MANAGEMENT'S DISCUSSION AND ANALYSIS

(Unaudited)

The objective of Management's Discussion and Analysis is to help readers of the University of California's financial statements better understand the financial position and operating activities for the year ended June 30, 2007, with selected comparative information for the years ended June 30, 2006 and 2005. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes to the financial statements. Unless otherwise indicated, years (2005, 2006, 2007, 2008, etc.) in this discussion refer to the fiscal years ended June 30.

The University of California's financial report communicates financial information for the University of California (the University), the University of California campus foundations (campus foundations) and the University of California Retirement System (the UCRS) through five primary financial statements and notes to the financial statements. Three of the primary statements, the statements of net assets, the statements of revenues, expenses and changes in net assets and the statements of cash flows, present the financial position, changes in financial position and cash flows for the University and the affiliated campus foundations. The financial statements for the campus foundations are presented discretely from the University. Two of the primary statements, the statements of plans' fiduciary net assets and statements of changes in plans' fiduciary net assets, present the financial position and operating activities for the UCRS. The notes to the financial statements provide additional information that is essential to a full understanding of the financial statements.

THE UNIVERSITY OF CALIFORNIA

The University of California, one of the largest and most acclaimed institutions of higher learning in the world, is dedicated to excellence in teaching, research and public service. The University has annual resources of nearly $20 billion and encompasses ten campuses, five medical schools and medical centers, three law schools and a statewide Division of Agriculture and Natural Resources. The University is also involved directly or indirectly in the operation and management of three national laboratories for the U.S. Department of Energy.

Campuses. The ten campuses are located in Berkeley, Davis, Irvine, Los Angeles, Merced, Riverside, San Diego, San Francisco, Santa Barbara and Santa Cruz. All of the campuses offer undergraduate, graduate and professional education; the San Francisco campus is devoted exclusively to the health sciences.

Health sciences. The University operates one of the nation's largest health science and medical training programs. The instructional program is conducted in 15 health sciences schools on six campuses. They include five medical, two dental, two nursing, two public health and two pharmacy schools, in addition to a school of optometry and a school of veterinary medicine. The University's medical schools play a leading role in the development of health services and advancement of medical science and research.

Law schools. The University has law schools at Berkeley, Davis and Los Angeles. Also, the Hastings College of the Law in San Francisco is affiliated with the University, although not included in the financial reporting entity.

Agriculture and Natural Resources. The Division of Agriculture and Natural Resources is a statewide research and public service organization that serves a large and diverse agricultural community. The division conducts studies on the Berkeley, Davis and Riverside campuses, on nine research and extension centers and on private land in cooperation with California producers. In addition, research and educational programs are conducted in each of the state's 58 counties.

University Extension. The foremost continuing education program of its kind in size, scope and quality of instruction, University Extension offers more than 18,000 self-supporting courses statewide and in several foreign countries.

National laboratories. Under contract with the U.S. Department of Energy (DOE), the University operates and manages the Ernest Orlando Lawrence Berkeley National Laboratory (LBNL) and the Lawrence Livermore National Laboratory (LLNL) in California. The University is a member in the Los Alamos National Security, LLC (LANS), a joint venture that operates and manages the Los Alamos National Laboratory (LANL) in New Mexico. The laboratories conduct broad and diverse basic and applied research in nuclear science, energy production, national defense and environmental and health areas.

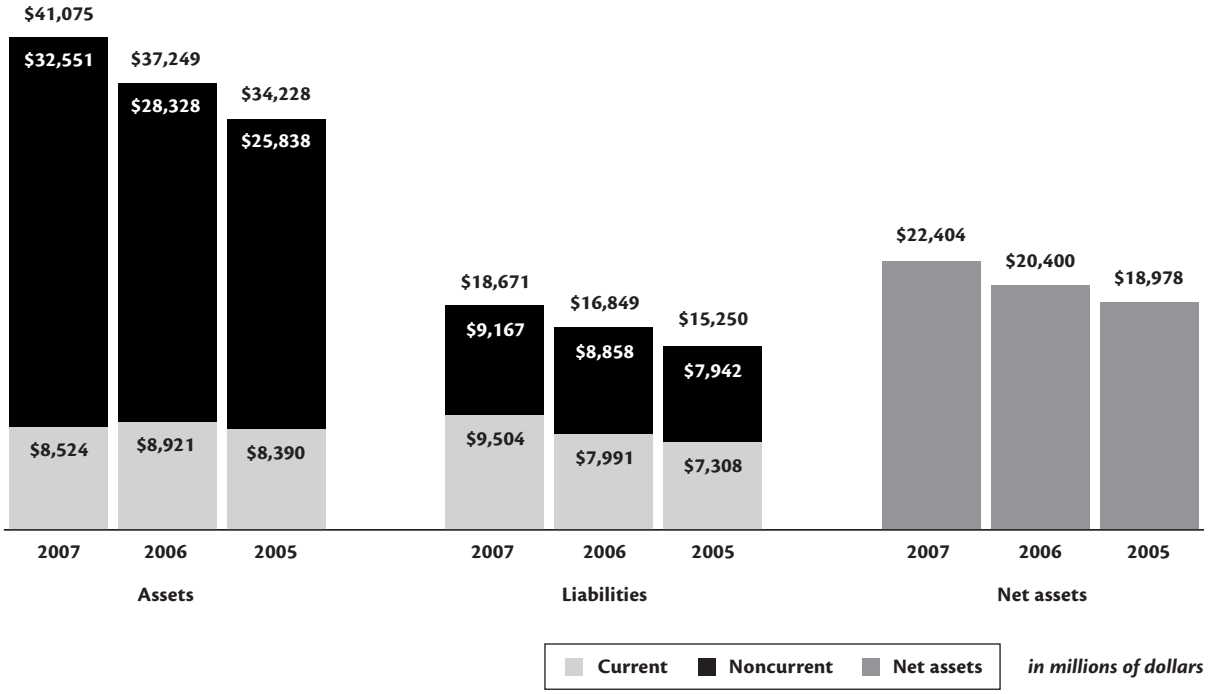
Adoption of New Accounting Standards

The University's financial statements are prepared in accordance with the accounting principles generally accepted in the United States of America established by the Governmental Accounting Standards Board (GASB).

During 2007, the University adopted GASB Statement No. 48, *Sales and Pledges of Receivables and Intra-Entity Transfers of Assets*, and Statement No. 50, *Pension Disclosures*. Statement No. 48 establishes criteria to ascertain whether certain transactions should be recorded as sales or collateralized borrowings. Statement No. 50 enhances pension information disclosed in financial statements or presented as required supplementary information. The implementation of these Statements had no effect on the University's net assets or changes in net assets in 2007 and there was no effect in 2006.

During 2006, the University adopted GASB Statement No. 47, *Accounting for Termination Benefits*. Statement No. 47 requires benefits such as early retirement incentives or severance to employees who are involuntarily terminated to be recognized in the period the University becomes obligated to provide the benefits. Benefits provided to employees who voluntarily terminate must be recognized when the termination offer is accepted. The effect of the implementation of GASB Statement No. 47 was not significant on the University's net assets or changes in net assets in 2006 and there was no effect in 2005.

The University's Financial Position



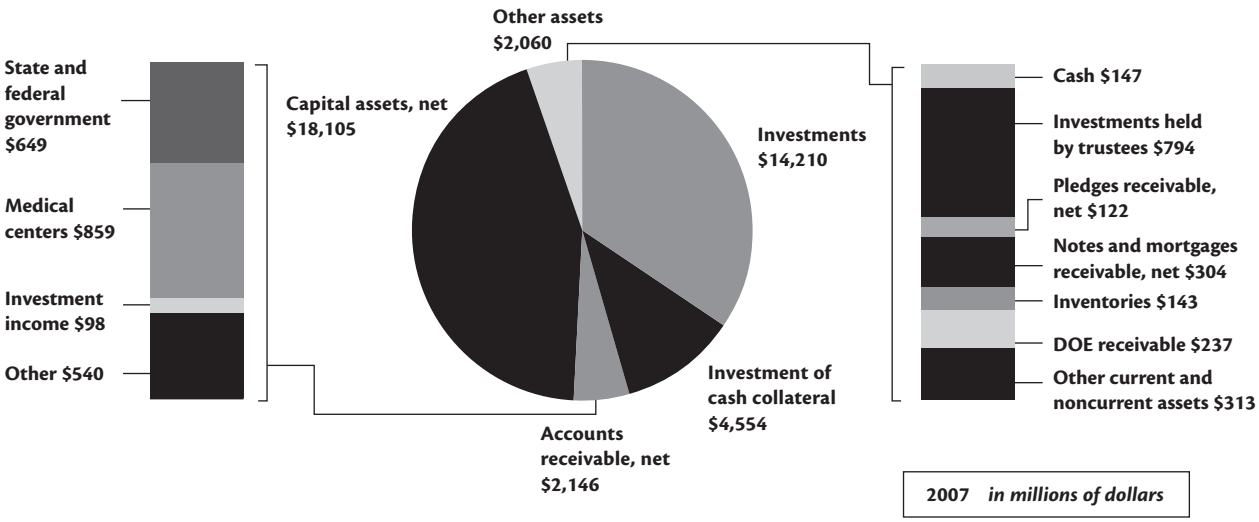
The statement of net assets presents the financial position of the University at the end of each year. It displays all of the University's assets and liabilities. The difference between assets and liabilities is net assets, representing a measure of the current financial condition of the University. At June 30, 2007, the University's assets were over $41 billion, liabilities were nearly $19 billion and net assets were over $22 billion, an increase of $2 billion from 2006. Net assets increased by $1.42 billion at the end of 2006 from 2005.

The major components of the assets, liabilities and net assets as of 2007, 2006 and 2005 are as follows:

(in millions of dollars)

	2007	2006	2005
ASSETS			
Investments	$ 14,210	$ 13,244	$ 12,075
Investment of cash collateral	4,554	3,455	2,578
Accounts receivable, net	2,146	1,955	1,746
Capital assets, net	18,105	16,665	15,530
Other assets	2,060	1,930	2,299
Total assets	**41,075**	**37,249**	**34,228**
LIABILITIES			
Debt, including commercial paper	9,364	8,876	7,945
Securities lending collateral	4,554	3,456	2,578
Other liabilities	4,753	4,517	4,727
Total liabilities	**18,671**	**16,849**	**15,250**
NET ASSETS			
Invested in capital assets, net of related debt	9,102	8,535	8,108
Restricted:			
Nonexpendable	920	873	823
Expendable	5,856	5,056	4,556
Unrestricted	6,526	5,936	5,491
Total net assets	**$22,404**	**$20,400**	**$18,978**

The University's Assets



The University's total assets have grown to $41.08 billion in 2007, compared to $37.25 billion in 2006 and $34.23 billion in 2005, primarily from increases in investments, including related securities lending activities, and capital assets, although a substantial portion of the capital assets was financed.

Investments *(in millions of dollars)*

The University's investments totaled $14.21 billion at the end of 2007, $2.57 billion classified as a current asset and $11.64 billion as a noncurrent asset. Investments classified as current assets are generally fixed or variable income securities in the Short Term Investment Pool (STIP) with a maturity date within one year. Maturities were slightly extended in 2007 relative to 2006. Noncurrent investments are generally securities in the General Endowment Pool (GEP) or other pools, in addition to fixed or variable income securities in the STIP with a maturity date beyond one year. The University's investments, by investment pool, are as follows:

(in millions of dollars)

	2007	2006	2005
STIP	$ 7,578	$ 7,424	$ 6,907
GEP	6,176	5,390	4,738
Other	456	430	430
University investments	**$14,210**	**$13,244**	**$12,075**

Overall, investments increased by $966 million in 2007. Investments in the STIP increased by $154 million primarily due to $330 million of STIP investment income and $57 million of net appreciation in the fair value of STIP investments held at the end of 2007, partially offset by the routine timing of cash collections and payments. Investments in the GEP and other securities increased by $812 million as a result of $178 million of investment income, $892 million of net appreciation in the fair value of investments, and new permanent endowments of $39 million, partially offset by participant withdrawals of $104 million and $193 million of annual income distributions to be used for operating purposes in 2008.

