HARVARD UNIVERSITY
FINANCIAL REPORT

FISCAL YEAR 2012

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Message from the President

I write to report Harvard University's financial results for fiscal 2012.

June 30, 2012, the close of our fiscal year, also marked the close of Harvard's 375th birthday year, a time that spurred us to consider not just the University's past but also its future, at a transformative time for higher education. A number of new initiatives launched during the year suggest both new directions and new capacities as Harvard looks ahead toward its fourth century. Early in the fall, a generous gift from Rita and Gus Hauser launched the Harvard Initiative for Learning and Teaching (HILT), a University-wide endeavor designed to address new environments and new opportunities for pedagogy in a digital and global era. The opening in November of the highly successful i-lab united the University in support of innovation and entrepreneurship. And in May we joined with MIT to create edX, a venture in digital learning that has generated worldwide excitement even in its rather unformed early stage. Sustaining momentum in all these areas will be a high priority in the months to come.

The sense of forward momentum that characterized the year was enhanced by progress in Allston. In September, the University announced its intention to move forward with advancing plans for a Health and Life Science Center, for developer-built housing and retail, and for longer-range aspirations for an enterprise zone on Harvard land in the area. We submitted regulatory filings detailing our Allston plans to the city this fall, outlining our aspirations for the decade ahead.

The past year also marked significant progress in the implementation of the governance reforms announced in December 2010. The new committee structure and larger Corporation have reinforced our strategic focus and enriched our capacity for University-wide decision-making and planning in areas including finance, facilities, capital planning, and governance. Ensuring the continuing success of the governance reforms is a high priority for the next year.

Enhanced capacity in financial planning supported by our new committee structure has proved timely. The academic year began with the debt ceiling crisis in Washington and ended with the enduring financial crisis in Europe, putting pressure on revenue sources and investment returns. Financial and political uncertainties have been a constant, and they are likely to prove even more destabilizing in the months ahead.

Fiscal 2012 investment returns were flat, though they outperformed our policy portfolio, and HMC CEO and President Jane Mendillo has warned that macroeconomic headwinds will continue to weigh on investment performance. Adjusting to and planning for new and sustained financial realities will be a significant priority for the entire University leadership team.

Sincerely,

Drew Gilpin Faust

Drew Gilpin Faust
PRESIDENT

November 2, 2012

Financial Overview

From the Vice President for Finance and the Treasurer

We write to report on the University's financial position and results for the fiscal year ended June 30, 2012. Since Harvard thinks and acts in long-term timeframes, we believe it is important not only to understand this year's approximately breakeven operating result, but also to consider that result in the broader context of Harvard's changed financial circumstances and prospects.

The University's financial profile has changed considerably over the last decade in ways that have mirrored changes in the broader economy. We accumulated and deployed significant resources through the middle of 2008 when the global recession caused us to retrench and then reconsider our financial strategies in very fundamental ways. The University has become increasingly sophisticated in managing our finances, which should serve us well as we consider the more challenging environment that lies ahead – a landscape that almost certainly will be widely shared across higher education.

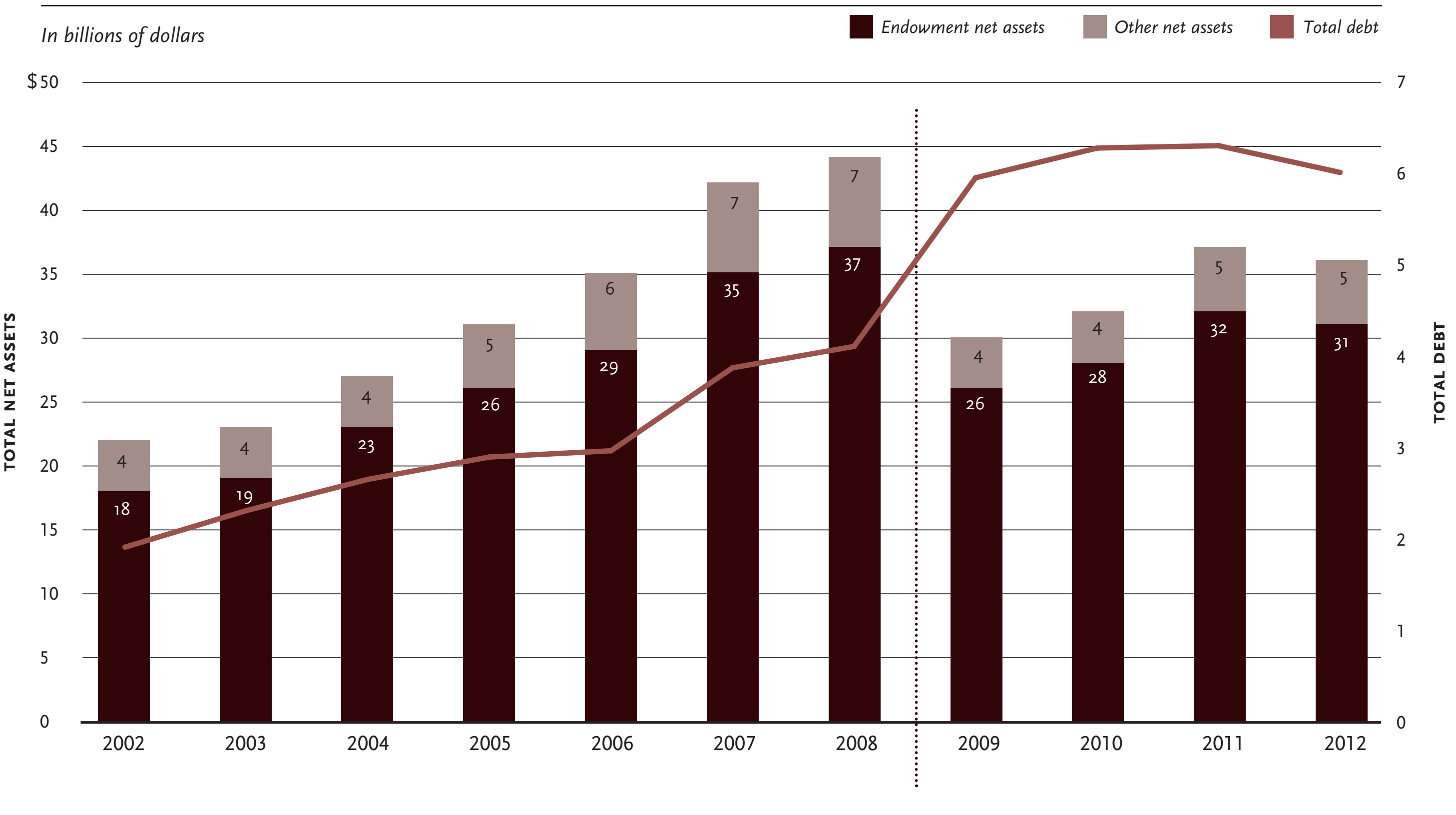
LOOKING BACK

The last decade is a story with two distinct chapters. In the first chapter, the University enjoyed substantial growth through fiscal 2008 driven by large increases in both endowment wealth and debt. Harvard was able to make important investments in the academic enterprise, adding approximately 200 faculty (a 10% increase) between fiscal 2002 and fiscal 2008. In the realm of science, the University enhanced its leadership position, bringing faculty from across the University and the affiliated hospitals together to support the first cross-University department in Stem Cell and Regenerative Biology and launching the Wyss Institute for Biologically Inspired Engineering. Investments made during this period required campus expansion with the addition of over four million gross square feet to the University's physical plant (a 20% increase).

Perhaps most noteworthy during this first chapter were the University's investments in better ensuring that a Harvard education would be accessible to students of extraordinary talent and promise regardless of financial means and sufficiently affordable to give those students the flexibility to pursue careers of their choosing without significant incremental debt. The Middle Income Initiative, announced by Harvard College in fiscal 2008, redefined the financial compact with undergraduates and their families by limiting the percentage of family household

UNIVERSITY NET ASSETS AND DEBT SINCE FY02

In billions of dollars



income that would be contributed toward an undergraduate education. This approach altered financial aid policy broadly across higher education, and from a financial perspective had a very meaningful impact. University-wide net tuition income actually declined by 1% in nominal terms between fiscal 2008 and fiscal 2009 – a noteworthy event that nonetheless was trumped by preceding growth of 80% in grant aid between fiscal 2002 and fiscal 2008.

The global financial crisis changed the University's financial profile in a sudden and consequential way, beginning a more turbulent second chapter. (See chart on page 3.) The endowment's negative return of 27% in fiscal 2009 caused an $11 billion decline in its value and an even greater decline of approximately $14 billion in the University's net assets. At the same time, the University issued $1.5 billion in incremental debt to enhance liquidity. The University's ratio of expendable resources to debt – a key metric used by credit rating agencies to evaluate balance sheet strength – fell in that one year from 9.2 to 3.9. The endowment's decline caused the University to implement a substantial reduction of $96 million and $129 million in the endowment payout for operations in fiscal 2010 and fiscal 2011, respectively. The University's interest expense, meanwhile, more than doubled to almost $300 million in fiscal 2011 compared to approximately $146 million in fiscal 2008.

As a further complication, over the past 10 years the University experienced only minimal inflation-adjusted growth in key non-endowment sources of revenue. As an example, our cumulative investments in financial aid have meant that net tuition has not been a source of meaningful support for new initiatives within Harvard. In fact, undergraduate net tuition actually has declined on an inflation-adjusted basis during the past decade at an average rate of 5%. Excluding the counter-cyclical benefits of federal government American Recovery and Reinvestment Act (ARRA) awards, federal sponsored research revenue has had an inflation-adjusted compound annual growth rate of only 2% since 2002, and non-federal sponsored research has fared worse. Meanwhile, on the expense side of the ledger, benefits expense has more than doubled in the past decade to $476 million in fiscal 2012.

The financial crisis has acted like a tidal wave that, as it receded, exposed certain vulnerabilities with a new clarity: endowment dependence and volatility, federal government dependence, non-endowment revenue stagnation, and a highly fixed cost structure. We have spent the past several years pursuing opportunities to be more efficient and effective without compromising our ability to fulfill our teaching and research mission. Among other things, exercising more discipline over staffing decisions, implementing organizational restructurings, constraining wage growth while nonetheless remaining competitive in attracting and retaining our talented individuals, and managing space for maximum efficiency have been important steps. While we have successfully achieved operating results of breakeven or better throughout this challenging period, we know additional financial headwinds may lie ahead. Flat investment returns in fiscal 2012 are just one good example. We know that our work is far from complete – and indeed, that we likely will need to undertake an even more fundamental examination of our activities with the goal of more crisply prioritizing what we do and what we are willing to forgo.

LOOKING FORWARD

The primary financial risks facing Harvard also are present at other large private research universities. We are challenged by volatility in the capital markets due to our endowment dependence and disproportionately fixed cost structure. We depend considerably on the federal government's funding of biomedical research at a time when the government's projected deficits and accumulated debt create enormous pressure to reduce such discretionary dollars. The University's sizable campus requires significant annual funding to maintain and still more funding to address deferred maintenance. And our employee benefit expense, of which health care is the largest component, has been increasing at an unsupportable rate relative to actual and expected growth in the University's revenue.

At the same time, Harvard has critical objectives that require near-term expenditures. Those objectives are embodied in both bricks (e.g., enhancing our cross-University science and engineering collaborations on the University's Allston campus) and bytes (e.g., investing in the promise of online education through our edX collaboration with MIT). Harvard has neither the desire nor the luxury to postpone its pursuit of critical priorities despite the prospect of challenging economic circumstances. Indeed, competition and opportunity compel us to move forward in a disciplined way – in which fundraising, creative restructurings, and more rigorous evaluations of the University's activities will be important endeavors.

After many decades of growth and stability, higher education is likely to face rapid, disorienting change. The ability to adapt quickly and effectively will be increasingly important. In the years ahead, we are likely to focus our efforts in a number of areas:

- *Pursuing integration opportunities:* Most universities are decentralized, and that decentralization typically results in incremental costs through the duplication of various activities. Harvard's significantly decentralized governance has contributed to an unmatched breadth of excellence across its various programs. Yet it comes at a financial cost. Our challenge is to determine where we might reduce or eliminate redundancies in order to be more efficient without compromising our ability to understand and pursue the highest-priority "local" opportunities that promise to make the University stronger. Our library reorganization is an initial attempt to meet such a challenge. We also are making progress consolidating IT management, and seeking to leverage the University's purchasing power by enhancing our strategic vendor relationships. Other initiatives are underway or in the works.

- *Evaluating benefits offerings:* Universities tend to be generous with their employee benefit offerings, and Harvard is no exception. Yet with those costs continuing to increase at unsustainable rates, Harvard – like its peers and indeed like most other businesses – cannot simply continue with the status quo. The University is committed to offering fair and competitive compensation to all its employees, but ultimately must balance our responsibilities to the workforce with our need to pursue the University's broader objectives.

- *Exploring incremental revenue:* Managing through the next decade will require more than cost constraint; it also will require the University to consider new ways to generate incremental resources. One increasingly clear path is a fundraising Campaign—which would be Harvard's first in more than a decade. We also will need to adopt more creative strategies to leverage the University's space and its vast intellectual resources for additional monies that can be reinvested in our teaching and research aspirations. Creativity of this sort has not been a distinguishing feature of the higher education industry, but given expected pressures on the business model of practically all colleges and universities, it increasingly will be a competitive differentiator.

IN CONCLUSION

The need for change in higher education is clear given the emerging disconnect between ever-increasing aspirations and universities' ability to generate the new resources to finance them. Certain aspirations more closely resemble imperatives and will require universities to make decisive and inevitably difficult choices from among competing priorities. We can be successful if we equate change with the opportunity to improve and move forward.

The road ahead will present any number of challenges and opportunities including, without doubt, a few surprises. Success will require a tolerance for ambiguity, an openness to different ways of doing things, a commitment to experimentation, an underlying confidence in our ability to implement a sustainable economic model, and an abiding passion for the University and its impact in the world. These are the same success factors that have enabled Harvard to thrive throughout the centuries, and we expect to achieve similar results in the future.

We hope this introduction provides you with a helpful context for evaluating the University's financial report.

Daniel S. Shore
VICE PRESIDENT FOR FINANCE AND
CHIEF FINANCIAL OFFICER

James F. Rothenberg
TREASURER

November 2, 2012

FINANCIAL OVERVIEW

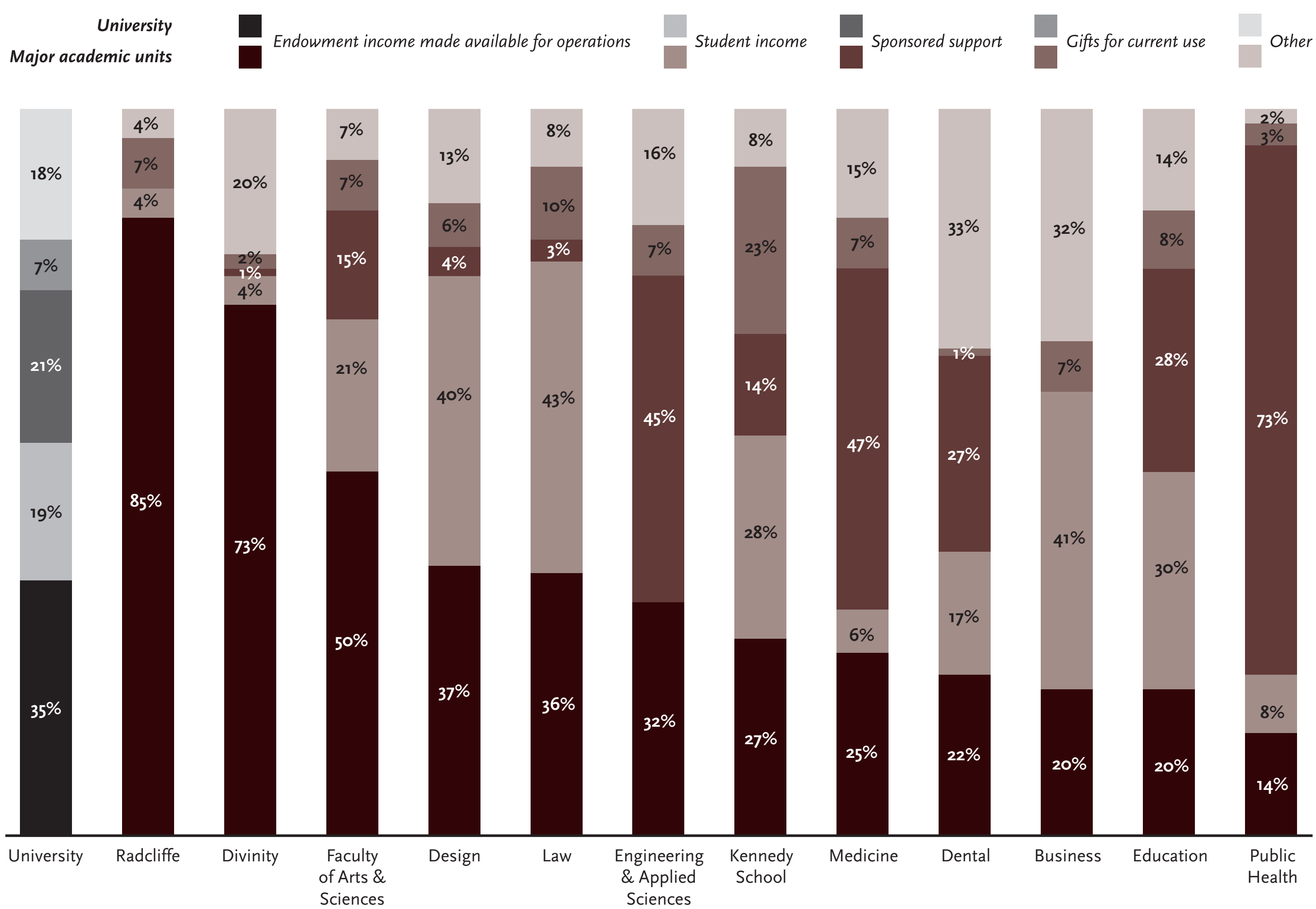
The University had an operating deficit of $4.5 million in fiscal 2012 compared to a deficit of $109 thousand in fiscal 2011. As of June 30, 2012, the University's net assets were $35.6 billion, a decrease of $1.2 billion from the prior year. The decrease in net assets resulted from the University making its annual endowment distribution for operations and subsequently achieving flat returns on its residual investments, causing the market value of the endowment to decline from $32.0 billion to $30.7 billion.

OPERATING REVENUE

Total operating revenue increased 3%, to $4.0 billion, due largely to the fiscal 2012 increase in the annual distribution from the endowment. The increase in total revenue was fully offset by a 3% increase in costs. In fiscal 2012, the endowment distribution was $1.4 billion compared to $1.3 billion in fiscal 2011. Growth in Harvard's endowment distribution was a result of the annual Corporation-approved increase, including the impact of new gifts. In the aggregate, Harvard's endowment payout rate (i.e., the dollars withdrawn annually for operations and for one-time or time-limited strategic purposes, as a percentage of the endowment's prior year-end market value) was 5.5%. This is in line with the University's targeted payout rate range of 5.0-5.5% and compares to a 5.3% payout rate in fiscal 2011.

