


HARVARD UNIVERSITY
FINANCIAL REPORT

FISCAL YEAR **2008**

An upperclass student in Kirkland House sketches during her free time.

“We want all students who might dream of a Harvard education to know that it is a realistic and affordable option. Education is fundamental to the future of individuals and the nation, and we are determined to do our part to restore its place as an engine of opportunity, rather than a source of financial stress...This is a huge investment for Harvard, but there is no more important commitment we could make. Excellence and opportunity must go hand in hand.”

—President Drew Gilpin Faust announcing the Middle Income Financial Aid Initiative, December 10, 2007

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Message from the President

I am pleased to present Harvard University's financial report for fiscal 2008. Under very challenging market conditions, we achieved endowment returns of 8.6%, raising the endowment to $36.9 billion. Income from the endowment contributed approximately one-third of the University's operating budget, while also supporting substantial capital outlays. In addition, our alumni and friends contributed $690.1 million during fiscal 2008, the second highest level of fundraising receipts in the University's history.

We are very fortunate to have these resources with which to fund our extraordinarily ambitious academic agenda. With an exceptionally strong leadership team now in place, planning is moving forward at a brisk pace in a number of areas. We have new deans in the Faculty of Arts and Sciences, the Graduate School of Arts and Sciences, Harvard College, the Medical School, the Design School, and the Radcliffe Institute, a new dean arriving in January at the School of Public Health, and a search underway for the dean of the School of Engineering and Applied Sciences. In addition, Judith Singer has become the new Senior Vice Provost for Faculty Development and Diversity, Ed Forst has joined us in the newly created role of Executive Vice President, and Christine Heenan has been named to succeed Alan Stone as Vice President for Government, Community, and Public Affairs as of October 1. Construction of the Harvard Allston Science Complex, which will house, among other things, the Harvard Stem Cell Institute, is underway and on schedule. Planning for Allston in the areas of transportation, infrastructure, and a range of academic and other uses is ongoing.

Meanwhile, the Common Spaces Steering Committee has begun its examination of physical spaces on our Cambridge campus to see what enhancements might be made in the near term to create a more inviting, interactive, and vibrant atmosphere for all members of the Harvard community. The Arts Task Force, appointed last year and chaired by Cogan University Professor of the Humanities Stephen Greenblatt, will report its findings this fall about the place of arts practice in the life of the University, with potential implications for curriculum, programming, and space. Our Greenhouse Gas Task Force released its report in June, and work is now underway to implement our plan to reduce Harvard's carbon emissions by 30%, inclusive of growth, by 2016, an ambitious goal that will help the University confront two of the most important challenges of our time—climate change and sustainability.

We will also continue to explore ways to reduce financial barriers to attending Harvard. In 2004, we launched the Harvard Financial Aid Initiative, under which families with incomes below $60,000 are not asked to contribute to the cost of sending their children to Harvard College. Last December, we announced a sweeping overhaul of College financial aid policies for middle income families, which eliminated loans and home equity from consideration in financial aid calculations, and ensured that families with incomes between $120,000 and $180,000 and with assets typical for those income levels would pay an average of 10% of their annual income to send a child to Harvard.

For all of these undertakings, and the many more not mentioned, we will continue to rely on the active engagement of our students, faculty, and staff, as well as on resources provided by the endowment and by our extraordinarily generous alumni and friends. For this past year, I am especially grateful to Robert S. Kaplan, interim CEO of the Harvard Management Company (HMC) from November 2007, who worked so effectively to ensure a smooth transition of HMC to its new leadership under Jane Mendillo.