Investments in 2006 of $13.24 billion grew from $12.08 billion in 2005, an increase of $1.17 billion. Investments in the STIP increased by $517 million primarily due to $293 million of STIP investment income and the routine timing of cash collections and payments, partially offset by $112 million of net depreciation in the fair value of STIP investments held at the end of 2006 as short-term interest rates continued to rise throughout the year. Investments in the GEP and other securities increased by $652 million as a result of $150 million of investment income, $426 million of net appreciation in the fair value of investments, and new permanent endowments and other participant contributions of $261 million, partially offset by $185 million of annual income distributions to be used for operating purposes in 2007.

The total investment return based upon unit value for the GEP, representing the combined income plus net appreciation or depreciation in the fair value of investments, during 2007 and 2006 was 19.8 percent and 11.6 percent, respectively. The investment return for the STIP distributed to participants during 2007 and 2006 was 4.7 percent and 4.2 percent, respectively.

Investment of cash collateral *(in millions of dollars)*

The University participates in a securities lending program incorporating securities owned by both the University and the UCRS as a means to augment income. It is managed as a single program. For financial reporting purposes, cash collateral and the associated liability related to securities specifically owned by either the University or the UCRS and lent to borrowers are directly reported in the appropriate entity. Cash collateral and the associated liability related to securities in investment pools jointly owned by both the University and the UCRS and lent to borrowers are allocated to each entity on the basis of their proportional ownership.

At the end of 2007, the investment of cash collateral increased from 2006 by $1.10 billion in response to increased lending availability in classes of fixed income securities sought by borrowers that resulted from extending maturities in 2007. Also during 2007, interest rates were substantially above 2006 levels leading to a significant increase in both gross income and rebates, and a slight increase in net income for the overall program.

At the end of 2006, the investment of cash collateral increased from 2005 by $877 million. Two additional securities lending agents provided additional activity under the University's program. During 2006, interest rates were substantially above 2005 levels leading to a considerable increase in both gross income and rebates, and a slight increase in net income for the overall program.

Accounts receivable, net *(in millions of dollars)*

Accounts receivable are from the state and federal governments, patients for care at the medical centers, investment activity and from others, including those related to private and local government grants and contracts and student tuition and fees.

Receivables increased by $191 million in 2007. Federal and state government receivables increased by $112 million primarily as a result of additional federal grants and contracts receivables ($27 million); receivables attributable to state educational appropriations ($24 million), state capital appropriations ($9 million) and grants and contracts ($15 million); and growth in pending reimbursements from the state for various construction projects ($35 million). Medical center receivables grew by $79 million corresponding to growth in patient revenue. Investment income receivables grew by $20 million. Various other receivables collectively declined by $20 million primarily due to the timing of clearing trades upon the sale of investments ($54 million), partially offset by additional private and local grants and contracts receivables ($30 million).

In 2006, accounts receivable increased by $209 million from 2005. Federal and state government receivables declined by $23 million as the University was reimbursed for various construction projects, medical center receivables grew by $101 million due to growth in patient revenue and receivables for investment income grew by $9 million. Various other receivables collectively increased by $122 million primarily due to the timing of clearing trades upon the sale of investments ($41 million), private and local grants and contracts ($25 million), student tuition and fees ($14 million), insurance refunds ($15 million) and legal settlements ($12 million) .

Capital assets, net *(in millions of dollars)*

Capital assets include land, infrastructure, buildings and improvements, equipment, libraries, collections and construction in progress. Capital assets, net of accumulated depreciation, increased by $1.44 billion to $18.11 billion in 2007 and by $1.14 billion to $16.67 billion in 2006.

Capital asset activity consists of the following:

(in millions of dollars)

	2007	2006
Capital expenditures:		
Land and infrastructure	$ 99	$ 98
Buildings and improvements	1,171	1,660
Equipment	461	404
Libraries and special collections	146	132
Construction in progress, net	660	(135)
Capital expenditures	**2,537**	**2,159**
Depreciation and amortization expense	(1,049)	(997)
Asset disposals, net	(48)	(27)
Increase in capital assets, net	**$1,440**	**$1,135**

After having dipped slightly over the prior two years, capital spending resumed at a brisk pace in order to provide the facilities necessary to accommodate current and future enrollment growth and for patient care. These facilities include core academic buildings, libraries, student services, housing and auxiliary enterprises, health science centers, utility plants and infrastructure, and remote centers for educational outreach, research and public service. Overall, capital spending increased by 17.5 percent in 2007, including a significant amount of spending for projects still under construction. At the end of 2007, the cost of projects under construction increased by $660 million bringing construction in progress at the end of the year to $3.84 billion, including $1.99 billion for campus projects and $1.85 billion for health care facilities.

Capital spending declined in 2006 and 2005 by 8.9 percent and 3.9 percent, respectively. Construction in progress was $3.18 billion at the end of 2006 and $3.31 billion at the end of 2005.

Accumulated depreciation and amortization was $11.71 billion in 2007, $10.98 billion in 2006 and $10.25 billion in 2005. Depreciation and amortization expense was $1.05 billion for 2007, $997 million for 2006 and $955 million for 2005. Disposals in both years generally were for equipment that was fully depreciated or had reached the end of its useful life.

Other assets *(in millions of dollars)*

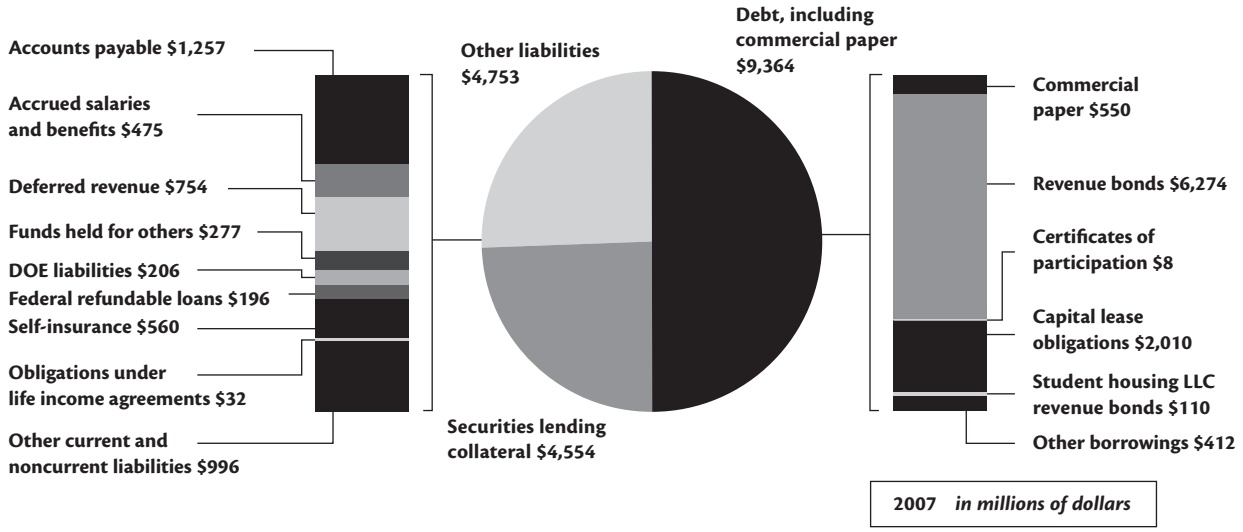
Other assets, including cash, investments held by trustees, pledges receivable, notes and mortgages receivable, inventories and a receivable from the DOE, increased by $130 million in 2007.

Investments held by trustees grew at the end of 2007 by $34 million, primarily trustee-held investments associated with self-insurance programs as the contributions to the trusts were greater than claim payments made this year. The

receivable from the DOE increased by $62 million, generally consisting of $17 million of contributions to the UCRP for employees who formerly worked at LANL and $40 million for operating and employee liabilities at LLNL and LBNL. Pledges receivable grew by $28 million, notes and mortgages receivables by $10 million, inventories by $14 million and other assets by $38 million, primarily undistributed equity in earnings from LANS and deferred costs of debt issued during the year. Partially offsetting these increases was a reduction in cash awaiting investment in the STIP of $55 million.

In 2006, other assets decreased by $369 million. The receivable from the DOE declined by $265 million at the end of 2006 with the transition to LANS of the contract to manage and operate LANL. Investments held by trustees also declined at the end of 2006 by $188 million. Trustee-held investments associated with self-insurance programs were $54 million higher, although trustee-held investments associated with long-term debt declined by $242 million, $74 million related to proceeds from University debt offerings and $168 million for spending on capital projects supported by lease-purchase financing with the state of California. Proceeds from the sale of the state's lease revenue bonds are held and invested by the trustee, then distributed to the University as the projects are constructed.

The University's Liabilities



The University's liabilities grew to $18.67 billion in 2007, compared to $16.85 billion in 2006 and $15.25 billion in 2005, principally as a result of debt issued to finance capital expenditures.

Debt, including commercial paper *(in millions of dollars)*

Capital assets are financed from a variety of sources, including University equity contributions, federal and state support, revenue bonds, certificates of participation, bank loans, leases or structures that involve separate legal entities. Commercial paper and bank loans provide interim financing. The University's debt used to finance capital assets, including $550 million of commercial paper outstanding at the end of all three years, grew to $9.36 billion at the end of 2007, compared to $8.88 billion at the end of 2006 and $7.95 billion at the end of 2005. Capital lease obligations under lease-purchase agreements with the state have accounted for over one-quarter, or $650 million, of the $2.45 billion increase in debt over the past three years.

Commercial paper is classified as a current liability. The current portion of long-term debt, excluding commercial paper, increased to $630 million in 2007 from $408 million in 2006, primarily as a result of a $137 million increase in interim loans from the state for capital projects to be refinanced by the state's issuance of lease revenue bonds. At the end of 2007, the current portion of long-term debt still includes nearly $203 million of these interim loans from the state for capital projects that will be refinanced as lease revenue bonds are issued by the state in the near future.

Outstanding debt increased by $488 million in 2007 and $931 million in 2006. A summary of the activity follows:

(in millions of dollars)

	2007	2006
ADDITIONS TO OUTSTANDING DEBT		
General Revenue Bonds	$ 1,366	$ 911
Limited Project Revenue Bonds		617
Medical Center Pooled Revenue Bonds	537	
Capital leases	473	240
Student Housing LLC Revenue Bonds		99
Other borrowings	244	243
Bond premium	53	53
Additions to outstanding debt	**2,673**	**2,163**
REDUCTIONS TO OUTSTANDING DEBT		
Refinancing and prepayments	(1,844)	(939)
Scheduled principal payments	(270)	(244)
Payments on other borrowings	(34)	(23)
Other, including deferred financing costs, net	(37)	(26)
Reductions to outstanding debt	**(2,185)**	**(1,232)**
Net increase in outstanding debt	**$ 488**	**$ 931**

During 2007, additions to outstanding debt totaled $2.67 billion, including bond premiums of $53 million.

General Revenue Bonds totaling $1.37 billion were issued in January and June 2007 to refinance certain facilities and projects of the University. Combined proceeds, including a bond premium of $49 million, were used to refund $1.13 billion of outstanding Multiple Purpose Projects Revenue Bonds, $179 million of Research Facilities Revenue Bonds and $39 million of certificates of participation.

Medical Center Pooled Revenue Bonds totaling $537 million, plus a bond premium of $4 million, were issued in January 2007 to finance or refinance certain improvements to each of the five medical centers. The bonds include $441 million with a fixed interest rate and $96 million with a variable interest rate. Proceeds were used to refund $93 million of Medical Center Revenue Bonds. In connection with the variable interest rate bonds, the University entered into an interest rate swap agreement with the intention that the variable interest rate it pays to the bondholders will approximate the variable payments it receives from the interest rate swaps, resulting in a fixed interest rate of 3.6 percent paid to the swap counterparty.

The University entered into a lease-purchase agreement with the state in October 2006, recorded as a capital lease, totaling $80 million to finance the construction of a University project. The state provides financing appropriations to the University to satisfy the annual lease requirement. At the conclusion of the lease term, ownership transfers to the University. In April 2007, the state of California issued $337 million of lease revenue refunding bonds to refinance certain facilities leased to the University. Proceeds were used to refund $357 million of outstanding lease revenue bonds. The state of California provided the University with the economic advantages of the refunding through amendments to the lease agreements. As a result, the University reduced its capital lease obligations and recorded a $20 million gain as nonoperating revenue.

In addition to lease-purchase agreements with the state, other new capital lease obligations during 2007 totaled $56 million, primarily for equipment.