Net student revenue increased 5%, from $741 million in fiscal 2011 to $777 million in fiscal 2012. Undergraduate net student revenue (i.e., undergraduate tuition, fees, board and lodging, less scholarships applied to student income) grew at a slower pace. This can be attributed to the University's continued commitment to financial aid with more than 60% of undergraduates receiving grant aid from Harvard in fiscal 2012, and an average grant size (among those receiving grant aid) of $40 thousand. Revenue from the University's continuing and executive education programs increased by $23 million or 9%, resulting from increases in both tuition and enrollment.

FISCAL 2012 SOURCES OF OPERATING REVENUE



The University's sponsored funding for fiscal 2012 decreased by 2%, from $852 million in fiscal 2011 to $833 million in fiscal 2012. Federal funding, which accounted for approximately 80% of the total sponsored funding during fiscal 2012, declined from $686 million in fiscal 2011 to $670 million in fiscal 2012 while non-federal funding declined from $166 million in fiscal 2011 to $163 million in fiscal 2012. The decline in sponsored funding was anticipated, resulting from declining American Recovery and Reinvestment Act of 2009 (ARRA) funding, as well as approximately flat revenue received from the Department of Health and Human Services (DHHS), the University's single largest grantor. Fortunately, the University received some offsetting increases in funding from other federal agencies as schools seek to diversify their sponsor base and announcements for new funding opportunities are more widely disseminated.

Current use gifts increased by 4%, from $277 million in fiscal 2011 to $289 million in fiscal 2012. Total giving, including gifts designated as endowment, increased 2% to $650 million (see Note 17 of the audited financial statements). As the University continues to plan for a capital Campaign, it has seen a meaningful increase in new pledges. We are extremely grateful to our donor community for their extraordinary generosity.

OPERATING EXPENSES

Total operating expenses increased 3%, to $4.0 billion. The main driver was compensation expense (i.e. salaries, wages and benefits), which represented approximately 50% of the University's total operating expense in fiscal 2012. Compensation expense increased 5%, from $1.9 billion in fiscal 2011 to $2.0 billion in fiscal 2012. The University's non-compensation expenditures grew by 2%.

Salaries and wages increased by 5%, or $78 million, to $1.5 billion in fiscal 2012, due to a combination of wage growth and increases in faculty, exempt and union staff populations.

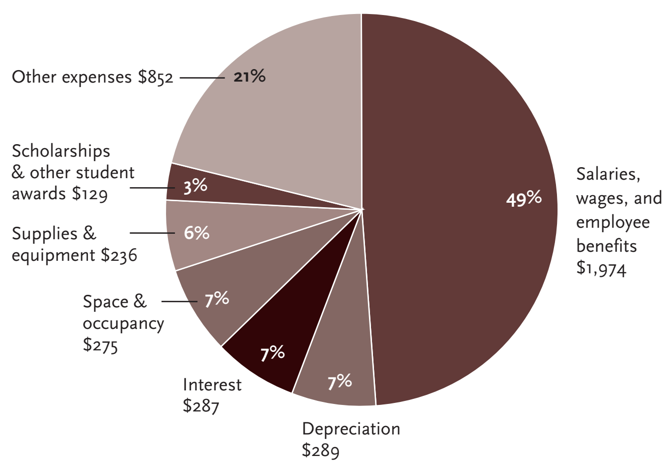
Employee benefits expense (before a one-time adjustment described below) increased 6%, primarily due to contributions to employee retirement plans, which are tied to employee wages, as well as increased enrollment and medical costs related to employee health benefit plans. In addition, there was an increase in the expense related to the University's defined benefit pension plans resulting from changes in actuarial assumptions used to calculate these costs.

During fiscal 2012, the University booked a one-time $14 million reduction in current year post-retirement health expense, due primarily to updating the demographic assumptions used to determine this expense. After accounting for this one-time adjustment, employee benefits expense grew 3%, or $15 million, to $476 million in fiscal 2012.

Of particular note within the University's non-compensation expenses, interest expense decreased 4%, from $299 million in fiscal 2011 to $287 million in fiscal 2012. The lower interest expense reflects the reduction in debt outstanding during fiscal 2012. After increasing from $1.3 billion at June 30, 2000 to $6.3 billion at June 30, 2010, the University's outstanding debt decreased to $6.0 billion at June 30, 2012.

FISCAL 2012 OPERATING EXPENSES

In millions of dollars



TOTAL OPREATING EXPENSES $4,042

BALANCE SHEET

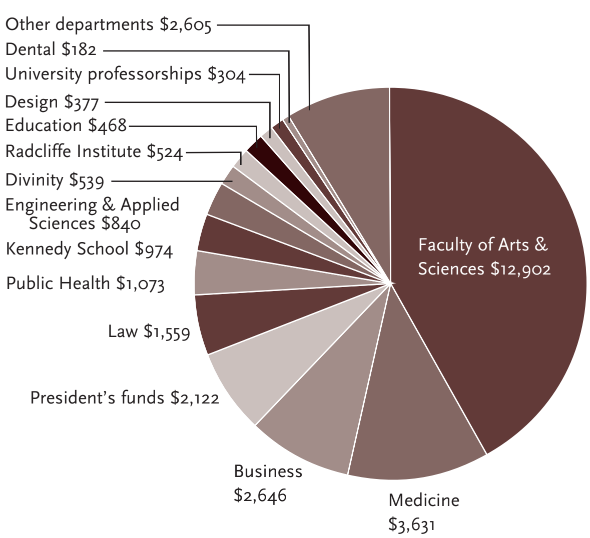
Investments

In fiscal 2012, the endowment earned an investment return of -0.05%, and its value (after the impact of endowment returns made available for operations and the addition of new gifts to the endowment during the year) decreased from $32 billion at the end of fiscal 2011 to $30.7 billion at the end of fiscal 2012. More information can be found in the Message from the CEO of Harvard Management Company (HMC), found on page 9 of this report.

The University's holdings of liquid investments (e.g., cash and treasuries) outside the General Investment Account (GIA) increased from $1.1 billion at June 30, 2011 to $1.3 billion at June 30, 2012. The GIA is managed by HMC and includes the endowment as well as a portion of the University's pooled operating funds. Over the past several years, the University has increased liquid, low risk investments held outside the GIA to ensure access to liquidity in situations of extreme financial duress. Harvard's efforts have been guided by a new liquidity management policy adopted during fiscal 2012 that calls for cash reserve levels sufficient to withstand a meaningful disruption to the endowment distribution for operations and/or a shock to the University's operating budget unrelated to investment performance.

FAIR VALUE OF THE ENDOWMENT AS OF JUNE 30, 2012

In millions of dollars



TOTAL FAIR VALUE $30,746

Debt

As noted previously, the University's outstanding debt decreased from $6.3 billion at June 30, 2011 to $6.0 billion at June 30, 2012. The weighted average interest rate of the portfolio was 4.7% at June 30, 2012, and the weighted average years to maturity was 17.8 years. The University is seeking to limit net new debt over the next several years in order to preserve financial flexibility and protect against potential revenue pressures on the University's budget.

The University's AAA/Aaa credit ratings with Standard & Poor's and Moody's Investors Service were re-affirmed in fiscal 2012. Additional detail regarding the University's debt portfolio can be found in Note 12 of the audited financial statements.

Capital Expenditures

The University invested $338.7 million in capital projects and acquisitions during fiscal 2012. This enabled progress on several significant projects including: continued work on The Harvard Art Museums' renovation and expansion, which will result in greater accessibility to the University's world-renowned collections; commencement of construction of the Science Center Plaza, which supports the University's goal of creating a new and programmable common space for the entire community; ground breaking on the Faculty of Arts and Sciences' renovation of Old Quincy, an undergraduate house that is being used as a test house for the broader renovation of the undergraduate river houses; retrofit of space for The Wyss Institute for Biologically Inspired Engineering; and completion of the Wasserstein Caspersen Clinical Wing Building at the Harvard Law School.

This concludes the summary of the key financial highlights for fiscal 2012. We encourage you to read the audited financial statements and related notes for more information regarding the financial position and results of the University.

Message from the CEO of Harvard Management Company

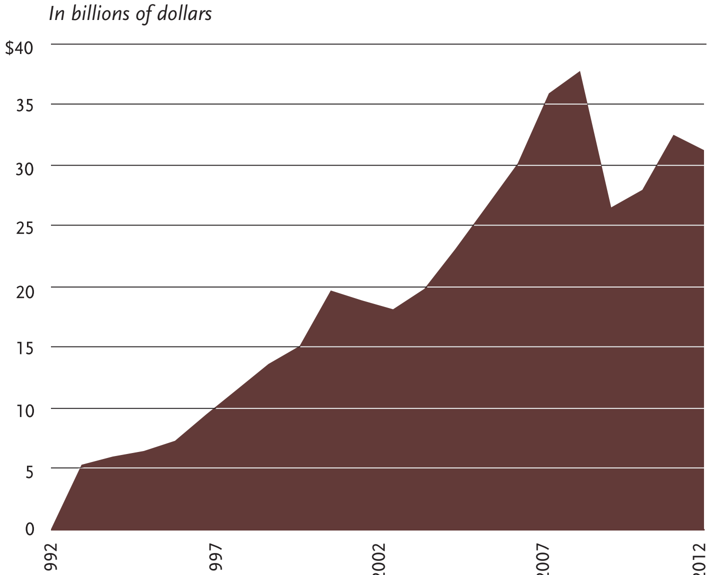
The return on the Harvard endowment for the fiscal year ended June 30, 2012 was essentially flat. The endowment earned an investment return of -0.05% and was valued at $30.7 billion at the end of the fiscal year. The fiscal year 2012 endowment return was 98 basis points in excess of the -1.03% return on the benchmark Policy Portfolio. Adding value relative to the Policy Portfolio – beating the markets – is not easily done and is not expected every year.

This is the third consecutive year that Harvard Management Company ("HMC") has beaten the Policy Portfolio. On a nominal basis, the average annual return for the endowment over the three year period since the financial crisis is 10.4%, exceeding the return on the Policy Portfolio benchmark by 125 basis points per year.

The markets during the last year continued to be choppy and highly sensitive to unresolved macroeconomic headwinds – with global equities down 6.5% for the year and the broad hedge fund industry experiencing total returns of -2.5%. In this context we are pleased that the endowment held steady and was able to provide substantial support to the University.

TOTAL VALUE (AFTER DISTRIBUTIONS) OF THE ENDOWMENT

In billions of dollars



As long-term investors, we manage the Harvard endowment with three primary objectives: growth, liquidity, and risk management. While market growth over the last twelve months was well below long-term averages, our portfolio benefited from the greatly improved liquidity and risk management we have built into the endowment over the last several years. We were also encouraged by the breadth of new investment opportunities we found through both internal and external managers during the year. We have invested in the best of these opportunities to enhance the positioning and balance of the overall portfolio and sow the seeds for future growth and alpha generation.

HISTORICAL CONTEXT

At HMC we are focused solely on providing strong financial support for Harvard University's many areas of excellence through successful portfolio management. We are constantly aware of both the opportunities and the responsibilities presented by the long-term nature of the endowment. This pool of assets needs to be kept

INVESTMENT RETURN
ANNUALIZED FOR PERIODS GREATER THAN ONE YEAR

	Harvard	Policy Portfolio Benchmark	60/40 Stock/bond Portfolio*
1 year	(0.05)%	(1.03)%	6.71%
3 years	10.42%	9.17%	12.82%
10 years	9.49%	7.09%	5.86%
20 years	12.29%	9.23%	7.94%

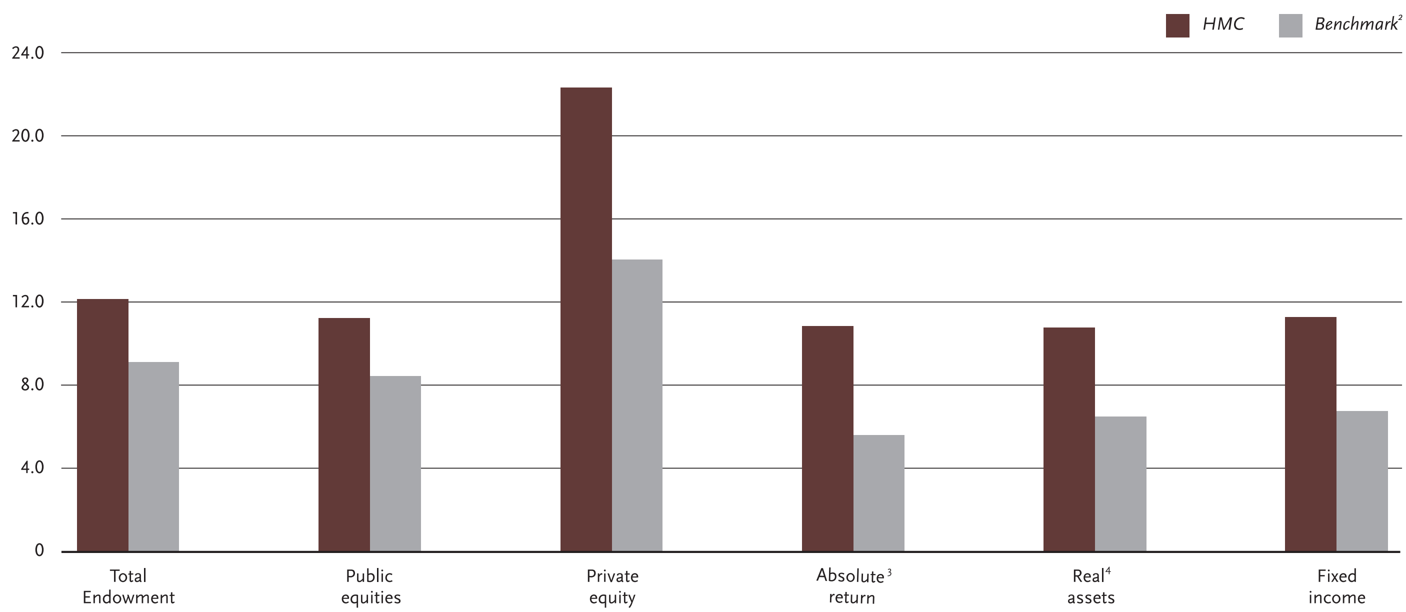
* *S&P 500 / CITI US BIG*

secure and to grow, in perpetuity. Such an extended investment horizon gives us an edge over the long-term, requiring that we think in decades, not months or years, when assessing the costs and benefits of our investment decisions and operating model.

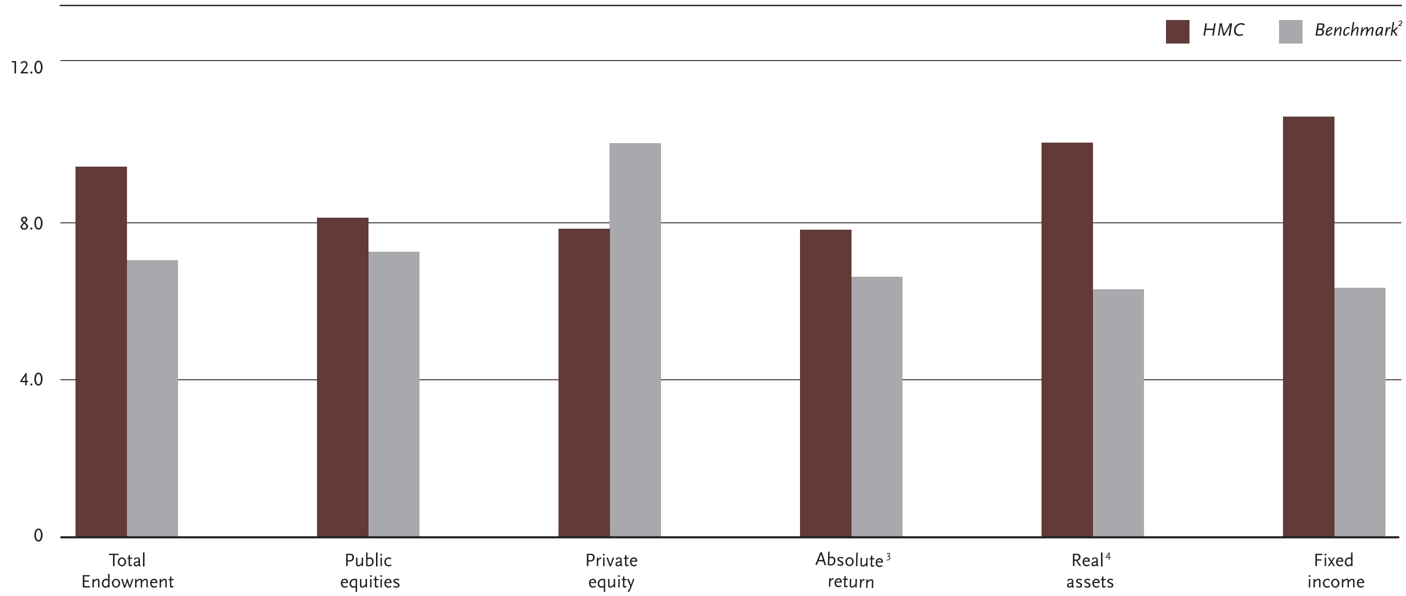
Over the past two decades the average annual return on the endowment has been 12.3%, beating our Policy Portfolio benchmark by over 300 basis points per year and a simple 60/40 stock/bond portfolio by even more substantial margins.

As markets and opportunities evolved over time, the drivers of Harvard's investment performance have also evolved, but our strategy of broad diversification and our long-term performance across all major asset classes has delivered significant value-added in total and across markets.

