10,637,866)	$ (3,311,954)	$	$ (13,949,820)
Infrastructure	(282,004)	(63,850)		(345,854)
Facilities and Other Improvements	(114,798)	(98,589)		(213,387)
Furniture and Equipment	(9,332,610)	(1,627,652)	40,531	(10,919,731)
Vehicles, Boats, and Aircraft	(731,304)	(87,798)		(819,102)
Other Capital Assets	(1,628,105)	(212,983)		(1,841,088)
Total Accumulated Depreciation	$ (22,726,687)	$ (5,402,826)	$ 40,531	$ (28,088,982)
Depreciable Assets, Net	$ 73,275,931	$ (2,205,836)	$ (12,514)	$ 71,057,581
Capital Assets, Net	$ 73,635,822	$ (79,756)	$ (12,514)	$ 73,543,552

Note 3: Deposits, Investments, and Repurchase Agreements

Deposits

University bank information as of August 31, 2007, is presented below:

Carrying Amount	Bank Balance
$ 4,142,373	$ 5,274,262

Cash on Hand	$ 3,000
Cash in Bank	4,142,373
Cash in State Treasury	2,501,399
Cash Equivalents	18,504,609
Total Cash and Cash Equivalents	$ 25,151,381
Current Assets Cash and Cash Equivalents	$ 25,010,857
Current Assets Restricted Cash and Cash Equivalents	140,524
Total Cash and Cash Equivalents	$ 25,151,381

Custodial Credit Risk
Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System maintains depository relationships with various banking institutions. The System's policy is that all deposits are governed by a bank depository agreement between the System and the respective banking institution. This agreement provides that the System's deposits, to the extent such deposits exceed the maximum insured limit under deposit insurance provided by the Federal Deposit Insurance Corporation, shall at all times be collateralized with either government securities or a surety bond issued by an insurer rated "AAA" or its equivalent by a nationally recognized rating organization or a combination thereof.

Investments
At the direction of the System Board of Regents, University's investments and cash equivalents are pooled at the System level in internal investment pools. The System is responsible for disclosure of all information on the pooled investments and has included these disclosures in its annual financial reports. Investments at August 31, 2007 totaling $22,469,784 consist of funds managed by the University of Texas Investment Company (UTIMCO). The fair value of the University's share of investments is presented below:

System Level Investment Fund - Intermediate Term Fund	$	15,142,939
System Level Investment Fund - General Endowment Fund		7,326,845
Total Investments	$	22,469,784
Non-Current Assets – Restricted Investments	$	11,801,257
Non-Current Assets – Investments		10,668,527
Total Investments	$	22,469,784

Investment Risks
(A) Credit Risk - Article VII, Section 11b of the Texas Constitution authorizes the UT System Board of Regents, subject to procedures and restrictions it establishes, to invest System funds in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System's investment policies limit investments in U.S. Domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, Baa3 or better by Moody's Investor Services, BBB- or better by Standard & Poor's Corporation, or BBB- or better by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment grade bonds. Per GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

(B) Concentrations of Credit Risk – The System's investment policy statements contain the limitation that no more than 5% of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer. As of August 31, 2007, the System did not hold any direct investments in any one issuer of corporate or municipal bonds that were five percent or more of the market value of the System's domestic fixed income investments.

(C) Custodial Credit Risk –The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the System's investment policy

statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. As of August 31, 2007, the University did not have any deposits or investments that are exposed to custodial credit risk.

(D) Interest Rate Risk – Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. Interest rate risk inherent in the System investments is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the System's investments to changes in interest rates. The System has no specific policy statement limitations with respect to its overall modified duration.

(E) Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes – In accordance with the System's investment policy statements, the System may invest in various mortgage backed securities, such as collateralized mortgage backed obligations. The System also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds and stripped Treasury and Agency securities created from coupon securities. As of August 31, 2007, the System's investments included the following investments that are highly sensitive to interest rate changes:

- Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Mortgage backed securities which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Asset backed securities which are backed by home equity loans, auto loans, equipment loans and credit card receivables. Prepayments by the obligees of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received.

- Step-up notes that grant the issuer the option to call the note on certain specified dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at the inception of the note. The call feature embedded within a step-up note causes the fair value of the instrument to be considered highly sensitive to interest rate changes.

(F) Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the System's non-U.S. dollar investments. The System's investment policy statement limits investments in non-U.S. denominated bonds to 50% of the System's total fixed income exposure.

Repurchase Agreements
The System, by statute, is authorized to enter into repurchase agreements. A repurchase agreement is when a holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate the buyer for this.

Securities Lending
In accordance with the prudent investor investment standards, the System participates in a securities lending program. The System began the program, under a contract with the System's lending agent, on September 1, 1995. The lending agent is authorized to lend any securities held by the System's custodian except those securities which the policy guidelines prohibits lending. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In security lending transactions, the System transfers its securities to brokers/dealers for collateral, which may be cash, securities issued or guaranteed by the United States government or its agencies, and irrevocable bank letters of credit, and simultaneously agrees to return the collateral for the same securities in the future.

Cash collateral received by the lending agent on behalf of the System is invested and reinvested in a non-commingled pool exclusively for the benefit of the System. The pool is managed in accordance with investment guidelines established by the System and is stated in the security lending contract. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent. On August 31, 2007, the System was collateralized 102 percent for securities on loan collateralized by cash.

Collateral pool investments are uninsured, and are held by the securities lending agent, in its name, on behalf of the System, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the System or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties' trust department or agent.

Lending income is earned if the returns on those investments exceed the "rebate" paid to borrowers of the securities. The income is then shared with the lending agent based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from the System's resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a "loan premium or fee" for the securities loan. This income is split with the same ratio as the earnings for cash collateral. The collateral pledged to the System by the borrower is custodied by the lending agent or through a third party arrangement. These securities held as collateral are not available to the System for selling or pledging unless the borrower is in default of the loan. On August 31, 2007, the System was collateralized 102 percent for securities on loan which were collateralized by securities.

The collateral received will have a fair value of 102 percent of the loaned securities of United States issuers. If the fair value of the collateral held in connection with loans of securities of United States issuers is less than 100 percent at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102 percent of the fair value.

For non-United States issuers, the collateral should remain at 105 percent of the fair value of the loaned securities at the close of any business day. If it falls below 105 percent, the borrower must deliver additional collateral by the close of the following business day. On August 31, 2007, the System was collateralized 105 percent for international loans.

In the event of default, where the borrower is unable to return the securities loaned, the System has authorized the lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the lending agent has indemnified the System from any loss due to borrower default.

At August 31, 2007, the System had no credit risk exposure to borrowers because the amounts the System owed to borrowers exceeded the amounts the borrowers owed the System. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Derivative Financial Instruments

Derivatives are financial instruments (securities or contracts) whose value is linked to, or "derived" from, changes in interest rates, currency rates, and stock and commodity prices. Derivatives cover a broad range of financial instruments, such as forwards, futures, options, swaps, and mortgage derivatives.

(A) Mortgage Derivatives – Mortgage derivatives are used to manage portfolio duration and to enhance portfolio yield, and, are influenced by changes in interest rates, the current economic climate, and the geographic make-up of underlying mortgage loans. There are varying degrees of risk associated with mortgage derivatives. For example, certain Collateralized Mortgage Obligations (CMOs) such as Planned Amortization Class (PACs) are considered a more conservative lower risk investment. In contrast, principal only and interest only strips are considered higher risk investments. The System's investment in CMOs, which was comprised almost exclusively of the lower risk investment class.

(B) Futures Contracts – Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. The net liability is included in payables from restricted assets. Futures contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss difference is referred to as the daily variation margin, which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The System executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the manager's various trading and credit monitoring techniques.

(C) Foreign Currency Exchange Contracts – The System enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward currency contract, the System agrees to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the System's net equity therein (representing unrealized gain or loss on the contracts, as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date) is included in other receivables. Realized and unrealized gains and losses are included in the consolidated statement of revenues, expenses and changes in net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the consolidated balance sheet. Risks arise from the possible inability of counter-parties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(D) Written Options – Written options are used to alter the market (systematic) exposure without trading the underlying cash market securities, and to hedge and control risks so that the actual risk/return profile is more closely aligned with the target risk/return profile. During the year, call options were written on Treasury Bond and equity index futures.

(E) Swaps – Swaps are used to adjust interest rate and yield curve exposures. During the year, the System entered into interest rate, inflation, credit default, total return and commodity swap contracts. They are included in other receivables and payables from restricted assets.

(F) Investment Funds – The System's investment funds include exchange traded funds, index funds, Securities Exchange Commission (SEC) regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and may be unregulated.

Marketable alternatives funds are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private market funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments are domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk, and investment manager risk.

Public market funds are invested in exchange traded funds, index funds, and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the funds. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market and public market funds include investments in private placement vehicles that are subject to risk which could result in the loss of invested capital. The risks include the following:

- *Non-regulation risk* – Some of these funds are not registered with the SEC, and therefore, are not subject to regulatory controls.
- *Key personnel risk* – The success of certain funds is substantially dependent upon key investment managers and the loss of those individuals may adversely impact the fund's performance.
- *Liquidity risk* – Many of the System's investment funds may impose lock-up periods which would cause the System to incur penalties to redeem its units or prevent the System from redeeming its shares until a certain period of time has elapsed.
- *Limited transparency* – As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
- *Investment strategy risk* – These funds often employ sophisticated investment strategies and may use leverage which could result in the loss of invested capital.

(G) Securities Sold Short – The System may sell securities it does not own in anticipation of a decline in the fair value of that security. When the System sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The System must pay dividends or interest on the securities sold short. Until the System covers it shorts sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold short at prices which may be significantly higher than the market value reflected in the statements of fiduciary net assets.

Note 4: Summary of Long-Term Liabilities

	Balance 9/1/2006	Additions	Deductions	Balance 8/31/2007	Amounts Due Within One Year
Employees' Compensable Leave	$ 2,069,592	$ 1,230,364	$ 1,042,572	$ 2,257,384	$ 942,051
Total	$ 2,069,592	$ 1,230,364	$ 1,042,572	$ 2,257,384	$ 942,051

Employees' Compensable Leave

Substantially all full-time University employees earn annual leave in the amount of 8 to 21 hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum of 532 hours for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements because experience indicates that the expense for sick leave will be minimal. Eligible part-time employees' sick leave accrual rate is proportional to the number of hours appointed to work.

Note 5: Bonded Indebtedness

The University receives proceeds from revenue bonds issued and held by the System to support capital projects of the System and its institutions. These proceeds are recorded as transfers from the System. The University disburses funds to the System for payments of principal and interest related to the University's share of bond proceeds. These disbursements are recorded as transfers to the System. All bonds issued by the System are defined as revenue bonds. As such, the revenues of the System, including the University, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures' lack of specifically identifiable activities and separate accounting requirements.

No amount of indebtedness related to these bonds has been recorded in the University's financial statements as the System is the party directly liable for these bonds. At August 31, 2007, however, the University's remaining unpaid share of the bond proceeds was $34,472,000.

Note 6: Interagency Balances / Activity

The University has numerous transactions with other components of the System and with other agencies of the state of Texas. At year end, amounts to be received or paid are reported as Due from Other Entities or Due to Other Entities.

DUE FROM/TO OTHER STATE ENTITIES

Entity		Due from Other State Entities		Due to Other State Entities	Purpose
The University of Texas System Administration	$	59,308	$		University presidents' deferred compensation
The University of Texas System Administration		239			Separately invested endowments 4th quarter earnings for FY 2007
The University of Texas System Administration		734,125			Bond funding for reimbursable construction expenses
Texas Department of Transportation		728			License Plate Scholarship funding
Texas Higher Education Coordination Board		7,400			Grant funding
The University of Texas System Administration				668,311	Payroll related Costs for August 2007 payroll
	$	801,800	$	668,311	

Interagency transfers made during the fiscal year are presented below:

TRANSFERS IN FROM/OUT TO OTHER STATE ENTITIES

Entity		Transfers In from Other State Entities		Transfers Out to Other State Entities	Purpose
UT System Administration	$	90,146	$	4,317,365	Debt Service - Mandatory
UT System Administration		3,171,000			Funding Available for Qualified Equipment Expenses
	$	3,261,146	$	4,317,365	

Note 7: Contingent Liabilities

As of August 31, 2007, the University was not aware of any significant contingent liabilities.

Note 8: Risk Financing and Related Insurance

All risk financing and related insurance for the University is part of coverage provided by the System. The System has six funded self-insurance plans providing coverage in the following areas: employee health and dental, unemployment compensation, workers' compensation, property protection, directors and officers/employment practices liability, and construction contractor insurance.

Employee and Retiree Insurance Benefits

The UT System Employee Benefits program provides health, dental, vision, life insurance, long term disability, short term disability, long term care and flexible spending account coverage to all benefits-eligible employees and retirees of the System and its fifteen institutions. These insurance benefits are provided through both self-funded and fully-insured arrangements. A portion of an individual's group health insurance premium is paid by the State as specified in the General Appropriations Act. The System's Office of Employee Benefits (OEB) is responsible for the overall administration of the insurance plans. OEB was established by Chapter 1601 (formerly Article 3.50-3) of the *Texas Insurance Code* and complies with State laws and statutes pertinent to employee benefits for the System.

Unemployment Compensation Insurance

The current General Appropriations Act requires the System to reimburse the Texas Workforce Commission (TWC) for 50% of the unemployment benefits paid to former employees that were paid from appropriated funds. The

System reimburses the TWC 100% of the unemployment benefits paid to former employees that were paid from local funds.

Worker's Compensation Insurance
The University of Texas System Workers' Compensation Insurance (WCI) program provides coverage to all employees of the System and its fifteen institutions. Under the oversight of the System's Office of Risk Management (ORM), the System self-insures and administers the program. The WCI staff is responsible for administering all aspects of the system-wide program, which provides income and medical benefits to all employees who have sustained job-related injuries or occupational diseases. The program's statutory authority is embodied in Chapter 503 of the *Texas Labor Code.*

Comprehensive Property Protection Program
The property protection plan consists of two programs. The first provides coverage for physical damage resulting from Named Windstorms and catastrophic flood losses up to $50 million. Insurance policies providing relatively low limits ($1-2 million per building and contents) are purchased through the Texas Windstorm Insurance Association and the National Flood Insurance Program on several facilities in the Tier 1 wind zone and other flood prone areas to provide a primary layer of insurance. The self-insurance component of the program participates in losses that exceed the coverage available under these primary policies or in cases where there is no underlying insurance.

The second program covers fire and other perils and includes commercial reinsurance for claims exceeding a per occurrence deductible of $7.5 million or an annual aggregate deductible of $25 million. The policy covers $15.9 billion in building and content values and $3.8 billion in business income. The maximum annual reimbursement under this policy is $1 billion per occurrence.

To fund the self-insurance portion of both property programs, the institutions make annual contributions to the loss reserve funds in addition to paying insurance premiums.

Directors and Officers/Employment Practices Liability Self-Insurance Plan
The Directors and Officers Liability (D&O) and Employment Practices Liability Self-insurance Plan provide coverage for claims arising from actual or alleged wrongful acts performed by the plan beneficiaries. The plan also provides coverage for employment practices liability (EPL) claims, such as wrongful termination, failure to promote and wrongful discipline.

Coverage applies to individual board members, employees, faculty, etc., as well as to the System itself. The limit of liability is a $10 million annual aggregate (Coverages A, B and C combined), except for $5 million annual aggregate sublimit for Coverage C. There is no deductible for Coverage A (individuals), a $100,000 deductible per director or officer with a $300,000 maximum deductible per loss for Coverage B. The deductible for Coverage C is $300,000. In 2003, the UT System Board of Regents allocated $3.7 million from the Available University Fund to establish the D&O/EPL loss reserve fund. Institutions make annual premium contributions to this fund as well.

Rolling Owner Controlled Insurance Program
A Rolling Owner Controlled Insurance Program (ROCIP) is established for the centralized purchase of construction contractor insurance on various capital projects. This program provides workers' compensation and general liability insurance for all contractors enrolled on projects participating in the program. The insurance carries a $250,000 per occurrence basket deductible, which is paid through the program's self-insurance fund.

Note 9: Related Parties
Through the normal course of operations, the University both receives funds from and provides funds to other State agencies in support of sponsored research programs. Federal funds received and provided during the year ended August 31, 2007, related to pass-through grants were $88,541.

The University entered into an agreement with Texas Southmost College (TSC) in 1991 to provide accessible, affordable, high quality postsecondary education, to conduct research which expands knowledge and to present programs of workforce training and continuing education, public service, and cultural value. The agreement combines the strengths of the community college and those of a university by increasing student access and eliminating inter-institutional barriers while fulfilling the distinctive responsibilities of each type of institution.

The governing boards of the University and TSC each retain their statutory responsibilities. The University is governed by the nine-member Board of Regents of the UT System appointed by the Governor. The Southmost Union Junior College District is governed by a seven-member board elected at large from the ad valorem taxing district of the college, which includes most of Cameron County. Chapter 51 of the Texas Education Code also provided for the governing board of each institution to appoint members to a Partnership Advisory Committee which is composed of three members from each board. This committee makes recommendations concerning the development of coordinated programs and services to meet the needs of the communities served by UTB/TSC.

The operation of UTB/TSC consolidates the administrative, instructional and support services of the two institutions. Under the provisions of the agreement, TSC retains all of its property and assets. The University leases needed facilities from the District. Through this unique arrangement, the University and TSC have embarked on a quest to provide the finest educational opportunities that their consolidated resources can create.

The legislatively approved agreement between the entities is in its 15th year of a 99-year term. The University operates under the rules of the Handbook of Operating Procedures (HOOP) created by the institution. It is aligned with UT System Regents' Rules, and the Texas Higher Education Coordinating Board's policies and procedures and the Texas Education Code. Although there are a small number of TSC employees, the vast majority of the institution's personnel are UT System employees; therefore, they fall under the purview of the policies and procedures established by the State of Texas. The financial statements of the University include Contracted Revenue received from TSC of $44,623,343 for the year ended August 31, 2007. Amounts due to TSC at year end for 2007 was $11,288,735 which is included in Accounts Payable.

Note 10: Stewardship, Compliance, and Accountability

The University had no significant violations of bond or note covenants. Per State law, the University cannot spend amounts in excess of appropriations granted by the Texas Legislature. There are no deficits reported in net assets.

Note 11: Restatements of Net Assets

The University reported no Restatements of Net Assets as of September 1, 2006.

Note 12: Employee Retirement Plans

Teacher Retirement System (TRS)

The State of Texas has joint contributory retirement plans for substantially all its employees. One of the primary plans in which the University participates is a cost-sharing multi-employer public employee retirement system administered by the Teacher Retirement System of Texas. TRS is primarily funded through state and employee contributions. Depending upon the source of funding for a participant's salary, the University may be required to make contributions in lieu of the state.

All University personnel employed in a position on a half time or greater basis for at least 4½ months or more are eligible for membership in the TRS retirement plan. Members with at least five years of service at age 65 or any combination of age plus years of service, which equals 80, have a vested right to retirement benefits. Additionally, reduced benefits are available at age 55 with at least five years of service or at any age below 50 with 30 years of service. Members are fully vested after five years of service and are entitled to any benefits for which the eligibility requirements have been met.

TRS contribution rates for both employers and employees are not actuarially determined but are legally established by the State Legislature. Contributions by employees are 6.4 percent of gross earnings. Depending upon the source of funding for the employee's compensation, the State or the University contributes a percentage of participant salaries totaling 6 percent of annual compensation. The University's contributions to TRS for the year ended August 31, 2007 were $1,653,040 which equaled the amount of the required contributions for the year.

TRS does not separately account for each of its component government agencies since the Retirement System itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. Further information regarding actuarial assumptions and conclusions, together with audited financial statements are included in the Retirement System's annual financial report, which may be found on the TRS website at www.trs.state.tx.us.

Optional Retirement Program (ORP)
The Optional Retirement Program (ORP) may be chosen by certain employees in lieu of TRS based on the job they perform. This program is a defined contribution plan governed by Internal Revenue Code Section 403(b). Benefits are based on the performance of the investments selected and are controlled by the employee. Participants are vested after one year and one day of participation with a right to both employee and employer contributions. This program provides a greater degree of portability than TRS.

Eligibility for ORP is strictly based on the job an employee performs, and is not based on years of service or salary level. Program eligibility requirements and rights are the similar to those for TRS, with the exception that members are fully vested after one year and one day of service. The contributory percentages of participant salaries provided by the State and by each participant enrolled in the plan on or before August 31, 1995, are 8.5 percent and 6.65 percent, respectively. The 8.5 percent is composed of 6.0 percent contributed by the State and an additional 2.5 percent contributed by the University. For participants who enrolled after September 1, 1995, State and participant contributions are 6.0 percent and 6.65 percent, respectively. Because these are individual annuity contracts, the State has no additional or unfunded liability for this program, and the University bears no responsibility for retirement commitments beyond contributions. The University's contributions for year ended August 31, 2007 were $1,251,502, with 305 employees participating.

Note 13: Deferred Compensation Program

University employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. Deferred compensation plans are administered by the Employees Retirement System.

The State's 457 Plan complies with Internal Revenue Code, Section 457. This plan is referred to as the TexaSaver Deferred Compensation Plan and is available to all employees. Deductions, purchased investments, and earnings attributed to the 457 Plan are the property of the State and subject only to the claims of the State's general creditors. Participant rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the 457 account for each participant. The State has no liability under the 457 Plan, and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

The University also administers a Tax-Deferred Account Program, created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The Tax-Deferred Account Program is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be insurance companies, banks, or approved non-bank trustees such as mutual fund companies. The assets of this plan do not belong to the University; and thus, it does not have a liability related to this plan.