Other newly originated borrowings in 2007 totaled $244 million, primarily loans from the state or from commercial banks to provide interim financing as a supplement to commercial paper or for capital projects supported by gifts to be received in the near future.

Reductions to outstanding debt in 2007 were $2.19 billion, primarily consisting of $1.84 billion for one-time principal payments for the refinancing or refunding of previously outstanding University revenue bonds ($1.40 billion), University certificates of participation ($39 million), capital leases ($357 million), payments on interim loans from the state as lease revenue bonds were sold ($9 million) and refinancing of previously outstanding bank loans ($39 million); $270 million for principal payments associated with scheduled debt service on revenue bonds, certificates of participation and capital lease obligations; and $34 million for scheduled payments on other borrowings.

Subsequent to 2007, Medical Center Pooled Revenue Bonds totaling $197 million, $7 million with a fixed interest rate and $190 million with a variable interest rate were issued to refinance certain improvements to one of the medical centers. Proceeds were used to refund $188 million of Medical Center Revenue Bonds. In connection with the variable interest rate bonds, the University entered into four interest rate swap agreements with a financial institution, such that the variable interest it pays to the bondholders matches the variable payments it receives from the interest rate swaps, resulting in a weighted average fixed interest rate of 4.7 percent paid to the swap counterparty. These swap transactions do not result in any basis or tax risk to the University.

In October 2007, the University proceeded with an offering statement for the sale of Limited Project Revenue Bonds to finance and refinance certain auxiliary enterprises of the University. Proceeds approximating $415 million would be available to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds.

The University's General Revenue Bond ratings are currently affirmed at AA by Standard & Poor's with a stable outlook. Subsequent to year end, Moody's Investors Service upgraded the University's General Revenue Bond rating to Aa1 with a positive outlook from Aa2 with a positive outlook. Moody's also upgraded five other University ratings, including its Medical Center Pooled Revenue Bonds and Limited Project Revenue Bonds.

During 2006, additions to outstanding debt totaled $2.16 billion, including bond premiums of $53 million.

General Revenue Bonds totaling $558 million were issued in July 2005 to refinance certain facilities and projects of the University. Proceeds, together with certain University funds, were used to refund $439 million of outstanding Multiple Purpose Projects Revenue Bonds, $43 million of Research Facilities Revenue Bonds and $81 million of certificates of participation. In October 2005, General Revenue Bonds totaling $353 million were sold to finance certain facilities of the University, pay issuance costs and repay interim financing incurred prior to the issuance of the bonds.

Limited Project Revenue Bonds totaling $617 million were issued in October 2005 to finance certain auxiliary enterprises of the University, pay issuance costs and repay interim financing incurred prior to the issuance of the bonds.

The University entered into a lease-purchase agreement with the state in December 2005, recorded as a capital lease, totaling $156 million to finance the construction of various University projects. In addition, other new capital lease obligations during 2006 for equipment and a capitalized ground lease totaled $84 million.

In April 2006, a legally separate, non-profit corporation that has developed and owns a student housing project on a campus through the use of a single-project limited liability corporation, through its conduit issuer, issued Student Housing Refunding Revenue Bonds totaling $99 million to partially refinance the construction of a student housing facility. Proceeds were used to refund $95 million of previously outstanding Student Housing Revenue Bonds. Neither the initial bonds, nor the refunding bonds, are collateralized by any encumbrance, mortgage or other pledge of property, except pledged revenues of the student housing project, and do not constitute general obligations of the University. Further, the University is not responsible for any payments related to the ownership, operation or financing of the student housing. However, under GASB requirements, the financial position and operating results of the legally separate organization are incorporated into the University's financial reporting entity.

Other newly originated borrowings in 2006 totaled $243 million, primarily loans from the state or from commercial banks to provide interim financing as a supplement to commercial paper or for capital projects supported by gifts to be received in the near future.

Reductions to outstanding debt in 2006 were $1.23 billion, primarily consisting of $939 million for one-time principal payments for the refinancing or refunding of previously outstanding University revenue bonds ($482 million), University certificates of participation ($81 million), a portion of the LLC's Student Housing Revenue Bonds ($95 million), payments on interim loans from the state as lease revenue bonds were sold ($124 million) and refinancing of previously outstanding bank loans ($157 million); $244 million for principal payments associated with scheduled debt service on revenue bonds, certificates of participation and capital lease obligations; and $23 million for scheduled payments on other borrowings.

The state of California, primarily through state financing appropriations, provided $162 million and $165 million in 2007 and 2006, respectively, of the University's debt service requirements, mainly under the terms of lease-purchase agreements.

Securities lending collateral *(in millions of dollars)*

Under the securities lending program, the University records a liability to the borrower for cash collateral received and held by the University for securities on loan at the end of the year. All borrowers are required to provide additional collateral by the next business day if the value of the collateral falls to less than 100 percent of the fair value of the securities lent. Securities lending collateral grew by $1.10 billion in 2007 and by $878 million in 2006. The amount of the securities lending collateral liability fluctuates directly with the investment of cash collateral as previously discussed.

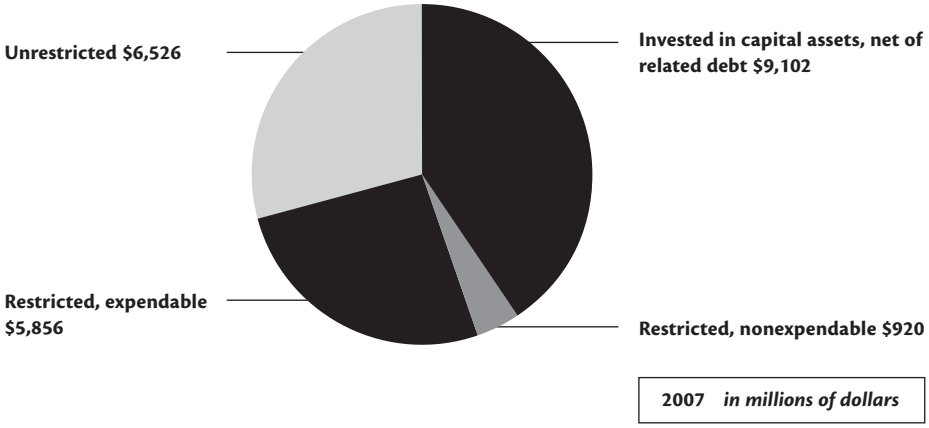
Other liabilities *(in millions of dollars)*

Other liabilities consist of accounts payable, accrued salaries and benefits, deferred revenue, funds held for others, the DOE laboratories' liabilities, federal refundable loans, self-insurance and obligations under life income agreements.

Other liabilities grew by $236 million in 2007, generally as a result of increases in accrued salaries and benefits of $89 million, including $17 million for contributions to the UCRP for employees who formerly worked at LANL; deferred revenue related to grants and contracts of $75 million; funds held for others of $24 million; DOE laboratories' liabilities of $40 million for operating and employee liabilities at LLNL and LBNL; self-insurance liabilities of $35 million; compensated absences of $19 million and obligations under life income agreements of $12 million were partially offset by decreases in accounts payable of $65 million. While payables for goods and services grew in 2007 by over $100 million, settlement liabilities associated with the purchase of investments declined by $174 million compared to 2006.

In 2006, other liabilities dropped by $210 million, primarily as a result of decreases in accrued salaries and benefits of $250 million as the monthly payroll was paid prior to the end of the year in 2006; DOE laboratories' liabilities of $272 million with the transition of the LANL contract to LANS; and self-insurance liabilities of $38 million, partially offset by increases in accounts payable of $224 million, particularly settlement liabilities for the purchase of investments of $216 million; deferred revenue of $68 million; funds held for others of $17 million; and compensated absences of $19 million.

The University's Net Assets



Net assets represent the residual interest in the University's assets after all liabilities are deducted. The University's net assets are $22.40 billion in 2007, compared to $20.40 billion in 2006 and $18.98 billion in 2005. Net assets are reported in four major categories: invested in capital assets, net of related debt; restricted, nonexpendable; restricted, expendable; and unrestricted.

Invested in capital assets, net of related debt *(in millions of dollars)*

The portion of net assets invested in capital assets, net of accumulated depreciation and the related outstanding debt used to finance the acquisition, construction or improvement of these capital assets, is $9.10 billion in 2007, compared to $8.54 billion in 2006 and $8.11 billion in 2005. The increase represents the University's continuing investment in its physical facilities in excess of the related financing and depreciation expense and accounts for a significant portion of the University's overall increase in its net assets for both 2007 and 2006.

Restricted, nonexpendable *(in millions of dollars)*

Restricted, nonexpendable net assets include the corpus of the University's permanent endowments and the estimated fair value of planned giving arrangements. Substantially all of the increase in both years is from new permanent endowment gifts received.

Restricted, expendable *(in millions of dollars)*

Restricted, expendable net assets are subject to externally imposed restrictions governing their use. These net assets may be spent only in accordance with the restrictions placed upon them and may include endowment income and gains, subject to the University's spending policy; support received from gifts, appropriations or capital projects; trustee held investments; or other third party receipts. In 2007, net unrealized appreciation in the fair value of investments contributed $416 million to the value of endowments and gifts; restricted expendable endowments, funds functioning as endowments and annuity and life income funds grew by $284 million; and restricted gifts and grants grew by $96 million. In 2006, net unrealized appreciation in the fair value of investments contributed $178 million to the value of endowments and gifts and restricted net assets available for capital assets grew by $460 million.

Unrestricted *(in millions of dollars)*

Under generally accepted accounting principles, net assets that are not subject to externally imposed restrictions governing their use must be classified as unrestricted for financial reporting purposes. Although unrestricted net assets are not subject to externally imposed restrictions, substantially all of these net assets are allocated for academic and research initiatives or programs, for capital purposes or for other purposes. Unrestricted net assets include funds functioning as endowments of $1.29 billion and $1.15 billion in 2007 and 2006, respectively.

The University's Results of Operations

The statement of revenues, expenses and changes in net assets is a presentation of the University's operating results. It indicates whether the financial condition has improved or deteriorated. In accordance with GASB requirements, certain significant revenues relied upon and budgeted for fundamental operational support of the core instructional mission of the University are required to be recorded as nonoperating revenues, including state educational appropriations, private gifts and investment income.

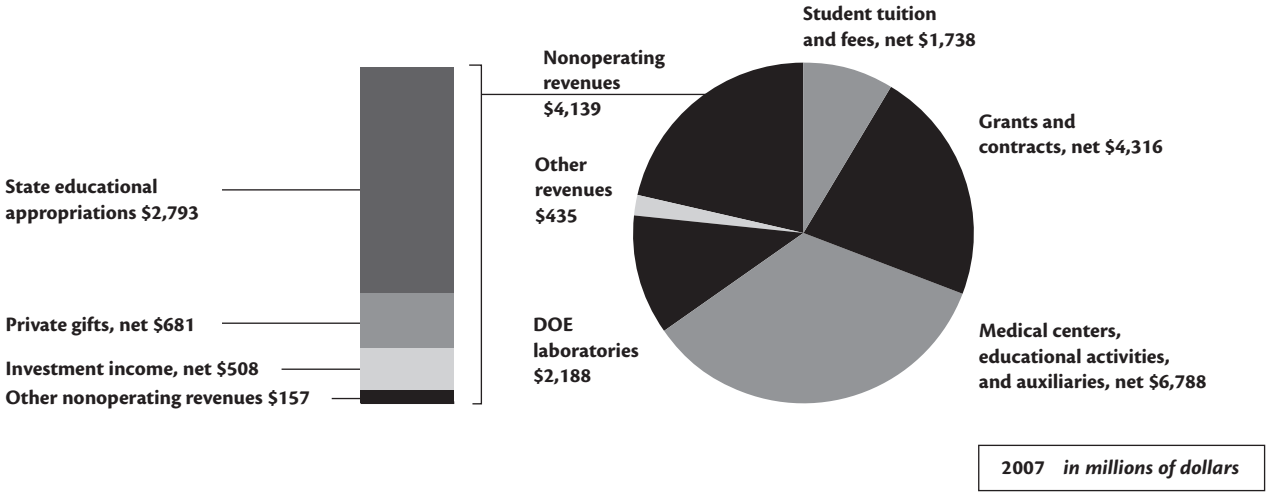
A summarized comparison of the operating results for 2007, 2006 and 2005, arranged in a format that matches the revenue supporting the core activities of the University with the expenses associated with core activities, is as follows:

(in millions of dollars)