ANNUALIZED TWENTY-YEAR PERFORMANCE[1]



ANNUALIZED TEN-YEAR PERFORMANCE[1]



1 *Returns are calculated on a time-weighted basis with the exception of private equity and real assets, which are calculated on a dollar-weighted basis. Returns are net of all internal management fees and expenses.*
2 *Individual benchmarks are representative of each asset class and are approved by the Board of Directors of HMC.*
3 *Absolute return asset class includes high yield.*
4 *Real assets consist of investments in real estate, natural resources, and publicly traded commodities.*

Policy Portfolio Benchmark

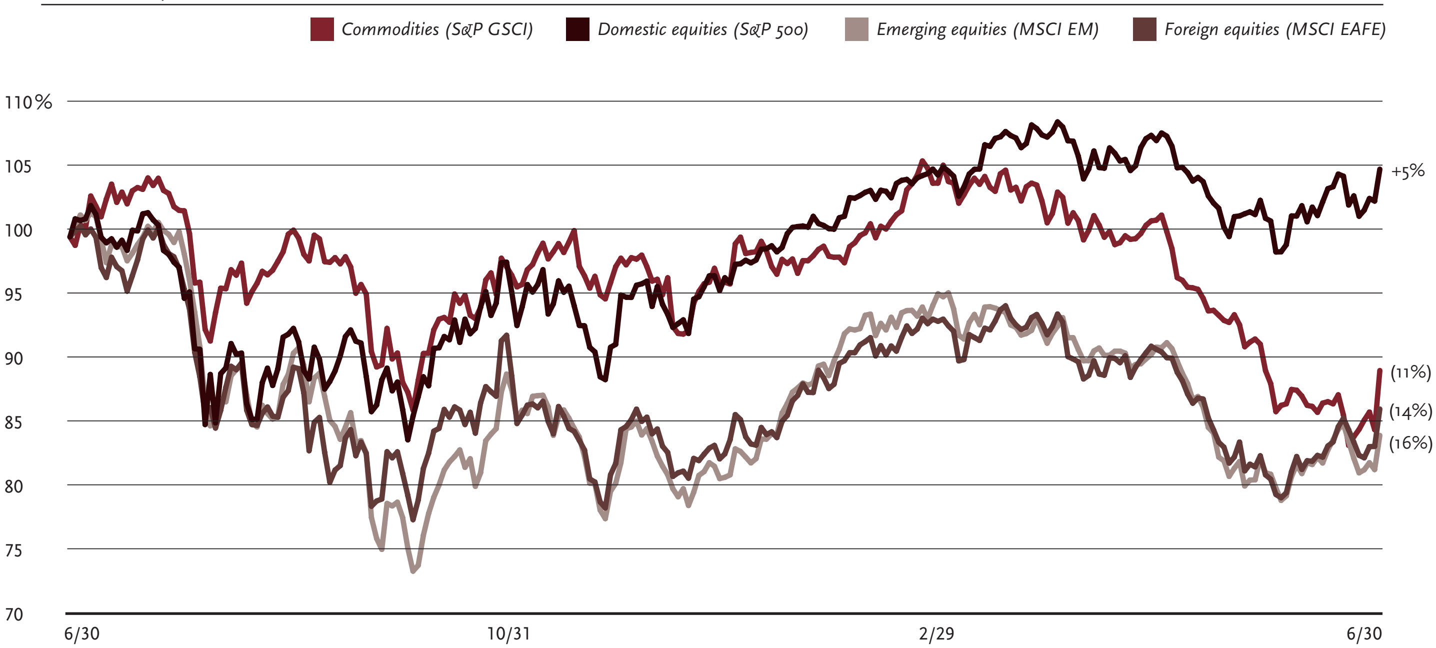
Each year, we review the long-term expected return, correlations and volatility for each of the asset classes in our diversified portfolio, and this work drives a thorough review and, from time to time, a revision of our benchmark Policy Portfolio. The Policy Portfolio is the mix of asset classes that we and the HMC Board determine is best equipped to meet Harvard's needs over the long-term. It provides HMC with a guide regarding asset allocation and a measuring stick for performance. When our return is in excess of the Policy Portfolio's return this means we have added value through active management. For more detail about the current Policy Portfolio and its evolution, visit HMC's website.

DISCUSSION OF FISCAL YEAR 2012

Market Overview

While we focus on the long-term in setting our investment strategy, current markets are also important. Over the last few years markets have been quite turbulent and managing through complexity has become one of our themes since the financial crisis of 2008. The 2012 fiscal year provided plenty of evidence that this theme remains relevant. The first five months of the year were characterized by a sharp downward correction in the public equity markets, driven by the US debt ceiling debate, stress in the euro zone, and fears of a slowdown in the Chinese economy. Although not as disorderly, there were some moments involving negative returns and high correlations among asset classes that were reminiscent of the summer-fall of 2008.

GLOBAL EQUITY AND COMMODITY INDICES FISCAL YEAR 2012



By early fall 2011 the impact was significant – the S&P was down nearly 20%, European stocks were down 30%, and natural gas was down 25%. As fall changed to winter the world equity markets shook off their anxiety and recovered nicely, however market sentiment turned sharply negative once again in the spring.

Fiscal 2012 Performance

Although we manage an exceptionally well-diversified portfolio, the endowment did feel the impact of market volatility during fiscal year 2012, especially in investments outside of the US. Despite these challenges, with our improved liquidity we have been active investors throughout the year in both liquid and illiquid markets. An example from each of these categories is discussed below.

	HMC	Benchmark	Relative
Public equities	(6.66)%	(9.05)%	2.39%
Private equity	1.99%	4.04%	(2.05)%
Fixed income	7.95%	7.85%	0.10%
Absolute return*	0.81%	(1.15)%	1.96%
Real assets	3.23%	1.55%	1.68%
TOTAL ENDOWMENT	**(0.05)%**	**(1.03)%**	**0.98%**

* *Includes high yield*

Public Equities—US and International

This year continues our record of outperformance in the combined public equities asset classes (US, foreign and emerging markets). On a combined basis, public equities in our portfolio added 239 basis points to the equity benchmark return, through a combination of internal and external strategies.

	HMC	Benchmark	Relative
Domestic equity	9.65%	4.08%	5.57%
Foreign equity	(10.81)%	(13.97)%	3.16%
Emerging markets	(17.43)%	(15.95)%	(1.48)%
PUBLIC EQUITIES	**(6.66)%**	**(9.05)%**	**2.39%**

Both US and foreign developed equities did very well relative to their market benchmarks last year, while emerging markets equities lagged their benchmark. Our US equity portfolio returned 9.7% (nearly 560 basis points over the US equity broad market benchmark).

We should note that Harvard carries relatively more exposure to both foreign and emerging markets than many of our peers. Our portfolio has roughly equal allocations to US, international developed, and emerging markets equities. The difference in returns among these markets was dramatic over the last twelve months, as can be seen from the public equities table above, but we remain convinced that active investing in emerging and international markets is not only wise, but imperative over the long-term.

We are now living and investing in a truly global economy: manufactured goods, commodities, capital, human talent, and services are shipped across borders and between hemispheres continuously. If chosen and executed well, emerging markets investments are poised to benefit from the phenomenal rate of change in local, regional, and global businesses worldwide and will be one of the key drivers of our portfolio's future performance.

Real Assets

As long-term investors driven by fundamentals, real assets investments hold strong appeal. Our definition of real assets includes real estate, natural resources, and publicly traded commodities. These three areas together make up about 25% of the total portfolio.

	HMC	Benchmark	Relative
Real estate	7.92%	6.80%	1.12%
Natural resources	2.40%	0.86%	1.54%
Publicly traded commodities	(8.14)%	(12.47)%	4.33%
REAL ASSETS	**3.23%**	**1.55%**	**1.68%**

We like the real assets theme for Harvard for several reasons: (a) long-term supply/demand characteristics and trends in many of these markets are favorable; (b) execution can be more complicated than in other investment areas, giving experienced investors an advantage; and (c) investors with a long-term view or more flexible timeline can do significantly better than those that are forced to transact by their specific investment mandate or time horizon.

Part 1 – Real Estate

Our revitalized real estate team and strategy, now about three years since inception, is beginning to bear fruit. Historically HMC's real estate strategy was focused exclusively on investments in private-equity-style real estate funds run by third-party managers. We are now investing a significant portion of our new capital in real estate through a direct deal/joint venture approach in specific market niches. This provides HMC much more discretion over capital allocation across markets and sectors, leverage, and development risk, as well as lower management fees. The assets invested in our new strategy returned about 15% last year. Our total real estate portfolio was up about 8% for the same period and outperformed its market benchmark.

Part 2 – Natural Resources

Our natural resource portfolio comprises hard assets, primarily timberland, agricultural land and other resource-bearing properties located around the world.

Our investment thesis in natural resources is fairly simple. We like the asset class because we believe its physical products are going to be in increasing demand in the global economy over the coming decades. At the same time, the supply of these physical products cannot be increased easily or quickly. In timberland, for example, it takes decades to produce incremental timber resources, while growing economies continue to demand more and more timber products today in order to build out infrastructure and satisfy growing consumer needs.

While we expect to see cycles in natural resources pricing, the inefficiencies in these markets can create excellent transaction opportunities, especially for investors like Harvard that have the ability to hold their investments for a long period of time.

Another reason we like this asset class is that experience counts. As a first mover, Harvard has developed a strong natural resources investment team including local market and natural resource specialists. Our expertise and scale allow us to make direct investments in individual properties, where we can have greater control over outcomes.

Sustainability is a key element of our natural resources investment strategy. We aim to manage so that our properties will be more productive with improved environmental outcomes at the end of our ownership period. We believe that by increasing the health and productivity of our assets, we will realize better value.

Returns in our natural resources portfolio were modest over the last twelve months at 2.4%, about 150 basis points over our benchmark. Since inception in 1997 our natural resources portfolio has delivered an average annual return of 12.7% versus the benchmark return of 6.7%.

Part 3 – Publicly Traded Commodities

The third leg of our real assets platform is broad-based exposure to publicly traded commodities. In this area we use a mix of internal and external management, with the common theme of applying strategic insight in individual markets or commodities in order to beat the public commodities indices.

Our internal management team in this asset class was new last year and got off to a very strong start, delivering over 1,100 basis points of return over our commodities benchmark. In total, our combined publicly traded commodities strategies added over 400 basis points of value relative to the commodities benchmark.

ORGANIZATIONAL UPDATE

Our company and our portfolio have stabilized and strengthened from their post-financial crisis state. Regarding the HMC organization, with a few near-term planned additions to our internal equities team, we anticipate being fully staffed on both the investment and support sides for the first time in several years. Our upgraded risk management team is providing essential and continuous input to our investment management functions. We have made good progress on rebalancing the mix of liquid and illiquid assets in our portfolio, although we are not quite where we want to be yet.

The experience, quality and commitment of our staff have never been better. Our portfolio management team in Boston is comprised of individuals with a diverse combination of backgrounds, cultures, and nationalities (many of whom share a direct connection to Harvard University).

We also continue to draw on the experiences and expertise of Harvard's broad global network, especially in areas such as China, India, Brazil, and other parts of the developing world. Harvard's unique reach has often provided us with deeper insight about opportunities and risks, and influenced the path of our thinking about how to best shape Harvard's portfolio going forward.

LOOKING AHEAD

One of the messages I constantly reinforce within HMC is that we can never stop evolving as stewards of Harvard's most valuable financial asset. We need to continually "up our game" as active investment managers, staying alert to change and focused on new opportunity. The world of investments changes every year – with more dollars, more analysts, and more investors of all types looking for additions to their portfolios that they hope will generate outstanding returns.

This is a time of unusual turbulence with significant macroeconomic issues facing regions around the world. While future returns may be uncertain, our strategy is to remain well diversified and focused on long-term value creation. We continue to concentrate on generating alpha on both a domestic and international stage.

Thank you for your support.

Sincerely,

Jane L. Mendillo
President and Chief Executive Officer

November 2, 2012

INSIDE HMC'S INVESTMENT PROCESS

At HMC we use a combination of internal and external teams to manage parts of the Harvard endowment in both public markets and alternative asset classes. Our process for evaluating investments for inclusion in the portfolio may vary by strategy, but always involves fundamental market analysis, asset valuation (and a plan for realizing that value), and assessments of expected return and risk. Our investment professionals' analysis is augmented by legal and operational due diligence conducted by separate dedicated teams within HMC. In every case, we consider several factors including:

- **Quality.** The quality of the underlying investment asset as well as the risk/reward profile of the investment must meet the standards of the world's largest endowment portfolio.

- **Innovation.** We strive for and value innovation in investment opportunities, with investment partners, and in our own organization. We know that the areas of best performance from prior decades will not necessarily give us our highest returns going forward, so it is imperative that we continue to look for innovation in our managers and in our own investment strategy.

- **Long-term Sustainability.** We are, by the nature of our mission, concerned with responsible stewardship and sustainability. While we are careful to avoid constraining our investment universe unnecessarily, we are responsible investors who fully vet potential investments and investment partners for long-term viability. We hold ourselves and our managers to a high standard regarding areas such as environmental stewardship, labor practices, and good governance.

Report of Independent Auditors

To the Board of Overseers of Harvard College:

In our opinion, the accompanying Balance Sheet and the related Statement of Changes in Net Assets with General Operating Account Detail, Changes in Net Assets of the Endowment, and Cash Flows, present fairly, in all material respects, the financial position of Harvard University (the "University") at June 30, 2012, and the changes in its net assets of the General Operating Account and endowment funds and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. The prior year summarized information has been derived from the University's fiscal 2011 financial statements, and in our report dated October 28, 2011, we expressed an unqualified opinion on those financial statements. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

November 2, 2012

PricewaterhouseCoopers LLP, 125 High Street, Boston, MA 02110
T: (617) 530 5000, F: (617) 530 5001, www.pwc.com/us

BALANCE SHEETS

with summarized financial information as of June 30, 2011

In thousands of dollars	June 30 2012	2011
ASSETS:		
Cash	$ **155,088**	$ 142,503
Receivables, net (*Note 6*)	**227,401**	199,231
Prepayments and deferred charges	**171,026**	163,886
Notes receivable, net (*Note 7*)	**363,566**	363,356
Pledges receivable, net (*Note 8*)	**908,558**	758,441
Fixed assets, net (*Note 9*)	**5,776,545**	5,647,077
Interests in trusts held by others (*Note 4*)	**343,798**	351,408
Investment portfolio, at fair value (*Notes 3 and 4*)	**43,385,126**	46,817,373
Securities pledged to counterparties, at fair value (*Notes 3 and 4*)	**6,383,535**	6,768,202
TOTAL ASSETS	**57,714,643**	**61,211,477**
LIABILITIES:		
Accounts payable	**284,250**	340,911
Deposits and other liabilities	**648,896**	679,326
Securities lending and other liabilities associated with the investment portfolio (*Notes 3, 4 and 12*)	**12,294,626**	14,335,814
Liabilities due under split interest agreements (*Note 11*)	**670,242**	771,568
Bonds and notes payable (*Note 12*)	**6,039,139**	6,335,709
Accrued retirement obligations (*Note 13*)	**1,056,015**	817,885
Government loan advances (*Note 7*)	**67,044**	66,987
TOTAL LIABILITIES	**21,060,212**	**23,348,200**
NET ASSETS, attributable to non-controlling interests in the pooled general investment account (*Note 3*)	**1,070,136**	**832,339**
NET ASSETS, attributable to the University	**35,584,295**	**37,030,938**
TOTAL LIABILITIES AND NET ASSETS	**$ 57,714,643**	**$ 61,211,477**

	Unrestricted	Temporarily restricted	Permanently restricted	June 30 2012	2011
NET ASSETS, attributable to the University:					
General Operating Account (*Note 14*)	$ 2,743,325	$ 1,448,690	$ 96,498	$ 4,288,513	$ 4,500,420
Endowment (*Note 10*)	5,362,336	19,763,294	5,619,904	30,745,534	32,012,729
Split interest agreements (*Note 11*)		70,705	479,543	550,248	517,789
TOTAL NET ASSETS	**$ 8,105,661**	**$ 21,282,689**	**$ 6,195,945**	**$ 35,584,295**	**$ 37,030,938**

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

STATEMENTS OF CHANGES IN NET ASSETS WITH GENERAL OPERATING ACCOUNT DETAIL

with summarized financial information for the year ended June 30, 2011

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2012	For the year ended June 30 2011
OPERATING REVENUE:					
Student income:					
Undergraduate program	$ 264,513			$ **264,513**	$ 254,095
Graduate and professional degree programs	432,518			**432,518**	411,152
Board and lodging	155,417			**155,417**	149,972
Continuing education and executive programs	281,317			**281,317**	260,390
Scholarships applied to student income (*Note 15*)	(357,001)			**(357,001)**	(335,036)
Total student income	776,764	0	0	**776,764**	**740,573**
Sponsored support (*Note 16*):					
Federal government - direct costs	493,003			**493,003**	509,958
Federal government - indirect costs	176,560			**176,560**	176,270
Non-federal sponsors - direct costs	60,750	$ 78,868		**139,618**	145,044
Non-federal sponsors - indirect costs	15,971	7,472		**23,443**	20,555
Total sponsored support	746,284	86,340	0	**832,624**	**851,827**
Gifts for current use (*Note 17*)	90,405	198,812		**289,217**	276,914
Investment income:					
Endowment returns made available for operations (*Note 10*)	258,151	1,163,913		**1,422,064**	1,321,743
GOA returns made available for operations	141,804			**141,804**	148,178
Other investment income	10,318	7,192		**17,510**	21,624
Total investment income	410,273	1,171,105	0	**1,581,378**	**1,491,545**
Other income (*Note 18*)	557,165			**557,165**	546,600
Net assets released from restrictions	1,506,745	(1,506,745)		**0**	0
TOTAL OPERATING REVENUE	**4,087,636**	**(50,488)**	**0**	**4,037,148**	**3,907,459**
OPERATING EXPENSES:					
Salaries and wages	1,497,928			**1,497,928**	1,420,023
Employee benefits (*Note 13*)	476,436			**476,436**	461,010
Depreciation (*Note 9*)	288,865			**288,865**	281,027
Interest (*Note 12*)	287,067			**287,067**	298,843
Space and occupancy	274,786			**274,786**	271,853
Supplies and equipment	235,920			**235,920**	233,655
Scholarships and other student awards (*Note 15*)	128,993			**128,993**	116,510
Other expenses (*Note 19*)	851,703			**851,703**	824,647
TOTAL OPERATING EXPENSES	**4,041,698**	**0**	**0**	**4,041,698**	**3,907,568**
NET OPERATING SURPLUS/(DEFICIT)	**45,938**	**(50,488)**	**0**	**(4,550)**	**(109)**
NON-OPERATING ACTIVITIES:					
Income from GOA investments	10,938			**10,938**	20,946
Realized and unrealized (depreciation)/appreciation, net (*Note 3*)	(162,764)			**(162,764)**	649,799
GOA returns made available for operations	(141,804)			**(141,804)**	(148,178)
Change in pledge balances (*Note 8*)		123,553		**123,553**	36,616
Change in interests in trusts held by others		8,140		**8,140**	6,120
Capital gifts for loan funds and facilities (*Note 17*)		25,969	$ 274	**26,243**	32,987
Change in retirement obligations (*Note 13*)	(208,814)			**(208,814)**	172,482
Other changes	(17,226)			**(17,226)**	(51,364)
Transfers between GOA and endowment	(5,832)	138,971	7,003	**140,142**	19,090
Transfers between GOA and split interest agreements		12,053	2,182	**14,235**	14,100
Non-operating net assets released from restrictions	59,664	(50,606)	(9,058)	**0**	0
TOTAL NON-OPERATING ACTIVITIES	**(465,838)**	**258,080**	**401**	**(207,357)**	**752,598**
GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR	**(419,900)**	**207,592**	**401**	**(211,907)**	**752,489**
Endowment net change during the year	(233,444)	(1,445,399)	411,648	**(1,267,195)**	4,447,700
Split interest agreement net change during the year (*Note 11*)		(3,268)	35,727	**32,459**	95,816
NET CHANGE DURING THE YEAR, attributable to the University	**(653,344)**	**(1,241,075)**	**447,776**	**(1,446,643)**	**5,296,005**
NET CHANGE IN NET ASSETS, attributable to non-controlling interests in the pooled general investment account	237,797			**237,797**	**235,004**
NET CHANGE DURING THE YEAR	**(415,547)**	**(1,241,075)**	**447,776**	**(1,208,846)**	**5,531,009**
Net assets, beginning of year	9,591,344	22,523,764	5,748,169	**37,863,277**	32,332,268
NET ASSETS, end of year	**$ 9,175,797**	**$ 21,282,689**	**$ 6,195,945**	**$ 36,654,431**	**$ 37,863,277**