Note 14: Donor Restricted Endowments

Funds held by System include $7,326,845 for the year ended August 31, 2007 of endowment funds. The net assets related to endowment funds include $5,100,493 of restricted nonexpendable and $2,226,352 of restricted expendable at August 31, 2007.

Distributions that are reinvested in endowments become permanent additions to the principal of the endowments: therefore, there is no amount of net appreciation on investments of donor-restricted endowments available for authorization of expenditures. This provision is outlined in the endowment agreements with donors.

Note 15: Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health and life insurance benefits for retired employees, in accordance with state statutes. Substantially all of the employees may become eligible for the health and life insurance benefits if they reach normal retirement age while working for the state. Currently, there are 171 retirees who are eligible for these benefits. Similar benefits for active employees are provided through self-funded plan and fully-insured plans. Depending upon the status of the employee at the time of retirement, the state or the

University recognizes the cost of providing these benefits. The cost of retiree post-employment benefits is recognized when paid. This contribution paid all of the "employee/retiree only" premiums and a portion of the premiums for those employees/retirees selecting dependent coverage. The employee/retiree was required to pay a portion of the cost of dependent coverage. For the fiscal year ended August 31, 2007, the cost of providing those benefits for the retirees was $800,147.

In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the System in fiscal year 2008. GASB Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. For the System, this will result in increased expenses and a related liability which will be significant. The System and its actuaries are evaluating the effect that GASB Statement No. 45 will have on the System's and University's financial statements.

Note 16: Disaggregation of Receivable and Payable Balances

Other receivables are detailed by type as follows at August 31,2007:

Net Other Receivables	
Receivables related to Gifts, Grants & Sponsored Programs (net of allowances of $1,386)	$ 117,608
Receivables related to Payroll (net of allowances of $3,034)	24,822
Receivables related to Other Various Activities (net of allowances of $2,142)	61,808
Total	**$204,238**

Note 17: Termination Benefits

There were no other nonroutine, widespread voluntary or involuntary termination arrangements that involved a substantial number of individual employees or group of employees meeting the criteria for liability recognition.

State Auditor's Office
John Keel, CPA
State Auditor

February 15, 2008

Dr. Juliet V. Garcia, President
The University of Texas at Brownsville
80 Fort Brown
Brownsville, Texas 78520

Subject: Management Letter Resulting from a Review of the University of Texas at Brownsville's Fiscal Year 2007 Financial Statements

Dear Dr. Garcia:

We offer this management letter in conjunction with our review of the financial statements of the University of Texas at Brownsville (University) for the fiscal year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

We appreciate the assistance provided during this review by the management of the University and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

Robert E. Johnson Building
1501 N. Congress Avenue
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SAO Report No. 08-338

The University of Texas at Dallas

Financial Statements and Auditor's Review Report as of August 31, 2007 and for the Year Then Ended

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State Auditor's Office
John Keel, CPA
State Auditor

Auditor's Review Report

February 4, 2008

Dr. David Daniel, President
The University of Texas at Dallas
800 West Campbell Road
Mail Station AD22
Richardson, Texas 75080

Dear Dr. Daniel:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of the University of Texas at Dallas (University) as of and for the year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the University.

A review consists principally of inquiries of University personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the University. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The University has not presented a management's discussion and analysis section that the Governmental Accounting Standards Board has identified as required supplementary information that is not part of the basic financial statements. However, such required supplementary information for the University of Texas System (System) is presented in the System's consolidated annual financial report.

This report is intended for use by the Board of Regents of the System, management of the University, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

Robert E. Johnson Building
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SAO Report No. 08-320

The University of Texas at Dallas

Balance Sheet

As of August 31, 2007

(See Auditor's Review Report on page 1)

ASSETS

Current Assets:		
Cash and Cash Equivalents	$	31,707,479
Restricted Cash and Cash Equivalents		8,186,846
Balance in State Appropriations		1,716,820
Accounts Receivable, net:		
Federal		5,184,205
Other Intergovernmental		42,032
Student (net of allowance of $1,502,834)		4,362,057
Interest and Dividends		380,947
Contributions (net of allowances of $53,102)		580,117
Other (net of allowances of $257,729)		3,648,222
Due from Other Entities		40,198,664
Inventories		452,491
Loans and Contracts (net of allowances of $38,848)		3,790,489
Other Current Assets		17,526,641
Total Current Assets		117,777,010
Non-Current Assets:		
Restricted:		
Investments		298,850,546
Loans, Contracts and Other (net of allowances of $116,123)		613,974
Contributions Receivable (net of allowances of $776)		454,140
Investments		77,012,294
Capital Assets:		
Non-Depreciable		19,800,904
Depreciable		471,447,980
Less: Accumulated Depreciation		(173,926,331)
Total Non-Current Assets		694,253,507
TOTAL ASSETS	$	**812,030,517**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Dallas
Balance Sheet
As of August 31, 2007

(See Auditor's Review Report on page 1)

LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities	$	15,939,472
Payable from Restricted Assets		100,761
Due to Other Entities		1,191,676
Deferred Revenue		43,339,692
Employees' Compensable Leave -Current Portion		2,350,615
Funds Held for Others		831,569
Other Current Liabilities		579,377
Total Current Liabilities		64,333,162
Non-Current Liabilities:		
Employees' Compensable Leave		2,199,611
Total Non-Current Liabilities		2,199,611
Total Liabilities		66,532,773
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		317,322,553
Restricted for:		
Nonexpendable		
Endowments and Annuities		118,676,213
Expendable		
Capital Projects		28,520,218
Endowment and Permanent Funds		4,877,993
Other		213,995,919
Unrestricted		62,104,848
Total Net Assets		745,497,744
TOTAL LIABILITIES AND NET ASSETS	**$**	**812,030,517**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Dallas

Statement of Revenues, Expenses, and Changes in Net Assets

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1)

OPERATING REVENUES		
Student Tuition and Fees	$	122,279,835
Discounts and Allowances		(27,659,679)
Auxiliary Enterprises		4,941,232
Sales and Services of Educational Activities		6,056,236
Federal Sponsored Programs		25,689,397
State Sponsored Programs		15,794,880
Local Sponsored Programs		417,030
Private Sponsored Programs		5,433,929
Other Operating Revenues		3,597,392
Total Operating Revenues		156,550,252
OPERATING EXPENSES		
Salaries and Wages		133,812,526
Payroll Related Costs		27,366,956
Professional Fees and Services		3,177,135
Scholarships and Fellowships		11,472,215
Travel		3,380,099
Materials and Supplies		15,496,364
Utilities		8,125,242
Communications		735,885
Repairs and Maintenance		2,570,477
Rentals and Leases		1,336,633
Printing and Reproduction		653,978
Depreciation and Amortization		19,129,856
Bad Debt Expense		210,306
Other Operating Expenses		16,576,764
Total Operating Expenses		244,044,436
Operating Loss	$	**(87,494,184)**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Dallas

Statement of Revenues, Expenses, and Changes in Net Assets

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1)

NONOPERATING REVENUES (EXPENSES)		
State Appropriations	$	72,194,123
Gift Contributions for Operations		8,953,820
Interest and Investment Income, net		12,736,449
Loss on Sale of Capital Assets		(333,470)
Net Increase in Fair Value of Investments		28,125,335
Other Nonoperating Revenues/(Expense)		(102,004)
Total Non operating Revenues		121,574,253
Income Before Other Revenues, Expenses, Gains (Losses) and Transfers		**34,080,069**
Gifts and Sponsored Programs for Capital Acquisitions		17,105,069
Additions to Permanent Endowments		5,868,485
Transfers to Other Entities		(11,358,659)
Transfers from Other Entities		12,355,073
Change in Net Assets		**58,050,037**
Net Assets, September 1, 2006		687,447,707
Net Assets, August 31, 2007	$	**745,497,744**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Dallas

Statement of Cash Flows

For the Year Ended August 31, 2007

(See Auditor's Review Report of page 1)

CASH FLOWS FROM OPERATING ACTIVITIES		
Proceeds from Tuition and Fees	$	98,514,490
Proceeds from Sponsored Programs		47,111,521
Proceeds from Auxiliaries		4,928,530
Proceeds from Other Revenues		9,707,502
Payments to Suppliers		(62,534,481)
Payments to Employees		(160,832,888)
Payments for Loans Provided		(7,305,768)
Proceeds from Loan Programs		6,341,586
Net Cash Used in Operating Activities		(64,069,508)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from State Appropriations		72,000,710
Proceeds from Operating Gifts		10,371,779
Proceeds from Private Gifts		5,868,485
Receipts for Transfers from Other Entities		3,428,321
Payments for Other Uses		(86,358)
Net Cash Used in by Noncapital Financing Activities		91,582,937
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from Capital Appropriations, Grants, and Gifts		2,825,158
Proceeds from Sale of Capital Assets		223,257
Payments for Additions to Capital Assets		(38,029,585)
Proceeds from Capital Debt Transferred from System		28,605,147
Payments of Principal on Capital Related Debt		(10,589,473)
Net Cash Used in Capital and Related Financing Activities		(16,965,496)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Interest and Investment Income		12,972,122
Payments to Acquire Investments		(13,951,768)
Net Cash Provided by Investing Activities		(979,646)
Net Increase in Cash and Cash Equivalents		9,568,287
Cash and Cash Equivalents, September 1, 2006		30,326,038
Cash and Cash Equivalents, August 31, 2007	$	**39,894,325**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Dallas

Statement of Cash Flows

For the Year Ended August 31, 2007

(See Auditor's Review Report on page 1)

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES

Operating Loss	$	(87,494,184)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation and Amortization		19,129,856
Bad Debt Expense		210,306
Changes in Assets and Liabilities:		
Increase in Receivables		(1,239,489)
Increase in Inventories		(9,695)
Increase in Loans and Contracts		(964,182)
Decrease in Payables		888,245
Increase in Due to Other Entities		111,761
Decrease in Deferred Revenue		5,010,301
Decrease in Funds Held for Others		(42,798)
Increase in Employees' Compensable Leave		346,594
Decrease in Other Liabilities		(16,223)
Total Adjustments		23,424,676
Net Cash Used in Operating Activities	$	(64,069,508)

NON CASH TRANSACTIONS

Net Increase in Fair Value of Investments	$	28,125,335
Miscellaneous Noncash Transactions		(349,116)

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas at Dallas

Statement of Changes in Unrestricted Net Assets

For the Year Ended August 31, 2007

	8/31/2007	8/31/2006	Differences
Unrestricted Net Assets:			
Unrestricted			
Reserved			
Encumbrances	$ 3,675,195	$ 3,596,584	$ 78,611
State Appropriations to be Lapsed			
Accounts Receivable	2,107,118	2,026,236	80,882
Inventories	438,332	427,436	10,896
Other Specific Purposes			
Advanced Research/Advanced Technology	540,094	841,942	(301,848)
Prepaid Expenses	795,194	448,494	346,700
Imprest Funds	28,375	24,429	3,946
Unreserved			
Allocated			
Travel Advances	14,384	25,875	(11,491)
Funds Functioning as Endowment	2,102,685	1,900,110	202,575
Provision for FY 2008 Operating Budget	2,498,370	4,107,876	(1,609,506)
Provision for Capital Projects	4,911,347	3,641,809	1,269,538
Debt Service	7,331,833	5,611,717	1,720,116
Start-up/Matching	3,500,000	2,100,000	1,400,000
Utilities Reserve	1,541,527	2,600,000	(1,058,473)
Research Enhancement and Support	4,909,870	2,800,000	2,109,870
Market Adjustments	5,600,000	1,944,000	3,656,000
Student Fees	6,616,684	11,468,833	(4,852,149)
Texas Tomorrow Fund Shortfall	461,066	413,053	48,013
Instructional Program Support	6,446,433	2,900,000	3,546,433
Dean & Chair Recruitment Packages	1,000,000	500,000	500,000
Self-Supporting Enterprises	7,442,989	4,097,004	3,345,985
Unallocated	143,352	111,013	32,339
Total Unrestricted Net Assets	$ 62,104,848	$ 51,586,411	$ 10,518,437

General Introduction

This report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of The University of Texas at Dallas (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria the report also includes a Statement of Changes in Unrestricted Net Assets, and a management letter describing issues noted in the review.

Reporting Entity

The University is a component of The University of Texas System and an agency of the State of Texas. The University prepares financial statements that are included in the State's *Comprehensive Annual Financial Report,* which is audited by the Texas State Auditor's Office.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The University reports as a business-type activity because it is financed in part by fees charged to external parties for goods or services. The accompanying financial statements present the financial position and operations of the University using the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. Operating revenues and expenses result from providing services or producing and delivering goods in connection with ongoing operations. Operating expenses include the cost of goods and services, administrative expenses, and depreciation on capital assets.

The financial statements of the University have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. The University applies all GASB pronouncements and applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

Cash and Cash Equivalents

Cash and cash equivalents are maintained for the purpose of meeting short-term expense requirements. Highly liquid investments with maturities of three months or less at the time of purchase are included as cash and cash equivalents.

Balance in State Appropriations

Balance in State Appropriations consists of amounts due from the State for reimbursements of expenditures from Appropriations for the fiscal year ended August 31, 2007.

Investments

Investments of the University are managed by the University of Texas Investment Management Company (UTIMCO), a private investment corporation that provides services to the entire UT

System. All investments are reported as non-current, as these funds have an investment horizon extending beyond one year. The System's investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the System are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes, and internal pricing matrices. Equity security market values are based on the New York Stock Exchange composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded (if a closing price is not available, the average of the last reported bid and ask price is used).

The audited financial statements of the funds managed by UTIMCO may be found on UTIMCO's Web site, and inquires may be directed to UTIMCO via http://www.utimco.org/ .

Endowments

The University's endowments are used to support operations, which require the simultaneous achievement of two contradictory objectives of generating a predictable stream of annual revenue at a rate at least equal to the average rate of inflation for current needs and of increasing the purchasing power of the funds (after annual distributions) at a rate at least equal to the average rate of inflation for future periods.

Funds are subject to restrictions of endowment and trust instruments, requiring that principal be maintained and that only the income be utilized. Funds may include endowments, term endowments, and funds functioning as endowments. Funds functioning as endowments consist of amounts that have been internally dedicated by the System for long-term investment purposes.

Contributions Receivable

Current and non-current contributions receivable are amounts pledged to the University by donors, net of allowances.

Inventories

Inventories, consisting primarily of supplies and merchandise for resale are valued at cost based on the specific identification method.

Restricted Assets

Restricted assets include funds restricted by legal or contractual requirements, including those related to sponsored programs, donor gifts for operations capital projects and endowments, bond covenants, and loan agreements.

Loans and Contracts

Current and non-current loans and contracts are receivables, net of allowances, related to student loans.

Capital Assets

Capital assets are recorded at the cost at the date of acquisition or fair value at the date of donation in the case of gifts. The University and the System follow the State's capitalization policy with a cost equal to or greater than $5,000 for equipment items; $100,000 for buildings, building improvements and improvements other than buildings; and $500,000 for infrastructure items with an estimated useful life of greater than one year. Purchases of library books are capitalized. Renovations to buildings, infrastructure, and land improvements that increase the value by at least 25 percent or extend the useful life by at least 25 percent are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expenses are incurred. Outlays for construction in progress are capitalized as incurred. Interest expense related to construction is capitalized net of interest income earned on the resources reserved for this purpose.

The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research, and public service. These collections are protected and preserved.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 2 to 15 years for equipment items, 15 years for library books, 10 to 50 years for buildings and their components, and 15 to 40 years for infrastructure elements. The following schedule shows the changes in capital assets during fiscal year 2007.

Other Assets
Included in other current assets are prepaid expenses and a gift-in-kind which will be liquidated within a year. The gift proceeds will be restricted for capital improvement purposes.

Deferred Revenue
Deferred revenue represents revenues collected but not earned as of August 31, such as tuition receipts from students received in August for the fall semester and payments received in advance for sponsored programs.

Assets Held for Others
Assets held for others represent funds held by the University as custodial or fiscal agent for students, faculty members, and others.

Net Assets
The University has classified resources into the following three net asset categories:

Invested in Capital Assets
Capital assets, net of accumulated depreciation.

Restricted:

Nonexpendable
Net Assets subject to externally imposed stipulations that require the amounts to be maintained in perpetuity by the University or the System. Such assets include the book value of the University's permanent endowment funds.

Expendable
Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire with the passage of time.

Unrestricted
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for special purposes by action of management or the UT System Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic, institutional support and research programs and initiatives as well as for capital programs. When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation.

Revenues and Expenses
Operating revenues include student tuition and fees, net of scholarship allowances, sales and

services of auxiliary enterprises; federal, state, and local grants and contracts. As defined by GASB Statement No. 34, *Basic Financial Statements -and Management's Discussion and Analysis -for State and Local Governments,* all operating revenues are considered program revenues since they are charges for services provided and program-specific operating grants and contributions. Operating expenses include salaries and wages, payroll related costs, materials and supplies, depreciation, and scholarships and fellowships.

Nonoperating revenues include gifts and pledges and other revenue sources that are defined as nonoperating revenues by GASB Statement No.9, *Reporting Cash Flow of Proprietary and Nonexpendable Trust Funds and Government Entities That Used Proprietary Fund Accounting,* and GASB Statement No. 34, such as State appropriations and investment income. As defined by GASB Statement No. 34, nonoperating revenues are comprised of general revenues and program-specific capital grants and contributions. Nonoperating expenses include activities such as interest expense on capital asset financings and other expenses that are defined as nonoperating expenses by GASB Statement Nos. 9, 34 and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.*

Scholarship Allowances and Student Aid

Financial aid to students is reported in the financial statements as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid (student loans, funds provided to students as awarded by third parties, and Federal Direct Lending) is accounted for as third-party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expenses or scholarship allowances, which reduce revenues. The amount reported as operating expenses represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed on an entity wide basis by allocating cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third-party aid.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make prudent and conservative estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Component Units

The statements do not include any component units because the net assets of the related entities do not meet the UT System established threshold for inclusion in the financial statements.

Stewardship, Compliance and Accountability

The vice president for business affairs designated the associate vice president of finance and controller as the financial reporting officer who is responsible for the integrity of the Annual Financial Report (AFR) and for the establishment of effective internal controls for its preparation. UTD followed its financial reporting polices which included the implementation of financial reporting certifications by account owners, year end reporting planning and financial year end closing and reporting training for all involved university staff, departments and divisions. The AFR for fiscal year 2007 has been prepared in accordance with Government Accounting Standards Board requirements and in accordance with the UT System Policy on the Annual Financial Reporting. In compliance with the Standards and UT system Policy on the Annual

Financial Reporting, there are no know violations of any legal or contractual provisions, there are no deficits in any of the individual funds, and no deficits in any individual appropriations. Also, there have been no changes in accounting principles, fund types, component units reporting or loan reporting. The AFR was submitted to UT System's Financial Reporting Division of the Office of the Controller, where it is consolidated with the annual financial reports from other UT System institutions. The UT System's AFR is then consolidated into the State of Texas Comprehensive Annual Financial Report. UTD, as a component of UT System complied with all the Texas State Controller's Uniform State Account System reporting requirements and filed the required reporting certifications.

Note 2: Changes in Capital Assets

	Beginning Balance	Completed CIP	Additions	Deletions	Ending Balance
Nondepreciable Assets:					
Land & Land Improvements	9,061,820	-	-	(25,000)	9,036,820
Construction in Progress (CIP)	82,129,631	(91,907,495)	17,316,798	-	7,538,934
Other Capital Assets	3,142,500	-	87,650	(5,000)	3,225,150
Total Nondepreciable Assets	94,333,951	(91,907,495)	17,404,448	(30,000)	19,800,904
Depreciable Assets:					
Buildings & Building Improvements	242,652,574	90,905,207	-	(198,257)	333,359,524
Infrastructure	11,953,367	-	-	-	11,953,367
Facilities and Other Improvements	7,971,697	1,002,288	-	-	8,973,985
Furniture and Equipment	69,087,659	-	12,445,073	(1,847,471)	79,685,261
Vehicles, Boats and Aircraft	1,100,922	-	70,082	-	1,171,004
Other Capital Assets (Including Library Books)	34,658,681	-	1,716,328	(70,170)	36,304,839
Total Depreciable Assets at Historical Cost	367,424,900	91,907,495	14,231,483	(2,115,898)	471,447,980
Less accumulated depreciation for:					
Buildings and Building Improvements	(90,045,831)	-	(9,570,864)	178,018	(99,438,677)
Infrastructure	(6,256,375)	-	(387,997)	-	(6,644,372)
Facilities and Other Improvements	(4,432,320)	-	(222,019)	-	(4,654,339)
Furniture and Equipment	(33,974,670)	-	(7,126,884)	1,411,153	(39,690,401)
Vehicles, Boats and Aircraft	(824,986)	-	(66,071)	-	(891,057)
Other Capital Assets (Including Library Books)	(20,851,464)	-	(1,756,021)	-	(22,607,485)
Total accumulated depreciation	(156,385,646)	-	(19,129,856)	1,589,171	(173,926,331)
Depreciable Assets, net	211,039,254	91,907,495	(4,898,373)	(526,727)	297,521,649
Capital Assets, net	305,373,205	-	12,506,075	(556,727)	317,322,553

Note 3: Deposits and Investments, and Repurchase Agreements

Deposits

University bank information as of August 31, 2007, is presented below:

	Carrying Amount	Bank Balance
	($5,114,135)	$762,298
Cash in Bank		$ -5,114,135
Cash in State Treasury		14,835,855
Cash Equivalents		28,695,955
Other		1,476,650
Total Cash Equivalents		$ 39,894,325
Cash & Cash Equivalents		$ 31,707,479
Restricted Cash & Cash Equivalents		8,186,846
Total Cash & Cash Equivalents		39,894,325

Custodial Credit Risk
Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System maintains depository relationships with various banking institutions. The System's policy is that all deposits are governed by a bank depository agreement between the System and the respective banking institution. This agreement provides that the System's deposits, to the extent such deposits exceed the maximum insured limit under deposit insurance provided by the Federal Deposit Insurance Corporation, shall at all times be collateralized with either government securities or a surety bond issued by an insurer rated "AAA" or its equivalent by a nationally recognized rating organization or a combination thereof. The deposits of the University at August 31, 2007 were fully collateralized.