	2007			2006			2005		
	OPERATING	NONOPERATING	TOTAL	OPERATING	NONOPERATING	TOTAL	OPERATING	NONOPERATING	TOTAL
REVENUES									
Student tuition and fees, net	$ 1,738		$ 1,738	$ 1,663		$ 1,663	$ 1,558		$ 1,558
State educational appropriations		$ 2,793	2,793		$ 2,573	2,573		$ 2,463	2,463
Grants and contracts, net	4,316		4,316	4,145		4,145	3,977		3,977
Medical centers, educational activities, and auxiliary enterprises, net	6,788		6,788	6,222		6,222	5,744		5,744
Department of Energy laboratories	2,188		2,188	4,232		4,232	4,146		4,146
Private gifts, net		681	681		624	624		537	537
Investment income, net		508	508		446	446		348	348
Other revenues	435	157	592	508	147	655	376	121	497
Revenues supporting core activities	**15,465**	**4,139**	**19,604**	**16,770**	**3,790**	**20,560**	**15,801**	**3,469**	**19,270**
EXPENSES									
Salaries and benefits	10,313		10,313	9,488		9,488	8,924		8,924
Scholarships and fellowships	401		401	358		358	363		363
Utilities	372		372	350		350	311		311
Supplies and materials	1,910		1,910	1,827		1,827	1,707		1,707
Depreciation and amortization	1,049		1,049	997		997	955		955
Department of Energy laboratories	2,170		2,170	4,198		4,198	4,112		4,112
Interest expense		385	385		347	347		296	296
Other expenses	2,509	2	2,511	2,299	14	2,313	2.108	6	2,114
Expenses associated with core activities	**18,724**	**387**	**19,111**	**19,517**	**361**	**19,878**	**18,480**	**302**	**18,782**
Income (loss) from core activities	**$ (3,259)**	**$ 3,752**	**493**	**$ (2,747)**	**$3,429**	**682**	**$ (2,679)**	**$3,167**	**488**
OTHER NONOPERATING ACTIVITIES									
Net appreciation in fair value of investments			949			315			278
Gain (loss) on disposal of capital assets, net			13			(6)			(37)
Income before other changes in net assets			**1,455**			**991**			**729**
OTHER CHANGES IN NET ASSETS									
State capital appropriations			293			220			189
Capital gifts and grants, net			217			167			218
Permanent endowments			39			44			48
Increase in net assets			**2,004**			**1,422**			**1,184**
NET ASSETS									
Beginning of year			20,400			18,978			17,794
End of year			**$ 22,404**			**$20,400**			**$18,978**

Revenues Supporting Core Activities

Categories of both operating and nonoperating revenue that supported the University's core activities in 2007 are as follows:



Revenues to support the University's core activities, including those classified as nonoperating revenues, were $19.60 billion, $20.56 billion and $19.27 billion in 2007, 2006 and 2005, respectively. These diversified sources of revenue decreased in 2007 by $956 million, largely a result of a loss of over $2 billion of revenue from termination of the University's direct contract with the DOE to manage LANL. Revenues increased by $1.29 billion in 2006. State of California educational appropriations, in conjunction with student tuition and fees, are the core components that support the instructional mission of the University. Grants and contracts provide opportunities for undergraduate and graduate students to participate in basic research alongside some of the most prominent researchers in the country. Gifts to the University allow crucial flexibility to faculty for support of their fundamental activities or new academic initiatives. Other significant revenues are from medical centers, educational activities and auxiliary enterprises such as student housing, food service operations and parking.

Student tuition and fees, net *(in millions of dollars)*

Student tuition and fees revenue, net of scholarship allowances, increased by $75 million and $105 million in 2007 and 2006, respectively. Scholarship allowances were $461 million in 2007, $436 million in 2006 and $383 million in 2005. The new fee revenue over the past several years generally replaces state educational appropriations. Consistent with past practices, approximately one-third of the revenue generated from these fee increases was used for financial aid to mitigate the impact on needy students.

In 2007, enrollment grew by 2.5 percent. Resident undergraduate and graduate student fees were not increased in 2007. Certain professional school student fees increased by modest amounts. In addition to the resident student fees, nonresident undergraduate and graduate students pay tuition that increased by nearly 5 percent.

In 2006, enrollment grew by 0.6 percent. Resident undergraduate fees increased by 8 percent, graduate student fees by 10 percent and professional school student fees increased by varying amounts. Nonresident undergraduate and graduate student tuition was increased by 5 percent.

In 2005, enrollment was maintained at essentially the same level as in 2004. Fees for resident undergraduate and graduate students rose by 14 percent and 20 percent, respectively. Professional school fees rose by varying amounts and nonresident student tuition was increased by 20 percent.

State educational appropriations *(in millions of dollars)*

Educational appropriations from the state of California increased in 2007 by $220 million. In 2006, educational appropriations increased by $110 million and marked the end of several years of budget reductions from the state that began in 2003 and included a round of mid-year reductions in both 2003 and 2004. In the intervening years, a wide variety of areas and programs were affected including administration, maintenance, libraries, equipment, academic preparation, K-12 teacher development, public service and student services. In order to maintain the quality of instruction, student fees were increased to partially offset the reduction in educational appropriations.

Grants and contracts, net *(in millions of dollars)*

Highlighting the continued competitive and effective nature of the University's research enterprise, revenue from federal, state, private and local government grants and contracts, including an overall facilities and administration cost recovery of $743 million, $712 million and $679 million in 2007, 2006 and 2005, respectively, increased in both 2007 and 2006 as follows:

(in millions of dollars)

	2007	2006	2005
Federal	$ 2,881	$ 2,814	$ 2,740
State	449	424	411
Private	804	744	681
Local	182	163	145
Grants and contracts net revenue	**$4,316**	**$4,145**	**$3,977**

In 2007, federal grants and contracts revenue, including the federal facilities and administration cost recovery of $590 million and direct expenditures of $2.29 billion, grew by $67 million, or 2.4 percent. This revenue represents support from a variety of federal agencies as indicated below:

(in millions of dollars)

	2007	2006	2005
Department of Health and Human Services	$ 1,682	$ 1,644	$ 1,560
National Science Foundation	422	423	414
Department of Education	240	215	210
Department of Defense	164	163	172
National Aeronautics and Space Administration	84	101	119
Department of Energy (excluding national laboratories)	76	76	78
Other federal agencies	213	192	187
Federal grants and contracts net revenue	**$2,881**	**$2,814**	**$2,740**

State grants and contracts revenue was up by $25 million, or 5.9 percent. Although revenue from private grants and contracts at the campuses can be volatile from year to year, overall it rose by $60 million (8.1 percent), due particularly to a growing number of awards. Local government grants and contracts revenue grew by $19 million (11.7 percent).

In 2006, overall revenue from federal, state, private and local government grants and contracts increased by $168 million, or 4.2 percent. Federal grants and contracts revenue grew by $74 million, or 2.7 percent; state grants and contracts revenue increased by $13 million, or 3.2 percent; private grants and contracts revenue grew by $63 million, or 9.3 percent, and local government grants and contracts revenue grew by $18 million, or 12.4 percent.

Medical centers, educational activities and auxiliary enterprises, net *(in millions of dollars)*

Revenue from medical centers, educational activities and auxiliary enterprises increased by $566 million, or 9.1 percent, from 2006. In 2006, these revenues increased $478 million, or 8.3 percent, from 2005. Revenues for each activity are as follows:

(in millions of dollars)

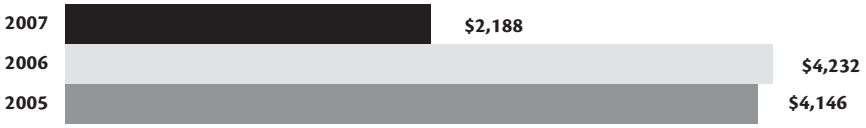
	2007	2006	2005
Medical centers, net	$ 4,526	$ 4,206	$ 3,834
Educational activities, net	1,250	1,123	1,063
Auxiliary enterprises, net	1,012	893	847
Medical centers, educational activities and auxiliary enterprises net revenues	**$6,788**	**$6,222**	**$5,744**

Medical center revenue, net of allowances for doubtful accounts, increased by $320 million and $372 million in 2007 and 2006, respectively. The revenue growth in both years is primarily due to renegotiated contracts, rate adjustments, improved reimbursement rates and a modest increase in patient activity (a 2.8 percent and 1.0 percent increase in patient days for 2007 and 2006, respectively, and outpatient visits declined by 1.1 percent and 0.3 percent for 2007 and 2006, respectively).

Revenue from educational activities, primarily physicians' professional fees, net of allowances for doubtful accounts, grew by $127 million in 2007, or 11.3 percent, and by $60 million, or 5.6 percent, in 2006 and is generally associated with an expanded patient base and higher rates.

Revenue from auxiliary enterprises, net of scholarship allowances, grew by $119 million in 2007, or 13.3 percent, and by $46 million in 2006, or 5.4 percent, generally as a result of student demand for additional room capacity in new residence halls and fee increases to support new and remodeled facilities in both years. Scholarship allowances, substantially all for housing expenses, were $119 million in 2007, $109 million in 2006 and $85 million in 2005.

DOE laboratories *(in millions of dollars)*



The national laboratories operate on federally financed budgets. Revenue related to each laboratory in 2007, 2006 and 2005 is as follows:

(in millions of dollars)

	2007	2006	2005
Los Alamos National Laboratory	$ 17	$ 2,055	$ 2,007
Lawrence Livermore National Laboratory	1,643	1,649	1,640
Lawrence Berkeley National Laboratory	528	528	499
DOE laboratories revenue	**$2,188**	**$4,232**	**$4,146**

LANL revenue in 2007 is entirely associated with DOE contributions to the UCRP for retirement benefits for employees who formerly worked at LANL. Operating revenue was reported in the University's financial statements through May 31, 2006 when the contract to manage and operate the laboratory was directly between the DOE and the University. The contract transitioned to LANS effective June 1, 2006. As a result, revenue comparisons for LANL are affected by the partial year in 2006 and the curtailment of operations for several months during a review of security procedures in 2005.

At LLNL, changes in revenue for both 2007 and 2006 are primarily related to the fluctuation in capital spending requirements for the National Ignition Facility.

Compensation to the University under the contracts directly with the DOE is based, in part, on performance and totaled $19 million in 2007 and $34 million in 2006 and 2005. The first full-year of compensation to the University as a member of LANS totaled $16 million in 2007 and is recorded as other operating revenue. A substantial portion of the compensation is available for research activities directed by the laboratories.

Private gifts, net *(in millions of dollars)*

Gifts may be made directly to the University or through one of the University's campus foundations. Private gifts, substantially all restricted as to use, increased by $57 million in 2007, including an $8 million increase in deferred gift arrangements, and were substantially above the $537 million received in 2005. Nearly two-thirds of the increase in 2007 came to the University from the campus foundations.

The University continues to be aggressive in developing private revenue sources and gifts received from the campus foundations have generally increased over the past several years. In addition to private gifts for operating purposes, gifts are also received for capital purposes—recorded as capital gifts and grants—and for permanent endowments. The combined gifts for operating, capital and permanent endowment purposes totaled $937 million in 2007, $835 million in 2006 and $803 million in 2005.

Investment income, net *(in millions of dollars)*

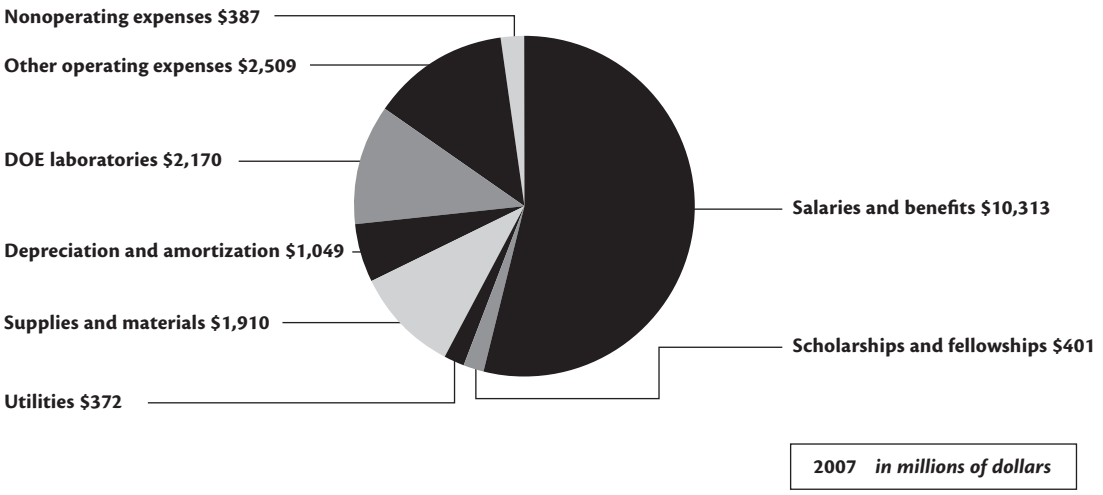
Investment income, principally consisting of $340 million primarily from the STIP and $162 million from endowments invested in the GEP, increased in 2007 by $62 million. Investment income from the STIP grew by $38 million and $95 million in 2007 and 2006, respectively, as short-term interest rates rose during the past two years. The 2007 investment return distributed to participants was 4.7 percent for the University's STIP (4.2 percent for 2006). Endowment income also grew by $29 million in 2007 and by $3 million in 2006.