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

STATEMENTS OF CHANGES IN NET ASSETS OF THE ENDOWMENT

with summarized financial information for the year ended June 30, 2011

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2012	For the year ended June 30 2011
Investment return (*Note 3*):					
Income from general investments	$ 19,269	$ 84,840		$ **104,109**	$ 161,206
Realized and unrealized appreciation/(depreciation), net	(15,806)	(87,903)		**(103,709)**	5,339,178
Total investment return	3,463	(3,063)	0	**400**	5,500,384
Endowment returns made available for operations	(258,151)	(1,163,913)		**(1,422,064)**	(1,321,743)
Net investment return	(254,688)	(1,166,976)	0	**(1,421,664)**	4,178,641
Gifts for capital (*Note 17*)	6,223	17,217	$ 203,054	**226,494**	212,364
Transfers between endowment and the GOA (*Note 10*)	5,832	(138,971)	(7,003)	**(140,142)**	(19,090)
Capitalization of split interest agreements (*Note 11*)		18,684	39,583	**58,267**	56,000
Change in pledge balances (*Note 8*)		7,761	17,749	**25,510**	(49,534)
Change in interests in trusts held by others (*Note 10*)		911	(16,661)	**(15,750)**	47,660
Other changes		(159,130)	159,220	**90**	21,659
Net assets released from restrictions (*Note 2*)	9,189	(24,895)	15,706	**0**	0
NET CHANGE DURING THE YEAR	**(233,444)**	**(1,445,399)**	**411,648**	**(1,267,195)**	**4,447,700**
Net assets of the endowment, beginning of year	5,595,780	21,208,693	5,208,256	**32,012,729**	27,565,029
NET ASSETS OF THE ENDOWMENT, end of year	**$ 5,362,336**	**$ 19,763,294**	**$ 5,619,904**	**$ 30,745,534**	**$ 32,012,729**

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

STATEMENTS OF CASH FLOWS

In thousands of dollars	For the year ended June 30 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	**$ (1,208,846)**	$ 5,531,009
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Change in net assets, attributable to non-controlling interests in the pooled general investment account	**(237,797)**	(235,004)
Depreciation	**288,865**	281,027
Realized and unrealized loss/(gain) on investments, net	**154,235**	(6,175,282)
Change in fair value of interest rate exchange agreements	**(18,675)**	(330,270)
Change in interests in trusts held by others	**7,610**	(53,779)
Change in liabilities due under split interest agreements	**(101,326)**	65,967
Gifts of securities	**(83,471)**	(53,717)
Gifts restricted for capital purposes	**(212,776)**	(235,636)
Loss on redemption of debt	**17,185**	32,190
Loss on disposal of assets	**1,348**	35,023
Change in accrued retirement obligations	**238,130**	(91,308)
Changes in operating assets and liabilities:		
Receivables, net	**(28,170)**	43,243
Prepayments and deferred charges	**(7,140)**	1,625
Pledges receivable, net	**(150,117)**	13,771
Accounts payable	**(14,666)**	(42,568)
Deposits and other liabilities	**(30,430)**	(56)
NET CASH USED IN OPERATING ACTIVITIES	**(1,386,041)**	**(1,213,765)**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans made to students, faculty, and staff	**(48,024)**	(45,987)
Payments received on student, faculty, and staff loans	**46,383**	37,470
Change in other notes receivable	**1,431**	9,470
Proceeds from the sales of gifts of securities	**83,471**	53,717
Proceeds from the sales and maturities of investments	**46,924,811**	72,153,105
Purchases of investments	**(47,337,633)**	(69,719,820)
Additions to fixed assets	**(437,673)**	(445,936)
NET CASH (USED IN)/PROVIDED BY INVESTING ACTIVITIES	**(767,234)**	**2,042,019**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in overdrafts included in accounts payable	**(24,003)**	30,866
Proceeds from the issuance of debt	**136,280**	1,065,587
Debt repayments	**(450,035)**	(1,046,265)
Gifts restricted for capital purposes	**212,776**	235,636
Change associated with securities lending agreements	**2,290,785**	(1,008,795)
Change in government loan advances	**57**	5,591
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	**2,165,860**	**(717,380)**
NET CHANGE IN CASH	**12,585**	**110,874**
Cash, beginning of year	**142,503**	**31,629**
CASH, end of year	**$ 155,088**	**$ 142,503**
Supplemental disclosure of cash flow information:		
Accounts payable related to fixed asset additions	$ 44,057	$ 62,049
Cash paid for interest	$ 302,149	$ 295,616

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

1. UNIVERSITY ORGANIZATION

Harvard University (the "University") is a private, not-for-profit institution of higher education with approximately 7,250 undergraduate and 13,800 graduate students. Established in 1636, the University includes the Faculty of Arts and Sciences, the School of Engineering and Applied Sciences, the Division of Continuing Education, ten graduate and professional Schools, the Radcliffe Institute for Advanced Study, a variety of research museums and institutes, and an extensive library system to support the teaching and research activities of the Harvard community. The President and Fellows of Harvard College (the "Corporation"), a governing board of the University, has oversight responsib ility for all of the University's financial affairs. The Corporation delegates substantial authority to the Schools and departments for the management of their resources and operations.

The University includes Harvard Management Company (HMC), a wholly owned subsidiary founded in 1974 to manage the University's investment assets. HMC is governed by a Board of Directors that is appointed by the Corporation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The consolidated financial statements present the activities of Harvard University as a whole, including significant affiliated organizations controlled by the University.

The financial statements include certain prior year summarized comparative information in total, not by net asset classification. This information is not presented in sufficient detail to conform with generally accepted accounting principles (GAAP). Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2011, from which the summarized information is derived.

Certain prior year amounts have been reclassified to conform to current year presentation. The reclassifications include moving the portion of the endowment payout accounted for in "Transfers between GOA and endowment" in non-operating activities to "Endowment returns made available for operations" in operating revenues in the *Statement of Changes in Net Assets with General Operating Account Detail*. This reclassification reduced the prior year operating deficit by $129.7 million. Additionally, the University reclassified $60.7 million of "Receivables" and $3.8 million of "Accounts payable" to the "Investment portfolio" in the *Balance Sheets*.

During a review of its endowment funds, the University noted that there were certain inconsistencies related to the recording of donor directed principal activity. As a result, the University has correctly reclassified $159.2 million from temporarily restricted to permanently restricted in the "Other changes" line item on the *Statement of Changes in Net Assets of the Endowment* for the year ended June 30, 2012. This reclassification had no impact on total net assets.

Funds transferred to the University on behalf of specific beneficiaries (agency funds) are recorded as assets and liabilities in the *Balance Sheets* and are not included in the *Statements of Changes in Net Assets with General Operating Account Detail*.

Net asset classifications

For the purposes of financial reporting, the University classifies resources into three net asset categories pursuant to any donor-imposed restrictions and applicable law. Accordingly, the net assets of the University are classified in the accompanying financial statements in the categories that follow:

UNRESTRICTED net assets are not subject to donor-imposed restrictions. Funds invested in fixed assets and unrestricted endowment funds comprise 91% of the University's unrestricted net assets as of June 30, 2012. In addition, this category includes unrestricted gifts and endowment income balances, University-designated loan funds, and other unrestricted current funds.

TEMPORARILY RESTRICTED net assets are subject to legal or donor-imposed stipulations that will be satisfied either by actions of the University, the passage of time, or both. These net assets include gifts donated for a particular purpose, amounts subject to time restrictions such as funds pledged for future payment, or amounts subject to legal restrictions such as portions of otherwise unrestricted capital appreciation and income, which must be reported as temporarily restricted net assets until appropriated for spending in accordance with Massachusetts law.

PERMANENTLY RESTRICTED net assets are subject to donor-imposed stipulations that they be invested to provide a perpetual source of income to the University. Generally, donors of these assets require the University to maintain and invest the original contribution in perpetuity, but permit the use of some or all investment returns for general or specific purposes.

Revenues from sources other than contributions are generally reported as increases in unrestricted net assets. Expenses are reported as decreases in unrestricted net assets. Investment returns earned by restricted donor funds are initially classified as temporarily restricted net assets and then reclassified to unrestricted net assets when expenses are incurred for their intended purpose.

Unconditional pledges are reported as increases in the appropriate categories of net assets in accordance with donor restrictions. Gains and losses on investments are reported as increases or decreases in unrestricted net assets, unless their use is restricted by donor stipulations or by law. Expirations of temporary restrictions on net assets are reported as reclassifications from temporarily restricted to unrestricted net assets and appear as "Net assets released from restrictions" and "Non-operating net assets released from restrictions" in the *Statements of Changes in Net Assets*.

Net operating surplus/(deficit)

Revenues earned, expenses incurred, and returns made available for operations for the purpose of teaching, conducting research, and the other programs and services of the University are the components of "Net operating surplus/(deficit)" in the *Statements of Changes in Net Assets with General Operating Account Detail*.

Collections

The University's vast array of museums and libraries houses priceless works of art, historical treasures, literary works, and artifacts. These collections are protected and preserved for public exhibition, education, research, and the furtherance of public service. They are neither disposed of for financial gain nor encumbered in any manner. Accordingly, such collections are not recorded for financial statement purposes.

Insurance programs

The University, together with the Harvard-affiliated teaching hospitals, participates in a group captive insurance company, Controlled Risk Insurance Company (CRICO), to secure limited professional liability, general liability, and medical malpractice insurance for its member shareholders. The University self-insures a portion of its professional liability and general liability programs and maintains a reserve for incurred claims, including those related to Harvard Medical School activities occurring away from the affiliated teaching hospitals. The CRICO provided malpractice coverage applies with no deductible for medical professionals practicing within Harvard's University Health Services department, the School of Dental Medicine, and the School of Public Health. The University also maintains reserves for the self-insured portion of claims related to automobile liability, property damage, and workers' compensation; these programs are supplemented with commercial excess insurance above the University's self-insured retention. In addition, the University is self-insured for unemployment, the primary senior health plan, and all health and dental plans for active employees. The University's claims liabilities are recognized as incurred, including claims that have been incurred but not reported, and are included in operating expenses.

Tax-exempt status

The University is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.

Use of estimates

The preparation of financial statements in accordance with GAAP in the United States of America requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

New accounting pronouncements

Effective July 1, 2010, the University adopted ASU 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 requires additional disclosures for significant transfers in and out of Levels 1 and 2 and the presentation of gross trading activity within the Level 3 rollforward. Further, ASU 2010-06 clarifies existing disclosures to include fair value measurement disclosures for each class of assets and liabilities as well as to require additional disclosures about inputs and valuation techniques utilized to measure fair value for Levels 2 and 3. The effects of adopting this amendment are addressed in *Notes 3* and *4*.

Effective July 1, 2010, the University adopted ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 requires additional disclosures surrounding credit losses on long-term receivables. The effects of adopting this amendment are addressed in *Note 7*.

Effective July 1, 2010, the University retroactively adopted ASU 2010-7 *Not-for-Profit Entities Mergers and Acquisitions*. While the University was not a party to any mergers or acquisitions, the guidance also impacts the financial statement treatment of non-controlling interests in consolidated entities. This guidance requires the University to report non-controlling interests in consolidated entities as a separate component of net assets on the Statement of Financial Position and the change in net assets attributable to the non-controlling interests separately within the *Statements of Changes in Net Assets with General Operating Account Detail*. The effects of adopting this amendment are addressed in *Note 3*.

3. INVESTMENTS

The significant accounting policies of the University related to investments are as follows:

A) Investments are presented at fair value based on trade date positions as of June 30, 2012 and 2011. The University endeavors to utilize all relevant and available information in measuring fair value.

B) The preparation of financial statements requires management to make estimates and assumptions about the effects of matters that may be inherently uncertain. Estimates, by their nature, are based on judgment and available information. Changes in assumptions could have a significant effect on the fair value of certain instruments. Actual results could differ from these estimates and could have a material impact on the financial statements.

C) Cash and short-term investments are recorded at cost, which approximates fair value, and include cash in bank accounts, institutional money market funds, and other temporary investments held for working capital purposes with maturities of three months or less. Cash and short-term investments do not include cash balances held as collateral.

D) Instruments listed or traded on a securities exchange are valued at the last quoted price on the primary exchange where the security is traded. Where no sale has occurred on the valuation date, long positions are valued at the bid price and short positions are valued at the ask price. Restrictions that are attached to a security are factored into the valuation of that security, reflective of the estimated impact of those restrictions. Investments in non-exchange traded debt and equity instruments are primarily valued using inputs provided by independent pricing services or by broker/dealers who actively make markets in these securities.

Investments managed by external advisors include investments in private equity, real assets, and certain other investments in limited partnerships and hedge funds classified as domestic equity, high yield, and absolute return. The majority of these external investments are not readily marketable and are reported at fair value utilizing the most current information provided by the external advisor, subject to assessments that the information is representative of fair value and in consideration of any additional factors deemed pertinent to the fair value measurement. The University evaluates its external advisors through a manager due-diligence program executed by HMC, which includes an analysis of an advisor's use of and adherence to fair value principles. In situations where the information provided by the external advisor is deemed to not be representative of fair value as of the measurement date, management will evaluate specific features of the investment and utilize supplemental fair value information provided by the external advisor along with any relevant market data to measure the investment's fair value as of that date.

Fair value measurements of real assets (including direct investments in natural resources and real estate) are based on a combination of information obtained from independent appraisals and/or one or more industry standard valuation techniques (e.g., income approach, market approach, or cost approach). The income approach is primarily based on the investment's anticipated future income using one of two principal methods, the discounted cash flow method or the capitalization method. Inputs and estimates developed and utilized in the income approach may be subjective and require judgment regarding significant matters such as estimating the amount and timing of future cash flows and the selection of discount and capitalization rates that appropriately reflect market and credit risks. The market approach derives investment value through comparison to recent and relevant market transactions with similar investment characteristics. The cost approach is utilized when the cost or the replacement cost amounts are determined to be the best representation of fair value. This method is typically used for newly purchased or undeveloped assets. These valuations are determined by management and subject to review by the HMC Board of Directors.

Over the counter derivative products classified as due to/from brokers include option, swap, credit default, interest rate, and forward contracts. These types of instruments are primarily valued using industry standard models with externally provided inputs or independent broker quotes. Inputs such as prices, spreads, curves, and/or broker quotes are evaluated for source reliability and consistency with industry standards. Counterparty marks obtained and used to determine daily collateral requirements are also used to corroborate input reasonability. Management considers current market conditions including interest rate and credit risks in its evaluation of inputs, pricing methodologies, and models utilized to determine fair values.

E) Dividend income is recognized net of applicable withholding taxes on the ex-dividend date. Non-cash dividends are recorded at the fair value of the securities received. Interest income and expenses are recorded net of applicable withholding taxes on the accrual basis of accounting. The University amortizes bond premiums and accretes bond discounts using the effective yield method and when cash collection is expected.

F) The University utilizes a number of wholly owned subsidiary entities to support its investment activities. The consolidated financial statements include all assets, liabilities, income, and expenses associated with these entities. All intercompany accounts and transactions have been eliminated during consolidation.

G) The University may enter into repurchase agreements, whereby the University acquires a security (collateral) for cash subject to an obligation by the counterparty to repurchase the security at an agreed-upon price and time. The University requires the fair value of the collateral received to be equal to or in excess of the total amount of the repurchase agreement, including interest. Securities purchased under repurchase agreements are reflected as an asset on the *Balance Sheets*. Interest earned or paid is recorded as a component of Investment income on the *Statements of Changes in Net Assets*. Generally, in the event of counterparty default, the University has the right to use the collateral to offset losses incurred. The collateral advanced under security borrowing agreements is in the form of cash. The minimum collateral the University requires by contract on each loaned security is 100% of the fair value of the security loaned. Collateral is exchanged as required by fluctuations in the fair value of the security loaned.

H) The *Balance Sheets* display both the assets and corresponding liabilities generated by reverse repurchase and securities lending transactions. Under the terms of a reverse repurchase agreement, the counterparty takes possession of an underlying security subject to an obligation of the University to repurchase the security at an agreed-upon price and time. The University pays the counterparty interest over the term of the reverse repurchase agreement. The University also separately reports the fair value of assets for which counterparties have the right to pledge or exchange the collateral they have received; assets of the investment portfolio that are unencumbered are included in "Investment portfolio, at fair value" in the *Balance Sheets*. Income and expenses related to reverse repurchase and securities lending transactions are included in "Income from general investments" in the *Statements of Changes in Net Assets of the Endowment*. These transactions are executed to support the investment activities of HMC.

The majority of the University's investments are managed by HMC in the General Investment Account (GIA), a pooled fund that consists primarily of endowment assets. Other investments are managed separately from the GIA. These investments consist primarily of cash, short-term investments, and fixed income securities (principally government securities) held for the University's working capital and liquidity needs, interest rate contracts on the University's debt portfolio, and publicly traded securities associated with split interest agreements. All investments are measured at fair value using valuation techniques consistent with ASC 820 and the accounting policies presented herein.

The University's investment holdings as of June 30, 2012 and 2011 are summarized in the following table (in thousands of dollars):

	2012	2011
Investment portfolio, at fair value:		
Pooled general investment account assets[1]	**$ 47,788,308**	$ 51,276,581
Other investments	**1,980,353**	2,308,994
Investment assets[2]	**49,768,661**	53,585,575
Pooled general investment account liabilities	**(11,912,733)**	(13,935,246)
Interest rate exchange agreements	**(381,893)**	(400,568)
Investment liabilities	**(12,294,626)**	(14,335,814)
TOTAL INVESTMENTS	**37,474,035**	39,249,761
Non-controlling interests attributable to the pooled general investment account	**(1,070,136)**	(832,339)
TOTAL INVESTMENTS, NET	**$ 36,403,899**	**$ 38,417,422**

1 *Includes securities pledged to counterparties of $6,383,535 and $6,768,202 at June 30, 2012 and 2011, respectively.*

2 *Investment holdings include cash and cash equivalents that consist principally of deposits that have maturities of 90 days or less. Cash and cash equivalents classified as investments were $926,896 and $1,363,712 at June 30, 2012 and 2011, respectively.*

A summary of the University's total return on investments for fiscal 2012 and 2011 is presented below (in thousands of dollars):

	2012	2011
Return on pooled general investment account:		
Realized and change in unrealized gains, net	$ (141,861)	$ 6,100,258
Net investment income	117,569	184,192
Total return on pooled general investment account[1]	(24,292)	6,284,450
Return on other investments:		
Realized and change in unrealized (losses)/gains, net	(12,374)	75,024
Net investment income	28,979	35,284
Total return on other investments	16,605	110,308
Realized and unrealized (losses)/gains on interest rate exchange agreements, net	(140,219)	7,877
TOTAL RETURN ON INVESTMENTS	**$ (147,906)**	**$ 6,402,635**

1 *Net of all internal and external management fees and expenses.*

The University's investment strategy incorporates a diversified asset allocation approach and maintains, within defined limits, exposure to the movements of the global equity, fixed income, real estate, commodities, and private equity markets. The Policy Portfolio provides HMC with a guide as to the targeted allocation in the core investment portfolio. The Policy Portfolio is the long-term asset mix determined by the HMC Board of Directors and management team that is considered most likely to meet the University's long-term return goals with the designated level of risk. It serves as the benchmark against which the performance of the pooled general investment account is measured. In addition, the University seeks to enhance the returns of certain asset classes through relative strategies designed to capture mispricing in specific financial instruments without changing the fundamental risk profile of the core investment account.