Investments
At the direction of the System Board of Regents, University's investments and cash equivalents are pooled at the System level in internal investment pools. The System is responsible for disclosure of all information on the pooled investments and has included these disclosures in its annual financial reports. The fair value of the University's share of investments is presented below:

Investments Held by System in:		
Intermediate Term Fund	$	111,887,977
General Endowment Fund		263,974,863
Total Investments	$	375,862,840
Noncurrent Assets Investments	$	77,012,294
Noncurrent Assets Restricted Investments:		
Investment		298,850,546
Total Investments	$	375,862,840

(A) Credit Risk - Article VII, Section II b, of the Texas Constitution authorizes the System Board of Regents, subject to procedures and restrictions it establishes, to invest System funds in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System's investment policies limit investments in US. Domestic bonds and non-dollar denominated bond investments to those that are rated investment grade , Baa3 or better by Moody's Investor Services, BBB-or better by Standard & Poor's Corporation, or BBB-or better by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment-grade bonds. Per GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment to CASB Statement No.3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the US. Government are not considered to have credit risk and do not require disclosure of credit quality.

(B) Concentrations of Credit Risk - The System's investment policy statements contain the limitation that no more than 5% of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer.

(C) Custodial Credit Risk - Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the System's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments.

(D) Interest Rate Risk - Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. Interest rate risk inherent in the System investments is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the System's investments to changes in interest rates. The System has no specific policy statement limitations with respect to its overall modified duration.

(E) Investments with Fair Values that Are Highly Sensitive to Interest Rate Changes -In accordance with the System's investment policy statements, the System may invest in various mortgage-backed securities, such as collateralized mortgage-backed obligations. The System also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds, and stripped Treasury and Agency securities created from coupon securities. As of August 31, 2007 the System's investments include the following investments that are highly sensitive to interest rate changes:

- Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Mortgage-backed securities which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Asset-backed securities which are backed by home equity loans, auto loans, equipment loans, and credit card receivables. Prepayments by the obliges of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received.

- Set-up notes that grant the issuer the option to call the note on certain specified dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at the inception of the note. The call feature embedded within a step-up note causes the fair value of the instrument to be considered highly sensitive to interest rate changes.

(F) Foreign Currency Risk -Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the System's non-U.S. dollar investments. The System's investment policy statement limits investments in non-US. denominated bonds to 50% of the System's total fixed income exposure.

Repurchase Agreements

The System, by statute, is authorized to enter into repurchase agreements. A repurchase agreement is made when a holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate the buyer for this. During the year ended August 31, 2007, the System participated in Repurchase Agreements. At August 31, 2007, there were no Repurchase Agreements outstanding.

Securities Lending

In accordance with the prudent investor investment standards, the System participates in a securities lending program. The System began the program, under a contract with the System's lending agent, on September 1, 1995. The lending agent is authorized to lend any securities held by the System's custodian except those securities that the policy guidelines prohibit lending. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In securities lending transactions, the System transfers its securities to brokers/dealers for collateral, which may be cash, securities issued or guaranteed by the United States government or its agencies, and irrevocable bank letters of credit, and simultaneously agrees to return the collateral for the same securities in the future.

Cash collateral received by the lending agent on behalf of the System is invested and reinvested in a non-commingled pool exclusively for the benefit of the System. The pool is managed in accordance with investment guidelines established by the System and is stated in the securities lending contract. The maturities of the investments in the pool do not necessarily match the term of the loans; rather, the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent. On August 31, 2007, the System was collateralized 102 percent for securities on loan collateralized by cash.

Collateral pool investments are uninsured, and are held by the securities lending agent, in its name, on behalf of the System, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the System or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties' trust department or agent.

Lending income is earned if the returns on those investments exceed the "rebate" paid to borrowers of the securities. The income is then shared with the lending agent based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from the System's resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a "loan premium or fee" for the securities loan. This income is split with the same ratio as the earnings for cash collateral. The collateral pledged to the System by the borrower is custodied by the lending agent or through a third-party arrangement. These securities held as collateral are not available to the System for selling or pledging unless the borrower is in default of the loan. On August 31, 2007, the System was collateralized 103 percent for securities on loan which were collateralized by securities.

The collateral received will have a fair value of 102 percent of the loaned securities of United States issuers. If the fair value of the collateral held in connection with loans of securities of United States issuers is less than 100 percent at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102 percent of the fair value.

For non-United States issuers, the collateral should remain at 105 percent of the fair value of the loaned securities at the close of any business day. If it falls below 105 percent, the borrower must deliver additional collateral by the close of the following business day. On August 31, 2007, the System was collateralized 105 percent for international loans.

In the event of default, where the borrower is unable to return the securities loaned, the System has authorized the lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the lending agent has indemnified the System from any loss due to borrower default.

At August 31, 2007, the System had no credit risk exposure to borrowers because the amounts the System owed to borrowers exceeded the amounts the borrowers owed the System.

There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Derivative Financial Instruments
Derivatives are financial instruments (securities or contracts) whose value is linked to, or "derived" from, changes in interest rates, currency rates, and stock and commodity prices. Derivatives cover a broad range of financial instruments, such as forwards, futures, options, swaps, and mortgage derivatives.

(A) Mortgage Derivatives -Mortgage derivatives are used to manage portfolio duration and to enhance portfolio yield, and, are influenced by changes in interest rates, the current economic climate, and the geographic make-up of underlying mortgage loans. There are varying degrees of risk associated with mortgage derivatives. For example, certain Collateralized Mortgage Obligations (CMOs) such as Planned Amortization Class (PACs) are considered a more conservative lower risk investment. In contrast, principal only and interest only strips are considered higher risk investments. The System's investment in CMOs, was comprised almost exclusively of the lower risk investment class.

(B) Futures Contracts -Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. The net liability is included in payables from restricted assets. Futures contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss difference is referred to as the daily variation margin, which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The System executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the manager's various trading and credit monitoring techniques.

(C) Foreign Currency Exchange Contracts -The System enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward currency contract, the System agrees to receive or deliver a fixed quantity of foreign

currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the System's net equity therein (representing unrealized gain or loss on the contracts, as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date) is included in other receivables. Realized and unrealized gains and losses are included in the consolidated statement of revenues, expenses, and changes in net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the consolidated balance sheet. Risks arise from the possible inability of counter-parties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(D) Written Options -Written options are used to alter the market (systematic) exposure without trading the underlying cash market securities, and to hedge and control risks so that the actual risk/return profile is more closely aligned with the target risk/return profile. During the year, call options were written on Treasury Bonds and equity index futures.

(E) Swaps -Swaps are used to adjust interest rate and yield curve exposures. During the year, the System entered into interest rate, total return, and commodity swap contracts.

(F) Other -The System's investment funds include exchange traded funds, index funds, Securities Exchange Commission (SEC) regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and may be unregulated .

Marketable alternatives funds are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private market funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments are domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk, and investment manager risk.

Public market funds are invested in exchange traded funds, index funds, and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the funds. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market and public market funds include investments in private placement vehicles that are subject to risk which could result in the loss of invested capital. The risks include the following:

- Non-regulation risk -Some of these funds are not registered with the SEC, and therefore, are not subject to regulatory controls.
- Key personnel risk - The success of certain funds is substantially dependent upon key investment managers and the loss of those individuals may adversely impact the fund's performance.

- Liquidity risk -Many of the System's investment funds may impose lock-up periods which would cause the System to incur penalties to redeem its units or prevent the System from redeeming its shares until a certain period of time has elapsed.
- Limited transparency -As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
- Investment strategy risk - These funds often employs sophisticated investment strategies and may use leverage which could result in the loss of invested capital.

(G) Securities Sold Short -The System may sell securities it does not own in anticipation of a decline in the fair value of that security. When the System sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The System must pay dividends or interest on the securities sold short. Until the System covers it shorts sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold short at prices which may be significantly higher than the market value reflected in the statements of fiduciary net assets.

Note 4: Summary of Long-Term Liabilities

	Beginning Balance 9/1/2006	Additions	Reductions	Ending Balance 8/31/2007	Current Portion
Other liabilities:					
Employees Compensable Leave	4,203,632	1,129,171	782,577	4,550,226	2,350,615

Employees' Compensable Leave, Substantially all full-time University staff earn annual leave from eight to twenty-one hours per month depending upon the respective employee's years of State employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum number of hours up to 532 for those employees with 35 or more years of State service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of State service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick Leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his/her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements since experience indicates the expense for sick leave to be minimal. Eligible part-time employees ' sick leave accrual rate is proportional to the number of hours appointed to work.

Note 5: Operating Leases

The University has entered into operating leases for a modular building. Rental expenses for operating leases were $94,704 in 2007. Minimum future lease rental payments under noncancelable operating leases having an initial term in excess of one year as of August 31, 2007, were as follows:

Fiscal Year		Lease Payments
2008	$	118,708
2009		0
2010		0
2011		0
2012		0
2013-2017		0
Total Minimum Future Payments	$	118,708

The University has also leased buildings and land to outside parities under operating leases. The cost, carrying value and accumulated depreciation of these leased assets as of August 31, 2007 is as follows:

Assets Leased		2007
Buildings:		N/A
Cost	$	
Less: Accumulated Depreciation		
Carrying Value of Buildings		
Land		350,142.54
Total Carrying Value	$	350,142.54

Minimum future lease rental income under noncancelable operating leases as of August 31, 2007, was as follows:

Fiscal Year		Lease Income
2008	$	110,000
2009		94,800
2010		96,800
2011		98,800
2012		100,800
2013 – 2017		534,000
2018 – 2022		112,800
2023 – 2027		
2028 – 2032		
2033 - 2037		
Total	$	1,148,000

Note 6: Bonded Indebtedness

The University receives proceeds from revenue bonds issued and held by the System to support capital projects of the System and its institutions. These proceeds are recorded as transfers from the System. The University disperses funds to the System for payments of principal and interest related to the University's share of bond proceeds. These disbursements are recorded as transfers to the System. All bonds issued by the System are defined as revenue bonds. As such, the revenues of the System, including the University, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures ' lack of specifically identifiable activities and external party imposed separate accounting requirements.

No amount of indebtedness related to these bonds has been recorded in the University's financial statements as the System is the party directly liable for these bonds. At August 31, 2007, however, the University's remaining unpaid share of the bond proceeds was $138,481,000.

Note 7: Contingent Liabilities

As of August 31, 2007, the University was not aware of any significant contingent liabilities.

Note 8: Risk Financing and Related Insurance

All risk financing and related insurance for the University is part of coverage provided by the System. The System has seven funded self-insurance plans providing coverage in the following areas: employee health and dental, unemployment compensation, workers' compensation, medical professional liability, property protection, directors' and officers'/employment practices liability, and construction contractor insurance.

Employee and Retiree Insurance Benefits

The UT System Employee Benefits program provides health, dental, vision, life insurance, long-term disability, short-term disability, long-term care, and flexible spending account coverage to all benefits-eligible employees and retirees of the System and its fifteen institutions. These insurance benefits are provided through both self-funded and fully-insured arrangements. A portion of an individual's group health insurance premium is paid by the State as specified in the General Appropriations Act.

Unemployment Compensation Insurance

The UT System Office of Risk Management manages the accounting and financial aspects of the Unemployment Compensation Insurance (UCI) program. An actuarially determined variable rate against payroll (capped at $9000) is charged to the institutions and all claims are reimbursed to the Texas Workforce Commission (TWC) from the UCI fund. The General Appropriations Act requires the System to reimburse the TWC for 50% of the unemployment benefits paid to former employees that were paid from general revenue funds. The System reimburses the TWC 100% of the unemployment benefits paid to former employees that were paid from local funds.

Workers' Compensation Insurance

The University of Texas System Workers' Compensation Insurance (WCI) program provides coverage to all employees of the System and its fifteen institutions. Under the oversight of the System's Office of Risk Management (ORM), the System self-insures and administers the program. The regional and local WCI staff is responsible for administering all aspects of the system-wide program, which provides income and medical benefits to all employees who have sustained job-related injuries or occupational diseases. The program's statutory authority is embodied in Chapter 503 of the Texas Labor Code.

Comprehensive Property Protection Program

The property protection plan consists of two programs. The first provides coverage for physical damage resulting from named windstorms and catastrophic flood losses up to $50 million. Insurance policies providing relatively low limits ($1-$2 million per building and contents) are purchased through the Texas Windstorm Insurance Association and the National Flood Insurance Program on several facilities in the Tier 1 wind zone and other flood prone areas to provide a primary layer of insurance. The self-insurance component of the program participates in losses that exceed the coverage available under these primary policies or in cases where there is no underlying insurance.

The second program covers fire and other perils and includes commercial reinsurance for claims exceeding a per occurrence deductible of $7.5 million or an annual aggregate deductible of $25 million. The policy covers $15.9 billion in building and content values and $3.8 billion in business income. The maximum annual reimbursement under this policy is $1 billion per occurrence.

To fund the self-insurance portion of both property programs, the institutions make annual contributions to the loss reserve funds in addition to paying insurance premiums.

Directors' and Officers'/Employment Practices Liability Self-Insurance Plan

The Directors' and Officers' Liability (D&O) and Employment Practices Liability Self-Insurance Plan provide coverage for claims arising from actual or alleged wrongful acts performed by the plan beneficiaries. The plan also provides coverage for employment practices liability (EPL) claims, such as wrongful termination, failure to promote and wrongful discipline.

Coverage applies to individual board members, employees, faculty, etc., as well as to the System itself. The limit of liability is a $10 million annual aggregate (Coverages A, B, and C combined), except for a $5 million annual aggregate sublimit for Coverage C. There is no deductible for Coverage A (individuals), a $100,000 deductible per director or officer with a $300,000 maximum deductible per loss for Coverage B. The deductible for Coverage C is $300,000. In 2003, the UT System Board of Regents allocated $3.7 million from the Available University Fund to establish the D&O/EPL loss reserve fund. Institutions make annual premium contributions to this fund as well.

Rolling Owner Controlled Insurance Program

A Rolling Owner Controlled Insurance Program (ROCIP) is established for the centralized purchase of construction contractor insurance on various capital projects. This program provides workers' compensation and general liability insurance for all contractors enrolled on projects participating in the program. The insurance carries a $250,000 per occurrence basket deductible, which is paid through the program's self-insurance fund.

Note 9: Related Parties

The University had no related parties as of August 31, 2007.

Note 10: Postemployment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health and life insurance benefits for retired employees, in accordance with state statutes. Substantially all of the employees may become eligible for the health and life insurance benefits if they reach normal retirement age while working for the state. Currently, there are 406 retirees who are eligible for these benefits. Similar benefits for active employees are provided through a self-funded plan and fully-insured plans. Depending upon the status of the employee at the time of retirement, the State or the System recognizes the cost of providing these benefits. The cost of retiree post-employment benefits is recognized when paid. This contribution paid all of the "employee/retiree only" premiums and a portion of the premiums for those employees/retirees selecting dependent coverage. The employee/retiree was required to pay a portion of the cost of dependent coverage. For the fiscal year ended August 31, 2007, the cost of providing those benefits for the retirees was $519,334 for the State and $1,354,182 for the University.

In August 2004, the GASB issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, effective for the System in fiscal year 2008. GASB Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. For the System, this will result in increased expenses and a related liability which will be significant. The System and its actuaries are evaluating the effect the GASB Statement No. 45 will have on the System's and University's financial statements.

Note 11: Employee Retirement Plans

Teacher Retirement System (TRS)

The State of Texas has joint contributory retirement plans for substantially all its employees. One of the primary plans in which the System participates is a cost-sharing multi-employer public employee retirement system administered the Teacher Retirement System of Texas. TRS is primarily funded though state and employee contributions. Depending upon the source of funding for a participant's salary, the System may be required to make contributions in lieu of the state.

All System personnel employed in a position on a half time or greater basis for at least 4 ½ months or more are eligible for membership in the TRS retirement plan. Members with at least five years of service at age 65 or any combination of age plus years of service, which equals 80, have a vested right to retirement benefits. Additionally, reduced benefits are available at age 55 with at least five years of service or at any age below 50 with 30 years of service. Members are fully vested after five years of service and are entitled to any benefits for which the eligibility requirements have been met.

TRS contribution rates for both employers and employees are not actuarially determined but are legally established by the State Legislature. Contributions by employees are 6.4 percent of gross earnings. Depending upon the source of funding for the employee's compensation, the State or the University contributes a percentage of participant salaries totaling 6 percent of annual compensation. The University's contributions to TRS for the year ended August 31, 2007 were $3,212,399, which equaled the amount of the required contributions for the year.

TRS does not separately account for each of its component government agencies since the Retirement System itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. Further information regarding actuarial assumptions and conclusions, together with audited financial statements are included in the Retirement System's annual financial report, which may be found on the TRS website at http://www.trs.state.tx.us.

Optional Retirement Program (ORP)

The Optional Retirement Program (ORP) may be chosen by certain employees in lieu of TRS based on the job they perform. This program is a defined contribution plan governed by Internal Revenue Code Section 403(b). Benefits are based on the performance of the investments selected and are controlled by the employee. Participants are vested after one year and one day of participation with a right to both employee and employer contributions. This program provides a greater degree of portability than TRS.

Eligibility for ORP is strictly based on the job an employee performs, and is not based on years of service or salary level. Program eligibility requirements and rights are similar to those for TRS, with the exception that members are fully vested after one year and one day of service. For ORP, employee contributions are 6.65 percent of gross earnings. The state contribution rate for ORP is also at 6 percent with a grandfathered group at 8.5%. Currently, as allowed by law, the University contributes an additional 1% making UT Dallas' total ORP contribution rate 7.0%. The University's contributions for the year ended August 31, 2007 were $4,315,841, and 626 employees participating.

Note 12: Deferred Compensation & Voluntary 403(b) accounts

University employees, through the System, may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. The University offers two voluntary retirement plans in this category.

The UTSaver Deferred Compensation Plan (DCP) complies with the Internal Revenue Code, Section 457 and is available to all employees. Elective deferrals by the employees under the 457 (b) plan are transferred to the Deferred Compensation Trust Fund. Employees can elect investments from among authorized UT Retirement Programs providers.

The System also administers the UTSaver Tax-Sheltered Annuity Program (TSA), created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The UTSaver TSA is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be annuity or mutual fund companies. The assets of this plan do not belong to the System or the State. Therefore, neither the System nor the State has a liability related to this plan.

Note 13: Donor-Restricted Endowments

For donor restricted endowments, pursuant to the Uniform Management of Institutional Funds Act, as adopted by Texas, the Board of Regents may distribute net appreciation, realized and unrealized, in the fair market value of the assets of endowment holdings over the historic dollar value of the gifts, to the extent prudent. The System's policy is to retain all undistributed net realized and unrealized appreciation within the endowment finds. The book value of endowments is reflected as nonexpendable assets, the appreciate value of endowments is reflected as expendable assets on the net assets sections of the balance sheet. In FY07 UTD did not expend any amounts from the appreciated value of its endowments. UTD is subject to the UT Board of Regents policies and procedures on endowment management.

Funds held by System include $263,974,863 for the year ended August 31, 2007 of endowment funds. The net assets related to endowment funds include $143,195,165 of restricted expendable and $2,102,685 of unrestricted at August 31, 2007.

Donor-Restricted Endowments	Amounts of Net Appreciation	Reported in Net Assets
True Endowments	$ 138,317,972	Restricted Other Expendable
Term Endowments	4,877,993	Restricted Expendable
	$ 143,195,965	

Note 14: Disaggregation of Other Receivable Balances

Other receivables are detailed by types as follows at August 31 2007:

Net Other Receivables	
Receivables related to gifts, grants and sponsored programs	$ 541,466
Receivables related to external parties/other companies	3,018,347
Receivables related to payroll	26,745
Receivables related to other various activities	61,664
Total	3,648,222

Note 15: Interagency Balance Activities

Entity		Due from Other State Entities		Due to Other State Entities	Purpose
State Comptroller	$	39,457	$		Engineering & Technology License Plate Rev.
State Comptroller		3,304			Scholarship
UT System Administration		40,155,903		1,191,676	Debt Service and Capital Project Funding
	$	40,198,664	$	1,191,676	

Entity		Transfers In from Other State Entities		Transfers Out to Other State Entities	Purpose
UT System Administration	$	12,355,073		10,589,473	Capital Project Funding/Debt Service
Texas Higher Education Coordinating Board				769,186	B-On Time and Doctorial Set - Aside
	$	12,355,073	$	11,358,659	

Note 16: Subsequent Events

Since the fiscal year closing and the preparation of the financial statements, there have not been any known subsequent events that would have a material impact on the year end financial statements.