Sincerely,

Drew Gilpin Faust

Drew Gilpin Faust
PRESIDENT

October 5, 2008

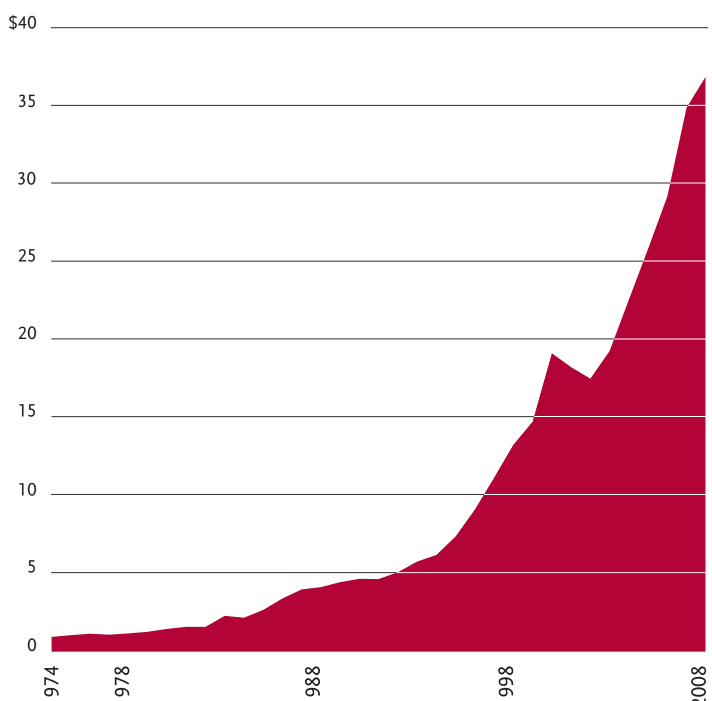
Financial highlights

The University's fiscal 2008 financial results were strong, thanks to continuing endowment growth and a high level of giving from alumni and friends. These financial achievements supported progress in many areas: planning for enhancements to the Allston campus and beginning construction in Allston of a signature science complex; a continued focus on financial aid, expected to expand significantly in fiscal 2009 as a result of the College's middle-income initiative; and growth in international programs, notably in China and Africa, bolstered by David Rockefeller's recent gift for study abroad programs.

To ensure future financial success and programmatic accomplishments, the University must continue to manage its resources wisely. These resources generate both great opportunity and tremendous responsibility.

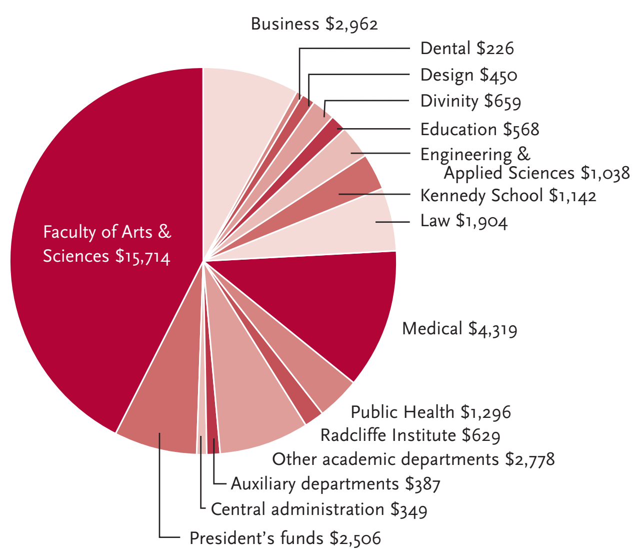
ENDOWMENT GROWTH

In billions of dollars



FAIR VALUE OF ENDOWMENT FUNDS AS OF JUNE 30, 2008

In millions of dollars



TOTAL FAIR VALUE $36,927

ENDOWMENT PERFORMANCE

Generous donors and solid investment returns boosted the University's endowment to a record fair value of $36.9 billion as of June 30, 2008. Harvard Management Company (HMC) is responsible for managing the investments that comprise the endowment. The endowment's total return for fiscal 2008 was 8.6%, exceeding the annual performance benchmark by 1.7% and resulting in a five-year annualized return of 17.6%.[1] The unaudited *Annual Report of the Harvard Management Company*, beginning on page 8, discusses HMC's investment philosophy and further analyzes the endowment's fiscal 2008 performance.

SUMMARY OF FINANCIAL RESULTS

In millions of dollars	2008	2007	2006	2005	2004
Total revenue	**$ 3,482.3**	$ 3,210.5	$ 2,999.6	$ 2,800.9	$ 2,597.7
Total expenses	**3,464.9**	3,170.7	2,999.5	2,757.4	2,560.9
Total gifts	**690.1**	615.0	595.8	590.7*	549.6*
Fixed assets, net	**4,951.3**	4,524.2	4,078.5	3,797.8	3,468.9
Total investments	**43,804.3**	41,832.9	34,249.6	29,938.2*	26,211.0*
Bonds and notes payable	**4,089.9**	3,847.0	2,922.2	2,849.1	2,604.7
Net assets–General Operating Account	**6,575.1**	6,438.6	5,116.1	4,197.6	3,935.5
Net assets–endowment	**36,926.7**	34,912.1	29,219.4	25,853.0	22,587.3
Total return on general investments**	**8.6%**	23.0%	16.7%	19.2%	21.1%