The University has various sources of liquidity at its disposal within its investment pools, including approximately $3.8 billion in cash and cash equivalents (including repurchase agreements of $3.0 billion) at June 30, 2012 in the General Investment Account and the General Operating Account. In addition, management estimates that as of June 30, 2012, it could liquidate additional unencumbered US government securities of $1.4 billion within one business day (typical settlement terms) to meet any immediate short-term needs of the University.

The pooled general investment account assets and liabilities below have been disaggregated into asset classes based on the exposure of the investment to various markets. Exposure to each asset class is achieved through investments in individual securities, direct investments in special purpose vehicles, and/or through vehicles advised by external managers.

The pooled general investment account assets and liabilities as of June 30, 2012 and 2011 are summarized as follows (in thousands of dollars):

	2012	2011
POOLED GENERAL INVESTMENT ACCOUNT ASSETS:		
Investment assets:		
Domestic common and convertible equity	**$ 3,510,380**	$ 3,806,649
Foreign common and convertible equity	**1,771,081**	2,062,218
Domestic fixed income	**5,232,751**	4,982,365
Foreign fixed income	**1,774,283**	3,112,809
Emerging market equity and debt	**2,959,047**	2,411,371
High yield	**1,557,938**	1,634,649
Absolute return	**4,751,754**	5,033,413
Private equities	**7,095,625**	7,262,271
Real assets[1]	**10,156,008**	8,816,619
Inflation-indexed bonds	**919,081**	1,303,314
Due from brokers	**299,518**	998,001
Total investment assets[2]	**40,027,466**	41,423,679
Repurchase and securities borrowing agreements	**6,002,202**	7,765,585
Cash and short-term investments	**750,733**	941,141
Other assets[3]	**1,007,907**	1,146,176
POOLED GENERAL INVESTMENT ACCOUNT ASSETS	**47,788,308**	**51,276,581**
POOLED GENERAL INVESTMENT ACCOUNT LIABILITIES:		
Investment liabilities:		
Equity and convertible securities sold, not yet purchased	**38,854**	358,553
Fixed income securities sold, not yet purchased	**3,343,931**	4,225,876
Due to brokers	**63,512**	803,307
Total investment liabilities	**3,446,297**	5,387,736
Reverse repurchase and securities lending agreements	**6,725,670**	6,198,268
Other liabilities[4]	**1,740,766**	2,349,242
POOLED GENERAL INVESTMENT ACCOUNT LIABILITIES	**11,912,733**	13,935,246
Non-controlling interests attributable to the pooled general investment account	**1,070,136**	832,339
POOLED GENERAL INVESTMENT ACCOUNT NET ASSETS[5]	**$ 34,805,439**	**$ 36,508,996**

1 *Real assets includes investments in natural resources and real estate managed by external advisors of $3,941,571 and $3,650,447 as of June 30, 2012 and 2011, respectively. The remaining balance consists of direct investments in natural resources and real estate held through special purpose vehicles of $6,214,437 and $5,166,172 as of June 30, 2012 and 2011, respectively.*

2 *Includes fair value of securities pledged to counterparties where the counterparty has the right to sell or repledge the securities of $6,383,535 and $6,768,202 as of June 30, 2012 and 2011, respectively.*

3 *As of June 30, 2012, other assets consisted primarily of receivables for the sale of securities of $179,148, and assets consolidated under ASC 810 of $426,018. As of June 30, 2011, other assets consisted primarily of receivables for the sale of securities of $748,598, and assets consolidated under ASC 810 of $397,577.*

4 *As of June 30, 2012, other liabilities consisted primarily of payables for the purchase of securities of $143,644, and other liabilities consolidated under ASC 810 of $1,203,333. As of June 30, 2011, other liabilities consisted primarily of payables for the purchase of securities of $1,433,911, and other liabilities consolidated under ASC 810 of $844,431.*

5 *The cost of the total pooled general investment account net assets was $33,203,550 and $32,266,809 as of June 30, 2012 and 2011, respectively.*

As of June 30, 2012 and 2011, the GIA was comprised of the following components (in thousands of dollars):

	2012	2011
POOLED GENERAL INVESTMENT ACCOUNT		
Endowment[1]	$ 29,907,024	$ 31,153,645
General operating account	3,792,118	4,202,095
Split interest agreements	761,333	796,563
Other internally designated funds	344,964	356,693
TOTAL POOLED GENERAL INVESTMENT ACCOUNT NET ASSETS	**$ 34,805,439**	**$ 36,508,996**

[1] *Includes only the portion of the endowment invested in the GIA and excludes pledges, interests in trusts held by others, other non-GIA investments, and GIA income.*

The asset allocation of the University's investment portfolio involves exposure to a diverse set of markets. The investments within these markets involve various risks such as price, interest rate, market, sovereign, currency, liquidity, and credit risks. Additionally, the GIA's investments in real assets, which include investments in natural resources and real estate, expose the University to a unique set of risks such as operational, environmental, and political risks. Furthermore, a component of the investment portfolio's asset allocation includes two diversified funds managed by external advisors, which represent 14% of the GIA net asset value ("NAV"), in the aggregate. The University anticipates that the value and composition of its investments may, from time to time, fluctuate substantially in response to any or all of the risks described herein.

The table on page 24 includes the total fair value of securities pledged to counterparties where the counterparty has the right, by contract or practice, to sell or repledge the securities. The total fair value of securities pledged that cannot be sold or repledged was $56.3 million and $172.6 million as of June 30, 2012 and 2011, respectively. The fair value of collateral accepted by the University was $5,571.8 million and $7,759.8 million as of June 30, 2012 and 2011, respectively. The portion of this collateral that was sold or repledged was $45.3 million and $178.9 million as of June 30, 2012 and 2011, respectively.

The University has consolidated certain non-controlling interests relating to its investments in real assets under ASU 2010-7. These non-controlling interests represent the minority interest portion of the real assets controlled by the University that are required to be presented on the University's balance sheet under GAAP. The table on page 24 includes the minority interest portion of real assets of $1,223.4 million and $892.0 million as of June 30, 2012 and 2011, respectively. Other assets include the minority interest portion of cash, receivables, and fixed assets of $56.1 million and $48.6 million as of June 30, 2012 and 2011, respectively. Other liabilities include the minority interest portion of accruals, payables, and debt of $209.4 million and $108.3 million as of June 30, 2012 and 2011, respectively. The net increase in non-controlling interests year over year relates to $78.1 million of new non-controlling interests acquired during the year ended June 30, 2012, and appreciation on existing non-controlling interests of $159.7 million for the year then ended.

Other liabilities on page 24 include debt outstanding on consolidated real asset portfolio investments of $979.4 million and $599.9 million as of June 30, 2012 and 2011, respectively. Based on the structure, duration, and nature of the debt being consolidated, the amounts approximate the fair value of the debt as of each reporting period. This debt is specific to real assets held by the investment portfolio, and does not extend to other assets held by the University.

4. FAIR VALUE OF INVESTMENT ASSETS AND LIABILITIES

The University's investments have been categorized based upon the fair value hierarchy in accordance with ASC 820. The ASC 820 fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value of investment assets and liabilities into three levels. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are:

LEVEL 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

LEVEL 2 Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

LEVEL 3 Prices or valuations that require inputs that are significant to the fair value measurement, unobservable and/or require the University to develop its own assumptions.

The level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Transfers between levels are recognized at the beginning of the year.

Investments that trade in inactive markets, but are valued based on quoted market prices, broker/dealer quotations, or independent pricing services supported by observable inputs are primarily classified within Level 2. These may include non-exchange traded equity and fixed income securities, securities subject to restriction, and certain over the counter derivatives. In evaluating the level at which the University's externally managed investments have been classified within this hierarchy, management has assessed factors including, but not limited to price transparency, the ability to redeem these investments at NAV at the measurement date, and the existence or absence of certain restrictions at the measurement date. Investments in externally managed funds generally have limited redemption options for investors and, subsequent to final closing, may or may not permit subscriptions by new or existing investors. These entities may also have the ability to impose gates, lockups, and other restrictions on an investor's ability to readily redeem out of their investment interest in the fund. At June 30, 2012 and 2011, certain externally managed funds where the University has the ability and the right to redeem interests within the next twelve months have been classified as Level 2 investments.

The University's Level 3 investments consist almost entirely of investments managed by external advisors, and direct investments in natural resources and real estate. Externally managed investments are generally valued using the most current information received from the external advisor, subject to assessments that the value is representative of fair value and in consideration of any additional factors deemed pertinent to the valuations. Direct investments are primarily valued using a combination of independent appraisals, when available, and/or other industry standard methodologies as applicable. Level 3 investments also include certain over the counter derivative products primarily valued using independent broker quotes. Valuations determined using significant and unobservable inputs or assumptions are subject to additional review and consideration by management; the University strives to corroborate information from third-party sources for relevance and accuracy. Valuation policies for these types of investments are further discussed in *Note 3*.

The following is a summary of the levels within the fair value hierarchy for those investment assets and liabilities subject to fair value measurement as of June 30, 2012 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Cash and short-term investments	$ 926,896			**$ 926,896**
Domestic common and convertible equity	190,117	$ 1,693,625	$ 1,807,661	**3,691,403**
Foreign common and convertible equity	82,331	1,056,359	713,439	**1,852,129**
Domestic fixed income	5,212,122	100,678	319	**5,313,119**
Foreign fixed income	1,797,397	3,120		**1,800,517**
Emerging market equity and debt	2,540,972	213,363	204,712	**2,959,047**
High yield	12,936	962,175	595,763	**1,570,874**
Absolute return		2,734,708	2,017,046	**4,751,754**
Private equities		1,952	7,193,196	**7,195,148**
Real assets	63,430	71,316	10,036,845	**10,171,591**
Inflation-indexed bonds	936,662			**936,662**
Due from brokers	30,743	242,474	26,302	**299,519**
Other investments	19,279	1,321	7,862	**28,462**
TOTAL INVESTMENT PORTFOLIO ASSETS*	**11,812,885**	**7,081,091**	**22,603,145**	**41,497,121**
Interests in trusts held by others			343,798	**343,798**
TOTAL INVESTMENT ASSETS	**$ 11,812,885**	**$ 7,081,091**	**$ 22,946,943**	**$ 41,840,919**

* *Excludes repurchase and securities borrowing agreements and other assets of $8,271,540.*

	Level 1	Level 2	Level 3	Total
INVESTMENT LIABILITIES:				
Equity and convertible securities sold, not yet purchased	$ 36,792	$ 2,062		**$ 38,854**
Fixed income securities sold, not yet purchased	3,233,121	110,810		**3,343,931**
Due to brokers	6,416	437,719	$ 1,270	**445,405**
TOTAL INVESTMENT LIABILITIES**	**3,276,329**	**550,591**	**1,270**	**3,828,190**
Liabilities due under split interest agreements		670,242		**670,242**
TOTAL LIABILITIES	**$ 3,276,329**	**$ 1,220,833**	**$ 1,270**	**$ 4,498,432**

** *Includes fair value of interest rate exchange agreements of $381,893 and excludes reverse repurchase and securities lending agreements and other liabilities of $8,466,436.*

The following is a summary of the levels within the fair value hierarchy for those investment assets and liabilities subject to fair value measurement as of June 30, 2011 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Cash and short-term investments	$ 1,363,712			**$ 1,363,712**
Domestic common and convertible equity	298,522	$ 1,749,239	$ 1,948,111	**3,995,872**
Foreign common and convertible equity	158,333	1,092,772	886,485	**2,137,590**
Domestic fixed income	5,064,584	1,969	12,405	**5,078,958**
Foreign fixed income	3,138,090			**3,138,090**
Emerging market equity and debt	1,757,074	365,313	288,984	**2,411,371**
High yield	20,366	776,190	858,459	**1,655,015**
Absolute return		2,733,664	2,299,749	**5,033,413**
Private equities		45,020	7,312,137	**7,357,157**
Real assets	73,736	77,889	8,680,598	**8,832,223**
Inflation-indexed bonds	1,323,144			**1,323,144**
Due from brokers	21,813	912,681	63,507	**998,001**
Other investments	28,856	1,744	3,677	**34,277**
TOTAL INVESTMENT PORTFOLIO ASSETS*	**13,248,230**	**7,756,481**	**22,354,112**	**43,358,823**
Interests in trusts held by others			351,408	**351,408**
TOTAL INVESTMENT ASSETS	**$ 13,248,230**	**$ 7,756,481**	**$ 22,705,520**	**$ 43,710,231**

* *Excludes repurchase and securities borrowing agreements and other assets of $10,226,752.*

	Level 1	Level 2	Level 3	Total
INVESTMENT LIABILITIES:				
Equity and convertible securities sold, not yet purchased	$ 358,553			**$ 358,553**
Fixed income securities sold, not yet purchased	4,225,876			**4,225,876**
Due to brokers	34,513	$ 1,160,179	$ 9,183	**1,203,875**
TOTAL INVESTMENT LIABILITIES**	**4,618,942**	**1,160,179**	**9,183**	**5,788,304**
Liabilities due under split interest agreements		771,568		**771,568**
TOTAL LIABILITIES	**$ 4,618,942**	**$ 1,931,747**	**$ 9,183**	**$ 6,559,872**

** *Includes fair value of interest rate exchange agreements of $400,568 and excludes reverse repurchase and securities lending agreements and other liabilities of $8,547,510.*

The following is a rollforward of Level 3 investments for the year ended June 30, 2012 (in thousands of dollars):

	Beginning balance as of July 1, 2011	Realized gains/ (losses)	Change in unrealized gains/(losses)*	Purchases	Sales	Transfer into Level 3	Transfer out of Level 3**	Ending balance as of June 30, 2012
INVESTMENT ASSETS:								
Domestic common and convertible equity	$ 1,948,111	$ 134,362	$ 109,828	$ 212,045	$ (653,700)	$ 57,015		**$ 1,807,661**
Foreign common and convertible equity	886,485	38,737	(152,352)	138,770	(238,737)	40,536		**713,439**
Domestic fixed income	12,405	1,680	111	14,133	(23,498)		$ (4,512)	**319**
Emerging market equity and debt	288,984	(50,485)	(93,460)	51,476	(168,518)	176,715		**204,712**
High yield	858,459	38,501	30,168	86,320	(229,986)	30,738	(218,437)	**595,763**
Absolute return	2,299,749	255,439	(241,720)	474,511	(986,508)	216,618	(1,043)	**2,017,046**
Private equities	7,312,137	596,506	(453,981)	991,832	(1,294,758)	41,460		**7,193,196**
Real assets	8,680,598	72,368	662,569	1,660,883	(1,046,146)	6,573		**10,036,845**
Due from brokers	63,507	(101)	(19,009)		(18,095)			**26,302**
Other investments	3,677	6	4,179					**7,862**
TOTAL INVESTMENT PORTFOLIO ASSETS	**22,354,112**	**1,087,013**	**(153,667)**	**3,629,970**	**(4,659,946)**	**569,655**	**(223,992)**	**22,603,145**
Interests in trusts held by others	351,408		(7,610)					**343,798**
TOTAL INVESTMENT ASSETS	**$ 22,705,520**	**$ 1,087,013**	**$ (161,277)**	**$ 3,629,970**	**$ (4,659,946)**	**$ 569,655**	**$ (223,992)**	**$ 22,946,943**
INVESTMENT LIABILITIES:								
Due to brokers	$ 9,183	$ (527)	$ (7,913)	$ 527				**$ 1,270**
TOTAL INVESTMENT LIABILITIES	**$ 9,183**	**$ (527)**	**$ (7,913)**	**$ 527**				**$ 1,270**

* *Total change in unrealized gains/(losses) relating to Level 3 investment assets and investment liabilities still held by the University at June 30, 2012 is $(573,061) and is reflected in "Realized and unrealized (depreciation)/appreciation, net" in the Statements of Changes in Net Assets.*

** *Changes in classification for certain externally managed funds from Level 3 to Level 2 are included in the above table as transfers out of Level 3.*

The following is a rollforward of Level 3 investments for the year ended June 30, 2011 (in thousands of dollars):

	Beginning balance as of July 1, 2010	Realized gains/ (losses)	Change in unrealized gains/(losses)*	Purchases	Sales	Transfer into Level 3	Transfer out of Level 3**	Ending balance as of June 30, 2011
INVESTMENT ASSETS:								
Domestic common and convertible equity	$ 1,977,249	$ 111,921	$ 902,554	$ 12,507	$ (292,430)		$ (763,690)	**$ 1,948,111**
Foreign common and convertible equity	711,184	(103,157)	555,610		(59,742)		(217,410)	**886,485**
Domestic fixed income	24,613	7,734	(4,024)	25,322	(48,449)	$ 7,209		**12,405**
Foreign fixed income		(1,095)	1,095					
Emerging market equity and debt	418,433	42,924	53,188	88,054	(677,190)	364,961	(1,386)	**288,984**
High yield	869,213	(6,474)	118,179	839,377	(270,074)		(691,762)	**858,459**
Absolute return	2,679,639	268,961	277,213	658,737	(1,293,301)		(291,500)	**2,299,749**
Private equities	6,358,302	575,938	949,492	1,100,628	(1,792,791)	165,640	(45,072)	**7,312,137**
Real assets	6,145,956	156,546	1,274,343	1,893,867	(771,784)		(18,330)	**8,680,598**
Due from brokers	45,973	3,659	325	17,138	(3,554)		(34)	**63,507**
Other investments	3,062	2	613					**3,677**
TOTAL INVESTMENT PORTFOLIO ASSETS	**19,233,624**	**1,056,959**	**4,128,588**	**4,635,630**	**(5,209,315)**	**537,810**	**(2,029,184)**	**22,354,112**
Interests in trusts held by others	297,629		53,779					**351,408**
TOTAL INVESTMENT ASSETS	**$ 19,531,253**	**$ 1,056,959**	**$ 4,182,367**	**$ 4,635,630**	**$ (5,209,315)**	**$ 537,810**	**$ (2,029,184)**	**$ 22,705,520**
INVESTMENT LIABILITIES:								
Equity and convertible securities sold, not yet purchased	$ 209	$ 202	$ (135)	$ (276)				
Fixed income securities sold, not yet purchased	620	(2,104)	548	936				
Due to brokers	15,901	898	(151)	(1,626)	$ (5,839)			**$ 9,183**
TOTAL INVESTMENT LIABILITIES	**$ 16,730**	**$ (1,004)**	**$ 262**	**$ (966)**	**$ (5,839)**			**$ 9,183**

* *Total change in unrealized gains/(losses) relating to Level 3 investment assets and investment liabilities still held by the University at June 30, 2011 is $2,766,382 and is reflected in "Realized and unrealized appreciation/(depreciation), net" in the Statements of Changes in Net Assets.*

** *Changes in classification for certain externally managed funds from Level 3 to Level 2 are included in the above table as transfers out of Level 3.*

The University has entered into agreements with private equity and real asset partnerships and other external investment managers, which include commitments to make periodic contributions in the form of cash in future periods. The amounts of these expected disbursements as of June 30, 2012 and 2011 are broken out below (in thousands of dollars):

	As of June 30, 2012		
	Fair value*	Remaining unfunded commitments	Estimated remaining life**
Private equities	$ 6,494,120	$ 2,382,070	4–10
Real assets	3,214,819	1,606,028	4–10
Other externally managed funds***	850,114	587,441	2–8
TOTAL	**$ 10,559,053**	**$ 4,575,539**	

	As of June 30, 2011		
	Fair value*	Remaining unfunded commitments	Estimated remaining life**
Private equities	$ 6,428,104	$ 2,888,016	5–10
Real assets	2,356,477	2,050,947	5–10
Other externally managed funds***	1,155,327	490,249	2–8
TOTAL	**$ 9,939,908**	**$ 5,429,212**	

* *Represents the fair value of the funded portion of investments with remaining unfunded commitments for each asset class.*

** *The estimated remaining lives of these funds, expressed in years, are forward-looking projections based on management's estimates and could vary significantly depending on the investment decisions of external managers, changes in the University's investment portfolio, and other circumstances.*

*** *Investments in externally managed funds primarily include exposures to absolute return, domestic, foreign, and emerging equities, and high yield asset classes.*

The University's interests in many of its partnership investments (primarily private equity and real estate) generally represent commitments that are not subject to redemption; instead the University is a limited partner in funds that invest in private companies or properties, or pursue specific investment strategies. The nature of these investments is that distributions are received through the liquidation of the underlying assets of the partnership. The fair value of the investments in these asset classes has generally been estimated using the University's capital account balance with each partnership, unless management has deemed the NAV to be an inappropriate representation of fair value. The University generally classifies its interest in these types of entities as Level 3 investments within the aforementioned fair value hierarchy.