Note 17: Termination Benefits

The University recognizes a liability and expense for voluntary termination benefits (for example, early-retirement incentives) when the offer is accepted and the amount can be estimated. A liability and expense for involuntary terminations benefits (for example, severance benefits) is recognized when a plan of termination has been approved by those with the authority to commit the university to the plan, the plan has been communicated to the employees, and the amounts can be estimated. As of August 31, 2007 the University did not have any executed involuntary termination plans for which an expense and a liability should be recognized.

State Auditor's Office
John Keel, CPA
State Auditor

February 4, 2008

Dr. David Daniel, President
The University of Texas at Dallas
800 West Campbell Road
Mail Station AD22
Richardson, Texas 75080

Subject: Management Letter Resulting from a Review of the University of Texas at Dallas's Fiscal Year 2007 Financial Statements

Dear Dr. Daniel:

We offer this management letter in conjunction with our review of the financial statements of the University of Texas at Dallas (University) for the year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

The University should enhance its due diligence and review process for its financial reports. Auditors identified a number of errors in the fiscal year 2007 financial report the University prepared for its accreditation review. While the University typically prepares a complete financial report only when it is required to receive an accreditation review, the type and quantity of the errors identified indicate a lack of attention to detail and inadequate review, which could lead to errors in other financial reports

During this review, the following errors were among those identified by auditors in the University's fiscal year 2007 financial report:

- The University omitted the amount for beginning net assets as of September 1, 2006, from the Statement of Revenues, Expenses, and Changes in Net Assets. This amount was $687 million, and the omission could have been detected by a mathematical verification of the statement.
- The University did not present disclosures about capital assets in the Notes to the Financial Statements as required by the Governmental Accounting Standards Board.
- The University made a number of minor errors. For example, the end date of the fiscal year was specified incorrectly on some pages of the financial report as August 3, 2007, instead of August 31, 2007.

The University corrected all of the errors noted prior to the completion of the review.

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Recommendation

The University should do the following when preparing future financial reports:

- Follow applicable requirements more carefully, including relevant accounting and reporting standards.
- Carefully review and correct the financial report prior to its completion.

Management's Response

Management agrees with the recommended improvements and has taken the following immediate actions: effective immediately, all reports will be subject to an additional quality review process. The review will be performed by qualified individuals with responsibility for ensuring that the reports are in compliance with the applicable accounting and reporting standards and are error free. The review process will be documented and the reviewer's signature will be reflected on the supporting documentation. Non-compliance with the established review procedures will be documented and will be included as a part of the performance review process.

Responsible Person: Associate VP for Finance & Controller

Implementation Date: Immediately

We appreciate the assistance provided during this review by the management of the University and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

A Review of

The University of Texas Health Science Center at San Antonio

A Report and Management Letter for the Southern Association of Colleges and Schools

January 2008

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State Auditor's Office
John Keel, CPA
State Auditor

Auditor's Review Report

January 7, 2008

Dr. Francisco G. Cigarroa, President
The University of Texas Health Science Center at San Antonio
7703 Floyd Curl Drive
San Antonio, Texas 78229-3900

Dear Dr. Cigarroa:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of the University of Texas Health Science Center at San Antonio (Health Science Center) as of and for the fiscal year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the Health Science Center.

A review consists principally of inquiries of Health Science Center personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the Health Science Center. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The Health Science Center has not presented a management's discussion and analysis section that the Governmental Accounting Standards Board has identified as required supplementary information that is not part of the basic financial statements. However, such required supplementary information for the University of Texas System (System) is presented in the System's consolidated annual financial report.

This report is intended for use by the Board of Regents of the System, management of the Health Science Center, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

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SAO Report No. 08-315

The University of Texas Health Science Center at San Antonio

Statement of Net Assets

At August 31, 2007

(See Auditor's Review Report on page 1.)

ASSETS		
Current Assets		
Cash and Cash Equivalents (Note 3)	$	35,277,371
Restricted:		
Cash and Cash Equivalents (Note 3)		38,369,729
Legislative Appropriations		23,084,717
Receivables, Net of Allowances:		
Federal		11,228,222
Other Intergovernmental		1,825,236
Interest and Dividends		585,769
Accounts		19,671,723
Gifts		2,102,174
University Health System, Veterans' Administration and Other Contracts		7,151,426
Other (Note 22)		5,517,894
Due from Other State Entities (Note 9)		91,543,328
Consumable Inventories		1,456,687
Loans and Contracts		1,383,033
Other Current Assets		346,375
Total Current Assets	$	239,543,684
Non-Current Assets		
Restricted:		
Investments (Note 3)	$	487,671,634
Loans and Contracts		5,197,476
Gifts Receivable		3,437,887
Investments (Note 3)		115,727,307
Capital Assets (Note 2):		
Non-Depreciable		72,002,206
Depreciable		519,409,027
Less: Accumulated Depreciation		(277,961,316)
Other Non-Current Assets		13,736,712
Total Non-Current Assets	$	939,220,933
Total Assets	$	**1,178,764,617**

The University of Texas Health Science Center at San Antonio

Statement of Net Assets

At August 31, 2007
(See Auditor's Review Report on page 1.)

LIABILITIES		
Current Liabilities		
Payables:		
Accounts	$	6,756,070
Accrued Liabilities		219,351
Payroll		10,952,156
Federal		5,128,684
Other		2,489,302
Due to Other State Entities (Note 9)		3,091,211
Deferred Revenue		26,426,420
Employees' Compensable Leave (Note 5)		15,954,551
Notes and Loans Payable (Note 5)		1,310,769
Liabilities Payable from Restricted Assets (Note 5)		18,191,795
Assets Held for Others (Note 5)		94,055
Other Current Liabilities		539,074
Total Current Liabilities	$	91,153,438
Non-Current Liabilities		
Employees' Compensable Leave (Note 5)	$	17,345,022
Notes and Loans Payable (Note 5)		11,938,864
Assets Held for Others (Note 5)		290,107
Other Non-Current Liabilities		655,626
Total Non-Current Liabilities	$	30,229,619
Total Liabilities	$	121,383,057
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	$	313,449,917
Restricted for:		
Non-Expendable		
Permanent Funds, True Endowments, Annuities		277,677,067
Expendable		
Capital Projects		77,165,319
Funds Functioning as Endowments		6,600,546
Other		243,146,072
Unrestricted		139,342,639
Total Net Assets	$	1,057,381,560
Total Liabilities and Net Assets	**$**	**1,178,764,617**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas Health Science Center at San Antonio

Statement of Revenues, Expenses, and Changes in Net Assets

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

OPERATING REVENUES		
Student Tuition and Fees	$	26,411,395
Discounts and Allowances		(1,722,574)
Professional Fees		257,123,651
Discounts and Allowances		(162,182,266)
Auxiliary Enterprises		4,130,027
Sales and Services of Educational Activities		40,085,501
Federal Revenue		111,690,508
State Grant Revenue		7,032,350
Local Grant Revenue		51,509,384
Private Grant Revenue		39,894,463
Other Operating Revenues		7,006,507
Total Operating Revenues	$	380,978,946
OPERATING EXPENSES		
Salaries and Wages		317,425,647
Payroll Related Costs		77,332,313
Professional Fees and Services		11,406,837
Travel		5,202,692
Materials and Supplies		31,730,256
Communications		5,265,223
Utilities		17,802,915
Repairs and Maintenance		4,032,011
Rentals and Leases		2,043,002
Printing and Reproduction		2,029,936
Depreciation and Amortization		22,804,861
Bad Debt Expense		281,459
Scholarships and Fellowships		1,783,435
Subrecipient Payments		15,505,254
Other Operating Expenses		42,773,235
Total Operating Expenses	$	557,419,076
Operating Income (Loss)	**$**	**(176,440,130)**

The University of Texas Health Science Center at San Antonio
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

NONOPERATING REVENUES (EXPENSES)		
Legislative (State) Appropriations	$	153,783,437
Gifts and Contributions for Operations		23,266,442
Interest and Investment Income (Loss)		29,004,708
Net Increase (Decrease) in Fair Value of Investments		49,672,695
Gain (Loss) on Sale of Capital Assets		(1,258,149)
Total Nonoperating Revenues (Expenses)	$	254,469,133
Income (Loss) Before Other Revenues, Expenses, Gains (Losses), and Transfers	$	**78,029,003**
OTHER REVENUES, EXPENSES, GAINS (LOSSES), AND TRANSFERS		
Gifts and Sponsored Programs for Capital Acquisitions	$	8,154,529
Additions to Permanent and Term Endowments		18,942,499
Transfers In from Other State Entities (Note 9)		95,839,230
Transfers Out to Other State Entities (Note 9)		(12,083,812)
Total Other Revenues, Expenses, Gains (Losses), and Transfers	$	110,852,446
CHANGE IN NET ASSETS	$	**188,881,449**
Net Assets, September 1, 2006	$	868,500,111
Restatements (Note 16)		
Net Assets, September 1, 2006, as Restated	$	868,500,111
NET ASSETS, August 31, 2007	$	**1,057,381,560**

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas Health Science Center at San Antonio

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

CASH FLOWS FROM OPERATING ACTIVITIES	
Proceeds from Tuition and Fees	$ 24,939,229
Receipts from Customers	93,143,601
Proceeds from Research Grants and Contracts	213,370,762
Proceeds from Loan Programs	1,184,994
Proceeds from Auxiliaries	4,137,267
Proceeds from Other Revenues	40,671,342
Payments to Suppliers for Goods and Services	(142,792,846)
Payments to Employees for Salaries	(391,533,515)
Payments for Loans Provided	(1,485,168)
Net Cash Provided (Used) by Operating Activities	$ (158,364,334)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Proceeds from Legislative Appropriations	$ 151,366,845
Proceeds from Gifts	20,990,165
Proceeds from Endowments	18,942,499
Proceeds from Transfers to Other Entities	1,986,718
Net Cash Provided (Used) by Non-Capital Financing Activities	$ 193,286,227
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from Gifts	3,489,579
Proceeds from Issuance of Capital-Related Debt	11,297,312
Proceeds of Transfers from Other Entities	41,060,378
Payments for Additions to Capital Assets	(55,901,146)
Payments for Transfers to Other Entities	(11,874,641)
Net Cash Provided (Used) by Capital and Related Financing Activities	$ (11,928,518)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Interest and Investment Income	$ 28,776,524
Payments to Acquire Investments	(53,509,450)
Net Cash Provided (Used) by Investing Activities	$ (24,732,926)
Net Increase (Decrease) in Cash and Cash Equivalents	$ (1,739,551)
Cash and Cash Equivalents, September 1, 2006	$ 75,386,651
Restatements	0
Cash and Cash Equivalents, September 1, 2006, as restated	$ 75,386,651
Cash and Cash Equivalents, August 31, 2007	**$ 73,647,100**

The University of Texas Health Science Center at San Antonio

Statement of Cash Flows

For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities

Operating Income (Loss)	$ (176,440,130)
Adjustments:	
Depreciation and Amortization	$ 22,804,861
Bad Debt Expense	281,459
Changes in Assets and Liabilities:	
(Increase) Decrease in Receivables	1,281,718
(Increase) Decrease in Inventories	(31,239)
(Increase) Decrease in Loans and Contracts	(300,174)
(Increase) Decrease in Other Assets	(6,745,336)
Increase (Decrease) in Payables	(2,947,468)
Increase (Decrease) in Due to Other Entities	228,251
Increase (Decrease) in Deferred Revenue	726,058
Increase (Decrease) in Employees' Compensable Leave	2,756,851
Increase (Decrease) in Funds Held for Others	7,458
Increase (Decrease) in Other Liabilities	13,357
Total Adjustments	$ 18,075,796
Net Cash Provided (Used) by Operating Activities	$ (158,364,334)
Non-Cash Transactions	
Net Increase (Decrease) in Fair Value of Investments	$ 49,672,695
Donated Capital Assets	4,664,950
Miscellaneous Non-Cash Transactions	(1,305,046)

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas Health Science Center at San Antonio

Statement of Changes in Unrestricted Net Assets

For the Fiscal Year Ended August 31, 2007

	8/31/2007	8/31/2006	Difference
Reserved			
Encumbrances	$ 11,241,427	$ 3,652,030	$ 7,589,397
Accounts Receivable	11,985,212	22,657,085	(10,671,873)
Inventories	1,456,687	5,450,436	(3,993,749)
Self-Insurance Plans	0	1,093,762	(1,093,762)
Capital Projects	(1,118,324)	4,442,579	(5,560,903)
Deposits	(84,617)	(74,186)	(10,431)
Prepaid Expenses	600	600	0
Travel Advances	10,691	6,563	4,128
Petty Cash	51,010	51,190	(180)
Texas Public Education Grants	312,816	516,079	(203,263)
Unreserved			
Allocated			
Future Operating Budgets	2,779,423	4,573,475	(1,794,052)
Capital Projects	24,000,000	2,000,000	22,000,000
Funds Functioning as Endowment - Unrestricted	8,265,164	6,829,876	1,435,288
Retirement of Indebtedness	1,722,328	3,000,000	(1,277,672)
Start-Up / Matching	6,845,465	4,700,000	2,145,465
Utilities Reserve	2,000,000	3,000,000	(1,000,000)
Student Fees	1,309,802	1,025,788	284,014
Other	93,759,197	77,414,191	16,345,006
Unallocated	(25,194,242)	(20,835,660)	(4,358,582)
Total Unrestricted Net Assets	$ 139,342,639	$ 119,503,808	$ 19,838,831

(See Auditor's Review Report on page 1.)

General Introduction

This report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of The University of Texas Health Science Center at San Antonio (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria, the report also includes a Statement of Changes in Unrestricted Net Assets, and a management letter describing issues noted in the review.

Reporting Entity

The University is a component of The University of Texas System, established by the Texas Constitution of 1876, and an agency of the State of Texas. The System is reported as a business-type activity in the State of Texas' *Comprehensive Annual Financial Report* and complies with applicable state statutes and GASB pronouncements. The System is governed by a board of regents, composed of nine members who are appointed by the Governor and confirmed by the Senate. Terms are scheduled for six years each and staggered so that three members' terms will usually expire on February 1 of odd-numbered years.

The University was charted in 1959 as the South Texas Medical School. In 1972, the University was officially designated as The University of Texas Health Science Center at San Antonio. The University's mission is to provide the best in health careers education, biomedical research, patient care and community service to San Antonio and the South Texas/Border Region.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, the University's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when an obligation has been incurred. Operating items are distinguished from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the principle of ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets.

The financial statements of the University have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by GASB.

Cash and Cash Equivalents

Cash and cash equivalents are maintained for the purpose of meeting short-term expense requirements. Highly liquid investments with maturities of three months or less at the time of purchase are included in cash and cash equivalents.

Investments

Investments of the University are managed by The University of Texas Investment Management Company (UTIMCO), a private investment corporation that provides services exclusively to the System. All investments are reported as noncurrent, as these funds have an investment horizon extending beyond one year. The System's investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the System are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes, and internal pricing matrices.

Equity security market values are based on the New York Stock Exchange composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded (if a closing price is not available, the average of the last reported bid and ask price is used).

The audited financial statements of the funds managed by UTIMCO may be found on UTIMCO's web site, and inquiries may be directed to UTIMCO via www.utimco.org.

Contributions Receivable

Current and noncurrent contributions receivable are amounts pledged to the University by donors, net of allowances.

Inventories

Inventories, consisting primarily of supplies and merchandise for resale, are valued at cost based on the specific identification method.

Restricted Assets

Restricted assets include funds restricted by legal or contractual requirements, including those related to sponsored programs, donors, constitutional restrictions, bond covenants, and loan agreements.

Loans and Contracts

Current and noncurrent loans and contracts are receivables, net of allowances, related to student loans.

Capital Assets

Capital assets are recorded at cost at the date of acquisition or at fair value at the date of donation in the case of gifts. The University follows the State's capitalization policy with a cost equal to or greater than $5,000 for equipment items; $100,000 for buildings, building improvements, and improvements other than buildings; and $500,000 for infrastructure items with an estimated useful life greater than one year. Purchases of library books are capitalized. Renovations to buildings, infrastructure, and land improvements that increase the value by at least 25 percent are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expenses are incurred. Outlays for construction in progress are capitalized as incurred. Interest expense related to construction is capitalized net of interest income earned on the resources reserved for this purpose.

The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research, and public service. These collections are protected and preserved.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 2 to 15 years for equipment items, 15 years for library books, 10 to 50 years for buildings and their components, and 15 to 40 years for infrastructure elements.

Other Assets

Included in other current assets are prepaid expenses and lease receivables due within one year. Included in other noncurrent assets are prepaid expenses and lease receivables that will be realized beyond one year.

Deferred Revenue

Deferred revenue represents revenues collected but not earned as of August 31, such as tuition receipts from students received in August for the fall semester and payments received in advance for sponsored programs.

Funds Held for Others

Funds held for others represent funds held by the University as custodial or fiscal agent for students, faculty members, and others.

Liability to Trust and Income Beneficiaries

The University holds numerous irrevocable charitable remainder trusts and a pooled income fund. Together, these assets are reflected in the accompanying financial statements within restricted investments.

The charitable remainder trusts designate the System Board of Regents as both trustee and remainder beneficiary. Donors (or other donor-designated income beneficiaries) are paid either a fixed amount or the lesser of a fixed percentage of the fair value of the trusts' assets of the trusts' income during the beneficiaries' lives. Trust assets are measured at fair value when received and monthly thereafter. A corresponding liability to beneficiaries is measured at the present value of expected future cash flows to be paid to the beneficiaries based upon the applicable federal rate on the gift date. Upon the deaths of the income beneficiaries, substantially all of the principal balance passes to the University to be used in accordance with the donors' wishes.

The pooled income fund was formed with contributions from several donors. The contributed assets are invested and managed by UTIMCO. Donors (or designated beneficiaries) periodically receive, during their lives, a share of the income earned on the fund proportionate to the value of their contributions to the fund. Upon the deaths of the income beneficiaries, substantially all of the principal balance passes to the University to be used in accordance with the donors' wishes. Contribution revenue is measured at the fair value of the assets received, discounted for a term equal to the life expectancies of the beneficiaries.

Net Assets

The University has classified resources into the following three net asset categories:

Invested in Capital Assets, Net of Related Debt
Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted:

> *Nonexpendable*
> Net assets subject to externally imposed stipulations that require the amounts to be maintained in perpetuity by the University or the System. Such assets include the University's permanent endowment funds.
>
> *Expendable*
> Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire with the passage of time.

Unrestricted
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for special purposes by action of management or the System

Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic and research programs and initiatives and for capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation. Generally, the University's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.

Revenues & Expenses

Operating revenues include activities such as student tuition and fees, net of scholarship allowances; sales and services; most federal, state, and local grants and contracts and federal appropriations; and interest on student loans. Operating expenses include salaries and wages, payroll related costs, materials and supplies, depreciation, scholarships and fellowships, and impairment losses and insurance recoveries received in the same year as the associated loss in accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

Nonoperating revenues include activities such as gifts, contributions, State appropriations, investment income, and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities that Use Proprietary Fund Accounting*, GASB Statement No. 34, and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Nonoperating expenses include activities such as interest expense on capital asset financing and other expenses that are defined as nonoperating expenses by GASB Statement Nos. 9, 34 and 42.

Scholarship Allowances and Student Aid

Financial aid to students is reported in the financial statements as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid (student loans, funds provided to students as awarded by third parties, and Federal Direct Lending) is accounted for as third-party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expenses or scholarship allowances, which reduce revenues. The amount reported as operating expenses represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed on an entity-wide basis by allocating cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third-party aid.

Charity Care

The University provides charity care to patients who meet certain criteria under their charity care policies without charge or at amounts less than its established rates. Because the University does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care charges amounted to approximately $86,314,112 and $101,866,765 for 2007 and 2006, respectively.

Net Patient Service Revenue

The University has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the University under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. The University recognized bad debt expense of $3,849,941 and $6,267,020 in 2007 and 2006, respectively.

Use of Estimates

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

Blended Component Unit

The following component unit is included in the consolidated financial statements because the University appoints a voting majority of the component unit's board and the University is able to impose its will on the component unit. Blended financial information is available upon request.

UT Medicine, 6126 Wurzbach Road, San Antonio, Texas 78238, is governed by a twenty-five member board appointed by the University. The corporation's fiscal year end is August 31.