Other revenues *(in millions of dollars)*

Other revenues are from a variety of sources, including state financing appropriations. Collectively, they declined by $63 million in 2007 after having increased by $158 million in 2006. Patent income dropped by $101 million compared to an increase in 2006 of $89 million that included a significant non-recurring legal settlement. State financing appropriations grew by $10 million and $26 million in 2007 and 2006, respectively, and the first full-year of compensation to the University as a member of LANS totaled $16 million in 2007.

Expenses Associated with Core Activities

Categories of both operating and nonoperating expenses related to the University's core activities in 2007 are as follows:



Expenses associated with the University's core activities, including those classified as nonoperating expenses, were $19.11 billion, $19.88 billion and $18.78 billion in 2007, 2006 and 2005, respectively. Expenses decreased in 2007 by $767 million, largely a result of a loss of over $2 billion of expenses from termination of the University's direct contract with the DOE to manage LANL, and increased in 2006 by $1.10 billion. Over one-half of the University's expenses are related to salaries and benefits and another 11.4 percent, or $2.17 billion, involve spending at the national laboratories. Salaries and benefits attributable to the employees working in the national laboratories are included as laboratory expenses.

Salaries and benefits *(in millions of dollars)*

There are over 127,000 full time equivalent (FTE) employees in the University, excluding employees who are associated with the national laboratories operated and managed directly by the University. FTE employees increased by approximately 3,400 over 2006. Over 50 percent of the increase was for academic and health sciences staff. The remaining increase in FTE employees was for staff to support the growth in research activities, as well as other activities of the University's mission.

Salaries and benefits for 2007, 2006 and 2005 are as follows:

(in millions of dollars)

	2007	2006	2005
Salaries and wages	$ 8,569	$ 7,880	$ 7,441
Benefits	1,744	1,608	1,483
Salaries and benefits	**$10,313**	**$9,488**	**$8,924**

During 2007, salaries and benefits grew by $825 million from 2006, or 8.7 percent, including $254 million at the University's five medical centers where the growth was 12.4 percent. Salaries and wages increased by $689 million, or 8.7 percent, generally related to new academic and administrative employees necessary to directly support the increase in academic and research programs and higher wages and costs associated with patient care activities. Benefit costs increased by $136 million, or 8.5 percent. Increases in health insurance costs of $99 million, the employer portion of payroll taxes of $45 million and worker's compensation costs of $29 million were partially offset by a reduction in compensated absences of $18 million and various other costs totaling $19 million.

In 2006, salaries and benefits grew by $564 million, or 6.3 percent. Salaries and wages increased by $439 million, or 5.9 percent, generally for the same reasons as indicated for 2007. Benefit costs increased by $125 million, or 8.4 percent. Increases in health insurance costs of $53 million, the employer portion of payroll taxes of $48 million and fee remissions for graduate student teaching assistants of $10 million were partially offset by declining workers' compensation expenses of $14 million.

Scholarships and fellowships *(in millions of dollars)*

Scholarships and fellowships, representing payments of financial aid made directly to students and reported as an operating expense, were higher by $43 million in 2007 than in 2006, an increase of 12.0 percent, and were lower by $5 million in 2006 than in 2005, a decrease of 1.4 percent. In addition, scholarship allowances, representing financial aid and fee waivers by the University, are also forms of scholarship and fellowship costs that increased in 2007 by $34 million, or 6.1 percent, to $587 million and increased in 2006 by 16.4 percent to $553 million. However, scholarship allowances are reported as an offset to revenue, not as an operating expense. On a combined basis, as the University continues its commitment to provide financial support for needy students, financial aid in all forms grew to $988 million in 2007 from $911 million in 2006 and $838 million in 2005, an increase of $150 million over the past two years, or 17.9 percent.

Utilities *(in millions of dollars)*

Utility costs rose by $22 million in 2007 and by $39 million in 2006. Almost three-quarters of the University's utility costs are for electricity and natural gas. In 2007, electricity costs grew by $27 million, after declining in 2006 by $1 million. Year-to-year comparisons are affected by the settlement in 2006 of outstanding litigation related to an electricity supply agreement. Natural gas costs dropped by $2 million in 2007, after growing by $30 million, or nearly 40 percent, in 2006.

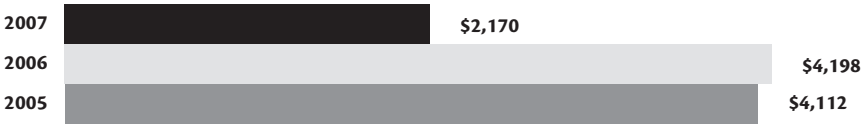
Supplies and materials *(in millions of dollars)*

During 2007, supplies and materials costs increased by $83 million, or 4.5 percent, and in 2006, by $120 million, or 7.0 percent. During the past two years, there has been inflationary pressure on the costs for medical supplies and laboratory instruments and higher costs for general supplies necessary to support expanded research activity and student enrollment. In addition, the University's capitalization threshold was increased in 2006 to the federal limit for research grants and contracts of $5,000 from $3,000 in the prior year resulting in $48 million, or 2.8 percent, of incremental expense.

Depreciation and amortization *(in millions of dollars)*

Higher capital spending over the past several years necessary to upgrade facilities and support both recent and anticipated enrollment growth resulted in depreciation and amortization expense increasing to $1.05 billion in 2007 from $997 million in 2006 and $955 million in 2005.

DOE laboratories *(in millions of dollars)*



DOE laboratories' expenses declined by $2.03 billion in 2007 and grew by $86 million in 2006. LANL expenses were reported in the University's financial statements through May 31, 2006 when the contract to manage and operate the laboratory was directly between the DOE and the University. The contract transitioned to LANS effective June 1, 2006. As a result, expenses were reduced in 2007 by over $2 billion, substantially all of the decline from 2006.

Salaries and benefits are the predominant expenses at the laboratories, totaling nearly $1.05 billion in 2007, and spending patterns for capital assets are generally responsible for most of the extreme year-to-year variations. In 2007, LBNL expenses increased by $7 million, although they were entirely offset by a $7 million decline at LLNL. In 2006, although managed and operated directly by the University for only eleven months of the year, expenses at LANL increased by $49 million compared to 2005 when operations were curtailed for several months during a review of security procedures. Expenses in 2006 at LBNL and LLNL grew by $27 million and $10 million, respectively.

Interest expense *(in millions of dollars)*

Interest expense, reported as a nonoperating expense, increased by $38 million in 2007 and by $51 million in 2006. In addition to lower capitalized interest in 2007 of $13 million, the University has incurred additional interest expense as a result of new bonds issued during the past three years, although the weighted average interest rate of the overall portfolio has decreased from two years ago due to refinancing previously outstanding bonds at lower rates.

Other expenses *(in millions of dollars)*

Other expenses, including other nonoperating expenses, increased by $198 million in 2007 and $199 million in 2006. In 2007 and in 2006, there were increases generally across a variety of expense categories, including travel, rent, insurance and repairs and maintenance. In addition, in 2006, the transition of LANL to being managed and operated directly by LANS rather than the University resulted in $21 million of expenses for reimbursements to the DOE associated with the transition of employees and their health benefits to LANS. Further, in 2006, nonoperating expenses included $16 million for infrastructure to be dedicated in conjunction with the purchase of land to be used to expand health care facilities.

In accordance with the GASB's reporting standards, operating losses were $3.26 billion in 2007, $2.75 billion in 2006 and $2.68 billion in 2005. However, these operating losses were more than offset by $3.75 billion, $3.43 billion and $3.17 billion of net revenue and expenses in 2007, 2006 and 2005, respectively, that are required by the GASB to be classified as nonoperating, but clearly support operating activities of the University. Therefore, revenue to support core activities exceeded the associated expenses by $493 million in 2007, $682 million in 2006 and $488 million in 2005. This income is restricted by either legal or fiduciary obligations, allocated for academic and research initiatives or programs, necessary for debt service or required for capital purposes.

Other Nonoperating Activities

The University's other nonoperating activities, generally noncash transactions and, therefore, not available to support operating expenses, are the net appreciation or depreciation in the fair value of investments and the gain or loss on the disposal of capital assets.

Net appreciation in fair value of investments *(in millions of dollars)*

In 2007, the University recognized net appreciation in the fair value of investments of $949 million compared to $315 million of net appreciation during 2006 and $278 million in 2005. As equity markets delivered substantial gains over the past two years, the equity portfolios appreciated in value. However, as short-term interest rates have generally risen over the past two years, the fair value of certain securities in the fixed-income portfolios has declined resulting in a modest net unrealized depreciation in these portfolios.

Gain (loss) on disposal of capital assets, net of proceeds *(in millions of dollars)*

Disposals and write-offs of capital assets resulted in a gain of $13 million in 2007 compared to a loss of $6 million in 2006. Typically, routine disposals result in a very slight gain or loss.

Other Changes in Net Assets

Similar to other nonoperating activities discussed above, other changes in net assets are also not available to support the University's operating expenses in the current year. State capital appropriations and capital gifts and grants may only be used for the purchase or construction of the specified capital asset. Only income earned from gifts of permanent endowments is available in future years to support the specified program.

State capital appropriations *(in millions of dollars)*

The University's enrollment growth requires new facilities, in addition to continuing needs for renewal, modernization and seismic correction of existing facilities. Capital appropriations from the state of California increased by $73 million in 2007 and increased by $31 million in 2006. Capital appropriations are from bond measures approved by the California voters.

Capital gifts and grants, net *(in millions of dollars)*

Capital gifts and grants increased by $50 million in 2007 after having declined by $51 million in 2006. In 2007, the University received $30 million from the state for capital requirements to support patient care for children. Comparisons between 2007, 2006 and 2005 are affected by the timing of Federal Emergency Management Agency (FEMA) grants, primarily for the replacement hospitals at UCLA as the projects approach completion, along with the receipt of certain other significant gifts. Grants from FEMA increased by $7 million in 2007, although declined by $19 million and $61 million in 2006 and 2005, respectively. The University also received gifts of software licenses of $24 million in 2005.

Permanent endowments *(in millions of dollars)*

Gifts of permanent endowments to the University are a measure of the University's continuing emphasis on private giving. In addition to gifts directly to the University, many gifts of permanent endowments are made through the campus foundations in support of University activities. Combined gifts of permanent endowments to both the University and campus foundations totaled $210 million in 2007, $204 million in 2006 and $170 million in 2005.

The University's Cash Flows

The statement of cash flows presents the significant sources and uses of cash. A summary comparison of cash flows for 2007, 2006 and 2005 is as follows:

(in millions of dollars)

	2007	2006	2005
Cash received from operations	$ 13,100	$ 12,454	$ 11,567
Cash payments for operations	(15,299)	(14,655)	(13,389)
Net cash used by operating activities	**(2,199)**	**(2,201)**	**(1,822)**
Net cash provided by noncapital financing activities	3,472	3,221	3,049
Net cash used by capital and related financing activities	(1,721)	(772)	(1,291)
Net cash provided (used) by investing activities	393	(210)	157
Net increase (decrease) in cash	**(55)**	**38**	**93**
Cash, beginning of year	202	164	71
Cash, end of year	**$ 147**	**$ 202**	**$ 164**

The University's cash in demand deposit accounts declined by $55 million in 2007 and increased by $38 million and $93 million in 2006 and 2005, respectively. Cash in demand deposit accounts is minimized by sweeping available cash balances into investment accounts on a daily basis.