* *These numbers have been recast to conform with fiscal 2006 presentation.*

** *Total return on general investments is net of all fees and expenses, and includes the impact of revenue-sharing agreements with certain fund managers.*

OPERATING RESULTS

The University's fiscal 2008 operating surplus was $17.4 million. Revenue rose 8% to $3.5 billion due primarily to growth in the University's endowment income distributed for operations. Operating expenses also totaled $3.5 billion, a 9% increase over the prior year.

Student income

Student income increased 4%, totaling $682.0 million in fiscal 2008. Revenue from both undergraduate and graduate tuition rose 3%, reflecting tuition rate growth partly offset by small declines in enrollment for some Schools. Total student board and lodging income grew 6%, primarily due to the annual increase in the undergraduate room and board rate and new graduate housing facilities. Continuing and executive education revenue rose 11%, largely a result of increased executive education revenue at Harvard Business School and enrollment growth at the Extension School, as well as new programs at Harvard Medical School.

Sponsored support

Total sponsored revenue increased 4% to $668.4 million in fiscal 2008. The University received 80% of its sponsored funding from the federal government, 13% from foundations, and 7% from other sources.

Total federal funding increased 4% to $535.0 million. Approximately 80% or $435.0 million of the University's federal funding originated from various agencies of the Department of Health and Human Services, most notably the National Institutes of Health (NIH). Funding from the NIH increased less than 2%. The President's Emergency Plan for AIDS Relief (PEPFAR) project in Africa grew significantly, with total support of $66.6 million in fiscal 2008, increasing 37% from $48.5 million in the prior year. The original PEPFAR award entered its fifth and final year in fiscal 2008.

Non-federal sponsored support grew 5% to $133.5 million. Corporate funding continued to account for approximately 15% of non-federal sponsored activity, and foundation support rose 12% to $81.4 million, increasing for the first time in five years.

[1] *These returns are calculated on a time-weighted basis, net of all fees and expenses, and include the impact of revenue-sharing agreements with certain fund managers.*

Gifts for current use

Gifts from alumni and friends provide vital funding for the University's ongoing operations and strategic priorities, such as faculty development and financial aid. Current use gifts rose 11% in fiscal 2008, totaling $236.6 million.

Investment income

Total investment income increased 15% to $1.4 billion. The largest component of investment income, endowment income distributed for operations, climbed 15% to $1.2 billion. When combined with endowment decapitalizations, the University's aggregate endowment payout rate was 4.8%, slightly below the University's targeted payout rate range of 5.0% to 5.5%.

Endowment income distributed for operations remained Harvard's largest source of income in fiscal 2008, representing 34% of total operating income compared with 23% ten years ago. This growth has resulted from the generous support of the University's alumni and friends as well as the endowment's continued strong performance.