Note 2: Capital Assets

A summary of changes in capital assets is shown below:

	Beginning Balance	Completed CIP	Additions	Deletions	Ending Balance
Nondepreciable Assets:					
Land & Land Improvements	$ 22,628,168	$ -	$ 4,650,000	$ -	$ 27,278,168
Construction in Progress	14,959,705	(13,634,490)	43,344,981	-	44,670,196
Other Capital Assets	53,842	-	-	-	53,842
Total Nondepreciable Assets	$ 37,641,715	$ (13,634,490)	$ 47,994,981	$ -	$ 72,002,206
Depreciable Assets:					
Buildings & Building Improvements	$ 354,697,795	$ 13,527,429	$ 6,645,853	$ -	$ 374,871,077
Facilities and Other Improvements	2,659,660	107,061	-	-	2,766,721
Furniture and Equipment	117,539,254	-	9,619,391	(6,550,215)	120,608,430
Vehicles, Boats and Aircraft	1,762,257	-	159,451	(218,977)	1,702,731
Other Capital Assets (Including Library Books)	19,420,046	-	146,359	(106,337)	19,460,068
Total Depreciable Assets at Historical Cost	$ 496,079,012	$ 13,634,490	$ 16,571,054	$ (6,875,529)	$ 519,409,027
Less accumulated depreciation for:					
Buildings and Building Improvements	$ (166,760,209)	$ -	$ (12,739,156)	$ -	$ (179,499,365)
Facilities and Other Improvements	(1,401,669)	-	(131,919)	-	(1,533,588)
Furniture and Equipment	(78,363,437)	-	(8,940,884)	5,247,323	(82,056,998)
Vehicles, Boats and Aircraft	(1,377,519)	-	(123,668)	216,823	(1,284,364)
Other Capital Assets (Including Library Books)	$ (12,824,104)	$ -	$ (869,234)	$ 106,337	$ (13,587,001)
Total accumulated depreciation	$ (260,726,938)	$ -	$ (22,804,861)	$ 5,570,483	$ (277,961,316)
Depreciable Assets, net	$ 235,352,074	$ 13,634,490	$ (6,233,807)	$ (1,305,046)	$ 241,447,711
Capital Assets, net	$ 272,993,789	$ -	$ 41,761,174	$ (1,305,046)	$ 313,449,917

Note 3: Deposits, Investments, and Repurchase Agreements

Deposits

University bank information as of August 31, 2007, is presented below:

Carrying Amount	Bank Balance
$4,660,574	$1,787,396

Cash Deposits	$ 4,660,574
Cash in State Treasury	31,626,878
Cash Equivalents	37,359,648
Total Cash and Cash Equivalents	73,647,100
Current Assets Cash and Cash Equivalents	$35,277,371
Current Assets Restricted Cash and Cash Equivalents	38,369,729
Total Cash and Cash Equivalents	$73,647,100

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System maintains depository relationships with various banking institutions. The System's policy is that all deposits are governed by a bank depository agreement between the System and the respective banking institution. This agreement provides that the System's deposits, to the extent such deposits exceed the maximum insured limit under deposit insurance provided by the Federal Deposit Insurance Corporation, shall at all times be collateralized with either government securities or a surety bond issued by an insurer rated "AAA" or its equivalent by a nationally recognized rating organization or a combination thereof.

Investments

At the direction of the System Board of Regents, University investments and cash equivalents are pooled at the System level in internal investment pools. The System is responsible for disclosure of all information on the pooled investments and has included these disclosures in its annual financial report. As of August 31, 2007, this fair value of the University's share of investments is presented below:

Investments Held by System in:	
Intermediate Term Fund	$196,080,876
General Endowment Fund	139,011,865
Permanent Health Fund	268,306,200
Total Investments	$603,398,941

Noncurrent Assets Investments	$115,727,307
Noncurrent Assets Restricted Investments	487,671,634
Total Investments	$603,398,941

(A) *Credit Risk* - Article VII, Section 11b of the Texas Constitution authorizes the UT System Board of Regents, subject to procedures and restrictions it establishes, to invest System funds in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System's investment policies limit investments in U.S. Domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, Baa3 or better by Moody's Investor Services, BBB- or better by Standard & Poor's Corporation, or BBB- or better by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment grade bonds. Per GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

(B) *Concentrations of Credit Risk* – The System's investment policy statements contain the limitation that no more than 5% of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer. As of August 31, 2007, the System did not hold any direct investments in any one issuer that represents five percent or more of total investments.

(C) *Custodial Credit Risk* – Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the System's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. As of August 31, 2007, the

System did not have any deposits or investments that are exposed to custodial credit risk.

(D) *Interest Rate Risk* – Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. Interest rate risk inherent in the System investments is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the System's investments to changes in interest rates. The System has no specific policy statement limitations with respect to its overall modified duration.

(E) *Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes* – In accordance with the System's investment policy statements, the System may invest in various mortgage backed securities, such as collateralized mortgage backed obligations. The System also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds and stripped Treasury and Agency securities created from coupon securities. As of August 31, 2007, the System's investments included the following investments that are highly sensitive to interest rate changes:

- Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Mortgage backed securities which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities.

- Asset backed securities which are backed by home equity loans, auto loans, equipment loans and credit card receivables. Prepayments by the obligees of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received.

- Step-up notes that grant the issuer the option to call the note on certain specific dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at the inception of the note. The call feature embedded within a step-up note causes the fair value of the instrument to be considered highly sensitive to interest rate charges.

(F) *Foreign Currency Risk* – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the System's non-U.S. dollar investments. The System's investment policy statement limits investments in non-U.S. denominated bonds to 50% of the System's total fixed income exposure.

Securities Lending

In accordance with the prudent investor investment standards, the System participates in a securities lending program. The System began the program, under a contract with the System's lending agent, on September 1, 1995. The lending agent is authorized to lend any securities held by the System's custodian except those securities which the policy guidelines prohibits lending. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In security lending transactions, the System transfers its securities to brokers/dealers for collateral, which may be cash, securities issued or guaranteed by the United States government or its agencies, and irrevocable bank letters of credit, and simultaneously agrees to return the collateral for the same securities in the future.

Cash collateral received by the lending agent on behalf of the System is invested and reinvested in a non-commingled pool exclusively for the benefit of the System. The pool is managed in accordance with investment guidelines established by the System and is stated in the security lending contract. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent. On August 31, 2007, the System was collateralized 102 percent for securities on loan collateralized by cash.

Collateral pool investments are uninsured, and are held by the securities lending agent, in its name, on behalf of the System, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the System or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties' trust department or agent.

Lending income is earned if the returns on those investments exceed the "rebate" paid to borrowers of the securities. The income is then shared with the lending agent based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from the System's resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a "loan premium or fee" for the securities loan. This income is split with the same ratio as the earnings for cash collateral. The collateral pledged to the System by the borrower is custodied by the lending agent or through a third party arrangement. These securities held as collateral are not available to the System for selling or pledging unless the borrower is in default of the loan. On August 31, 2007, the System was collateralized 102 percent for securities on loan which were collateralized by securities. On August 31, 2006, the System was collateralized 103 percent for securities on loan which were collateralized by securities.

The collateral received must have a fair value of 102 percent of the loaned securities of United States issuers. If the fair value of the collateral held in connection with loans of securities of United States issuers is less than 100 percent at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102 percent of the fair value.

For non-United States issuers, the collateral should remain at 105 percent of the fair value of the loaned securities at the close of any business day. If it falls below 105 percent, the borrower must deliver additional collateral by the close of the following business day. On August 31, 2007 and 2006, the System was collateralized 105 percent for international loans.

In the event of default, where the borrower is unable to return the securities loaned, the System has authorized the lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the lending agent has indemnified the System from any loss due to borrower default.

At August 31, 2007 and 2006, the System had no credit risk exposure to borrowers because the amounts the System owed to borrowers exceeded the amounts the borrowers owed the System.

There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses and no recoveries of prior period losses during the year.

Derivative Financial Instruments

Derivatives are financial instruments (securities or contracts) whose value is linked to, or "derived" from, changes in interest rates, currency rates and stock and commodity prices. Derivatives cover a broad range of financial instruments, such as forwards, futures, options, swaps and mortgage derivatives.

(A) *Mortgage Derivatives* – Mortgage derivatives are used to manage portfolio duration and to enhance portfolio yield and are influenced by changes in interest rates, the current economic climate and the geographic make-up of underlying mortgage loans. There are varying degrees of risk associated with mortgage derivatives. For example, certain Collateralized Mortgage Obligations (CMOs) such as Planned Amortization Class (PACs) are considered a more conservative lower risk investment. In contrast, principal only and interest only strips are considered higher risk investments. The System's investment in CMOs at August 31, 2007 was comprised almost exclusively of the lower risk investment class.

(B) *Futures Contracts* – Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. The net liability is included in payables from restricted assets. Futures contracts are marked to market daily; that is, they are valued at the close of business each day and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss difference is referred to as the daily variation margin, which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The System executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the manager's various trading and credit monitoring techniques.

(C) *Foreign Currency Exchange Contracts* – The System enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward currency contract, the System agrees to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the System's net equity therein, representing unrealized gain or loss on the contracts, as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date, is included in other receivables. Realized and unrealized gains and losses are included in the consolidated statement of revenues, expenses and changes in net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the consolidated balance sheet. Risks arise from the possible inability of counter-parties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(D) *Written Options* – Written options are used to alter the market (systematic) exposure without trading the underlying cash market securities, and to hedge and control risks, so that the actual risk/return profile is more closely aligned with the target risk/return profile.

(E) *Swaps* – Swaps are used to adjust interest rate and yield curve exposures. During the year, the System entered into interest rate, inflation, credit default, total return and commodity swap contracts. They are included in other receivables and payables from restricted assets.

(F) *Investment Funds* – The System's investment funds include exchange traded funds, index funds, Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures, which are generally unrated and may be unregulated.

Marketable alternatives investment pools are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private market funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments, domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk and investment manager risk.

Public market funds are invested in exchange traded funds, index funds and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the funds. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are investment manager risk, market risk and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market and public market funds include investments in private placement vehicles that are subject to risk, which could result in the loss of invested capital. The risks include the following:

- *Non-regulation risk* – Some of these funds are not registered with the Securities and Exchange Commission, and therefore are not subject to regulatory controls.
- *Key personnel risk* – The success of certain funds is substantially dependent upon key investment managers and the loss of those individuals may adversely impact the fund's performance.
- *Liquidity risk* – Many of the System's investment funds may impose lock-up periods, which would cause the System to incur penalties to redeem its units or prevent the System from redeeming its shares until a certain period of time has elapsed.
- *Limited transparency* – As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
- *Investment strategy risk* – These funds often employ sophisticated investment strategies and may use leverage, which could result in the loss of invested capital.

(G) *Securities Sold Short* – The System may sell securities it does not own in anticipation of a decline in the fair value of that security or as means to adjust the duration of certain fixed income portfolios. When the System sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The securities sold short as of August 31, 2007, are commitments to sell U.S. Treasury securities that do not require cash deposit. The System must pay dividends or interest on the securities sold short. Until the System covers it shorts sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold short at prices, which may be significantly higher than the market value reflected in the statements of fiduciary net assets.

Note 4: Short-Term Debt

The University had no short-term debt outstanding at any time during the year ended August 31, 2007.

Note 5: Summary of Long-Term Liabilities

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Notes and loans payable	$ 1,952,321	$ 12,366,447	$ 1,069,135	$ 13,249,633	$ 1,310,769
Compensated absences	30,542,722	5,649,494	2,892,643	33,299,573	15,954,551
Assets held for others	376,704	66,099	58,641	384,162	94,055
Long-term liabilities	$ 32,871,747	$ 18,082,040	$ 4,020,419	$ 46,933,368	$ 17,359,375

Employees' Compensable Leave

Employees' Compensable Leave Balances represent the liability that becomes "due" upon the occurrence of relevant events such as resignations, retirements, and uses of leave balances by covered employees. Liabilities are reported separately as either current or non-current in the statement of net assets. These obligations are normally paid from the same funding source from which each employee's salary or wage compensation was paid.

Substantially all full-time University employees earn annual leave in the amount of 8 to 21 hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum of 532 hours for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or

336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements because experience indicates that the expense for sick leave will be minimal. Eligible part-time employees' sick leave accrual rate is proportional to the number of hours appointed to work.

Notes Payable includes:

- Note or loan payable issue name: University Hospital
  Purpose: Reimburse University Hospital for clinical practice expenses under terms of a mediator-negotiated contractual settlement
  Institution: UT Health Science Center at San Antonio
  Issue Date: April 1, 2001
  Authorized Amount: $2,862,717
  Source of revenue for debt service: Patient service revenue from MSRDP Designated funds collected by UT Medicine San Antonio
  Terms: January 1, 2002 through January 1, 2009. Interest is computed at five percent (5%) annually.

- Note or loan payable issue name: Frost Bank
  Purpose: Remodel/renovation-UPG Administrative Service Building
  Institution: UT Health Science Center at San Antonio
  Issue Date: January 31, 2004
  Authorized Amount: $1,334,799
  Source of revenue for debt service: Patient service revenue from MSRDP Designated funds collected by UT Medicine San Antonio
  Terms: January 31, 2004 through November 7, 2008

- Note or loan payable issue name: City of Shavano Park Health Facilities Development Corporation
  Purpose: Purchase EPIC Patient and Sales Tracking Software Package
  Institution: UT Health Science Center at San Antonio
  Issue Date: December 1, 2006
  Authorized Amount: $9,000,000.00
  Source of revenue for debt service: Patient service from MSRDP Designated Funds collected by UT Medicine San Antonio
  Terms: February 1, 2007 through January 1, 2018. Interest is computed at 4.13% annually.

- Note or loan payable issue name: City of Shavano Park Health Facilities Development Corporation
  Purpose: Purchase EPIC Patient and Sales Tracking Software Package
  Institution: UT Health Science Center at San Antonio
  Issue Date: January 1, 2007
  Authorized Amount: $3,000,000.00

Source of revenue for debt service: Patient service from MSRDP Designated Funds collected by UT Medicine San Antonio
Terms: February 1, 2007 through January 1, 2018. Interest is computed at 4.15% annually.

Notes payable are due in annual installments through 2007. General information related to notes payable at August 31, 2007, which in substance are not bonds, is summarized as follows:

Fiscal Year	Principal	Interest	Total
2008	$ 1,310,769	$ 555,111	$ 1,865,880
2009	1,520,898	481,827	2,002,725
2010	1,054,611	416,676	1,471,287
2011	1,099,680	371,606	1,471,286
2012	1,145,784	325,503	1,471,287
2013 – 2017	6,511,257	845,175	7,356,432
2018 – 2022	606,634	6,411	613,045
Total Requirements	$ 13,249,633	$ 3,002,309	$ 16,251,942

Note 6: Bonded Indebtedness

The University receives proceeds from revenue bonds issued and held by the System to support capital projects of the System and its institutions. These proceeds are recorded as transfers from the System. The University disburses funds to the System for payments of principal and interest related to the University's share of bond proceeds. These disbursements are recorded as transfers to the System. At August 31, 2007, the System had outstanding bonds payable of $3,513,359,000. All bonds issued by the System are defined as revenue bonds. As such, the revenues of the System, including the University, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures' lack of specifically identifiable activities and separate accounting requirements imposed by an external party.

No amount of indebtedness related to these bonds has been recorded in the University's financial statements as the System is the party directly liable for these bonds. At August 31, 2007, however, the University's remaining unpaid share of the bond proceeds was $190,617,000.

Note 7: Capital Leases

The University had no capital leases at August 31, 2007.

Note 8: Operating Lease Obligations

The University has entered into various operating leases for buildings, equipment and land. Rental expenses for operating leases were $1,475,869 in 2007. Future minimum lease rental payments under noncancellable operating leases having an initial term in excess of one year as of August 31, 2007, were as follows:

Fiscal Year		Lease Payments
2008	$	1,771,213
2009		887,929
2010		610,721
2011		200,557
2012		24,749
2013 – 2017		51,840
Total Minimum Future Payments	$	3,547,009

Note 9: Interagency Balances / Activity

The University has numerous transactions with other components of the System and with other agencies of the State of Texas. At year-end, amounts to be received or paid are reported as Due from Other Entities or Due to Other Entities.

Agency	Due from Other Entities	Due to Other Entities	Purpose
The University of Texas System Administration	$ 101,032		University president's deferred compensation
The University of Texas System Administration	2,646,812		Tobacco Funding Investment Income - Regional Academic Health Center (RAHC)
The University of Texas System Administration	872,424		Tobacco Funding Investment Income - Permanent Health Fund (PHF)
The University of Texas System Administration	24,483		4th quarter Separately Invested Assets (SIA) Income
The University of Texas System Administration	1,400,422		Miscellaneous Assets held for Resale
The University of Texas System Administration	86,498,155		Bond funding for qualified reimbursable construction expenditures.
The University of Texas System Administration		$ 3,091,211	Payroll related costs for August 2007 payroll
Totals	**$91,543,328**	**$3,091,211**	

Interagency transfers made during the fiscal year are presented below:

Agency	Transfers in from Other Entities	Transfers out to Other Entities	Purpose
The University of Texas System Administration		$11,874,641	Debt Service Payment (mandatory)
The University of Texas System Administration	$94,202,517		For capital projects
The University of Texas System Administration	598,791		Tobacco - RAHC interest transfer
The University of Texas System Administration	159,303		Workers Compensation Insurance (WCI) Resource Allocation Program
The University of Texas System Administration	878,619		Distribution of various awards
The University of Texas System Administration		162,274	Tuition Set-asides
The University of Texas System Administration		46,897	Transfer of capital assets net of depreciation
Totals	**$95,839,230**	**$12,083,812**	

Note 10: Contingent Liabilities

As of August 31, 2007, the University was not aware of any significant contingent liabilities.

Note 11: Risk Financing and Related Insurance

All risk financing and related insurance for the University is part of coverage provided by the System. The System has seven funded self-insurance plans providing coverage in the following areas: employee health and dental, unemployment compensation, workers' compensation, medical professional liability, property protection, directors and officers/employment practices liability, and construction contractor insurance.

Employee and Retiree Insurance Benefits

The UT System Employee Benefits program provides health insurance, dental insurance, vision insurance, life insurance, long-term disability, short-term disability, long-term care and flexible spending account coverage to all benefits-eligible employees and retirees of the System and its fifteen institutions. These insurance benefits are provided through both self-funded and fully-insured arrangements. A portion of the System's cost of providing group health and basic life insurance coverage is paid by the State as specified in the General Appropriations Act. The System's Office of Employee Benefits (OEB) is responsible for the overall administration of the insurance plans. OEB was established by Chapter 1601 (formerly Article 3.50-3) of the *Texas Insurance Code* and complies with State laws and statutes pertinent to employee benefits for the System.

Effective January 1, 2006, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 established prescription drug coverage for Medicare beneficiaries under Medicare Part D. Medicare Part D provides sponsors of postemployment healthcare plans up to 28 percent of the amount of eligible prescription drug benefit costs of retirees who are eligible for, but not enrolled in, Medicare Part D, if the sponsor's plan provides a prescription drug benefit that is actuarially equivalent to the Medicare Part D benefit.

Unemployment Compensation Insurance

The General Appropriations Act requires the System to reimburse the Texas Workforce Commission (TWC) for 50 percent of the unemployment benefits paid to former employees that were paid from general revenue funds. The System reimburses the TWC 100 percent of the unemployment benefits paid to former employees that were paid from local funds.

Workers' Compensation Insurance

The University of Texas System Workers' Compensation Insurance (WCI) program provides coverage to all employees of the System and its fifteen institutions. Under the oversight of the System's Office of Risk Management (ORM), the System self-insures and administers the program. The WCI staff is responsible for administering all aspects of the system-wide program, which provides income and medical benefits to all employees who have sustained job-related injuries or occupational diseases. The program's statutory authority is embodied in Chapter 503 of the *Texas Labor Code.*

Professional Medical Liability Benefit Plan

The coverage provided under the Professional Medical Liability Benefit Plan (Plan) is on an occurrence basis; thus, a participant is covered by the Plan for claims and lawsuits relating to events that occurred while enrolled in the Plan, including those filed after the participant has left the System's employment or training. The Plan covers all of the System staff physicians, dentists, residents, fellows, and medical students who have been enrolled. The limits of liability of the Plan include an annual policy aggregate of $30,000,000, an annual aggregate of $1,500,000 for each staff physician ($500,000 per claim), an annual aggregate of $300,000 for each resident or fellow ($100,000 per claim) and a $75,000 annual aggregate for each medical student ($25,000 per claim). Other coverage is available for medical student externships outside of Texas and for approved international activities.

Liability is limited to $2,000,000 per incident, regardless of the number of claimants or physicians involved in an incident. As of September 1, 2003, the limits of liability are prescribed by law as $100,000 per claim per physician. Also effective September 1, 2003, UT institutions are covered under the Plan for actions that could have been brought against an individual plan participant. The liability of a UT institution is limited by law to $250,000 per claimant and $500,000 per occurrence for bodily injury or death.

Comprehensive Property Protection Program

The property protection plan consists of two programs. The first covers fire and other perils and includes commercial coverage for claims exceeding a per occurrence deductible of $7.5 million or an annual aggregate deductible of $20 million. The policy covers all UT System buildings, personal property and business income reported by the institutions. The maximum reimbursement under this policy is $1 billion per occurrence.

The second program provides coverage for physical damage resulting from Named Windstorms and catastrophic flood losses up to $50 million. Insurance policies providing underlying limits ($1-2 million per building and contents) are purchased through the Texas Windstorm Insurance Association and the National Flood Insurance Program on several facilities in the Tier 1 wind zone and other flood prone areas to provide a primary layer of insurance. The self-insurance component of the program participates in losses that exceed the coverage available under these primary policies or in cases where there is no underlying insurance.

To fund the self-insurance portion of both property programs, the institutions make annual contributions to the loss reserve funds in addition to paying insurance premiums.

Directors and Officers/Employment Practices Liability Self-Insurance Plan

The Directors and Officers Liability (D&O) and Employment Practices Liability (EPL) Self-insurance Plan (the "Plan") provides coverage for claims arising from actual or alleged wrongful acts performed by the plan beneficiaries. The plan also provides coverage for EPL claims, such as wrongful termination, failure to promote and wrongful discipline. In 2003, the UT System Board of Regents allocated $3.7 million from the Available University Fund to establish the D&O/EPL loss reserve fund. Institutions make annual premium contributions to this fund.