Nearly $2.20 billion of cash was used for operating activities in 2007, offset by $3.47 billion of cash provided by noncapital financing activities, resulting in $1.27 billion of cash before capital financing or investing activities. Similarly, in 2006, $2.20 billion of cash was used for operating activities, offset by $3.22 billion of cash provided by noncapital financing activities, resulting in $1.02 billion available for capital financing or investing activities. Noncapital financing activities, as defined by the GASB, include state educational appropriations and gifts received for other than capital purposes that are used to support operating activities.

Cash of $1.72 billion and $772 million in 2007 and 2006, respectively, was used for capital and related financing activities, primarily for purchases of capital assets and principal and interest payments, partially offset by sources that include new external financing, state and federal (FEMA) capital appropriations and gifts for capital purposes. During 2007, purchases of capital assets were greater than 2006 by $745 million and proceeds from the issuance of debt, net of the refinancing of previously outstanding debt, were lower than 2006 by $255 million.

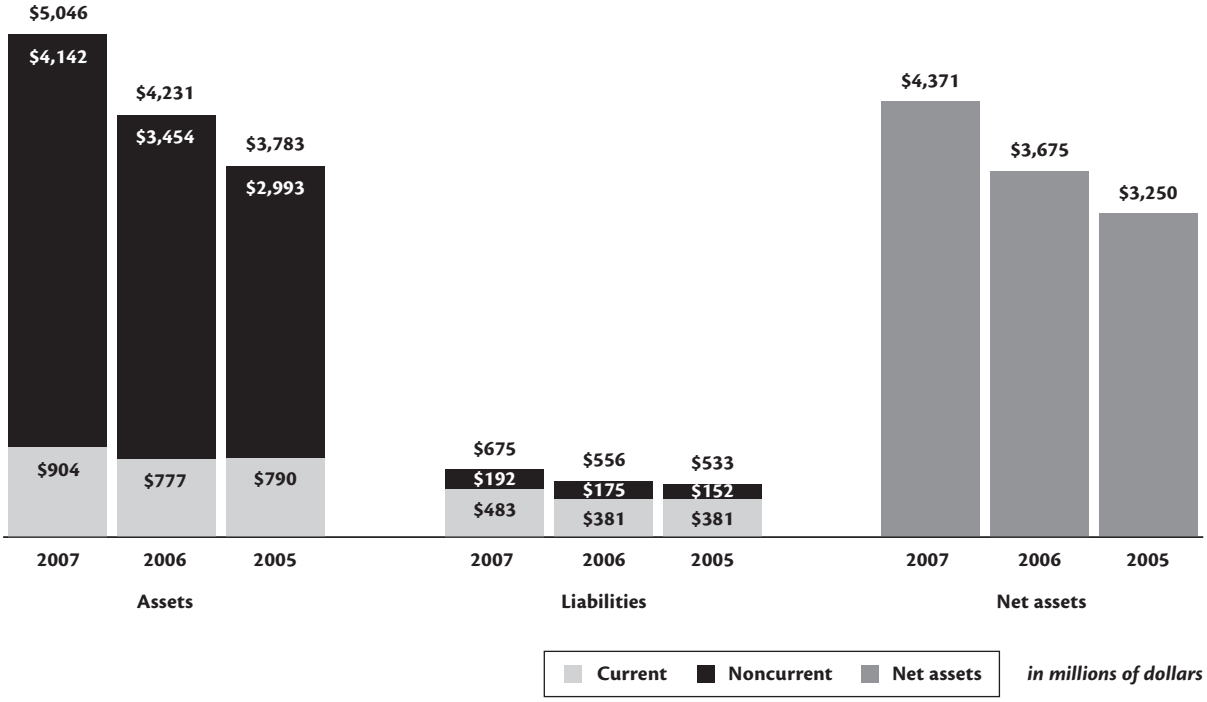
Cash provided by investing activities totaled $393 million in 2007 and $157 million in 2005, compared to cash used by investing activities of $210 million in 2006. The differences are a result of the routine timing of investment transactions and greater investment income.

THE UNIVERSITY OF CALIFORNIA CAMPUS FOUNDATIONS

Separate foundations at each individual campus provide valuable assistance in fundraising, public outreach and other support for the missions of the campus and the University. Although independent boards govern each of these ten foundations, they are affiliated with, and their assets are dedicated for, the benefit of the University of California.

The Campus Foundations' Financial Position

The campus foundations' statement of net assets presents their combined financial position at the end of the year. It displays all of the campus foundations' assets, liabilities and net assets. The difference between assets and liabilities are net assets, representing a measure of the current financial condition of the campus foundations.



The major components of the combined assets, liabilities and net assets of the campus foundations at 2007, 2006 and 2005 are as follows:

(in millions of dollars)

	2007	2006	2005
ASSETS			
Investments	$ 4,037	$ 3,364	$ 2,950
Investment of cash collateral	367	280	288
Pledges receivable, net	450	430	427
Other assets	192	157	118
Total assets	**5,046**	**4,231**	**3,783**
LIABILITIES			
Securities lending collateral	367	280	288
Obligations under life income agreements	181	163	162
Other liabilities	127	113	83
Total liabilities	**675**	**556**	**533**
NET ASSETS			
Restricted:			
Nonexpendable	1,728	1,527	1,360
Expendable	2,628	2,132	1,874
Unrestricted	15	16	16
Total net assets	**$4,371**	**$3,675**	**$3,250**

Assets. Investments in 2007 grew by $673 million. The significant changes were $172 million of new permanent endowments, $451 million of net appreciation in the fair value of investments and $79 million of investment income, partially offset by $31 million of net cash distributions as cash receipts from gifts were less than the foundations' grants to the University.

Investments in 2006 grew by $414 million, generally resulting from $159 million of new permanent endowments, $234 million of net appreciation in the fair value of investments and $68 million of investment income, partially offset by $48 million of net cash distributions.

The Board of Trustees for each campus foundation is responsible for its specific investment policy, although asset allocation guidelines are recommended to campus foundations by the Investment Committee of The Regents. The Boards of Trustees may determine that all or a portion of their investments will be managed by the University's Chief Investment Officer. The Chief Investment Officer managed $1.13 billion and $938 million of the campus foundations' investments at the end of 2007 and 2006, respectively.

The campus foundations' statement of net assets includes an allocation of the University's securities lending assets and liabilities at the end of each year and income and rebates for the year, in accordance with their respective investments with the University. One campus foundation participates directly in its own securities lending program. The investment of cash collateral and related securities lending liability allocated by the University to the campus foundations totaled $320 million and $230 million at the end of 2007 and 2006, respectively. The campus foundation with direct participation loaned securities for cash collateral of $46 million and $50 million at the end of 2007 and 2006, respectively.

Certain campuses and campus foundations have comprehensive fund-raising campaigns underway, raising both gifts and pledges. Pledges receivable, representing gifts to be received in the future, were $450 million at the end of 2007, up $20 million from last year. Pledges receivable were $430 million in 2006, an increase of $3 million from 2005.

Liabilities. Total campus foundations' liabilities were $675 million in 2007 compared to $556 million in 2006 and $533 million in 2005. The $119 million increase in 2007 is primarily related to securities lending activity that grew by $87 million. While securities lending activity declined in 2006 by $8 million, the Berkeley campus foundation deferred revenue from a conditional gift in 2006 that contributed to an overall increase in liabilities of $23 million in that year.

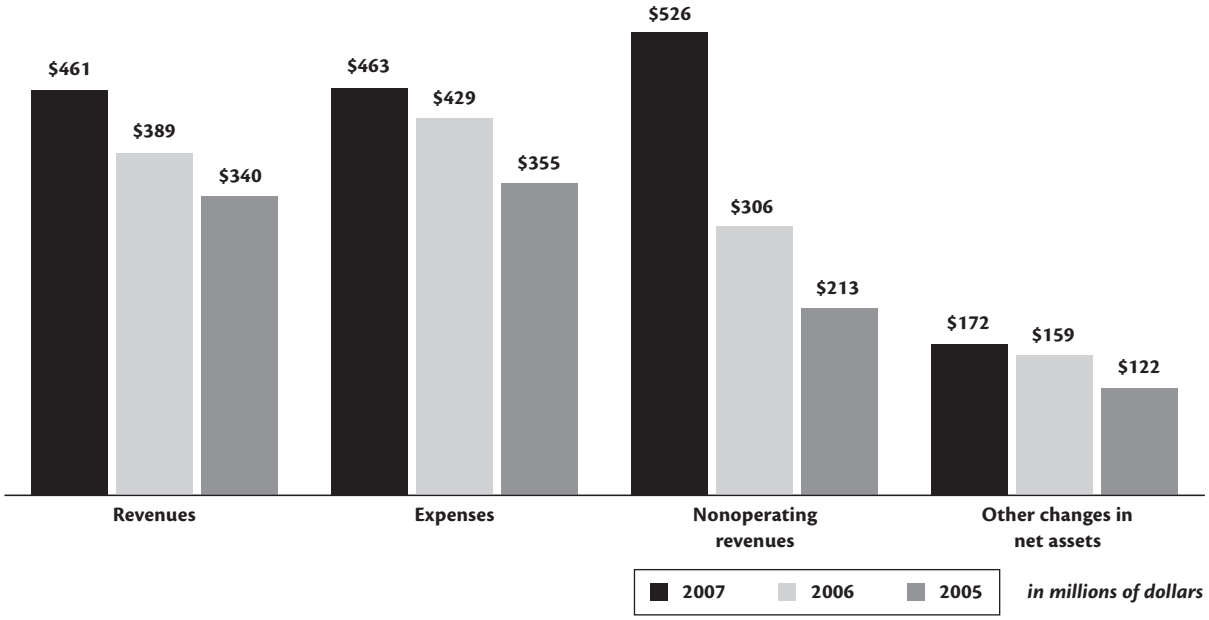
Net assets. Net assets are reported in certain categories based upon the nature of the restrictions on their use.

Restricted, nonexpendable net assets include the corpus of the campus foundations' permanent endowments and the estimated fair value of certain planned giving arrangements. The increase is primarily attributable to new permanent endowment gifts received, partially offset by an increase in the estimated liability to beneficiaries of the planned giving arrangements.

Restricted, expendable net assets are subject to externally imposed restrictions governing their use. These net assets may be spent only in accordance with the restrictions placed upon them and may include endowment income and investment gains, subject to each individual campus foundation's spending policy; support received from gifts; trustee held investments; or other third party receipts. New gifts and net appreciation in the fair value of investments were the primary reasons for the increase in value in 2007 and 2006.

Under generally accepted accounting principles, net assets that are not subject to externally imposed restrictions governing their use must be classified as unrestricted for financial reporting purposes.

The Campus Foundations' Results of Operations



The campus foundations' combined statement of revenues, expenses and changes in net assets is a presentation of their operating results for the year. It indicates whether their financial condition has improved or deteriorated during the year. A summarized comparison of the operating results for 2007, 2006 and 2005 is as follows:

(in millions of dollars)

	2007	2006	2005
OPERATING REVENUES			
Private gifts	$ 458	$ 388	$ 332
Other revenues	3	1	8
Total operating revenues	**461**	**389**	**340**
OPERATING EXPENSES			
Grants to campuses	451	416	344
Other expenses	12	13	11
Total operating expenses	**463**	**429**	**355**
Operating loss	**(2)**	**(40)**	**(15)**
NONOPERATING REVENUES (EXPENSES)			
Investment income	79	69	62
Net appreciation in fair value of investments	451	234	151
Other nonoperating revenues (expenses)	(4)	3	
Income before other changes in net assets	**524**	**266**	**198**
OTHER CHANGES IN NET ASSETS			
Permanent endowments	172	159	122
Increase in net assets	**696**	**425**	**320**
NET ASSETS			
Beginning of year	3,675	3,250	2,930
End of year	**$4,371**	**$3,675**	**$3,250**

Operating loss. Operating revenues generally consist of current-use gifts, including pledges and income from other fund-raising activities, although they do not include additions to permanent endowments and endowment income. Operating revenues increased by $72 million and $49 million in 2007 and 2006, respectively.