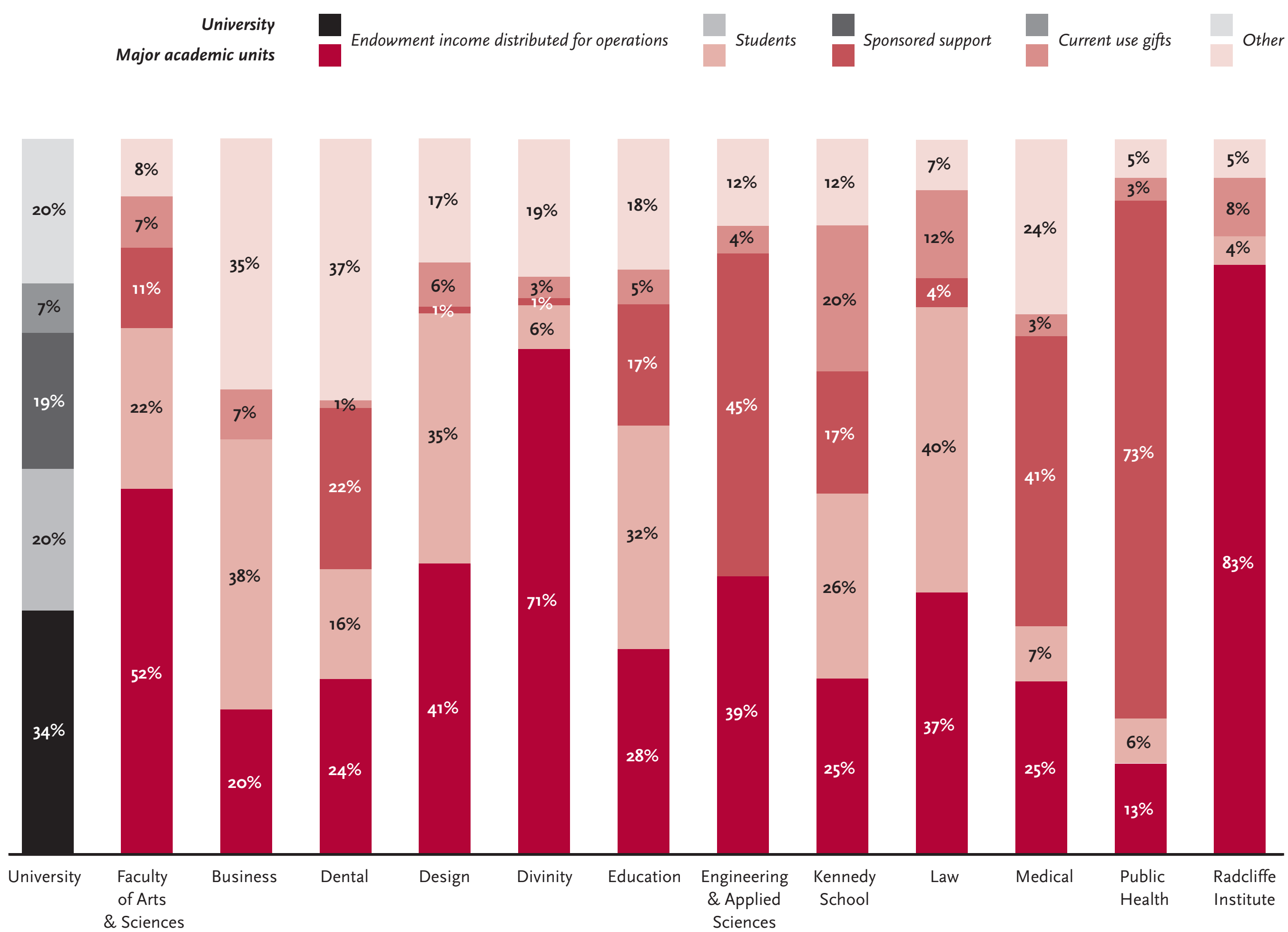
Other income

Other income rose 5% to $510.9 million in fiscal 2008, primarily due to increases in royalty income for Harvard Business School Publishing and Harvard Medical School.

Compensation

Compensation costs represented 48% of the University's total expenses in fiscal 2008. These costs totaled $1.7 billion in fiscal 2008, an increase of 7% over fiscal 2007. This increase was driven by 8% growth in total salary and wage costs and a 6% increase in benefits expenses.

FISCAL 2008 SOURCES OF REVENUE

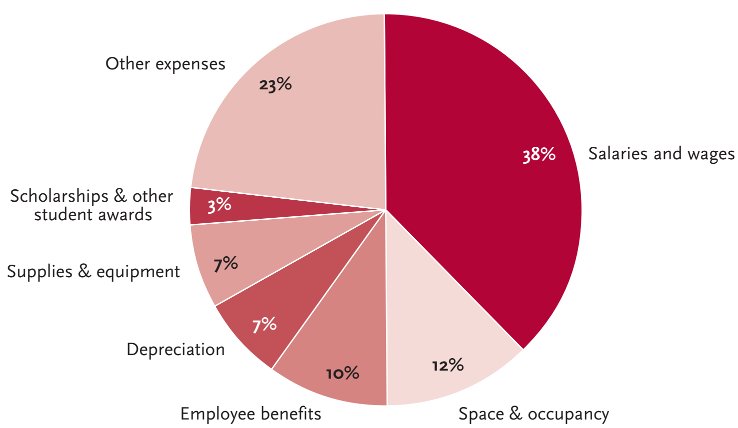


Inflationary trends in health care costs continue to be a concern and have driven the University to develop a multi-year health care strategy. In fiscal 2008, a new pharmacy benefits manager was adopted, with associated cost savings of approximately $6.6 million anticipated over the next three years. In addition, the University engaged in a competitive proposal process for health plan administration, resulting in the consolidation of health care offerings under a smaller number of administrators. Through this consolidation, the University expects to save an additional $6.2 million over the next three years.