Coverage applies to individual board members, employees, faculty, etc., as well as to the System itself. The limit of liability is a $10 million annual aggregate (Coverages A, B and C combined), except for $5 million annual aggregate sublimit for Coverage C. Coverage A applies to individuals and it has no deductible. Coverage B applies to a UT institution that is required to indemnify a covered individual with deductibles of $100,000 per individual and $300,000 per occurrence. Coverage C applies to a UT institution and related entities with a $300,000 deductible. An excess coverage commercial insurance policy provides $10 million of excess coverage after the Plan's liability limits have been exhausted.

Rolling Owner Controlled Insurance Program

The Rolling Owner Controlled Insurance Program (ROCIP) was established for the centralized purchase of construction contractor insurance on various capital projects. This program provides workers' compensation and general liability insurance for all contractors enrolled on projects participating in the program. The insurance carries a

$250,000 per occurrence basket deductible, which is paid through the program's self-insurance fund.

Incurred But Not Reported Self-Insurance Claims

Insurance claims that were Incurred But Not Reported (IBNR) were actuarially determined for the employee's health and dental, workers' compensation, professional medical liability, directors and officers/employment practices liability, and rolling owner controlled self-insurance plans. IBNR figures for the workers' compensation, professional medical liability, directors and officers/employment practices liability, and rolling owner controlled self-insurance plans include liabilities for unpaid reported claims and are reported on an undiscounted basis. The IBNR liability for the property protection self-insurance plan is not actuarially determined but rather estimated based on unpaid reported claims. Since an annual accrual is recorded for the third quarter TWC billing, no IBNR liability is recorded for Unemployment Compensation Insurance. No settlements exceeded insurance coverage in the past three fiscal years.

Note 12: Subsequent Events

Subsequent to the end of the 2007 fiscal year, the University assumed responsibility for the operation of the Cancer Therapy and Research Center (CTRC), a 501(c)(3) non-profit corporation. In the merger of the two entities, the University acquired possession of the real and personal property of CTRC, paying off the long-term real estate indebtedness of CTRC at a cost of $13,836,725.92. The purchase will be financed with the issuance of RFS debt. Net property and equipment acquired in the combination is valued at $55,289,856 as of September 30, 2007.

In the combination of the two entities, the CTRC Board of Directors also agreed to make a three-year, $24 million gift of cash to the University. The purpose if the gift is to help fund CTRC operations for the next three years.

The CTRC Board of Directors remains in existence and maintains custody of the CTRC Foundation endowment, valued at $71,271,844 as of September 30, 2007. The board manages these assets for the sole purpose of supporting the operations and mission of the CTRC.

In the combination UTHSCSA acquires ground leases of about 49 acres and five buildings totaling 316,000 gross square feet. Approximately 350-400 CTRC employees engaged in the direct delivery and administration of cancer related research and patient care are converted to University employees effective 12/17/2007.

Real estate acquired in the combination is as follows:

> CTRC's ground lease interest in approximately 14 acres located at 7979 Wurzbach Road, San Antonio, Bexar County, Texas, and the

approximately 260,000 square feet of improvements constructed by CTRC on the ground lease tract.

Approximately 20.65 acres at 14960 and 14980 Omicron Drive, Bexar County, Texas, and the approximately 56,000 square feet of improvements located at 14960 Omicron Drive.

Note 13: Related Parties

Through the normal course of operations, the University both receives funds from and provides funds to other State agencies in support of sponsored research programs. Funds received and provided during the year ended August 31, 2007, related to pass-through grants were $1,125,937 and $-0- respectively. Funds received and provided during the year ended August 31, 2006, related to pass-through grants were $1,565,683 and $-0- respectively.

Other related-party transactions identified in the financial statements include Due From/To Other State Agencies, State Appropriations, Capital Appropriations and Transfers From/To Other State Agencies.

Note 14: Stewardship, Compliance and Accountability

The University had no significant violations of bond or note covenants. Per State law, the University cannot spend amounts in excess of appropriations granted by the Texas Legislature. There are no deficits reported in net assets.

Note 15: The Financial Reporting Entity

As required by Generally Accepted Accounting Principles, the financial statements present the University and its component units. The component units discussed in this note are included in the University's reporting entity because of the significance of their operational or financial relationships with the University.

Individual Component Unit Disclosures
Blended Component Unit. A twenty-two member board appointed by the University governs the University's 501(a) non-profit corporation, UT Medicine San Antonio. Although it is legally separate from the University, UT Medicine San Antonio is reported as if it were part of the University because its sole purpose is to provide practice management services to the University and the University is able to impose its will on the component unit.

The clinical activities of the University's School of Medicine faculty are administered through UT Medicine San Antonio in accordance with an Operating Agreement. Under this Agreement, UT Medicine San Antonio acts as the agent for University-employed faculty in the provision of practice management services. UT Medicine San Antonio is a Texas Not-for-profit Health Corporation ("501(a)") and a Federal

Tax-exempt 501(c)(3) corporation. Under Texas CNPHC corporation rules, the UT Medicine San Antonio governing board must be comprised of licensed physicians. The 22-member UT Medicine San Antonio Board of Directors includes the 16 clinical department Chairs and six at-large physician faculty members. The University Dean of the School of Medicine is ex-officio Chairman of the UT Medicine San Antonio Board. UT Medicine San Antonio sole corporate Member is the University's President, ex-officio. The corporation's fiscal year end is August 31.

Blended financial information is available upon request to the component unit:

UT Medicine
6126 Wurzbach Road
San Antonio, Texas 78238

Note 16: Restatements of Net Assets

The University had no restatements of net assets for the year ended August 31, 2007.

Note 17: Employee Retirement Plans

The State of Texas has joint contributory retirement plans for substantially all of its employees. One of the primary plans in which the University participates is administered by the Teacher Retirement System of Texas (Retirement System). The contributory percentages currently provided by the State and by each participant are 6.0 percent and 6.4 percent, respectively, of annual compensation.

The Retirement System does not separately account for each of its component government agencies because the Retirement System itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. Further information regarding actuarial assumptions and conclusions, together with audited financial statements, are included in the Retirement System's annual financial report, which may be found on the TRS website at www.trs.state.tx.us.

The State has also established an Optional Retirement Program for institutions of higher education. Participation in the Optional Retirement Program is in lieu of participation in the Retirement System. The Optional Retirement Program provides for the purchase of annuity contracts and mutual funds. The contributory percentages of participant salaries provided by the State and by each participant enrolled in the plan on or before August 31, 1995, are 8.5 percent and 6.65 percent, respectively. The 8.5 percent is composed of 6.0 percent contributed by the State and an additional 2.5 percent contributed by the University. For participants who enrolled after September 1, 1995, State and participant contributions are 6.0 percent and 6.65 percent, respectively. Because these are individual annuity contracts, the State has no additional or unfunded liability for this program, and the University bears no responsibility for retirement commitments beyond contributions.

The retirement expense to the University was $17,866,878 for the year ended August 31, 2007. Of this amount, $7,967,693 represents the portion of appropriations made by the State Legislature expended on behalf of the University and $9,899,185 represents the portion paid from the University's funds.

Note 18: Deferred Compensation Program

University employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. Deferred compensation plans are administered by the Employees Retirement System.

The State's 457 Plan complies with Internal Revenue Code, Section 457. This plan is referred to as the TexaSaver Deferred Compensation Plan and is available to all employees. Deductions, purchased investments, and earnings attributed to the 457 Plan are the property of the State and subject only to the claims of the State's general creditors. Participant rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the 457 account for each participant. The State has no liability under the 457 Plan, and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

The University also administers a Tax-Deferred Account Program, created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The Tax-Deferred Account Program is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be insurance companies, banks, or approved non-bank trustees such as mutual fund companies. The assets of this plan do not belong to the University, and thus it does not have a liability related to this plan.

Note 19: Donor Restricted Endowments

Net Asset Classification of Endowments		2007
Restricted, nonexpendable	$	276,192,542
Restricted, expendable:		
Net Appreciation		114,119,663
Funds Functioning as Endowments		6,600,546
Unrestricted:		
Funds Functioning as Endowments		8,265,164
Total	$	405,177,915

In the table above, amounts reported as "Net Appreciation" represent net appreciation on investments of donor or constitutionally restricted endowments that are available for authorization for expenditure by the UT System Board of Regents. For donor restricted endowments, pursuant to the Uniform Management of Institutional Funds Act, as adopted by Texas, the UT System Board of Regents may distribute net appreciation, realized and unrealized, in the fair market value of the assets of endowment holdings over the historic dollar value of the gifts, to the extent prudent. The System's policy is to retain all undistributed net realized and unrealized appreciation within the endowment funds. The System's endowment distribution policy is further discussed below.

Endowments and Similar Funds - State

These endowments are comprised of: the Permanent University Fund (PUF) and the Permanent Health Fund for Higher Education (PHF). The PUF was established for the benefit of the System and the Texas A&M University System. A portion of the PHF was established for the benefit of the System's health-related institutions, as well as for the Texas A&M University Health Science Center, the University of North Texas Health Science Center at Fort Worth, the Texas Tech University Health Science Center and Baylor College of Medicine.

The PUF was established by the Texas Constitution of 1876 through the appropriation of land grants. Amendments to the Constitution, approved by voters in 1999, were related to the investment of the PUF and the distributions from the PUF to the Available University Fund (AUF). The Constitution, as amended, is summarized as follows: (i) The UT System Board of Regents is held to a "prudent investor" rather than a "prudent person" standard; (ii) distributions to the AUF are made from the total return on all PUF investment assets; (iii) the UT System Board of Regents determines the amount of distributions to the AUF, which may not exceed an amount equal to seven percent of the average net fair value of investment assets, except as necessary to pay debt service on PUF bonds and notes; (iv) the UT System Board of Regents determines the amount of distributions to the AUF in a manner intended to provide the AUF with a stable and predictable stream of annual distributions and to maintain, over time, the purchasing power of PUF investments and annual distributions to the AUF; and (v) the expenses of managing PUF land and investments are paid by the PUF.

The UT System Board of Regents manages certain permanent funds for health-related institutions of higher education as more fully described in Chapter 63 of the Texas Education Code. Certain funds created by this statute were transferred to the UT System Board of Regents on August 30, 1999, to be managed and invested in the same manner as the UT System Board of Regents manages and invests other endowment funds. The PHF as defined in the statute is classified as Endowment and Similar Funds – State. These endowments provide support for programs that benefit medical research, health education or treatment at health-related institutions. The UT System Board of Regents determines the amount of distributions to support the programs based on the PHF's investment policy.

The investment policy provides that the annual payout will be adjusted by the average consumer price index of the previous twelve quarters. However, if this inflationary increase results in a distribution rate below 3.5%, the UTIMCO Board may recommend an increase in the distribution amount as long as such increase does not result in a distribution rate of more than 5.5%. If the distribution rate exceeds 5.5%, the board may recommend a reduction in the per unit distribution amount. Notwithstanding any of the forgoing provisions, the UT System Board of Regents may approve a per unit distribution amount that, in their judgment, would be more appropriate than the rate calculated by the policy provisions.

The General Endowment Fund (GEF), created March 1, 2001, is a pooled fund established for the collective investment of long-term funds under the control and management of the UT System Board of Regents. The GEF is organized as a pooled investment and has two participants, the PHF and the Long Term Fund (LTF). The PHF and LTF initially purchased units of the GEF on March 1, 2001, in exchange for the contribution of their investment assets. The GEF provides for greater diversification of investments than would be possible if each account were managed separately. As provided in the LTF investment policy, distributions from the LTF are determined in the same manner as the PHF described above.

Endowment and Similar Funds - Other than State

Funds subject to restrictions of endowment and trust instruments, requiring that the principal be maintained and that only the income be utilized. Funds may include Endowments, Term Endowments and Funds Functioning as Endowments. Funds Functioning as Endowments consist of amounts that have been internally dedicated by the System for long-term investment purposes. Funds with external donor restrictions are classified as Funds Functioning as Endowments – Restricted. If no external restriction exists, the funds are classified as Funds Functioning as Endowments – Unrestricted. Endowment and Term Endowment holdings may be invested in the LTF, or may be separately invested based upon the following three factors: (i) there are investment restrictions incorporated into the trust or endowment document; (ii) the inability to sell the gifted investment asset; or (iii) they are holdings being migrated upon liquidation into the LTF. Distributions are based upon the actual income received from the separately invested holdings.

Annuity and Life Income Funds

The Annuity Funds consist of funds donated to an institution on the condition that the institution pay a stipulated amount of the funds to the donor or designated individual for a specified time or until the time of death of the annuitant. The Life Income Funds consist of funds contributed to an institution subject to the requirement that the institution periodically pay the income earned on the assets, less management expenses, to designated beneficiaries.

Note 20: Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health and life insurance benefits for retired employees, in accordance with state statutes. Substantially all of the employees may become eligible for the health and life insurance benefits if they reach normal retirement age while working for the State. Currently, there are 1,156 retirees who are eligible for these benefits. Similar benefits for active employees are provided through a self-funded plan and fully insured plans. Depending upon the status of the employee at the time of retirement, the State or the System recognizes the cost of providing these benefits. The cost of retiree post-employment benefits is recognized when paid. This contribution paid all of the "employee/retiree only" premiums and a portion of the premiums for those employees/retirees selecting dependent coverage. The employee/retiree was required to pay a portion of the cost of dependent coverage. For the fiscal year ended August 31, 2007, the cost of providing those benefits for the retirees was $4,946,711 for the University.

Note 21: Special or Extraordinary Items

As of August 31, 2007, the University had no special or extraordinary items.

Note 22: Disaggregation of Receivable Balances

Net other receivables at August 31, 2007 are detailed by type as follows:

Net Other Receivables		**2007**
Receivables related to investments	$	49,390
Receivables related to healthcare		234,546
Receivables related to gifts, grants and sponsored programs		3,358,833
Receivables related to external parties/other companies		1,450,168
Receivables related to payroll		1,272
Receivables related to travel		9,422
Receivables related to loan funds and financial aid		14,290
Receivables related to other various activities		399,973
Total	$	5,517,894

Note 23: Termination Benefits

There were no nonroutine, widespread voluntary or involuntary termination arrangements that involved a substantial number of individual or group of employees meeting the criteria for liability recognition.

State Auditor's Office
John Keel, CPA
State Auditor

January 7, 2008

Dr. Francisco G. Cigarroa, President
The University of Texas Health Science Center at San Antonio
7703 Floyd Curl Drive
San Antonio, Texas 78229-3900

Subject: Management Letter Resulting from a Review of the University of Texas Health Science Center at San Antonio's Fiscal Year 2007 Financial Statements

Dear Dr. Cigarroa:

We offer this management letter in conjunction with our review of the financial statements of the University of Texas Health Science Center at San Antonio (Health Science Center) for the fiscal year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

We appreciate the assistance provided during this review by the management of the Health Science Center and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

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SAO Report No. 08-316

The University of Texas Medical Branch at Galveston

Financial Statements and Auditor's Review as of and for the year ended August 31, 2007

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John Keel, CPA
State Auditor

Auditor's Review Report

January 14, 2008

Dr. David L. Callender, President
The University of Texas Medical Branch at Galveston
301 University Boulevard
Galveston, Texas 77555-0129

Dear Dr. Callender:

We have reviewed the accompanying Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements of the University of Texas Medical Branch at Galveston (Medical Branch) as of and for the fiscal year ended August 31, 2007, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. The review was performed in accordance with the Southern Association of Colleges and Schools' (Southern Association) *Criteria for Accreditation*. All information included in these financial statements is the representation of management of the Medical Branch.

A review consists principally of inquiries of Medical Branch personnel and analytical procedures applied to financial data. A review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying statements were prepared to present the financial position, the changes in financial position, and the cash flows of the Medical Branch. These statements are prepared pursuant to criteria of the Southern Association for supplementary special reports by institutions in states that conduct statewide audits.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The Medical Branch has not presented a management's discussion and analysis section that the Governmental Accounting Standards Board has identified as required supplementary information that is not part of the basic financial statements. However, such required supplementary information for the University of Texas System (System) is presented in the System's consolidated annual financial report.

This report is intended for use by the Board of Regents of the System, management of the Medical Branch, and the Southern Association. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

John Keel, CPA
State Auditor

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SAO Report No. 08-317

The University of Texas Medical Branch at Galveston
Statement of Net Assets
As of August 31, 2007
(See Auditor's Review Report on page 1.)

ASSETS		
Current Assets		
Cash and Cash Equivalents	$	57,856,430
Restricted:		
Cash and Cash Equivalents		15,624,533
Legislative Appropriations		1,776,180
Receivables, Net of Allowances:		
Federal		8,422,347
Other Intergovernmental		2,519,129
Student Receivables		5,305,058
Patient Receivables		91,447,463
Interest and Dividends		940,887
Contributions Receivable		470,976
Other		8,357,262
Due from Other State Entities		17,491,479
Inventories		9,002,771
Loans and Contracts		720,941
Other Current Assets		7,767,393
Total Current Assets	$	227,702,849
Non-Current Assets		
Restricted:		
Investments	$	553,395,389
Loans and Contracts		6,201,989
Contributions Receivable		447,136
Investments		157,024,107
Capital Assets		
Non-Depreciable		156,607,295
Depreciable		1,130,474,848
Less: Accumulated Depreciation		(691,864,114)
Other Non-Current Assets		131,535
Total Non-Current Assets	$	1,312,418,185
Total Assets	$	1,540,121,034

The University of Texas Medical Branch at Galveston
Statement of Net Assets
As of August 31, 2007
(See Auditor's Review Report on page 1.)

LIABILITIES		
Current Liabilities		
Payables:		
Accounts	$	113,383,590
Due to Other State Entities		8,684,946
Deferred Revenue		45,156,514
Employees' Compensable Leave - Current Portion		53,923,185
Payable From Restricted Assets		8,965,741
Funds Held for Others		321,232
Total Current Liabilities	$	230,435,208
Non-Current Liabilities		
Employees' Compensable Leave	$	5,555,606
Liabilities to Beneficiary		2,767,515
Other Non-Current Liabilities		40,698
Total Non-Current Liabilities	$	8,363,819
Total Liabilities	$	238,799,027
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	$	595,218,028
Restricted for:		
Non-Expendable		
Permanent Funds, True Endowments, Annuities		277,314,559
Expendable		
Capital Projects		19,094,408
Funds Functioning as Endowments		19,725,654
Other		225,631,673
Unrestricted		164,337,685
Total Net Assets	$	1,301,322,007

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas Medical Branch at Galveston
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

OPERATING REVENUES		
Tuition and Fees - Pledged	$	15,861,423
Discounts and Allowances		(990,824)
Professional Fees - Pledged		327,882,084
Discounts and Allowances		(176,849,299)
Auxiliary Enterprises - Pledged		9,157,222
Sales and Services of Educational Activities		2,814,768
Sales and Services of Hospitals		1,585,852,605
Discounts and Allowances		(911,148,000)
Federal Sponsored Programs		120,454,458
State Sponsored Programs		34,164,292
Local Sponsored Programs		2,508,096
Private Sponsored Programs		70,903,626
Other Operating Revenues		12,837,347
Total Operating Revenues	$	1,093,447,798
OPERATING EXPENSES		
Cost of Goods Sold	$	68,022,131
Salaries and Wages		746,791,476
Payroll Related Costs		175,621,863
Professional Fees and Services		28,816,798
Travel		8,409,477
Materials and Supplies		116,964,903
Communications and Utilities		42,904,075
Repairs and Maintenance		32,226,826
Rentals and Leases		14,377,493
Printing and Reproduction		2,411,683
Depreciation and Amortization		57,123,625
Bad Debt Expense		6,544
Scholarships and Fellowships		4,693,860
Other Operating Expenses		134,606,570
Total Operating Expenses	$	1,432,977,324
Operating Income (Loss)	$	(339,529,526)

The University of Texas Medical Branch at Galveston
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

NONOPERATING REVENUES (EXPENSES)		
Legislative Appropriations	$	306,205,851
Gift Contributions for Operations		6,336,397
Net Investment Income		42,048,559
Net Increase (Decrease) in Fair Value of Investments		61,580,382
Gain (Loss) on Sale of Capital Assets		(820,902)
Other Nonoperating Revenues - Pledged		401,325
Other Nonoperating Expenses		(90,738)
Total Nonoperating Revenues (Expenses)	$	415,660,874
Income (Loss) Before Other Revenues, Expenses, Gains (Losses), and Transfers	$	76,131,348
OTHER REVENUES, EXPENSES, GAINS (LOSSES), AND TRANSFERS		
Gifts and Sponsored Programs for Capital Acquisitions	$	72,170,979
Additions to Permanent and Term Endowments		13,124,649
Transfers In Between Institutions, Other State Entities, & System Admin		119,608,938
Transfers Out Between Institutions, Other State Entities, & System Admin		(137,262,275)
Total Other Revenues, Expenses, Gains (Losses), and Transfers	$	67,642,291
CHANGE IN NET ASSETS	$	143,773,639
Net Assets, September 1, 2006	$	1,157,548,368
Restatements		
Net Assets, September 1, 2006, as Restated	$	1,157,548,368
NET ASSETS, August 31, 2007	$	1,301,322,007

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas Medical Branch at Galveston
Statement of Cash Flows
For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1.)