Operating expenses generally consist of grants to University campuses, comprised of current-use gifts and endowment income and other expenses, including gift fees. Grants to campuses typically follow the pattern indicated by private gift revenue; however, the campus' programmatic needs are also taken into consideration, subject to abiding by the designated purposes of gifts to the endowment and the amounts available for grants in any particular year.

Private gift revenue includes pledges, a non-cash operating revenue. Grants to the campuses can only be made when the cash is received and, in addition, also include endowment investment income, classified as nonoperating income. Therefore, operating losses can occur when grants distributed to the campuses in any particular year exceed private gift revenue.

Nonoperating revenues (expenses). Nonoperating revenues or expenses include net investment income, net appreciation or depreciation in the fair value of investments and adjustments to gift annuity and trust liabilities. Investment income of $79 million was up from $69 million in 2006 and $62 million in 2005. Due to the performance of the financial markets in 2007 and 2006, the campus foundations' results include $451 million and $234 million, respectively, of net appreciation in the fair value of investments.

Other changes in net assets. Gifts of permanent endowments of $172 million in 2007 grew by $13 million from 2006 levels. In 2006, gifts of permanent endowments grew by $37 million from 2005.

The Campus Foundations' Cash Flows

The campus foundations' combined statement of cash flows presents the significant sources and uses of cash and cash equivalents. A summary comparison of cash flows for 2007, 2006 and 2005 is as follows:

(in millions of dollars)

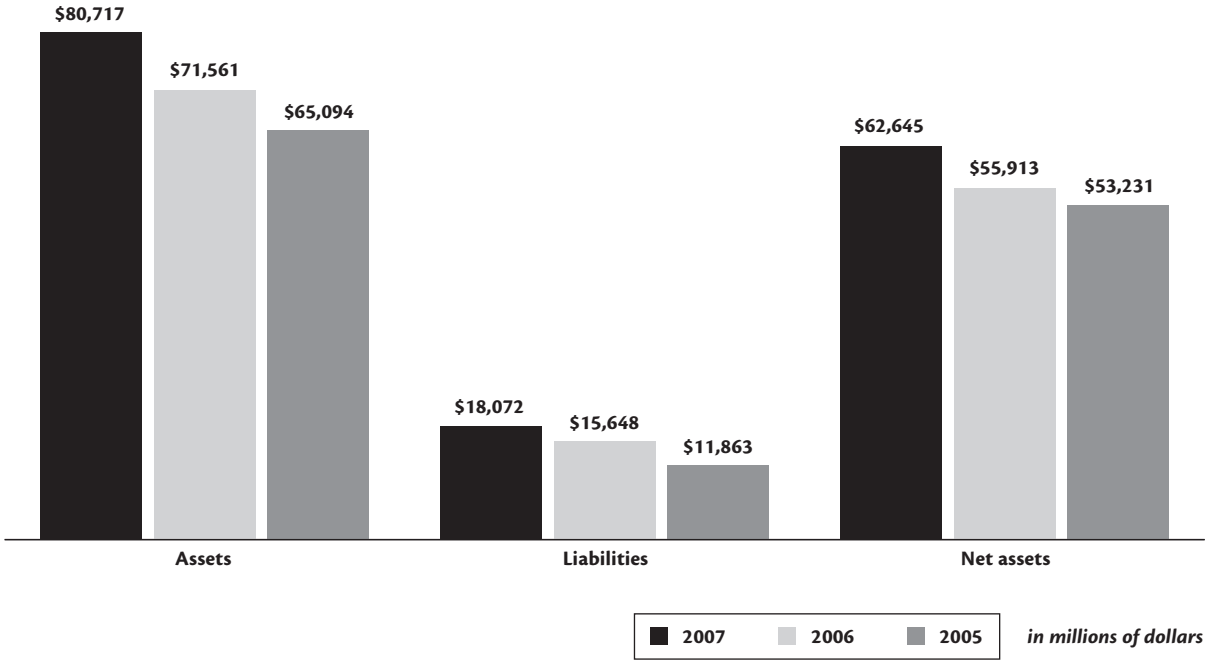
	2007	2006	2005
Cash received from private gifts	$ 429	$ 385	$ 338
Cash payments for grants	(463)	(430)	(370)
Other cash receipts (payments), net	3	(3)	4
Net cash used by operating activities	**(31)**	**(48)**	**(28)**
Net cash provided by noncapital financing activities	163	141	107
Net cash used by investing activities	(96)	(47)	(88)
Net increase (decrease) in cash and cash equivalents	**36**	**46**	**(9)**
Cash and cash equivalents, beginning of year	126	80	89
Cash and cash equivalents, end of year	**$ 162**	**$ 126**	**$ 80**

Cash and cash equivalents were $162 million in 2007 compared to $126 million in 2006, an increase of $36 million. In 2006, cash increased by $46 million. Cash used by operating activities was $31 million in 2007 compared to $48 million in 2006 due to increasing grants made to campuses. As discussed above, cash payments for grants are an operating activity, but these payments also include investment income which is an investing activity. In addition, while the trend is for grants to campuses to coincide with contributions revenue, the timing may not always occur in the same year. Cash provided by noncapital financing activities primarily results from cash gifts for permanent endowments.

THE UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)

The UCRS is a valuable component of the comprehensive benefits package offered to employees of the University. The UCRS consists of the University of California Retirement Plan (the UCRP), a defined benefit plan for members; the University of California Retirement Savings Program that includes three defined contribution plans (the DCP, the 403(b) and the 457(b) plans) to complement the defined benefit plan, with several investment portfolio options for participants' elective and non-elective contributions; and the California Public Employees Retirement System (PERS) Voluntary Early Retirement Incentive Plan (PERS-VERIP) for certain University employees that were members of PERS who elected early retirement.

The UCRS' Financial Position



The statement of plans' fiduciary net assets presents the financial position of the UCRS at the end of the fiscal year. It displays all of the retirement system's assets, liabilities and net assets. The difference between assets and liabilities are the net assets held in trust for pension benefits. These represent amounts available to provide pension benefits to members of the UCRP and participants in the defined contribution plans and the PERS-VERIP. At June 30, 2007, the UCRS plans' assets were nearly $81 billion, liabilities were over $18 billion and net assets held in trust for pension benefits exceeded $62 billion, an increase of $6.73 billion from 2006. Net assets increased in 2006 by $2.68 billion from 2005.

The major components of the assets, liabilities and net assets available for pension benefits for 2007, 2006 and 2005 are as follows:

(in millions of dollars)

	2007	2006	2005
ASSETS			
Investments	$ 59,685	$ 53,866	$ 51,372
Participants' interest in external mutual funds	3,794	3,019	2,359
Investment of cash collateral	16,884	13,993	10,894
Other assets	354	683	469
Total assets	**80,717**	**71,561**	**65,094**
LIABILITIES			
Securities lending collateral	16,885	13,994	10,891
Other liabilities	1,187	1,654	972
Total liabilities	**18,072**	**15,648**	**11,863**
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS			
Members' defined benefit plan benefits	48,192	43,440	41,936
Participants' defined contribution plan benefits	14,453	12,473	11,295
Total net assets held in trust for pension benefits	**$62,645**	**$55,913**	**$53,231**

Assets. UCRS investments, including participants' interest in external mutual funds, totaled $63.48 billion at the end of 2007 compared to $56.89 billion at the end of 2006, an increase of $6.59 billion, including the net effect at the end of the year of security purchases and sales yet to be settled of $141 million. The increase, net of the effect of future settlements of security purchases and sales, was generally a result of $7.86 billion net appreciation in the fair value of investments, $1.06 billion in contributions to the UCRS and $1.87 billion in net investment earnings, partially offset by benefit payments and participant withdrawals of $2.57 billion and a transfer of UCRP assets to the LANS defined benefit plan of $1.44 billion.

In 2006, UCRS investments, including participants' interest in external mutual funds, increased by $3.16 billion, including the net effect at the end of the year of security purchases or sales yet to be settled of $553 million. The increase, net of the effect of future settlements of security purchases and sales, was primarily a result of $2.14 billion net appreciation in the fair value of investments, $1.02 billion in contributions to the UCRS and $1.72 billion in net investment earnings, partially offset by benefit payments of $2.17 billion.

During 2007, participants' interest in external mutual funds, representing defined contribution plan contributions to certain external mutual funds on a custodial plan basis, grew by $775 million to $3.79 billion primarily through a combination of $278 million of participant contributions, $581 million of investment earnings and appreciation in the fair value of investments and $158 million transferred from University managed investments, partially offset by $242 million of participant withdrawals. In 2006, participants' interest in external mutual funds grew by $660 million to $3.02 billion generally through $267 million of participant contributions, $302 million of investment earnings and appreciation in the fair value of investments and $257 million transferred from University managed investments, partially offset by $154 million of participant withdrawals.

Along with the University, the UCRS participates in a securities lending program as a means to augment income. The investment of cash collateral and the associated liability for collateral held by the UCRS for securities on loan at the end of the year increased in 2007 and 2006 by 20.7 percent and 28.4 percent, respectively. The securities lending investment income, net of fees and rebates, increased to $32 million in 2007 from $24 million in 2006.

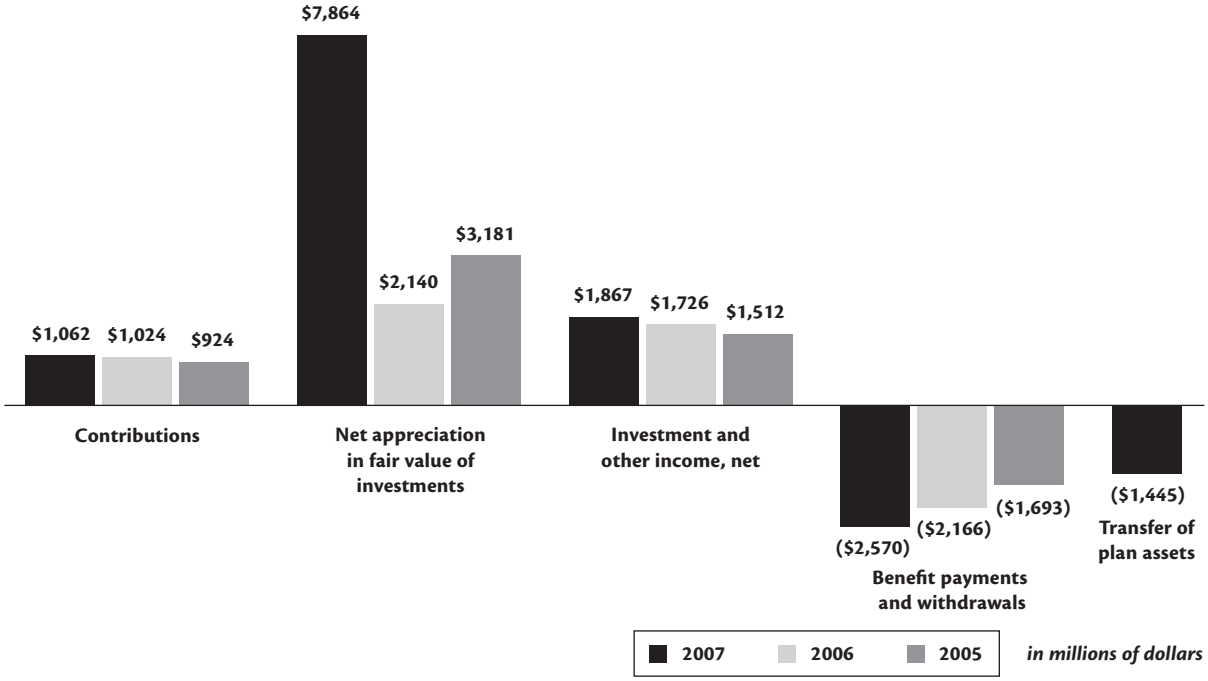
During 2006, two additional securities lending agents provided additional activity under the University's program. Lending activity and interest rates in the past two years are substantially above 2005 levels leading to a large increase in both gross income and rebates, and an increase in net income for the overall program.

Liabilities. Total UCRS liabilities were $18.07 billion in 2007 compared to $15.65 billion in 2006. Over $2.89 billion of the increase results from the securities lending program discussed above, with the remainder a result of liabilities for security purchases to be settled after year-end.

Net assets. A total of $48.19 billion of the net assets are dedicated to the UCRP members' defined benefit plan benefits and over $14.45 billion are associated with participants' tax deferred, defined contribution plan benefits. As of June 30, 2007, the date of the most recent actuarial report, the UCRP's overall funded ratio was 104.8 percent compared to 104.1 percent as of June 30, 2006. This indicates that for every dollar of benefits due to UCRP members under the University's defined benefit plan, assets of over $1.04 are available to cover benefit obligations.