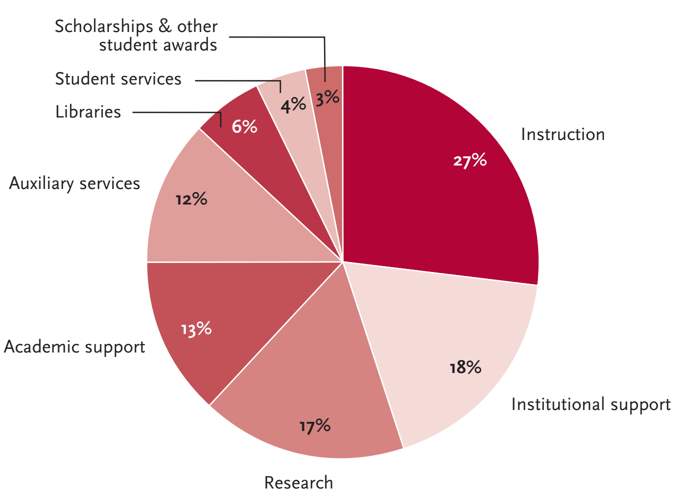
Financial aid

Expanding the financial aid programs for both undergraduate and graduate students continues to be one of the University's top priorities. Scholarships and student awards, including amounts applied against student income, rose 7% to $362.7 million in fiscal 2008.

FISCAL 2008 OPERATING EXPENSES



FISCAL 2008 FUNCTIONAL EXPENSES



In addition, the University spent $56.8 million on student employment, loaned $32.6 million to students, and acted as agent on behalf of specific student recipients for $12.6 million in aid from outside sponsors.

Building on the success of the undergraduate Harvard Financial Aid Initiative, which eliminated the parental contribution for families earning $60,000 or less, in fiscal 2008, Harvard College announced major financial aid enhancements to ensure greater affordability for middle- and upper-middle income families. Beginning in the 2008-09 academic year, parents with incomes of $180,000 or less and assets typical for those income levels will be asked to contribute significantly less to the cost of a Harvard education: on average from 0% to 10% of their total income. Additionally, home equity will no longer be considered in determining a family's ability to contribute, and students will not be expected to take out loans, which will be replaced by need-based Harvard scholarships.

Supplies and equipment

Supplies and equipment expenses increased 9% to $235.0 million. This increase is primarily related to supplies for sponsored projects, costs of goods sold associated with higher computer sales to students and affiliates, as well as library collections acquired during fiscal 2008. University-wide contracts with vendor partners together with cost-conscious purchasing practices contained further expense growth.

Space and occupancy

Space and occupancy costs totaled $411.1 million in fiscal 2008, a 1% increase over the prior year. Higher space-related maintenance and operations expenses as well as moderate growth in utilities costs were offset by lower interest expense associated with variable-rate bonds and notes payable. The University continues to manage utilities rate growth by refining its electricity and natural gas purchasing strategies, and by promoting energy conservation and sustainability efforts.

Other expenses

Other expenses grew 18% to $800.9 million, largely due to costs associated with the Broad Institute; increases in subcontracted research for sponsored projects at the School of Public Health; and payments to the Harvard-affiliated hospitals. In addition, travel costs increased 18%, as the University's global presence continued to expand.

CAPITAL ACTIVITIES

The University invested $591.1 million in capital projects and acquisitions during fiscal 2008. Of this amount, 54% was spent on new construction and acquisitions, and 46% was invested in the existing physical plant.

The Faculty of Arts and Sciences (FAS) completed work on two new science buildings during fiscal 2008: the Laboratory for Integrated Science and Engineering and the Northwest Science Building. Laboratory fit-outs in the Northwest Science Building will continue during fiscal 2009. The FAS also made substantial investments in student life during fiscal 2008, completing renovation work at the New College Theatre and structural improvements at the Malkin Athletic Center. The FAS now is focusing on a long-term renewal strategy for its undergraduate Houses.