CASH FLOWS FROM OPERATING ACTIVITIES		
Proceeds from Tuition and Fees	$	15,971,721
Receipts from Patients and Customers		825,757,152
Proceeds from Sponsored Programs		242,107,229
Proceeds from Loan Programs		1,236,877
Proceeds from Auxiliaries		9,169,255
Proceeds from Other Revenues		13,483,668
Payments to Suppliers for Goods and Services		(445,976,348)
Payments to Employees for Salaries		(934,260,075)
Payments for Loans Provided		(1,026,237)
Net Cash Provided (Used) by Operating Activities	$	(273,536,758)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Proceeds from Legislative Appropriations	$	301,009,798
Proceeds from Operating Gifts		8,205,374
Proceeds from Private Gifts for Endowment and Annuity Life Purposes		13,124,648
Proceeds from Other Nonoperating Revenues		401,325
Payments/Receipts for Transfers to/from Oth. Agencies		(490,484)
Payments for Other Uses		(136,397)
Net Cash Provided (Used) by Non-Capital Financing Activities	$	322,114,264
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from Capital Debt Transferred from System	$	16,121,768
Proceeds from Capital Appropriations, Grants and Gifts		69,980,148
Proceeds from Sale of Capital Assets		167,694
Payments for Additions to Capital Assets		(122,892,785)
Mandatory Transfers to System for Capital Related Debt		(26,569,458)
Net Cash Provided (Used) by Capital and Related Financing Activities	$	(63,192,633)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales of Investments	$	9,502
Proceeds from Interest and Investment Income		41,949,591
Payments to Acquire Investments		(17,641,767)
Net Cash Provided (Used) by Investing Activities	$	24,317,326
Net Increase (Decrease) in Cash and Cash Equivalents	$	9,702,199
Cash and Cash Equivalents, September 1, 2006	$	63,778,764
Restatements		-
Cash and Cash Equivalents, September 1, 2006, as restated	$	63,778,764
Cash and Cash Equivalents, August 31, 2007	$	73,480,963

The University of Texas Medical Branch at Galveston
Statement of Cash Flows
For the Fiscal Year Ended August 31, 2007
(See Auditor's Review Report on page 1)

Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities

Operating Income (Loss)	$	(339,529,526)
Adjustments:		
Depreciation and Amortization	$	57,123,625
Bad Debt Expense		6,544
Changes in Assets and Liabilities:		
(Increase) Decrease in Receivables		5,369,017
(Increase) Decrease in Inventories		561,329
(Increase) Decrease in Loans and Contracts		210,640
(Increase) Decrease in Other Assets		81,696
Increase (Decrease) in Payables		(5,257,458)
Increase (Decrease) in Due to System		200,319
Increase (Decrease) in Deferred Revenue		5,628,701
Increase (Decrease) in Employees' Compensable Leave		106,539
Increase (Decrease) in Assets Held for Others		(1,754,168)
Increase (Decrease) in Other Liabilities		3,715,984
Total Adjustments	$	65,992,768
Net Cash Provided (Used) by Operating Activities	$	(273,536,758)
Non-Cash Transactions		
Net Increase (Decrease) in Fair Value of Investments	$	61,580,382
Miscellaneous Noncash Transactions		(876,397)

The accompanying Notes to the Financial Statements are an integral part of this statement.

The University of Texas Medical Branch at Galveston
Statement of Changes in Unrestricted Net Assets
For the Fiscal Year Ended August 31, 2007

	8/31/2007	8/31/2006	Difference
Reserved			
Encumbrances	$ 36,238,095	$ 39,210,357	$ (2,972,262)
Accounts Receivable	96,748,978	96,471,609	277,369
Inventories	9,002,770	9,564,378	(561,608)
Advanced Research / Advanced Technology Programs	-	168,016	(168,016)
Deposits	1,683,477	1,688,093	(4,616)
Prepaid Expenses	5,132,348	2,934,433	2,197,915
Imprest Funds	67,090	64,994	2,096
Travel Advances	35,101	18,365	16,736
Unreserved			
Allocated			
Future Operating Budgets	-	818,977	(818,977)
Funds Functioning as Endowment - Unrestricted	17,954,142	15,645,903	2,308,239
Practice Plan Minimum Operating Reserve of 90 days	40,126,556	26,788,273	13,338,283
Unallocated Unreserved - Patient Care Support	6,298,700	-	6,298,700
Unallocated	(48,949,572)	(45,459,903)	(3,489,669)
Total Unrestricted Net Assets	$ 164,337,685	$ 147,913,495	$ 16,424,190

Notes to the Financial Statements for the Fiscal Year Ended August 31, 2007

(See Auditor's Review Report on page 1.)

General Introduction

This report has been prepared for the use of the Southern Association of Colleges and Schools (Southern Association) in connection with the review of the University of Texas Medical Branch at Galveston (University) for accreditation purposes. This report includes a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Net Assets; a Statement of Cash Flows; and the related Notes to the Financial Statements. In accordance with Southern Association criteria, the report also includes a Statement of Changes in Unrestricted Net Assets, and a Management Letter describing issues noted in the review.

Reporting Entity

The University is a component of the University of Texas System (System) and an agency of the State of Texas. The System is reported as a business-type activity in the State of Texas *Comprehensive Annual Financial Report* and reflects compliance with applicable state statutes and GASB pronouncements. The State of Texas *Comprehensive Annual Financial Report* is audited by the Texas State Auditor's Office. The System is governed by a Board of Regents, composed of nine members who are appointed by the Governor and confirmed by the Senate. Terms are scheduled for six years each and staggered so that three members' terms will usually expire on February 1 of odd-numbered years. The University follows System's policies except where noted within this report.

The University was established in 1891 as the University of Texas Medical Department. The University has grown from one building, 23 students and 13 faculty members to a modern health science center with more than 70 major buildings, 2,422 students and over 1,300 faculty members. The 84-acre campus includes four schools, three institutes for advanced study, a major medical library, a network of hospitals and clinics that provide a full range of primary and specialized medical care, an affiliated Shriners Burns Hospital, and numerous research facilities.

Note 1: Summary of Significant Accounting Policies

Basis of Accounting

The University reports as a business-type activity because it is financed in part by fees charged to external parties for goods or services. The accompanying financial statements present the financial position and operations of the University using the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. Operating items are distinguished from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with ongoing operations. Operating expenses include the cost of goods and services, administrative expenses, and depreciation on capital assets.

Cash and Cash Equivalents

Short-term, highly liquid investments with maturities of three months or less when purchased are generally considered cash and cash equivalents. It is the System and University policy to exclude items that meet this definition if they are part of an investment pool, which has an investment horizon of one year or greater. Therefore, highly liquid investments that are part of the Intermediate Term Fund and the Long Term Fund are not considered cash and cash equivalents.

Additionally, Funds Functioning as Endowments invested in money market accounts are also excluded from Cash and Cash Equivalents as it is management's intent to invest these funds for more than one year. Cash held in the State Treasury for the Permanent University Fund (PUF), the Permanent Health Fund (PHF) are considered cash and cash equivalents. Other highly liquid investments of these major funds invested with custodians are not considered cash and cash equivalents according to the investment policies of the System.

Balance in State Appropriations

This item represents the balance of General Revenue funds at August 31 as calculated in the Texas State Comptroller's General Revenue Reconciliation.

Investments

Investments of the University are managed by the University of Texas Investment Management Company (UTIMCO), a private investment corporation that provides services entirely to the System. All investments are reported as noncurrent as these funds have an investment horizon extending beyond one year. The System's investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the System are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes, and internal pricing matrices.

Equity security market values are based on the New York Stock Exchange composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded (if a closing price is not available, the average of the last reported bid and ask price is used).

Private market investments and certain other equity securities are fair valued by management. The fair values of these investments are estimated by management using the partnership's capital account balance at the closest available reporting period, as communicated by the general partner, adjusted for contributions and withdrawals subsequent to the latest available reporting period as well as consideration of any other information, which has been provided by the partnership or other source. In rare cases the private market funds are valued at cost, but only when management feels this is the best approximation of value. The audited financial statements of the funds managed by UTIMCO may be found on UTIMCO's web site, and inquiries may be directed to UTIMCO via www.utimco.org.

The System is authorized to invest funds, as provided in Section 51.0031 of the Texas Education Code and the Constitution of the State of Texas, under prudent investor investment standards. Such investments include various fixed income and equity type securities. The investments of the System are governed by various investment policies approved by the UT System Board of Regents.

Endowments

The University's endowments are used to support operations, which require the simultaneous achievement of two contradictory objectives of generating a predictable stream of annual revenue at a rate at least equal to the average rate of inflation for current needs and of increasing the purchasing power of the funds (after annual distributions) at a rate at least equal to the average rate of inflation for future periods.

Funds are subject to restrictions of endowment and trust instruments, requiring that principal be maintained and that only the income be utilized. Funds may include endowments, term endowments, and funds functioning as endowments. Funds functioning as endowments consist of amounts that have been internally dedicated by the System for long-term investment purposes.

The Permanent Health Fund (PHF) is an internal UT System mutual fund for the pooled investment of state endowment funds for health-related institutions of higher education. The University of Texas System Board of Regents established the PHF in August 1999 with proceeds from state tobacco litigation. Distributions fund programs that benefit medical research, health education, or treatment programs. The PHF provides for greater diversification of investments than would be possible if each account were managed separately.

Contributions Receivable

Current and noncurrent contributions receivable are amounts pledged to the University by donors, net of allowances.

Inventories

Inventories, consisting primarily of supplies and merchandise for resale, are valued at cost, typically based on the specific identification, weighted average or first-in, first-out methods, which are not in excess of net realizable value.

Restricted Assets

Restricted assets include funds restricted by legal or contractual requirements, including those related to sponsored programs, donors, constitutional restrictions, and loan agreements.

Loans and Contracts

Current and noncurrent loans and contracts are receivables, net of allowances, related to student loans.

Capital Assets

Capital assets are recorded at cost at the date of acquisition or fair value at the date of donation in the case of gifts. The University follows the Centers for Medicare and Medicaid Provider Reimbursement Manual (PRM), Section 108.1, which establishes the capital threshold for all capital assets at $5,000. The University capitalizes all real property assets in compliance with PRM Section 108.1. Following PRM Section 108.1 versus the Texas Comptroller of Public Accounts' (Comptroller) capitalization policy was approved by the Comptroller's Executive Director of Cost Reimbursements on December 2, 2004.

Purchases of library books are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred. Outlays for construction in progress are capitalized as incurred. Interest expense related to construction is capitalized net of interest income earned on the resources reserved for this purpose. The University capitalizes, but does not depreciate works of art and historical treasures that are held for exhibition, education, research and public service. These collections are protected and preserved.

The University follows the American Hospital Association guidelines for depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally two to fifteen years for equipment items, fifteen years for library books, ten to fifty years for buildings and their components and fifteen to forty years for infrastructure elements.

Other Assets

Included in other current assets are prepaid expenses due within one year. Included in the other noncurrent assets are prepaid expenses that will be realized beyond one year.

Deferred Revenue

Deferred revenue represents revenues collected but not earned as of August 31 such as tuition recorded in August for the fall semester and payments received in advance for sponsored programs.

Funds Held for Others

Funds held for others represent funds held by the University as custodial or fiscal agent for students, faculty members, foundations, and others. University funds held for others as of August 31, 2007 totaled $321,232.

Liability to Beneficiaries

The University holds numerous irrevocable charitable remainder trusts and a pooled income fund. Together these assets are reflected in the accompanying financial statements within restricted investments.

The charitable remainder trusts designate the System Board of Regents as both trustee and remainder beneficiary. Donors (or other donor-designated income beneficiaries) are paid either a fixed amount or the lesser of a fixed percentage of the fair value of the trusts' assets or the trusts' income during the beneficiaries' lives. Trust assets are measured at fair value when received and monthly thereafter. A corresponding liability to beneficiaries is measured at the present value of expected future cash flows to be paid to the beneficiaries based upon the applicable federal rate on the gift date. Upon the deaths of the income beneficiaries, substantially all of the principal balance passes to the University to be used in accordance with the donors' wishes.

The pooled income fund was formed with contributions from several donors. The contributed assets are invested and managed by UTIMCO. Donors (or designated beneficiaries) periodically receive, during their lives, a share of the income earned on the fund proportionate to the value of their contributions to the fund. Upon the deaths of the income beneficiaries, substantially all of the principal balance passes to the University to be used in accordance with the donors' wishes. Contribution revenue is measured at the fair value of the assets received, discounted for a term equal to the life expectancies of the beneficiaries.

Net Assets

The University has classified resources into the following three net asset categories:

Invested in Capital Assets, Net of Related Debt

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted:

Nonexpendable

Net assets which are subject to externally imposed stipulations that require the amounts to be maintained perpetuity by the University. Such assets include the University's permanent endowment funds.

Expendable

Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire with the passage of time.

Unrestricted

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for special purposes by action of University management or the System Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic, research programs, patient care initiatives, and for capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation. Generally, the University's policy is to first apply the expense toward restricted resources and then toward unrestricted resources.

Revenues and Expenses

Operating revenues include activities such as student tuition and fees, net of scholarship allowances; sales and services of auxiliary enterprises; sales and services of hospitals; professional fees; most federal, state and local grants and contracts and federal appropriations; and interest on student loans. As defined by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, all operating revenues are considered program revenues since they are charges for services provided and program-specific operating grants and contributions. Operating expenses include salaries and wages, payroll related costs, materials and supplies, depreciation, scholarships and fellowships, and impairment losses and insurance recoveries received in the same year as the associated loss in accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

Nonoperating revenues include activities such as gifts and contributions, insurance recoveries received in years subsequent to the associated loss, State appropriations, investment income and other revenue sources that are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*, GASB Statement No. 34, and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Nonoperating expenses include other expenses that are defined as nonoperating expenses by GASB Statement Nos. 9, 34 and 42.

Scholarship Allowances and Student Aid

Financial aid to students is reported in the financial statements as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid (student loans, funds provided to students as awarded by third parties and Federal Direct Lending) is accounted for as third party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expense or scholarship allowances, which reduce revenues. The amount reported as operating expense represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the University's specific student identification method, amounts are computed on an individual basis by allocating cash payments to each student.

Charity Care

The University provides charity care to patients who meet certain criteria under charity care policies without charge or at amounts less than its established rates. Because the University does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The University's total unsponsored charity care amounted to approximately $391,703,430 for 2007.

Net Patient Service Revenue

The University has agreements with third-party payors that provide for payments to the University at amounts different from their established rates.

Medicare

The University's inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are reimbursed under a prospective reimbursement methodology. Also, additional reimbursement is received for graduate medical education, disproportionate share, bad debts and other reimbursable costs, as defined, under a variety of payment methodologies.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective reimbursement methodology. Certain outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement cost methodology. The University is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the University and audits thereof by the Medicaid fiscal intermediary. The University recognized bad debt expense of approximately $87,896,131 in 2007.

The University has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the University under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Use of Estimates

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

Note 2: Capital Assets

A summary of changes in the capital assets for the year ended August 31, 2007, is presented below.

	Balance 2006	Completed CIP	Additions	Deletions	Balance 2007
Nondepreciable Assets:					
Land & Land Improvements	$ 16,942,065	$ -	$ 36,516	$ -	$ 16,978,580
Construction in Progress	108,251,586	(60,402,874)	91,780,003	-	139,628,715
Total Nondepreciable Assets	$ 125,193,651	$ (60,402,874)	$ 91,816,519	$ -	$ 156,607,295
Depreciable Assets:					
Buildings & Building Improvements	$ 657,500,813	$ 1,646,116	$ -	$ -	$ 659,146,930
Infrastructure	40,881,849	-	-	-	40,881,849
Facilities and Other Improvements	21,960,322	26,392,536	-	-	48,352,858
Furniture and Equipment	253,142,196	32,140,267	$ 31,248,411	(9,770,408)	306,760,466
Vehicles, Boats and Aircraft	5,772,844	-	1,129,252	(475,349)	6,426,747
Other Capital Assets (Including Library Books)	68,616,804	223,955	86,996	(21,757)	68,905,998
Total Depreciable Assets at Historical Cost	$ 1,047,874,828	$ 60,402,874	$ 32,464,659	$ (10,267,514)	$ 1,130,474,848
Less accumulated depreciation for:					
Buildings and Building Improvements	$ (383,565,105)	$ -	$ (22,669,714)	$ -	$ (406,234,819)
Infrastructure	(25,416,459)	-	(1,243,660)	-	(26,660,119)
Facilities and Other Improvements	(14,432,509)	-	(838,141)	-	(15,270,650)
Furniture and Equipment	(170,804,520)	-	(27,756,078)	8,825,454	(189,735,144)
Vehicles, Boats and Aircraft	(4,921,457)	-	(457,488)	397,968	(4,980,977)
Other Capital Assets (Including Library Books)	(44,823,858)	-	(4,158,547)	-	(48,982,405)
Total accumulated depreciation	$ (643,963,908)	$ -	$ (57,123,628)	$ 9,223,422	$ (691,864,114)
Depreciable Assets, net	$ 403,910,920	$ 60,402,874	$ (24,658,969)	$ (1,044,092)	$ 438,610,733
Capital Assets, net	$ 529,104,571	$ -	$ 67,157,550	$ (1,044,092)	$ 595,218,029

Note 3: Deposits, Investments, and Repurchase Agreements

Deposits

University bank information as of August 31, 2007 is presented below.

	Carrying Amount	Bank Balance
	$ (9,903,718)	$ 10,718,332

Cash on Hand	$ 67,090
Cash in Bank	(9,903,718)
Cash in State Treasury	470,925
Cash Equivalents	82,846,666
Total Cash and Cash Equivalents	$ 73,480,963
Current Assets Cash and Cash Equivalents	$ 57,856,430
Current Assets Restricted Cash and Cash Equivalents	15,624,533
Total Cash and Cash Equivalents	$ 73,480,963

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System maintains depository relationships with various banking institutions. The System's policy is that all deposits are governed by a bank depository agreement between the System and the respective banking institution. This agreement provides that the System's deposits, to the extent such deposits exceed the maximum insured limit under deposit insurance provided by the Federal Deposit Insurance Corporation, shall at all times be collateralized with either government securities or a surety bond issued by an insurer rated "AAA" or its equivalent by a nationally recognized rating organization or a combination thereof. There were no bank balances that were exposed to custodial credit risk as of August 31, 2007.

Investments

At the direction of the System Board of Regents, University investments and cash equivalents are pooled at the System level in internal investment pools. The System is responsible for disclosure of all information on the pooled investments and has included these disclosures in its annual financial report.

As of August 31, 2007, the fair value of the University's share of investments is presented below:

Pooled Operating Funds ITF	$	207,074,164
Pooled Endowment Funds LTF		503,164,436
Real Estate		180,896
Total Investments	$	710,419,496
Non-Current Assets – Restricted Investments	$	553,395,389
Non-Current Assets – Investments		157,024,107
Total Investments	$	710,419,496

(A) *Credit Risk* - Article VII, Section 11b of the Texas Constitution authorizes the UT System Board of Regents, subject to procedures and restrictions it establishes, to invest System funds in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the UT System Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System's investment policies limit investments in U.S. Domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, Baa3 or better by Moody's Investor Services, BBB- or better by Standard & Poor's Corporation, or BBB- or better by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment grade bonds. Per GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3,* unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. GASB 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk.

(B) *Concentrations of Credit Risk* – The System's investment policy statements contain the limitation that no more than five percent of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer. As of August 31, 2007 and 2006, the System did not hold any direct investments in any one issuer of corporate or municipal bonds that were five percent or more of the market value of the System's domestic fixed income investments.

(C) *Custodial Credit Risk* – Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the System's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. As of August 31, 2007 and 2006, the System did not have any deposits or investments that are exposed to custodial credit risk.

(D) *Interest Rate Risk* – Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. Interest rate risk inherent in the System investments is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the System's investments to changes in interest rates. The System has no specific policy statement limitations with respect to its overall modified duration.

(E) *Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes* – In accordance with the System's investment policy statements, the System may invest in various mortgage backed securities, such as collateralized mortgage backed obligations. The System also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds and stripped Treasury and Agency securities created from coupon securities. No percentage of holdings limitations are specified in the investment policy statements regarding these types of securities.

(F) *Foreign Currency Risk* – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the System's non-U.S. dollar investments. The System's investment policy statement limits investments in non-U.S. denominated bonds to 50 percent of the System's total fixed income exposure.

Repurchase Agreements

The System, by statute, is authorized to enter into repurchase agreements. A repurchase agreement is when a holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate the buyer for this.

Securities Lending

In accordance with the prudent investor investment standards, the System participates in a securities lending program. The System began the program, under a contract with the System's lending agent, on September 1, 1995. The lending agent is authorized to lend any securities held by the System's custodian except those securities which the policy guidelines prohibits lending. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In security lending transactions, the System transfers its securities to brokers/dealers for collateral, which may be cash, securities issued or guaranteed by the United States government or its agencies, and irrevocable bank letters of credit, and simultaneously agrees to return the collateral for the same securities in the future.

Cash collateral received by the lending agent on behalf of the System is invested and reinvested in a non-commingled pool exclusively for the benefit of the System. The pool is managed in accordance with investment guidelines established by the System and is stated in the security lending contract. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent.

Collateral pool investments are uninsured, and are held by the securities lending agent, in its name, on behalf of the System, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the System or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties' trust department or agent.

Lending income is earned if the returns on those investments exceed the "rebate" paid to borrowers of the securities. The income is then shared with the lending agent based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from the System's resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a "loan premium or fee" for the securities loan. This income is split with the same ratio as the earnings for cash collateral. The collateral pledged to the System by the borrower is custodied by the lending agent or through a third party arrangement. These securities held as collateral are not available to the System for selling or pledging unless the borrower is in default of the loan.