All assets of the UCRP are available to pay any member's benefits. However, assets and liabilities for the campus and medical center segment of the UCRP are internally tracked separately from the DOE national laboratory segment of the UCRP. As of June 30, 2007, the funded ratio for the campus and medical center segment was 105.2 percent compared to 105.6 percent as of June 30, 2006. For the DOE national laboratory segment, as of June 30, 2007 the funded ratio was 103.5 percent compared to 100.1 percent as of June 30, 2006. The DOE has a continuing obligation to the University to provide contributions to pay UCRP benefits to laboratory segment retirees.

The UCRS' Results of Operations



The statement of changes in plans' fiduciary net assets is a presentation of the UCRS' operating results. It indicates whether the financial condition has improved or deteriorated during the year. A summarized comparison of the operating results for 2007, 2006 and 2005 is as follows:

(in millions of dollars)

	2007	2006	2005
ADDITIONS			
Contributions	$ 1,062	$ 1,024	$ 924
Net appreciation in fair value of investments	7,864	2,140	3,181
Investment and other income, net	1,867	1,726	1,512
Total additions	**10,793**	**4,890**	**5,617**
DEDUCTIONS			
Benefit payments and participant withdrawals	2,570	2,166	1,693
Plan expenses	46	42	33
Transfer of assets to the LANS defined benefit plan	1,445		
Total deductions	**4,061**	**2,208**	**1,726**
Increase in net assets held in trust for pension benefits	**$ 6,732**	**$ 2,682**	**$ 3,891**

Contributions. Contributions in 2007 increased by $38 million and in 2006 by $100 million. The majority of contributions are made into the defined contribution plans that included $13 million and $21 million of University contributions in 2007 and 2006, respectively. Participants are required to make contributions to the DCP and may make voluntary and rollover contributions to the DCP, 403(b) plan, and 457(b) plan established in 2005. Due to the UCRP's funded position, neither the University nor the members has been required to make contributions since 1990. However, $25 million of contributions were recorded in 2007, primarily a $17 million contribution from the DOE on behalf of members who formerly worked at LANL.

Net appreciation in fair value of investments. The UCRS recognized net appreciation in the fair value of investments of $7.86 billion during 2007 compared to $2.14 billion during 2006.

The overall investment gain based upon unit values for the UCRS was 17.7 percent and 7.1 percent in 2007 and 2006, respectively.

Investment and other income. Investment and other income in 2007 of $1.87 billion increased by $141 million, or 8.2 percent. Similarly, investment and other income in 2006 of $1.73 billion increased by $214 million, or 14.2 percent. Short-term interest rates rose in both years.

Benefit payments and withdrawals. Benefit payments and participant withdrawals were $404 million higher in 2007 than in 2006 and $473 million higher in 2006 than in 2005. Payments from the UCRP and PERS-VERIP to retirees increased by $175 million and $124 million in 2007 and 2006, respectively, due to a growing number of retirees receiving payments and cost-of-living adjustments and member withdrawals. There are 45,400 retirees and beneficiaries currently receiving payments compared to 41,500 at the end of 2005. In addition, elections of lump sum cash-outs of the UCRP and participant withdrawals from the Retirement Savings Plans grew by $229 million and $350 million in 2007 and 2006, respectively. In 2007 and 2006, participant withdrawals from the Retirement Savings Plans were affected by former employees at LANL transitioning from the University to LANS.

Transfer of assets to LANS' defined benefit plan. With the selection of LANS as the successor contractor to the University for the management of LANL effective June 1, 2006, assets and liabilities attributable to the UCRP benefits of the approximately 6,500 LANL employees who accepted employment with LANS and elected to participate in the defined benefit plan established by LANS were transferred to the LANS defined benefit plan. The market value of assets transferred as of March 31, 2007 to the LANS defined benefit plan associated with the transitioning employees who are not retained in the UCRP was $1.44 billion.

Additional information on the retirement plans can be obtained from the 2007 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plans and the University of California PERS-VERIP by writing to the University of California, Office of the President, Human Resources/Benefits Department, Financial Services and Plan Disbursements, 300 Lakeside Drive, Suite 400, Oakland, California 94612.

LOOKING FORWARD

The University of California is a world center of learning, known for generating a steady stream of talent, knowledge and social benefits, and has always been at the center of California's capacity to innovate. The excellence of its programs attracts the best students, leverages hundreds of millions of dollars in state, federal and private funding and promotes discovery of new knowledge that fuels economic growth.

Major financial strengths of the University include a diverse source of revenues, including those from the state of California, student fees, federally sponsored grants and contracts, medical centers, private support and self-supporting enterprises.

The variety of fund sources has become increasingly important over the past several years given the effects of the state fiscal crisis that required reductions in both instructional and non-instructional programs. Student fee increases were necessary to address the reductions in state educational appropriations. The state is continuing its work to resolve its financial situation in which expenditures have continued to exceed revenues. Three years ago, the University and the Governor agreed on a Compact to provide guidance and financial commitments to a long-term resource plan for the University. The Compact addresses fundamental financial support, enrollment, student fees and other key program elements for 2007 through 2011. It provides a financial foundation for the University and the ability to plan for student fee levels over the next several years. In exchange for this long-term stability, the University commits to focus its resources to address long-term accountability goals for enrollment, student fees, financial aid and program quality, among other areas.

As a result of some improvement in the state's financial position, resident student fees were not increased in 2007 as they had been for the prior four years in order to maintain the quality of instructional programs, although nonresident undergraduate student tuition was raised by 5 percent. However, for 2008, resident undergraduate fees will increase by 7 percent, graduate student fees by 7 percent and most professional school fees will increase between 7 and 10 percent. In addition to the resident student fees, nonresident undergraduate and graduate students pay tuition. Tuition will increase by 5 percent for undergraduate students. Consistent with past practice, a portion of the fee increases will be used for financial aid.

The University remains highly competitive in attracting federal grants and contracts revenue, with fluctuations in the awards received closely paralleling trends in the budgets of federal research granting agencies. Over two-thirds of the University's federal research revenue comes from two agencies, the Department of Health and Human Services, primarily through the National Institutes of Health, and the National Science Foundation. Other agencies that figure prominently in the University's awards are the Department of Education, Department of Defense, the National Aeronautics and Space Administration and the Department of Energy. While the federal government is under tight fiscal constraints, there is a bi-partisan effort underway to focus on innovation and competitiveness for the nation. The University is a unique national resource for helping the nation address competitiveness and economic initiatives.

The University's medical centers have demonstrated very positive financial results, although they continue to face financial challenges in a price-sensitive, managed care environment, along with the added costs and responsibilities related to their function as academic institutions. The demand for health care services and the cost of providing them are increasing significantly. In addition to the rising costs of salaries, benefits and medical supplies faced by hospitals across the state, the University's medical centers also face additional costs associated with new technologies, biomedical research, the education and training of health care professionals and the care for a disproportionate share of the medically underserved in California. Other than Medicare and Medi-Cal (California's Medicaid program), health insurance payments do not recognize the added cost of teaching in their payment to academic medical centers. Over the last few years, Medicare margins have declined as a result of payment reductions. Recent changes to the Medi-Cal program will likely limit or reduce the rates of payment growth to the medical centers in future years. Also, as a result of state legislation, the medical centers face capital requirements to ensure that facilities can maintain uninterrupted operations following a major earthquake. While the state has provided additional capital to meet these requirements, the level of support provided will not cover the full cost to the University. Other sources of capital are required.

The continuing financial success of the medical centers is predicated on a multifaceted strategy, which includes competing in commercial markets and offering high quality regional services. Positive results in commercial contracts

have helped address the lack of support for medical education and care for the poor. Further, the medical centers remain competitive in their respective markets by reducing costs through improved efficiencies, making strategic investments and by expanding their presence in the market through stronger links with other providers and payers. Payment strategies must recognize the need to maintain an operating margin sufficient to cover debt, provide working capital, purchase state-of-the-art equipment and invest in infrastructure and program expansion.

The University's private support is a testament to its distinction as a leader in philanthropy among the nation's colleges and universities and the high regard in which its alumni, corporations, foundations and other supporters hold the University. The level of private support underscores the continued confidence among donors in the quality of the University's programs and the importance of its mission. At the same time, private support in 2008 will likely reflect the changes in the economy and financial markets, the effect of which is not determinable at this time.

Additional, affordable and accessible student housing will be required in order to satisfy the demand. Most campus residence halls continue to be occupied at design capacity. The University is responding to the demand by building student housing in the traditional manner, with housing fees set to generate sufficient revenue to cover direct and indirect operating costs and debt service, and by seeking development opportunities for privately owned housing on University campuses.

The University must have a balanced array of many categories of facilities to meet its education, research and public service goals and continues to assess its long-term capital requirements. The support for the University's capital program will be provided from a combination of sources, including the state of California, external financing, gifts and other sources.

In November 2006, a general obligation bond package for education was approved by the California voters. As a result, the University will receive $690 million for its capital program for the two-year period 2008 and 2009. In addition, the University will receive over $200 million over the same period for expansion of the University's medical schools and delivery of health care through telemedicine. This level of support from the state will not meet all of the University's capital needs and institutional resources will continue to be necessary to address many critical projects.

There are also plans for additional capital projects that are traditionally not considered to be state supportable. This is a continuing process that is amended, as required, to include projects when gifts or other supplemental resources are obtained or financing plans are developed.

The University operates and manages, or participates in the management of, three national laboratories on behalf of the DOE since their formation, without financial gain, as a public service to the nation.

The University's contract to manage LLNL for the National Nuclear Security Administration of the United States Department of Energy expired on September 30, 2007. The University is a member in a joint venture, Lawrence Livermore National Security, LLC (LLNS), that was selected to operate and manage LLNL effective October 1, 2007. LLNS is a separate corporate entity that is expected to be reported as a joint venture using the equity method in the University's financial statements. As a result, the gross revenues and expenses associated with the successor contract are not expected to be reported in the University's statement of revenues, expenses and changes in net assets.

With the selection of LLNS as the successor contractor to the University for the management of LLNL effective October 1, 2007, the assets and liabilities attributable to the UCRP benefits of the approximately 7,300 employees who may accept employment with LLNS and who elect to participate in the defined benefit plan established by LLNS are expected to be transferred to the LLNS plan at a future date provided all required and advisable regulatory rulings and approvals are obtained. The amount of the assets and liabilities to be retained in the UCRP for LLNL members who are retired or are inactive, and the amount of assets that may be transferred to the LLNS plan for the transitioning employees who elected to participate in the LLNS plan is not currently known and is dependent on the assumptions used and future discussions with the DOE.

The UCRP costs are funded by a combination of investment earnings, employee member and employer contributions. Since 1990, there have not been any University contributions to the UCRP. In addition, since 1990, the required employee member contributions to the UCRP have been suspended. However, contributions are required to be made to the separate defined contribution plan maintained by the University. The Regents recently updated the funding policy for

UCRP to provide for a targeted funding level of 100 percent over the long term, and for University and UCRP member contributions at rates necessary to maintain that level within a range of 95 percent to 110 percent. The University will implement a multi-year contribution strategy under which shared employer and employee contribution rates will increase gradually over time to 16 percent of covered compensation, shared between employer and employees, based upon UCRP's current normal cost. The Regents has not yet authorized the initial resumption of shared employer and employee contributions.

In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the University in 2008. Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. Currently, the University records retiree medical and dental costs as they are paid and does not recognize the liability in the financial statements. The University is currently evaluating the effect that Statement No. 45 will have on its financial statements, although it is expected that retiree medical and dental costs, including normal cost, amortization of the unfunded transition liability over 30 years and interest on the unfunded liability will range between $1.35 billion and $1.45 billion. The transition liability is expected to range between $11.70 billion and $12.60 billion. The University will continue to pay for these benefits on a "pay-as-you-go" basis in 2008.

Cautionary Note Regarding Forward-Looking Statements

Certain information provided by the University, including written as outlined above or oral statements made by its representatives, may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, which address activities, events, or developments that the University expects or anticipates will or may occur in the future contain forward-looking information.

In reviewing such information, it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information. This forward-looking information is based upon various factors and was derived using various assumptions. The University does not undertake to update forward-looking information contained in this report or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.