5. DERIVATIVES

The University uses a variety of financial instruments with off-balance sheet risk involving contractual or optional commitments for future settlement, which are exchange traded or executed over the counter. These instruments are used in both the core portfolio to increase or decrease exposure to a given asset class and in the relative value strategies, with the goal of enhancing the returns of certain asset classes. The University may also invest in derivative instruments when it believes investments or other derivatives are mispriced in relation to other investments, and the University can benefit from such mispricing. The fair value of these financial instruments is included in the "Investment portfolio, at fair value" and "Securities lending and other liabilities associated with the investment portfolio" line items of the *Balance Sheets*, with changes in fair value reflected as "Realized and changes in unrealized appreciation/(depreciation), net" within the *Statements of Changes in Net Assets*.

The market risk of a strategy is influenced by the relationship between the financial instruments with off-balance sheet risk and the offsetting positions recorded in the *Balance Sheets*. The University manages exposure to market risk through the use of industry standard analytical tools that measure the market exposure of each position within a strategy. The strategies are monitored daily, and positions are frequently adjusted in response to changes in the financial markets.

Derivative instruments entered into by limited partnerships and commingled investment vehicles pose no direct off-balance sheet risk to the University due to the limited liability structure of the investments.

The following table presents the gross fair values and the net profit/(loss) from derivatives by primary risk exposure for the year ended June 30, 2012 (in thousands of dollars):

	As of June 30, 2012		For the year ended June 30, 2012
Primary risk exposure	Gross derivative assets	Gross derivative liabilities	Net profit/(loss)
Equity instruments:			
Equity futures		$ 3,615	$ 58,307
Equity options	$ 58,236	31,730	7,871
Equity exchange agreements	83,168	55,589	(488,127)
TOTAL EQUITY INSTRUMENTS	**141,404**	**90,934**	**(421,949)**
Fixed income instruments:			
Fixed income futures	10,069	5,075	(113,800)
Fixed income options	5,409	4,194	796
Interest rate exchange agreements[1]	776,602	1,070,542	(205,686)
Interest rate caps and floors	169,899	172,167	303
TOTAL FIXED INCOME INSTRUMENTS	**961,979**	**1,251,978**	**(318,387)**
Commodity instruments:			
Commodity futures	26,619	30,052	19,898
Commodity options	53,846	41,019	2,706
Commodity exchange agreements	42,660	18,109	(62,253)
TOTAL COMMODITY INSTRUMENTS	**123,125**	**89,180**	**(39,649)**
Currency instruments:			
Currency forwards	1,780,893	1,777,928	71,673
Currency options	42,498	11,581	(2,087)
Currency exchange agreements	34,649	21,013	4,558
TOTAL CURRENCY INSTRUMENTS	**1,858,040**	**1,810,522**	**74,144**
CREDIT INSTRUMENTS	**47,071**	**34,878**	**(6,099)**
TOTAL	**3,131,619**	**3,277,492**	**$ (711,940)**
Counterparty netting[2]	(2,820,570)	(2,820,556)	
INCLUDED IN INVESTMENT PORTFOLIO, AT FAIR VALUE	**$ 311,049**	**$ 456,936**	

[1] *Includes $11,531 and $393,424 of gross derivative assets and liabilities, respectively, and a net profit/(loss) of $(140,219), related to interest rate exchange agreements on the University's debt portfolio, further discussed in Note 12.*

[2] *GAAP permits the netting of derivative assets and liabilities and the related cash collateral received and paid when a legally enforceable master netting agreement exists between the University and a derivative counterparty.*

The following table presents the gross fair values and the net profit/(loss) from derivatives by primary risk exposure for the year ended June 30, 2011 (in thousands of dollars):

Primary risk exposure	As of June 30, 2011 Gross derivative assets	Gross derivative liabilities	For the year ended June 30, 2011 Net profit/(loss)
Equity instruments:			
Equity futures		$ 1,090	$ (400)
Equity options	$ 37,715	7,894	1,016
Equity exchange agreements	75,846	71,649	675,299
TOTAL EQUITY INSTRUMENTS	**113,561**	**80,633**	**675,915**
Fixed income instruments:			
Fixed income futures	28,014	17,401	7,376
Fixed income options	6,259	5,033	(3,678)
Interest rate exchange agreements[1]	662,684	929,106	34,733
Interest rate caps and floors	65,781	67,942	32,692
TOTAL FIXED INCOME INSTRUMENTS	**762,738**	**1,019,482**	**71,123**
Commodity instruments:			
Commodity futures	9	9	
Commodity exchange agreements	6,314	2,204	231,309
COMMODITY INTSTRUMENTS	**6,323**	**2,213**	**231,309**
Currency instruments:			
Currency forwards	1,663,481	1,686,469	(31,707)
Currency options	52,753	32,822	(6,694)
Currency exchange agreements	21,852	10,949	11,666
TOTAL CURRENCY INSTRUMENTS	**1,738,086**	**1,730,240**	**(26,735)**
CREDIT INSTRUMENTS	**48,751**	**42,226**	**(24,329)**
TOTAL	**2,669,459**	**2,874,794**	**$ 927,283**
Counterparty netting[2]	(1,662,597)	(1,662,058)	
INCLUDED IN INVESTMENT PORTFOLIO, AT FAIR VALUE	**$ 1,006,862**	**$ 1,212,736**	

[1] *Includes $8,861 and $409,429 of gross derivative assets and liabilities, respectively, and a net profit/(loss) of $7,877, related to interest rate exchange agreements on the University's debt portfolio, further discussed in Note 12.*

[2] *GAAP permits the netting of derivative assets and liabilities and the related cash collateral received and paid when a legally enforceable master netting agreement exists between the University and a derivative counterparty.*

The following section details the accounting for each type of derivative contract, as well as the University's intended purpose for entering into each type of derivative instrument.

Options

The University purchases and sells put and call options to take advantage of mispricing due to expectations in the marketplace of future volatility of the underlying instruments. When purchasing an option, the University pays a premium, which is included in the pooled general investment account table in *Note 3* as an asset and subsequently marked-to-market to reflect the current value of the option. Premiums paid for purchased options that expire unexercised are treated as realized losses within the *Statements of Changes in Net Assets*.

When the University sells (writes) a call or put option, an amount equal to the premium received is recorded as a liability in the pooled general investment account table in *Note 3* and subsequently marked-to-market to reflect the current fair value of the option written. Premiums received from writing options that expire unexercised are treated as realized gains within the *Statements of Changes in Net Assets*.

When a purchased option is closed before expiration or exercise, the University records a realized gain or loss equal to the difference between the proceeds received upon closing and the premium paid. When a written option is closed before expiration or exercise, the University records a realized gain or loss equal to the difference between the cost to close the option and the premium received from selling the option.

During fiscal 2012, the University transacted approximately 500 equity and fixed income option trades with an average transaction size of approximately 2,500 contracts. Additionally, the University transacted approximately 400 currency option contracts with average USD equivalent notional amounts of approximately $23.0 million per contract.

During fiscal 2011, the University transacted approximately 500 equity and fixed income option trades with an average transaction size of approximately 3,500 contracts. Additionally, the University transacted approximately 275 currency option contracts with average USD equivalent notional amounts of approximately $25.0 million per contract.

Swap contracts

The University enters into swap contracts, which are contracts between two parties to exchange future cash flows at periodic intervals based on a notional principal amount. Payments are exchanged at specified intervals, accrued daily commencing with the effective date of the contract and recorded as realized gains or losses. Gains or losses are realized in the event of an early termination of a swap contract. Risks of loss may include unfavorable changes in the returns of the underlying instruments or indexes, adverse fluctuations of interest rates, failure of the counterparty to perform under the terms of the agreement, and lack of liquidity in the market.

Collateral in the form of securities or cash may be posted to or received from the swap counterparty in accordance with the terms of the swap contract. Realized gains or losses are recorded within the *Statements of Changes in Net Assets* on periodic payments received or made on swap contracts and with respect to swaps that are closed prior to termination date. When the University enters into a swap transaction, it may make or receive a payment equal to the value of the swap on the entry date and amortizes such payments to realized gain or loss over the outstanding term of the swap. The terms of the swap contracts can vary, and they are reported at fair value based on a valuation model or a counterparty provided price.

The University enters into swap contracts to increase or decrease its exposure to changes in the level of interest rates, underlying asset values and/or credit risk. In the normal course of its trading activities, the University enters into credit default, interest rate, and total return swap contracts.

Credit default contracts

The University enters into credit derivatives to simulate long and short bond exposure that is either unavailable or considered to be less attractively priced in the bond market, or to hedge exposure obtained in the bond market.

The University also uses these derivatives to reduce risk where it has exposure to the issuer, or to take an active long or short position with respect to the likelihood of an event of default. The reference obligation of the derivative can be a single issuer, a "basket" of issuers, or an index. During fiscal 2012, the University transacted approximately 700 credit default contracts with average notional amounts of approximately $22.0 million. During fiscal 2011, the University transacted approximately 600 credit default contracts with average notional amounts of approximately $11.5 million.

In instances where the University has purchased credit protection on an underlying reference obligation, the University is obligated to pay the seller of the credit protection a periodic stream of payments over the term of the contract in return for a contingent payment upon the occurrence of a credit event with respect to the underlying reference obligation. The contingent payment may be a cash settlement or a physical delivery of the reference obligation in return for payment of the face amount of the obligation. The amount paid for purchased protection is typically a nominal percentage of the notional amount. In instances where the University has sold credit protection on an underlying reference obligation, the University receives a fixed rate of income throughout the term of the contract, which typically is between one month and five years, and in some instances up to ten years. In the case where the University sold credit protection, if a credit event occurs, the University may cash settle the contract or pay the purchaser of credit protection the full notional value of the contract in exchange for the reference obligation.

As of June 30, 2012, the University's purchased and written credit derivatives had gross notional amounts of $1.8 billion and $0.3 billion, respectively, for total net purchased protection of $1.5 billion in notional value. As of June 30, 2011, the University's purchased and written credit derivatives had gross notional amounts of $2.0 billion and $0.2 billion, respectively, for total net purchased protection of $1.8 billion in notional value.

The table below summarizes certain information regarding credit protection purchased and written as of June 30, 2012 and 2011 (in thousands of dollars):

	As of June 30, 2012							
	Purchased protection		Written protection					
			Years to maturity					
Credit rating on underlying	Purchased notional amount*	Purchased fair value	< 5 years	5-10 years	Total written notional	Offsetting purchased notional**	Net written notional	Net written credit protection fair value
A- to AAA	$ 654,143	$ 2,777	$ 75,000	$ 23,000	$ 98,000	$ 12,000	$ 86,000	$ (3,269)
BBB- to BBB+	854,000	769	50,000		50,000		50,000	3,601
Non-investment grade	252,208	31,922	113,042		113,042	12,000	101,042	(23,606)
TOTAL	**$ 1,760,351**	**$ 35,468**	**$ 238,042**	**$ 23,000**	**$ 261,042**	**$ 24,000**	**$ 237,042**	**$ (23,274)**

	As of June 30, 2011							
	Purchased protection		Written protection					
			Years to maturity					
Credit rating on underlying	Purchased notional amount*	Purchased fair value	< 5 years	5-10 years	Total written notional	Offsetting purchased notional**	Net written notional	Net written credit protection fair value
A- to AAA	$ 584,750	$ 194	$ 14,498	$ 26,500	$ 40,998	$ 17,998	$ 23,000	$ 166
BBB- to BBB+	1,210,115	(271)		28,500	28,500		28,500	(326)
Non-investment grade	175,368	32,905	38,581	59,386	97,967	24,250	73,717	(29,735)
TOTAL	**$ 1,970,233**	**$ 32,828**	**$ 53,079**	**$ 114,386**	**$ 167,465**	**$ 42,248**	**$ 125,217**	**$ (29,895)**

* *Amounts shown are net of purchased credit protection that directly offsets written credit protection, as discussed in the note (**) below.*
** *Offsetting purchased credit derivatives represent the notional amount of purchased credit derivatives to the extent they hedge written credit derivatives with identical underlyings.*

Credit ratings on the underlying reference obligation, together with the period of expiration, are indicators of payment/performance risk. For example, the seller of credit protection is least likely to pay or otherwise be required to perform where the credit ratings are AAA and the period of expiration is "< 5 years". The likelihood of payment or performance is generally greater as the credit ratings fall and period of expiration increases.

Interest rate contracts

The University enters into interest rate swaps (including swaptions) to hedge certain investment positions against interest rate fluctuations; to benefit from interest rate fluctuations; to obtain better interest rate terms than it would have been able to get without the swap; or to manage the interest, cost, and risk associated with its outstanding debt and to hedge issuance of future debt. Interest rate swaps involve the exchange by the University with another party of its respective commitments to pay or receive interest at specified intervals based on a notional amount of principal.

During fiscal 2012, the University transacted approximately 3,500 interest rate swap and cap and floor contracts with average notional amounts of approximately $200.0 million. During fiscal 2011, the University transacted approximately 3,500 interest rate swap and cap and floor contracts with average notional amounts of approximately $400.0 million.

Total return swaps

The University enters into total return swaps to manage its exposure to market fluctuations in various asset classes. Total return swaps involve commitments to pay interest in exchange for a market linked return, both based on notional amounts. To the extent the total return of the security or index underlying the transaction exceeds or falls short of the offsetting interest rate obligation, the University will receive a payment from or make a payment to the counterparty, respectively. During fiscal 2012, the University transacted approximately 400 commodity swap contracts, 700 equity swap contracts, and 200 currency swap contracts with average notional amounts of approximately $12.0 million,

$10.0 million, and $8.0 million, respectively. During fiscal 2011, the University transacted approximately 90 commodity swap contracts, 1,300 equity swap contracts, and 250 currency swap contracts with average notional amounts of approximately $30.0 million, $2.5 million, and $13.0 million, respectively.

Forward currency contracts

The University enters into forward currency contracts in connection with settling planned purchases or sales of securities, for investment purposes, or to hedge the currency exposure associated with some or all of the University's portfolio securities. A forward currency contract is an agreement between two parties to buy and sell a currency at a set price on a future date. The value of a forward currency contract fluctuates with changes in forward currency exchange rates. Forward currency contracts are marked-to-market daily and the change in fair value is recorded by the University as an unrealized gain or loss. Realized gains or losses equal to the difference between the fair value of the contract at the time it was opened and the fair value at the time it was closed are recorded upon delivery or receipt of the currency or, if a forward currency contract is offset by entering into another forward currency contract with the same broker, upon settlement of the net gain or loss. During fiscal 2012, the University transacted approximately 5,700 forward currency contracts with average USD equivalent notional amounts of approximately $3.0 million. During fiscal 2011, the University transacted approximately 5,000 forward currency contracts with average USD equivalent notional amounts of approximately $2.3 million.

Futures contracts

The University uses futures contracts to manage its exposure to financial markets, including to hedge such exposures. Buying futures tends to increase the University's exposure to the underlying instrument. Selling futures tends to decrease exposure to the underlying instrument. Upon entering into a futures contract, the University is required to deposit with its prime broker an amount of cash or liquid securities in accordance with the initial margin requirements of the broker or exchange.

Gains and losses are realized when the contracts expire or are closed. Futures contracts are marked-to-market daily based on settlement prices established by the board of trade or exchange on which they are traded, and an appropriate payable or receivable for the change in fair value is recorded by the University. During fiscal 2012, the University transacted approximately 10,000 futures trades with an average transaction size of approximately 100 contracts. During fiscal 2011, the University transacted approximately 5,000 futures trades with an average transaction size of approximately 100 contracts.

Counterparty credit exposure

Financial instruments with off-balance sheet risk involve counterparty credit exposure. The policy of the University is to require collateral to the maximum extent possible under normal trading practices. Collateral is moved on a daily basis as required by fluctuations in the market. The collateral is generally in the form of debt obligations issued by the US Treasury. In the event of counterparty default, the University has the right to use the collateral to offset the loss associated with the replacements of the agreements. The University enters into arrangements only with counterparties believed to be creditworthy. Specific credit limits are established for counterparties based on their individual credit ratings. Credit limits are monitored daily by the University and are adjusted according to policy.

Some of the financial instruments entered into by the University contain credit-risk-related contingency features that allow the parties to the agreement to demand immediate payment for outstanding contracts and/or collateral. If material credit-risk-related contingency features were triggered on June 30, 2012 and 2011, the additional collateral due to counterparties for derivative contracts would have been $6.4 million and $19.5 million, respectively.

6. RECEIVABLES

The major components of receivables, net of reserves for doubtful accounts of $12.0 million and $13.1 million as of June 30, 2012 and 2011, respectively, were as follows (in thousands of dollars):

	2012	2011
Federal sponsored support	$ **66,902**	$ 63,557
Publications	**37,114**	31,113
Gift receipts	**27,167**	7,402
Executive education	**23,286**	22,978
Non-federal sponsored support	**13,450**	13,108
Tuition and fees	**12,807**	12,670
Other	**46,675**	48,403
TOTAL RECEIVABLES, NET	**$ 227,401**	**$ 199,231**

7. NOTES RECEIVABLE

Notes receivable are recorded initially at face value plus accrued interest, which approximates fair value. Notes receivable, and the related allowance for doubtful accounts, were as follows (in thousands of dollars):

	2012			2011		
	Receivable	Allowance	Net	Receivable	Allowance	Net
Student loans:						
Government revolving	$ 80,039	$ 2,619	**$ 77,420**	$ 80,664	$ 2,509	**$ 78,155**
Institutional	83,931	2,955	**80,976**	82,244	2,800	**79,444**
Federally insured	985		**985**	1,434		**1,434**
Total student loans	164,955	5,574	**159,381**	164,342	5,309	**159,033**
Faculty and staff loans	187,081	422	**186,659**	185,788	422	**185,366**
Other loans	22,393	4,867	**17,526**	22,932	3,975	**18,957**
TOTAL	**$ 374,429**	**$ 10,863**	**$ 363,566**	**$ 373,062**	**$ 9,706**	**$ 363,356**

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled $67.0 million as of June 30, 2012 and 2011, are classified as liabilities in the *Balance Sheets*. Interest earned on the revolving and institutional loan programs is reinvested to support additional loans. The repayment and interest rate terms of the institutional loans vary considerably.