The collateral received must have a fair value of 102 percent of the loaned securities of United States issuers. If the fair value of the collateral held in connection with loans of securities of United States issuers is less than 100 percent at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102 percent of the fair value.

For non-United States issuers, the collateral should remain at 105 percent of the fair value of the loaned securities at the close of any business day. If it falls below 105 percent, the borrower must deliver additional collateral by the close of the following business day.

In the event of default, where the borrower is unable to return the securities loaned, the System has authorized the lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the lending agent has indemnified the System from any loss due to borrower default.

At August 31, 2007 and 2006, the System had no credit risk exposure to borrowers because the amounts the System owed to borrowers exceeded the amounts the borrowers owed the System.

There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Derivative Financial Instruments

Derivatives are financial instruments (securities or contracts) whose value is linked to, or "derived" from, changes in interest rates, currency rates, and stock and commodity prices. Derivatives cover a broad range of financial instruments, such as forwards, futures, options, swaps, and mortgage derivatives.

(A) *Mortgage Derivatives* – Mortgage derivatives are used to manage portfolio duration and to enhance portfolio yield, and, are influenced by changes in interest rates, the current economic climate, and the geographic make-up of underlying mortgage loans. There are varying degrees of risk associated with mortgage derivatives. For example, certain Collateralized Mortgage Obligations (CMOs) such as Planned Amortization Class (PACs) are considered a more conservative lower risk investment. In contrast, principal only and interest only strips are considered higher risk investments. The System's investment in CMOs, which was comprised almost exclusively of the lower risk investment class, was 1.5 percent of total investments with a fair value of $392,563,747 at August 31, 2007 and 0.8 percent of total investments with a fair value of $172,275,247 at August 31, 2006.

(B) *Futures Contracts* – Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. The net liability is included in payables from restricted assets. Futures contracts are marked to market daily; that is, they are valued at the close of business each day and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss difference is referred to as the daily variation margin, which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts. The amount of the net realized gain on the futures contracts was $37,121,227 for the year ended August 31, 2007. The amount of the net realized loss on the futures contracts was $18,378,163 for the year ended August 31, 2006. The System executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the manager's various trading and credit monitoring techniques.

(C) *Foreign Currency Exchange Contracts* – The System enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward currency contract, the System agrees to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the System's net equity therein (representing unrealized gain or loss on the contracts, as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date) is included in other receivables. Realized and unrealized gains and losses are included in the consolidated statement of revenues, expenses, and changes in net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the consolidated balance sheet. Risks arise from the possible inability of counter-parties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(D) *Written Options* – Written options are used to alter the market (systematic) exposure without trading the underlying cash market securities, and to hedge and control risks, so that the actual risk/return profile is more closely aligned with the target risk/return profile. They are included in payables from restricted assets. During the year, call options were written on Treasury Bond and equity index futures.

(E) *Swaps* – Swaps are used to adjust interest rate and yield curve exposures. During the year, the System entered into interest rate, total return and commodity swap contracts. They are included in other receivables and payables from restricted assets.

(F) *Investment Funds* – The System's investment funds include exchange traded funds, index funds, Securities Exchange Commission (SEC) regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and may be unregulated.

Marketable alternatives funds are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private market funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments are domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk, and investment manager risk. The System had committed $2,045,612,860 and $1,639,100,238 of future funding to various private market investments as of August 31, 2007 and 2006, respectively.

Public market funds are invested in exchange traded funds, index funds, and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the funds. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market and public market funds include investments in private placement vehicles that are subject to risk which could result in the loss of invested capital. The risks include the following:

• *Non-regulation risk* – Some of these funds are not registered with the SEC, and therefore, are not subject to regulatory controls.
• *Key personnel risk* – The success of certain funds is substantially dependent upon key investment managers and the loss of those individuals may adversely impact the fund's performance.
• *Liquidity risk* – Many of the System's investment funds may impose lock-up periods which would cause the System to incur penalties to redeem its units or prevent the System from redeeming its shares until a certain period of time has elapsed.
• *Limited transparency* – As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
• *Investment strategy risk* – These funds often employ sophisticated investment strategies and may use leverage which could result in the loss of invested capital.

(G) *Securities Sold Short* – The System may sell securities it does not own in anticipation of a decline in the fair value of that security or as means to adjust the duration of certain fixed income portfolios. When the System sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The market value of System securities sold short as of August 31, 2007 and 2006 were $35,097,262 and $14,913,501, respectively. The securities sold short as of August 31, 2007, are commitments to sell U.S. Treasury securities that do not require cash deposit. As of August 31, 2007 there was no Deposit with Broker for Securities Sold Short. As of August 31, 2006, System Deposit with Broker for Securities Sold short was $11,811,105. The System must pay dividends or interest on the securities sold short. Until the System covers it shorts sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold short at prices, which may be significantly higher than the market value reflected in the statements of fiduciary net assets.

Note 4: Endowments

Funds subject to restrictions of endowment and trust instruments require that principal be maintained and that only the income be utilized. Funds held by the University include $496,876,230 for the year ended August 31, 2007 of endowment funds.

Donor Restricted Endowments

Distributions that are reinvested in endowments become permanent additions to the principal of the endowments; therefore, there is no amount of net appreciation on investments of donor-restricted endowments available for authorization of expenditures. This provision is outlined in the endowment agreements with donors.

Note 5: Summary of Long-Term Liabilities

Long-term liabilities are presented below.

	Bal 9/1/2006	Additions	Deductions	Bal 8/31/2007	Amounts Due Within One Year
Employees' Compensable Leave	$ 59,372,252	$ 68,424,277	$ (68,317,738)	$ 59,478,791	$ 53,923,185
Liabilities to Beneficiaries	2,737,354	469,788	(439,627)	2,767,515	-
Total	$ 62,109,606	$ 68,894,065	$ (68,757,365)	$ 62,246,306	$ 53,923,185

Employees' Compensable Leave

Substantially all full-time University employees earn annual leave in the amount of 8 to 21 hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum of 532 hours for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rate and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave.

Sick leave, the accumulation of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of his or her death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated entitlement or 336 hours, whichever is less. The University's policy is to recognize the cost of sick leave when paid, and the liability is not shown in the financial statements because experience indicates that the expense for sick leave will be minimal. Eligible part-time employees' sick leave accrual rate is proportional to the number of hours appointed to work.

Note 6: Bonded Indebtedness

The University receives proceeds from revenue bonds issued and held by the System to support capital projects of the System and its institutions. These proceeds are recorded as transfers from the System. The University disburses funds to the System for payments of principal and interest related to the University's share of bond proceeds. These disbursements are recorded as transfers to the System. At August 31, 2007, the System had outstanding bonds payable of $3,755,040,000. All bonds issued by the System are defined as revenue bonds. As such, the revenues of the System, including the University, are pledged for repayment of the bonds. Segment information requirements are not applicable, due to the bond indentures' lack of specifically identifiable activities and separate accounting requirements imposed by an external party.

No amount of indebtedness related to these bonds has been recorded in the University's financial statements as the System is the party directly liable for these bonds. At August 31, 2007, however, the University's remaining unpaid share of the bond proceeds was $116,116,000.

Note 7: Capital Leases

Certain leases to finance the purchase of property are capitalized at the present value of future minimum lease payments. The University had no capital leases as of August 31, 2007.

Note 8: Operating Lease Obligations

As of August 31, 2007, the University's operating lease obligations are as follows:

Year Ended August 31, 2007		Total
2008	$	3,751,423
2009		2,931,637
2010		2,103,422
2011		1,182,394
2012		514,126
2013 - 2017		724,318
Total Minimum Future Lease Payments	$	11,207,320

Note 9: Interagency Balances / Activity

The University has transactions with System Administration. At year-end, amounts to be received or paid are reported as Due from Other Entities or Due to Other Entities.

Entity	Due from Other State Entities	Due to Other State Entities
System Administration	$ 17,491,479	$ 8,684,946
Totals	$ 17,491,479	$ 8,684,946

Interagency transfers made during the fiscal year are presented below:

Entity	Transfers In from Other State Entities, UT Institutions and System Administration	Transfers Out to Other State Entities, UT Institutions and System Administration
Texas State Comptroller Office		
(DISPRO, UPL, and 2% Tuition Set Aside)	$ 86,243,652	$ 86,367,569
UT System Administration	33,365,286	29,030,939
State Institutions (Texas Tech HSC and TAMU Galveston)		30,553
UT Institutions		21,833,214
Total	$ 119,608,938	$ 137,262,275

Note 10: Contingent Liabilities

As of August 31, 2007, the University was not aware of any significant contingent liabilities.

Note 11: Risk Financing and Related Insurance

All risk financing and related insurance for the University is part of coverage provided by the System. The System has self-insurance plans providing coverage in the following areas: employee health and dental, unemployment compensation, workers' compensation, property protection, directors' and officers'/employment practices liability, and construction contractor insurance.

Employee and Retiree Insurance Benefits

The System Employee Benefits program provides health insurance, dental insurance, vision insurance, life insurance, long-term disability, short-term disability, long-term care, and flexible spending account coverage to all benefits-eligible employees and retirees of the System and its fifteen institutions. These insurance benefits are provided through both self-funded and fully-insured arrangements. A portion of the System's cost of providing group health and basic life insurance coverage is paid by the State as specified in the General Appropriations Act. The System's Office of Employee Benefits (OEB) is responsible for the overall administration of the insurance plans. OEB was established by Chapter 1601 (formerly Article 3.50-3) of the *Texas Insurance Code* and complies with State laws and statutes pertinent to employee benefits for the System.

Unemployment Compensation Insurance

The General Appropriations Act requires the System to reimburse the Texas Workforce Commission (TWC) for 50% of the unemployment benefits paid to former employees that were paid from general revenue funds. The System reimburses the TWC 100% of the unemployment benefits paid to former employees that were paid from local funds.

Workers' Compensation Insurance

The University of Texas System Workers' Compensation Insurance (WCI) program provides coverage to all employees of the System and its fifteen institutions. Under the oversight of the System's Office of Risk Management (ORM), the System self-insures and administers the program. The WCI staff is responsible for administering all aspects of the system-wide program, which provides income and medical benefits to all employees who have sustained job-related injuries or occupational diseases. The program's statutory authority is embodied in Chapter 503 of the *Texas Labor Code.*

Professional Medical Liability Benefit Plan

The coverage provided under the Professional Medical Liability Benefit Plan (Plan) is on an occurrence basis; thus, a participant is covered by the Plan for claims and lawsuits relating to events that occurred while enrolled in the Plan, including those filed after the participant has left the System's employment or training. The Plan covers all of the System staff physicians, dentists, residents, fellows, and medical students who have been enrolled. The limits of liability of the Plan include an annual policy aggregate of $30,000,000, an annual aggregate of $1,500,000 for each staff physician ($500,000 per claim), an annual aggregate of $300,000 for each resident or fellow ($100,000 per claim) and a $75,000 annual aggregate for each medical student ($25,000 per claim). Medical students may be eligible for additional coverage when they enroll in an institution approved "externship" outside of the State of Texas.

Liability is limited to $2,000,000 per incident, regardless of the number of claimants or physicians involved in an incident. As of September 1, 2003, the limits of liability are prescribed by law as $100,000 per claim per physician. Also effective September 1, 2003, UT institutions are covered under the Plan for actions that could have been brought against an individual plan participant. The liability of a UT institution is limited by law to $250,000 per claimant and $500,000 per occurrence for bodily injury or death.

Comprehensive Property Protection Program

The property protection plan consists of two programs. The first provides coverage for physical damage resulting from Named Windstorms and catastrophic flood losses up to $50 million. Insurance policies providing underlying limits ($1-2 million per building and contents) are purchased through the Texas Windstorm Insurance Association and the

National Flood Insurance Program on several facilities in the Tier 1 wind zone and other flood prone areas to provide a primary layer of insurance. The self-insurance component of the program participates in losses that exceed the coverage available under these primary policies or in cases where there is no underlying insurance.

The second program covers fire and other perils and includes commercial coverage for claims exceeding a per occurrence deductible of $7.5 million or an annual aggregate deductible of $25 million. The policy covers all UT System buildings and personal property and business income reported by the institutions. The maximum annual reimbursement under this policy is $1 billion per occurrence.

To fund the self-insurance portion of both property programs, the institutions make annual contributions to the loss reserve funds in addition to paying insurance premiums.

Directors and Officers/Employment Practices Liability Self-Insurance Plan

The Directors and Officers Liability (D&O) and Employment Practices Liability Self-insurance Plan provides coverage for claims arising from actual or alleged wrongful acts performed by the plan beneficiaries. The plan also provides coverage for employment practices liability (EPL) claims, such as wrongful termination, failure to promote and wrongful discipline.

Coverage applies to individual board members, employees, faculty, etc., as well as to the System itself. The limit of liability is a $10 million annual aggregate (Coverages A, B and C combined), except for $5 million annual aggregate sublimit for Coverage C. There is no deductible for Coverage A (individuals), a $100,000 deductible per director or officer with a $300,000 maximum deductible per loss for Coverage B. The deductible for Coverage C is $300,000. In 2003, the UT System Board of Regents allocated $3.7 million from the Available University Fund to establish the D&O/EPL loss reserve fund. Institutions make annual premium contributions to this fund.

Rolling Owner Controlled Insurance Program

The Rolling Owner Controlled Insurance Program (ROCIP) was established for the centralized purchase of construction contractor insurance on various capital projects. This program provides workers' compensation and general liability insurance for all contractors enrolled on projects participating in the program. The insurance carries a $250,000 per occurrence basket deductible, which is paid through the program's self-insurance fund.

Note 12: The Financial Reporting Entity

Blended Component Unit

The UTMB Healthcare Systems, Inc., a component unit, is included in the consolidated financial statements. Net assets of the blended component unit are insignificant to the University. UTMB Healthcare Systems, Inc is governed by an eight-member board appointed by UT Medical Branch at Galveston. The corporation's fiscal year end is August 31.

Note 13: Employee Retirement Plans

TEACHER RETIREMENT SYSTEM (TRS)

The State of Texas has joint contributory retirement plans for substantially all its employees. One of the primary plans in which the System participates is a cost-sharing multi-employer defined benefit pension plan administered by the Teacher Retirement System of Texas. TRS is primarily funded through State and employee contributions. Depending upon the source of funding for a participant's salary, the System may be required to make contributions in lieu of the State.

All System personnel employed in a position on a half time or greater basis for at least 4½ months or more are eligible for membership in the TRS retirement plan. However, students employed in positions that require student status as a condition of employment do not participate. Members with at least five years of service at age 65 or any combination of age plus years of service, which equals 80, have a vested right to retirement benefits. Additionally, reduced benefits are available at age 55 with at least five years of service or at any age below 50 with 30 years of service. Members are fully vested after five years of service and are entitled to any benefits for which the eligibility requirements have been met.

TRS contribution rates for both employers and employees are not actuarially determined but are legally established by the State Legislature. Contributions by employees are 6.4 percent of gross earnings. Depending upon the source of funding for the employee's compensation, the State or the System contributes a percentage of participant salaries totaling 6 percent of annual compensation. The University's contributions to TRS for the year ended August 31, 2007, were $15,336,858.

TRS does not separately account for each of its component government agencies since the Retirement System itself bears sole responsibility for retirement commitments beyond contributions fixed by the State Legislature. Further information regarding actuarial assumptions and conclusions, together with audited financial statements are included in the Retirement System's annual financial report, which may be found on the TRS website at www.trs.state.tx.us.

OPTIONAL RETIREMENT PROGRAM (ORP)

The ORP may be chosen by certain employees in lieu of TRS based on the job they perform. This program is a defined contribution plan governed by Internal Revenue Code Section 403(b). Benefits are based on the performance of the investments selected and are controlled by the employee. Employees are vested after one year and one day of participation with a right to both employee and employer contributions.

EMPLOYEES RETIREMENT SYSTEM (ERS)

Certain employees at the University participate in the Employees Retirement System of Texas. The Board of Trustees of the Employees Retirement System of Texas is the administrator of the ERS, which is considered to be a single employer defined benefit pension plan. ERS covers the eligible University employees who are not covered by the TRS or the ORP. Benefits vest after five years of credited service. Employees may retire at age 60 with five years of service or any combination of age plus years of service that equals 80.

The ERS plan provides a standard monthly benefit in a life annuity at retirement as well as death and disability benefits for members. Additional payment options are available. The benefit and contribution provisions are authorized by State law and may be amended by the Texas Legislature. Contribution requirements are not actuarially determined. The ERS contribution requirement, calculated using entry age normal actuarial cost method, is established through State statute.

The funding policy requires monthly contributions by both the State and employees. For the biennium beginning September 1, 2005, the required contribution for both the State and employees is 6 percent of pay. Additional information can be obtained from the separately issued ERS Comprehensive Annual Financial Report.

Note 14: Deferred Compensation Program

University employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in Texas Government Code, Section 609.001. Deferred compensation plans are administered by the Employees Retirement System.

The State's 457 Plan complies with Internal Revenue Code, Section 457. This plan is referred to as the TexaSaver Deferred Compensation Plan and is available to all employees. Deductions, purchased investments, and earnings attributed to the 457 Plan are the property of the State and subject only to the claims of the State's general creditors. Participant rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the 457 account for each participant. The State has no liability under the 457 Plan, and it is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

The University also administers a Tax-Deferred Account Program, created in accordance with Internal Revenue Code, Section 403(b). All employees are eligible to participate. The Tax-Deferred Account Program is a private plan, and the deductions, purchased investments, and earnings attributed to each employee's 403(b) plan are held by vendors chosen by the employee. The vendors may be insurance companies, banks, or approved non-bank trustees such as mutual fund companies. The assets of this plan do not belong to the University, and thus it does not have a liability related to this plan.

Note 15: Post-Employment Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provided certain health and life insurance benefits for retired employees, in accordance with state statutes. Substantially all of the employees may become eligible for the health and life insurance benefits if they reach normal retirement age while working for the State. Currently, there are 3,051 retirees who are eligible for these benefits. Similar benefits for active employees are provided through a self-funded plan and fully insured plans. Depending upon the status of the employee at the time of retirement, the State or the System recognizes the cost of providing these benefits. The cost of retiree post-employment benefits is recognized when paid. This contribution paid all of the “employee/retiree only” premiums and a portion of the premiums for those employees/retirees selecting dependent coverage. The employee/retiree was required to pay a portion of the cost of dependent coverage. For the fiscal year ended August 31, 2007, the cost of providing those benefits for the retirees was $13,731,304 for the University.

Note 16: Disaggregation of Receivable and Payable Balances

Net other receivables at August 31, 2007 are detailed by type as follows:

Net Other Receivables		**2007**
Receivables related to healthcare	$	743,163
Receivables related to gifts, grants and sponsored programs		6,874,467
Receivables related to external parties/other companies		57,680
Receivables related to payroll		311,738
Receivables related to travel		35,768
Receivables related to other various activities		334,446
Total	$	8,357,262

Note 17: Termination Benefits

In 2007, the University implemented a reduction in force effective September, 2006. The benefits package provided to the 159 terminated employees consisted of normal benefits and salaries with no special benefits or severance packages offered.

Healthcare continuation under the Consolidated Omnibus Budget Reconciliation Act (COBRA) is provided for both voluntary and involuntary terminations. The COBRA members are eligible to remain in the group benefits program for 18 months or 29 months, if disabled. Dependents are eligible to remain in the program for 36 months. COBRA benefits for the terminated employees for the year ended August 31, 2007 are provided below:

	2007
Number of Participants[1]	5
Premium Revenue	$ 16,673
2% Administrative Fee Revenue[2]	333
Total Revenue for COBRA	17,006
Less Claims Paid	(3,472)
Cost to State[3]	$ None

[1]The participants above are for the self-insured program. There were no participants in the fully-insured program (HMO) as the HMO was not available to the employees at the University.
[2]The 2 percent administrative fee is not retained by the System but is passed to the carrier.
[3]Since the revenues for COBRA exceeded the claims there was no cost to the State.

There were no other nonroutine, widespread voluntary or involuntary termination arrangements that involved substantial number of individual employees or group of employees meeting the criteria for liability recognition.

Note 18: Funds Held in Trust by Others

The balances, or transactions, of funds held in trust by others on behalf of the University, including Charitable Lead Trusts, are not reflected in the financial statements. The University is the beneficiary of an independently controlled foundation, the Sealy & Smith Foundation, which had net assets in excess of $500 million at December 31, 2006 based on available public information. During the year ended August 31, 2007, the Sealy & Smith Foundation contributed approximately $11.5 million of revenue recognized to the University.

State Auditor's Office
John Keel, CPA
State Auditor

January 14, 2008

Dr. David L. Callender, President
The University of Texas Medical Branch at Galveston
301 University Boulevard
Galveston, Texas 77555-0129

Subject: Management Letter Resulting from a Review of the University of Texas Medical Branch at Galveston's Fiscal Year 2007 Financial Statements

Dear Dr. Callender:

We offer this management letter in conjunction with our review of the financial statements of the University of Texas Medical Branch at Galveston (Medical Branch) for the fiscal year ended August 31, 2007. We reviewed the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; the Statement of Cash Flows; and the Notes to the Financial Statements. In the course of our review, which was substantially less in scope than an audit, we did not find that material modifications needed to be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

We appreciate the assistance provided during this review by the management of the Medical Branch and Internal Audit. If you have any questions, please call me at (512) 936-9500.

Sincerely,

Sandra Vice

Sandra Vice, CGAP, CIA, CISA
Assistant State Auditor

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