Faculty and staff notes receivable primarily consists of mortgage and educational loans. Mortgages include shared appreciation loans and loans that bear interest at the applicable federal rate. In addition, certain mortgages bear interest at the current market rate, which may be subsidized for an initial period. The educational loans are primarily zero-interest loans.

The University assesses the adequacy of the allowance for doubtful accounts by evaluating the loan portfolio, including such factors as the differing economic risks associated with each loan category, the financial condition of specific borrowers, the economic environment in which the borrowers operate, the level of delinquent loans, the value of any collateral, and, where applicable, the existence of any guarantees or indemnifications. In addition to these factors, the University reviews the aging of the loans receivable and the default rate in comparison to prior years. The allowance is adjusted based on these reviews. The University considers the allowance at June 30, 2012 and 2011 to be reasonable and adequate to absorb potential credit losses inherent in the loan portfolio.

8. PLEDGES RECEIVABLE

Unconditional promises to donate to the University in the future are initially recorded at fair value (pledge net of discount) and subsequently amortized over the expected payment period, net of an allowance for uncollectible pledges. Discounts of $34.4 million and $41.8 million for the years ended June 30, 2012 and 2011, respectively, were calculated using discount factors based on the appropriate US Treasury Note rates for pledges received prior to the adoption of ASC 820, and using the University's taxable unsecured borrowing rate for pledges received since fiscal 2009.

Pledges receivable included in the financial statements as of June 30, 2012 and 2011 are expected to be realized as follows (in thousands of dollars):

	2012	2011
Within one year	**$ 157,294**	$ 134,080
Between one and five years	**629,175**	536,317
More than five years	**210,582**	193,902
Less: discount and allowance for uncollectible pledges	**(88,493)**	(105,858)
TOTAL PLEDGES RECEIVABLE, NET	**$ 908,558**	**$ 758,441**

Pledges receivable as of June 30, 2012 and 2011 have been designated for the following purposes (in thousands of dollars):

	2012	2011
General Operating Account balances:		
Gifts for current use	**$ 429,859**	$ 330,138
Non-federal sponsored grants	**106,149**	95,768
Loan funds and facilities	**62,391**	47,886
Total General Operating Account balances	**598,399**	473,792
Endowment	**310,159**	284,649
TOTAL PLEDGES RECEIVABLE, NET	**$ 908,558**	**$ 758,441**

Because of uncertainties with regard to realizability and valuation, bequest intentions and other conditional promises are only recognized as assets if and when the specified conditions are met. Non-bequest conditional pledges totaled $63.8 million and $30.4 million as of June 30, 2012 and 2011, respectively.

9. FIXED ASSETS

Fixed assets are reported at cost or, if a gift, at fair value as of the date of the gift, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

The major categories of fixed assets as of June 30, 2012 and 2011 are summarized as follows (in thousands of dollars):

	2012	2011	Estimated useful life (in years)
Research facilities	**$ 2,091,652**	$ 1,990,895	*
Classroom and office facilities	**1,572,065**	1,324,352	35
Housing facilities	**1,173,626**	1,150,756	35
Other facilities	**526,102**	519,968	35
Service facilities	**568,626**	561,422	35
Libraries	**434,622**	408,666	35
Museums and assembly facilities	**312,214**	310,440	35
Athletic facilities	**167,427**	165,221	35
Land	**698,673**	695,570	N/A
Construction in progress	**719,589**	807,095	N/A
Equipment	**950,602**	864,903	**
SUBTOTAL AT COST	**9,215,198**	8,799,288	
Less: accumulated depreciation	**(3,438,653)**	(3,152,211)	
FIXED ASSETS, NET	**$ 5,776,545**	**$ 5,647,077**	

* *Estimated useful lives of components range from 10 to 45 years.*
** *Estimated useful lives of equipment range from 3 to 8 years.*

Certain University facilities are subject to restrictions as to use, structural modifications, and ownership transfer. Included in the fixed asset balances are restricted facilities with a net book value of $226.4 million and $222.3 million as of June 30, 2012 and 2011, respectively.

The costs of research facilities are separated into the shell, roof, finishes, fixed equipment, and services. These components are separately depreciated.

Equipment includes general and scientific equipment, computers, software, furniture, and vehicles.

The University has asset retirement obligations of $61.3 million and $67.4 million, which are included in the "Deposits and other liabilities" in the *Balance Sheets* as of June 30, 2012 and 2011, respectively.

10. ENDOWMENT

The University's endowment consists of approximately 12,000 separate funds established over many years for a wide variety of purposes. Endowment fund balances, including funds functioning as endowment, are classified and reported as unrestricted, temporarily restricted, or permanently restricted net assets in accordance with donor specifications and state law. Net unrealized losses on permanently restricted endowment funds are classified as a reduction to unrestricted net assets until such time as the fair value equals or exceeds historic dollar value. Unrestricted net assets were reduced by $23.4 million and $13.1 million for such losses in fiscal 2012 and 2011, respectively. Although funds functioning as endowment are not subject to donor restrictions, decisions to spend their principal require the approval of the Corporation. All but a small fraction of the endowment is invested in the GIA (*Note 3*).

The University is also the beneficiary of certain irrevocable trusts held and administered by others. The estimated fair values of trust assets, which include the present values of expected future cash flows from outside trusts and the fair value of the underlying assets of perpetual trusts, are recognized as assets and increases in net assets when the required trust documentation is provided to the University. The fair values of these trusts are provided by the external trustees and are adjusted annually by the University. These are included as Level 3 investments in the fair value hierarchy table in *Note 4*.

The endowment consisted of the following as of June 30, 2012 and 2011 (in thousands of dollars):

	2012				2011
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Endowment funds	$ (23,417)	$ 17,204,271	$ 5,064,566	**$ 22,245,420**	$ 23,131,202
Funds functioning as endowment	5,385,753	2,511,525		**7,897,278**	8,288,451
Pledge balances		34,552	275,607	**310,159**	284,649
Interests in trusts held by others		12,946	279,731	**292,677**	308,427
TOTAL ENDOWMENT	**$ 5,362,336**	**$ 19,763,294**	**$ 5,619,904**	**$ 30,745,534**	**$ 32,012,729**

The University's endowment distribution policies are designed to preserve the value of the endowment in real terms (after inflation) and generate a predictable stream of available income. Each fall, the Corporation approves the endowment distribution for the following fiscal year. The endowment distribution is based on presumptive guidance from a formula that is intended to provide budgetary stability by smoothing the impact of annual investment gains and losses. The formula's inputs reflect expectations about long-term returns and inflation rates. For fiscal 2012, the endowment distribution approved by the Corporation (prior to decapitalizations) was equal to 4.6% of the fair value of the endowment invested in the GIA as of the beginning of the fiscal year. The total endowment distribution made available for operations was $1.4 billion and $1.3 billion in fiscal 2012 and 2011, respectively.

Each year the Corporation also approves certain decapitalizations from the endowment to support strategic, mission-critical activities or objectives that are typically one-time or time-limited. These decapitalizations totaled $308.5 million and $105.0 million in fiscal 2012 and 2011, respectively. These additional decapitalizations, in combination with the endowment distribution, resulted in an aggregate payout rate of 5.5% and 5.3% in fiscal 2012 and 2011, respectively.

11. SPLIT INTEREST AGREEMENTS

Under split interest agreements, donors enter into trust arrangements with the University in which the University receives benefits that are shared with other beneficiaries and institutions. Split interest agreement (SIA) investment assets are invested primarily in the GIA and publicly traded securities, a small segment is managed by an external advisor, and all are recorded at fair value as discussed in *Notes 3* and *4*. The publicly traded securities are included as Level 1 and externally managed investments are included as Level 3 investments in the fair value hierarchy table in *Note 4*. Associated liabilities are recorded at the present value of estimated future payments due to beneficiaries and other institutions. These liabilities were calculated using discount factors based on the appropriate US Treasury Note rates for gifts received prior to the adoption of ASC 820, and using the University's current taxable unsecured borrowing rate for gifts received beginning in fiscal 2009.

The changes in split interest agreement net assets for fiscal 2012 and 2011 were as follows (in thousands of dollars):

	2012			2011
	Temporarily restricted	Permanently restricted	Total	Total
Investment return:				
Investment income	$ 3,571	$ 10,392	$ **13,963**	$ 15,670
Realized and unrealized appreciation/(depreciation), net	(7,112)	(20,697)	**(27,809)**	193,148
Total investment return	(3,541)	(10,305)	**(13,846)**	208,818
Gifts for capital (*Note 17*)*	6,671	13,497	**20,168**	24,891
Payments to annuitants	(14,899)	(43,358)	**(58,257)**	(58,925)
Transfers to endowment	(18,684)	(39,583)	**(58,267)**	(56,000)
Transfers between SIA and the GOA	(12,053)	(2,182)	**(14,235)**	(14,100)
Change in liabilities and other adjustments	39,238	117,658	**156,896**	(8,868)
NET CHANGE DURING THE YEAR	**(3,268)**	**35,727**	**32,459**	**95,816**
Total split interest agreement net assets, beginning of year	**73,973**	**443,816**	**517,789**	421,973
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	**$ 70,705**	**$ 479,543**	**$ 550,248**	**$ 517,789**

* *Shown at net present value. The undiscounted value of these gifts was $51,045 and $41,807 for the years ended June 30, 2012 and 2011, respectively.*

Split interest agreement net assets as of June 30, 2012 and 2011 consisted of the following (in thousands of dollars):

	2012	2011
Split interest agreement investments (*Note 3*):		
Charitable remainder trusts	**$ 786,258**	$ 842,092
Charitable lead trusts	**115,618**	117,115
Charitable gift annuities	**213,847**	225,335
Pooled income funds	**104,767**	104,815
Total split interest agreement investments	**1,220,490**	1,289,357
Liabilities due under split interest agreements:		
Amounts due to beneficiaries	**(560,474)**	(656,138)
Amounts due to other institutions	**(109,768)**	(115,430)
Total liabilities due under split interest agreements	**(670,242)**	(771,568)
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	**$ 550,248**	**$ 517,789**

12. BONDS AND NOTES PAYABLE

Bonds and notes payable as of June 30, 2012 and 2011 were as follows (in thousands of dollars):

	Fiscal year of issue	Years to final maturity*	One-year yield**	Outstanding principal 2012***	Outstanding principal 2011****
Tax-exempt bonds and notes payable:					
Variable-rate bonds and notes payable:					
Series R - daily	2000-2006	20	0.1%	**$ 131,200**	$ 131,200
Series Y - weekly	2000	23	0.1	**117,905**	117,905
Commercial paper	2012	<1	0.2	**288,735**	319,681
Total variable-rate bonds and notes payable			0.1	**537,840**	568,786
Fixed-rate bonds:					
Series N	1992	8	6.3	**79,210**	79,109
Series Z	2001	1	5.7	**10,143**	19,748
Series DD	2002	N/A	5.0		135,071
Series FF	2003	25	5.1	**185,154**	185,312
Series 2005A	2005	24	4.8	**93,049**	93,213
Series 2005B	2006	20	4.8	**104,324**	104,512
Series 2005C	2006	23	4.9	**129,469**	129,622
Series 2008B	2008	26	4.8	**215,829**	216,094
Series 2009A	2009	24	5.4	**984,205**	985,106
Series 2010A	2010	22	4.5	**523,579**	526,987
Series 2010B	2011	28	4.6	**657,918**	661,672
Total fixed-rate bonds			5.0	**2,982,880**	3,136,446
Total tax-exempt bonds and notes payable			**4.2**	**3,520,720**	3,705,232
Taxable bonds and notes payable:					
Series GG2 - weekly	2005	N/A	0.2		24,355
Series 2006A	2006	25	6.3	**401,459**	401,437
Series 2008A	2008	26	4.9	**387,805**	387,760
Series 2008C	2008	6	5.3	**125,205**	125,205
Series 2008D	2009	27	6.1	**996,820**	1,196,376
Series 2010C	2011	28	4.9	**298,105**	298,038
Commercial paper	2012	<1	0.2	**158,007**	44,045
Total taxable bonds and notes payable			**5.4**	**2,367,401**	**2,477,216**
Other notes payable	Various	Various	Various	**151,018**	153,261
TOTAL BONDS AND NOTES PAYABLE			**4.7%**	**$ 6,039,139**	**$ 6,335,709**

* *The weighted average maturity of the portfolio on June 30, 2012 was 17.8 years.*

** *Exclusive of interest rate exchange agreements. Inclusive of these agreements, the overall portfolio rate was 5.1%.*

*** *Series N, FF, 2006A, 2008A, 2008D, 2009A and 2010C principal are net of $0.8 million, $1.3 million, $0.5 million, $0.2 million, $3.2 million, $15.8 million and $1.9 million of discounts, respectively. Series 2005A, 2005B, 2005C, 2008B, 2010A and 2010B principal include premiums of $3.9 million, $3.8 million, $3.6 million, $7.0 million, $43.6 million and $56.9 million, respectively.*

**** *Series N, DD, FF, 2006A, 2008A, 2008D, 2009A and 2010C principal are net of $0.9 million, $0.8 million, $1.2 million, $0.6 million, $0.2 million, $3.6 million, $14.9 million and $2.0 million of discounts, respectively. Series Z, 2005A, 2005B, 2005C, 2008B, 2010A and 2010B principal include premiums of $0.01 million, $4.1 million, $4.0 million, $3.7 million, $7.2 million, $47.0 million and $60.6 million, respectively*

Interest expense related to bonds and notes payable was $285.8 million and $296.4 million for fiscal 2012 and 2011, respectively. The interest expense in the *Statement of Changes in Net Assets with General Operating Account Detail* includes additional components related to capital leases. Excluding maturity of commercial paper and unamortized discounts and premiums, scheduled principal payments are (in thousands of dollars):

Fiscal year	Principal payments
2013	$ 345,573
2014	65,935
2015	38,603
2016	38,601
2017	29,724
Thereafter	4,979,013
TOTAL PRINCIPAL PAYMENTS	**$ 5,497,449**

In fiscal 2012, the University redeemed Series DD and Series GG2 in full ($135.9 million and $16.6 million, respectively) by exercising the bonds' call options and $200.0 million of Series 2008D, scheduled to mature in 2014, by exercising the bond's make-whole call option. The redemption of these bonds was funded with cash on hand.

In fiscal 2012, the University entered into a $2.0 billion unsecured, revolving credit facility with a syndicate of banks, of which $1.0 billion expires in January 2013 and $1.0 billion expires in January 2017. There was no outstanding balance on the credit facility at June 30, 2012.

In fiscal 2012, the University's AAA/Aaa credit ratings were affirmed with Standard & Poor's and Moody's Investors Service, respectively.

As of June 30, 2012, the University had $249.1 million of variable-rate bonds outstanding (excluding commercial paper) with either a daily or weekly interest rate reset, as noted in the bonds and notes payable table on page 39. In the event that the University receives notice of any optional tender on its variable-rate bonds, or if the bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a general obligation to purchase the bonds tendered.

In fiscal 2011, the University issued $601.1 million of tax-exempt fixed-rate Series 2010B bonds, and $300.0 million of taxable fixed-rate Series 2010C bonds. The proceeds from these bonds were primarily used for a combination of redemptions, refinancings, and the funding of certain capital projects and acquisitions. In fiscal 2011, the University also redeemed $300.0 million of Series 2008D bonds by exercising the bond's make-whole call option.

The estimated fair value of the University's outstanding bonds and notes payable, including accrued interest, was $7,213.9 million and $6,854.6 million as of June 30, 2012 and 2011, respectively.

In July 2012, the University redeemed the remaining $186.5 million outstanding of Series FF by exercising the bond's call option, and funded the redemption with cash.

In August 2012, the University obtained reauthorization of its tax-exempt commercial paper program.

Interest rate exchange agreements

The University has entered into various interest rate exchange agreements in order to manage the interest cost and risk associated with its outstanding debt and to hedge issuance of future debt. The interest rate exchange agreements were not entered into for trading or speculative purposes. Each of these agreements is collateralized, as described in *Note 5*, and thereby carries liquidity risk to the extent the relevant agreements have negative mark-to-market valuations (pursuant to methodologies described below).

In fiscal 2012, the University terminated interest rate exchange agreements with a notional value of $756.0 million, for which it realized a loss of $134.6 million. In addition, interest rate exchange agreements with $207.8 million notional value matured during fiscal 2012.

The fair value of interest rate exchange agreements is the estimated amount that the University would have received or (paid), including accrued interest, to terminate the agreements on the dates of the *Balance Sheets*. The notional amount and fair value of interest rate exchange agreements were $1,075.6 million and $(381.9) million, respectively, as of June 30, 2012 and $2,039.4 million and $(400.6) million, respectively, as of June 30, 2011. The fair value of these agreements is included in the "Securities lending and other liabilities associated with the investment portfolio" line in the *Balance Sheets*.

The net expense realized related to interest rate exchange agreements was $23.0 million and $36.3 million for fiscal 2012 and 2011, respectively. All unrealized and realized gains and losses and settlements from interest rate exchange agreements are included in the "Realized and unrealized (depreciation) / appreciation, net" line in the *Statements of Changes in Net Assets with General Operating Account Detail*.

NOTIONAL AMOUNT OF INTEREST RATE EXCHANGE AGREEMENTS
In thousands of dollars

Beginning balance, July 1, 2011	$ 2,039,355
Interest rate exchange agreements terminated/matured	(963,800)
ENDING BALANCE, JUNE 30, 2012	**$ 1,075,555**

13. EMPLOYEE BENEFITS

The University offers current employees a choice of health plans, a dental plan, short-term and long-term disability plans, life insurance, tuition assistance, and a variety of other benefits such as subsidized passes for public transportation and for Harvard athletic facilities. In addition, the University has retirement plans covering substantially all employees.

The University uses a measurement date of June 30 for its pension and postretirement health plans.

Pension benefits

All eligible faculty members, staff and hourly employees are covered by retirement programs that include a defined benefit component, a defined contribution component, or a combination of the two.

In accordance with the Employee Retirement Income Security Act (ERISA) requirements, the University has established a trust to hold plan assets for its defined benefit pension plans. The fair value of the trust's assets was $755.4 million and $746.9 million as of June 30, 2012 and 2011, respectively.

During fiscal year 2012, the University used $36.9 million of internally designated funds for a discretionary defined benefit pension plan contribution. The University recorded expenses for its defined contribution plans of $110.3 million and $104.5 million for fiscal 2012 and 2011, respectively. Gross benefits paid for pensions were $41.0 million and $41.3 million as of June 30, 2012 and 2011, respectively.

Postretirement health benefits

The University provides postretirement health coverage and life insurance to substantially all of its employees. As of June 30, 2012, the University had internally designated and invested $339.0 million to fund the postretirement health benefit accrued liability of $901.5 million. As of June 30, 2011, the University had internally designated and invested $311.9 million to fund an accrued liability of $782.2 million.

The following table sets forth the pension and postretirement plans' funded status that is reported in the *Balance Sheets* as of June 30, 2012 and 2011 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2012	2011	2012	2011
Change in projected benefit obligation:				
Projected benefit obligation, beginning of year	**$ 782,567**	$ 762,862	**$ 782,219**	$ 812,336
Service cost	**13,514**	14,491	**32,748**	38,091
Interest cost	**43,200**	44,951	**46,628**	50,323
Plan participants' contributions			**3,089**	2,876
Plan change*			**(41,605)**	
Gross benefits paid	**(41,013)**	(41,345)	**(26,660)**	(22,087)
Expected federal subsidy on benefits paid			**790**	
Actuarial (gain)/loss	**107,811**	1,608	**104,261**	(99,320)
Special termination benefits	**3,830**			
PROJECTED BENEFIT OBLIGATION, end of year	**909,909**	**782,567**	**901,470**	**782,219**
Change in plan assets:				
Fair value of plan assets, beginning of year	**746,901**	666,005		
Actual return on plan assets	**8,768**	122,241		
Employer contributions	**40,708**			
Gross benefits paid	**(41,013)**	(41,345)		
FAIR VALUE OF PLAN ASSETS, end of year	**755,364**	746,901	**0**	0
UNFUNDED STATUS	**$(154,545)**	**$ (35,666)**	**$ (901,470)**	**$ (782,219)**

* *The 2012 postretirement current year prior service credit was primarily due to the introduction of a medical deductible and co-insurance and a new cost sharing program for pharmacy.*

The accumulated benefit obligation associated with pension benefits was $791.5 million and $659.9 million at June 30, 2012 and 2011, respectively. The funded status disclosed above has been prepared in accordance with pension accounting rules. When measured on an IRS funding basis, which informs the University's required cash contribution amount, the plan was overfunded at January 1, 2012.

Net periodic benefit (income)/cost

Components of net periodic benefit (income)/cost recognized in operating activity and other amounts recognized in non-operating activity in unrestricted net assets in the *Statements of Changes in Net Assets with General Operating Account Detail* are summarized as follows for the years ended June 30 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2012	2011	2012	2011
Components of net periodic benefit (income)/cost:				
Service cost	**$ 13,514**	$ 14,491	**$ 32,748**	$ 38,091
Interest cost	**43,200**	44,951	**46,628**	50,323
Expected return on plan assets	**(48,694)**	(52,231)		
Amortization of:				
Actuarial (gain)/loss	**264**	(975)	**(4,227)**	2,895
Prior service (credit)/cost	**(1,247)**	(4,633)	**727**	1,411
Transition (asset)/obligation			**6,062**	6,062
Cost of special termination benefits	**3,830**			
Total net periodic benefit (income)/cost recognized in operating activity	**10,867**	1,603	**81,938**	**98,782**
Other amounts recognized in non-operating activity in unrestricted net assets:				
Current year actuarial (gain)/loss	**147,737**	(68,402)	**104,261**	(99,320)
Amortization of:				
Current year prior service (credit)/cost			**(41,605)**	
Transition asset/(obligation)			**(6,062)**	(6,062)
Prior service credit/(cost)	**1,247**	4,633	**(727)**	(1,411)
Actuarial gain/(loss)	**(264)**	975	**4,227**	(2,895)
Total other amounts recognized in non-operating activity*	**148,720**	(62,794)	**60,094**	(109,688)
Total recognized in *Statements of Changes in Net Assets with General Operating Account Detail*	**$ 159,587**	**$ (61,191)**	**$ 142,032**	**$ (10,906)**

Cumulative amounts recognized as non-operating changes in unrestricted net assets are summarized as follows for the years ended June 30 (in thousands of dollars):

	2012	2011	2012	2011
Net actuarial (gain)/loss	**$ 141,160**	$ (6,313)	**$ 89,563**	$ (18,926)
Prior service (credit)/cost	**118**	(1,129)	**(35,529)**	741
Transition (asset)/obligation				12,125
Cumulative amounts recognized in unrestricted net assets*	**$ 141,278**	**$ (7,442)**	**$ 54,034**	**$ (6,060)**

* *These amounts totaling $208.8 million in fiscal 2012 and ($172.5) million in fiscal 2011 include gains and losses and other changes in the actuarially determined benefit obligations arising in the current period but that have not yet been reflected within net periodic benefit (income)/cost and are included in the "Change in Retirement Obligations" line in the Statements of Changes in Net Assets with General Operating Account Detail.*

The estimated net actuarial gain and prior service credit for the defined benefit plan that will be amortized from unrestricted net assets into net periodic benefit (income)/cost in fiscal 2013 are $11.9 million and ($0.1) million, respectively. The estimated prior service cost for the postretirement health benefit that will be amortized from unrestricted net assets into net periodic benefit (income)/cost in fiscal 2013 is ($3.2) million.

Assumptions and health care cost trend rates used in determining the year end obligation as well as the net periodic benefit (income)/cost of the pension and postretirement health plans are summarized as follows for fiscal 2012 and 2011:

	Pension benefits		Postretirement health benefits	
	2012	2011	2012	2011
Weighted-average assumptions used to determine benefit obligation as of June 30:				
Discount rate	**4.45%**	5.60%	**4.55%**	5.80%
Rate of compensation increase	**4.00%**	4.00%	**4.00%**	4.00%
Health care cost trend rate:				
– Initial rate	**N/A**	N/A	**7.00%**	8.50%
– Ultimate rate	**N/A**	N/A	**5.00%**	5.00%
– Years to ultimate rate	**N/A**	N/A	**6**	7
Weighted-average assumptions used to determine net periodic benefit (income)/cost:				
Discount rate	**5.60%**	6.00%	**5.80%**	6.00%
Expected long-term rate of return on plan assets	**7.25%**	7.50%	**N/A**	N/A
Rate of compensation increase	**4.00%**	4.00%	**4.00%**	4.00%
Health care cost trend rate:				
– Initial rate	**N/A**	N/A	**8.50%**	11.00%
– Ultimate rate	**N/A**	N/A	**5.00%**	5.00%
– Years to ultimate rate	**N/A**	N/A	**7**	8

As an indicator of sensitivity, a one percentage point change in assumed health care cost trend rate would affect 2012 as shown in the following table (in thousands of dollars):

	1% point increase	1% point decrease
Effect on 2012 postretirement health benefits service and interest cost	24,544	(16,218)
Effect on postretirement health benefits obligation as of June 30, 2012	190,970	(146,831)

The expected return on pension plan assets is determined by utilizing HMC's capital markets model, which takes into account the expected real return, before inflation, for each of the pension portfolio's asset classes, as well as the correlation of any one asset class to every other asset class. This model calculates the real returns and correlations and derives an expected real return for the entire portfolio, given the percentage weighting allocated to each asset class. After calculating the expected real return, an assessment is made to accommodate the expected inflation rate for the forthcoming period. The final expected return on assets is the aggregate of the expected real return plus the expected inflation rate.

Plan assets

The actual asset allocation of the investment portfolio for the pension plan at June 30, 2012 and 2011, along with target allocations for June 30, 2013, is as follows:

	2013 target	June 30, 2012	June 30, 2011
Asset allocation by category for pension plan:			
Equity securities	30 – 50%	42.0%	48.2%
Fixed income securities	30 – 50	28.6	19.8
Real estate	0 – 10	6.0	5.9
Commodities	0 – 10	0.0	1.8
Absolute return	10 – 30	20.0	22.5
Cash	0 – 10	3.4	1.8
TOTAL OF ASSET ALLOCATION CATEGORIES		**100.0%**	**100.0%**

The University's investment strategy for the pension portfolio is to manage the assets across a broad and diversified range of investment categories, both domestic and international. The objective is to achieve a risk-adjusted return that is in line with the long-term obligations that the University has to the pension plan beneficiaries. During fiscal year 2012, the University has increased its allocation to fixed income securities to better manage the interest rate volatility associated with its pension obligations. The University expects to continue this strategy in future years. The investment program is also managed to comply with all ERISA regulations.

The following is a summary of the levels within the fair value hierarchy for the pension plan assets subject to fair value measurement as of June 30, 2012 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Absolute return and special situations funds		$ 123,891	$ 24,681	$ **148,572**
Cash and short-term investments	$ 34,591			**34,591**
Domestic common and convertible equity	6,777	97,881		**104,658**
Domestic fixed income	208,820			**208,820**
Due from broker	235			**235**
Emerging market equity and debt	51,900			**51,900**
Foreign common and convertible equity	42,538	46,136		**88,674**
High yield		4,636	4	**4,640**
Private equities			68,261	**68,261**
Real estate			42,918	**42,918**
TOTAL INVESTMENT ASSETS*	**$ 344,861**	**$ 272,544**	**$ 135,864**	**$ 753,269**

* *Excludes investment assets not subject to fair value of $2,095.*

The following is a summary of the levels within the fair value hierarchy for the pension plan assets subject to fair value measurement as of June 30, 2011 (in thousands of dollars):

	Level 1	Level 2	Level 3	Total
INVESTMENT ASSETS:				
Absolute return and special situations funds		$ 77,766	$ 87,999	$ **165,765**
Cash and short-term investments	$ 22,814			**22,814**
Domestic common and convertible equity	19,969	106,123		**126,092**
Domestic fixed income	100,997			**100,997**
Emerging market equity and debt	66,471			**66,471**
Foreign common and convertible equity	50,644	53,229		**103,873**
High yield		4,544		**4,544**
Inflation-indexed bonds	38,737			**38,737**
Private equities			72,717	**72,717**
Real estate			43,456	**43,456**
TOTAL INVESTMENT ASSETS*	**$ 299,632**	**$ 241,662**	**$ 204,172**	**$ 745,466**

* *Excludes investment assets not subject to fair value of $1,435.*

The following is a rollforward of Level 3 investments for the year ended June 30, 2012 (in thousands of dollars):

	Beginning balance as of July 1, 2011	Realized gains/ (losses)	Change in unrealized gains/(losses)	Purchases	Sales	Net transfers out of Level 3	Ending balance as of June 30, 2012
INVESTMENT ASSETS:							
Absolute return and special situations funds	$ 87,999	$ 54	$ (2,496)	$ 21	$ (1,258)	$ (59,639)	$ **24,681**
Foreign common and convertible equity		(4)			4		
High yield			4				**4**
Private equities	72,717	9,179	(1,937)	4,508	(16,206)		**68,261**
Real estate	43,456	780	2,626	1,445	(5,389)		**42,918**
TOTAL INVESTMENT ASSETS	**$ 204,172**	**$ 10,009**	**$ (1,803)**	**$ 5,974**	**$ (22,849)**	**$ (59,639)**	**$ 135,864**

The following is a rollforward of Level 3 investments for the year ended June 30, 2011 (in thousands of dollars):

	Beginning balance as of July 1, 2010	Realized gains/ (losses)	Change in unrealized gains/(losses)	Purchases	Sales	Net transfers into Level 3	Ending balance as of June 30, 2011
INVESTMENT ASSETS:							
Absolute return and special situations funds	$ 80,446	$ 4,395	$ 5,101	$ 24,357	$ (26,300)		$ **87,999**
Domestic fixed income		(14)	7		(3)	$ 10	
Foreign common and convertible equity	1,547	(2,520)	2,594		(1,621)		
High yield	57	58	(57)		(58)		
Private equities	76,337	8,298	3,312	8,317	(23,547)		**72,717**
Real estate	39,250	2,258	4,745	1,460	(4,257)		**43,456**
TOTAL INVESTMENT ASSETS	**$ 197,637**	**$ 12,475**	**$ 15,702**	**$ 34,134**	**$ (55,786)**	**$ 10**	**$ 204,172**

Expected future benefit payments

There are no expected employer contributions for fiscal 2013 to funded pension or postretirement health benefit plans. The following table summarizes expected benefit payments and subsidies for pension and other postretirement benefits for the University (in thousands of dollars):

Fiscal year	Expected benefit payments: Pension	Expected benefit payments: Postretirement health	Expected Medicare Part D subsidies	Net Postretirement health
2013	$ 49,877	$ 21,484	$ 52	$ 21,432
2014	48,841	23,409	99	23,310
2015	50,191	25,270	150	25,120
2016	53,292	27,169	217	26,952
2017	53,749	29,114	301	28,813
Thereafter	275,244	182,569	3,174	179,395

14. GENERAL OPERATING ACCOUNT

The GOA consists of the general or current funds of the University as well as the assets and liabilities related to student and faculty loans and facilities. The GOA accepts, manages, and pays interest on deposits made by University departments; invests surplus working capital; makes loans; and arranges external financing for major capital projects. It is used to manage, control, and execute all University financial transactions, except for those related to investment activities conducted by HMC.

The GOA consisted of the following as of June 30, 2012 and 2011 (in thousands of dollars):

	2012 Unrestricted	2012 Temporarily Restricted	2012 Permanently Restricted	2012 Total	2011 Total
General Operating Account	$ 2,743,325	$ 1,448,690	$ 96,498	**$ 4,288,513**	**$ 4,500,420**

The temporarily restricted net assets consist primarily of unexpended income, gifts, and pledges. The permanently restricted net assets are loan funds.

15. STUDENT FINANCIAL AID

Financial aid granted to students in fiscal 2012 and 2011 is summarized as follows (in thousands of dollars):

	2012	2011
Scholarships and other student awards:		
Scholarships applied to student income	**$ 357,001**	$ 335,036
Scholarships and other student awards paid directly to students	**128,993**	116,510
Total scholarships and other student awards	**485,994**	**451,546**
Student employment	**64,088**	66,690
Student loans	**22,015**	22,059
Agency financial aid*	**9,158**	16,779
TOTAL STUDENT FINANCIAL AID	**$ 581,255**	**$ 557,074**

* *Represents aid from sponsors for which the University acts as an agent for the recipient.*

16. SPONSORED SUPPORT

Total expenditures funded by US government sponsors or by institutions that subcontract federally sponsored projects to the University were $669.6 million and $686.2 million in fiscal 2012 and 2011, respectively. The University's principal source of federal sponsored funds is the Department of Health and Human Services. The University also has many non-federal sources of sponsored awards and grants, including corporations, foundations, state and local governments, foreign governments, and research institutes.

Sponsored grants and contracts normally provide for the recovery of direct and indirect costs. The University recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related indirect costs is generally recorded at fixed or predetermined rates negotiated with the federal government and other sponsors. Predetermined federal indirect cost rates have been established for the University Area and the Medical School (including the School of Dental Medicine) through fiscal year 2015. The School of Public Health has predetermined indirect cost rates through fiscal 2013. Funds received for federally sponsored activity are subject to audit.

17. GIFTS

Gifts that are available for current purposes are classified as either "Gifts for current use" or "Non-federal sponsored grants," as appropriate. Gifts that have been restricted by the donor or designated by the Corporation for facilities, loan funds, endowment, or similar purposes are classified as "Gifts for capital." Gifts for current use, non-federal sponsored grants, and gifts for capital are classified as unrestricted, temporarily restricted, or permanently restricted net assets in accordance with donor specifications.

Gifts received for the years ended June 30, 2012 and 2011 are summarized as follows (in thousands of dollars):

	2012	2011
Gifts for current use	**$ 289,217**	$ 276,914
Non-federal sponsored grants	**88,262**	91,980
Gifts for capital:		
Endowment funds	**226,494**	212,364
Split interest agreements*	**20,168**	24,891
Loan funds and facilities	**26,243**	32,987
Total gifts for capital	**272,905**	270,242
TOTAL GIFTS	**$ 650,384**	**$ 639,136**

* *Shown at net present value. The gross value of these gifts was $51,045 and $41,807 for the years ended June 30, 2012 and 2011, respectively.*

18. OTHER INCOME

The major components of other income for the years ended June 30, 2012 and 2011 were as follows (in thousands of dollars):

	2012	2011
Rental and parking	**$ 147,373**	$ 136,102
Royalties from patents, copyrights, and trademarks	**112,814**	107,067
Publications	**78,086**	78,079
Services income	**68,080**	62,010
Health and clinic fees	**51,689**	49,878
Sales income	**45,605**	49,103
Interest income	**11,280**	10,768
Other student income	**5,934**	6,711
Other	**36,304**	46,882
TOTAL OTHER INCOME	**$ 557,165**	**$ 546,600**

19. OTHER EXPENSES

The major components of other expenses for the years ended June 30, 2012 and 2011 were as follows (in thousands of dollars):

	2012	2011
Services purchased	**$ 424,898**	$ 381,536
Subcontract expenses under sponsored projects	**160,961**	170,297
Travel	**79,459**	68,020
Publishing	**49,579**	44,371
Taxes and fees	**33,543**	30,286
Postage	**21,181**	22,177
Advertising	**19,728**	18,876
Insurance	**13,212**	18,409
Telephone	**12,907**	12,307
Other	**36,235**	58,368
TOTAL OTHER EXPENSES	**$ 851,703**	**$ 824,647**

20. FUNCTIONAL CLASSIFICATION OF OPERATING EXPENSES

Operating expenses are allocated functionally on a direct basis. Interest, depreciation, and operations and maintenance expenses are allocated based on square footage.

Operating expenses by functional classification for the years ended June 30, 2012 and 2011 were as follows (in thousands of dollars):

	2012	2011
Instruction	**$ 1,063,971**	$ 1,016,221
Research	**769,077**	734,526
Institutional support	**657,082**	673,424
Academic support	**539,516**	529,948
Auxiliary services	**478,366**	455,075
Libraries	**237,082**	231,629
Student services	**167,611**	150,235
Scholarships and other student awards	**128,993**	116,510
TOTAL EXPENSES	**$ 4,041,698**	**$ 3,907,568**

21. COMMITMENTS AND CONTINGENCIES

Lease commitments

The University is the lessee of equipment and space under operating (rental) and capital leases. Rent expense related to leases was $51.8 million and $48.4 million for the years ended June 30, 2012 and 2011, respectively.

Future minimum payments under these operating and capital leases are as follows (in thousands of dollars):

	Operating	Capital
2013	$ 58,554	$ 7,050
2014	45,426	7,119
2015	41,518	7,403
2016	31,287	7,711
2017	27,497	7,916
Thereafter	90,320	176,029
TOTAL FUTURE MINIMUM PAYMENTS	**$ 294,602**	**$ 213,228**

Fixed asset-related commitments

The University has various commitments for capital projects involving construction and renovation of certain facilities, real estate acquisitions, and equipment purchases, for which the outstanding commitments as of June 30, 2012 totaled approximately $301.7 million.

Environmental remediation

The University is subject to laws and regulations concerning environmental remediation and has established reserves for potential obligations that management considers to be probable and for which reasonable estimates can be made. These estimates may change substantially depending on new information regarding the nature and extent of contamination, appropriate remediation technologies, and regulatory approvals. Costs of future environmental remediation have been discounted to their net present value. Management is not aware of any existing conditions that it believes are likely to have a material adverse effect on the University's financial position, changes in net assets, or cash flows.

Utilities purchase commitments

The University has entered into Power Purchase Agreements (PPAs) with a series of utilities providers to purchase natural gas and electricity for various quantities and time periods. As of June 30, 2012, future obligations under the PPAs are as follows (in thousands of dollars):

2013	$ 21,691
2014	14,223
2015	10,800
2016	6,420
2017	3,930
Thereafter	29,685
TOTAL UTILITY FUTURE PURCHASE OBLIGATIONS	**$ 86,749**

General

The University is a defendant in various legal actions arising from the normal course of its operations. While it is not possible to predict accurately or determine the eventual outcome of such actions, management believes that the outcome of these proceedings will not have a material adverse effect on the University's financial position, changes in net assets, or cash flows.

The University has evaluated subsequent events through November 2, 2012, the date the financial statements were available for issuance.