Many of Harvard's other Schools and units advanced important capital projects during fiscal 2008, including Harvard Law School's Northwest Corner building, where site excavation and foundation work was undertaken; and the Harvard Art Museum's planned renovation and expansion project, for which design activities are ongoing.

Construction on the Harvard Allston Science Complex began in January 2008, after an intensive public review and subsequent approval by the Boston Redevelopment Authority. The University has entered into a voluntary agreement with the Commonwealth of Massachusetts to cap greenhouse gas emissions from new buildings constructed in its Allston Science Complex to 50% below that of a standard laboratory building and 30% below established standards for the full Allston campus development. The University is continuing extensive consultation with the Harvard community, the City of Boston, and Allston neighbors on a proposed institutional master plan that will be filed in 2009.

As part of the continuing advancement of the master plan, and as a related community benefit, a cooperation agreement was developed and negotiated with the City of Boston, resulting in significant benefits to the Allston neighborhood in the areas of education; public realm improvements, including a new public space currently known as Library Park; as well as workforce and economic development. Other related projects begun during the year included planning, development, and opening of the Harvard Allston Education Portal in North Allston, allowing neighborhood residents to access educational and recreational resources at the University, and active participation with the Boston Redevelopment Authority in community-wide planning for the neighborhood.

Realizing the University's academic aspirations in Allston, continuing to ensure access and affordability for students, and expanding Harvard's global presence are merely a few of the coming years' priorities, all of which will require significant resources. Careful stewardship of Harvard's investments and resources remains essential. This stewardship, and the ongoing generosity of donors, will help support the University's mission in the decades to come.

Daniel S. Shore
ACTING CHIEF FINANCIAL OFFICER

James F. Rothenberg
TREASURER

October 5, 2008

Annual Report of the Harvard Management Company

Harvard Management Company (HMC) is a wholly owned subsidiary of Harvard University that is governed by a Board of Directors (the "Board") appointed by the President and Fellows of Harvard College (the "Corporation"). Established in 1974, HMC is charged with management of the University's endowment, pension assets, working capital, and deferred-giving balances. As of June 30, 2008, HMC managed a total of $45.2 billion, $43.0 billion of which consisted of the General Investment Account (GIA). The GIA is a pooled fund consisting primarily of $36.9 billion of endowment assets. The information presented in this unaudited report relates to the GIA.

PERFORMANCE OF THE GENERAL INVESTMENT ACCOUNT

The GIA experienced solid absolute and relative performance for the year ended June 30, 2008. The total investment return amounted to 8.6%, calculated on a time-weighted basis, net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers. After including gifts, distributions, and other changes, the total value of the GIA increased from $40.8 billion as of June 30, 2007 to $43.0 billion as of June 30, 2008. The endowment, the largest component of the GIA, grew from $34.9 billion to $36.9 billion during the same period.

The fiscal 2008 investment return is consistent with HMC's history of strong investment performance. Relative to the major U.S. indices, the GIA outpaced the negative 13.1% registered by the S&P 500 Index and the 7.1% registered by the Lehman Aggregate Index (which is a broad measure of the bond market) during fiscal 2008.

Within the overall investment return, HMC's efforts to add value contributed 1.7% (8.6% versus a policy portfolio benchmark return of 6.9%) for fiscal 2008, translating into $717.6 million of additional value for the GIA.

Traditionally, HMC has measured itself against the TUCS median (Trust Universe Comparison Service) for peer comparison. In comparison with this measure, which incorporates available data on 165 large institutional investors, the GIA's performance exceeded the median return of negative 4.4%, as well as the top five percentile return of 3.2%.

HMC's value-added efforts benefited from internal and external portfolio management's specific investment strategies, as well as top-down adjustments in overall positioning of the GIA. Specifically, the GIA's value was enhanced by:

- the outperformance of the internal portfolio management group;
- asset allocation adjustments driven by intra-year risk mitigation considerations as well as market overlay strategies intended to serve as protection against extreme market events; and
- the strong results delivered by a number of long-standing and recently added external managers.

RESULTS BY ASSET CLASS

Consistent with global developments, the main drivers of the GIA performance came from investments in liquid commodities and domestic, foreign, and inflation-indexed bonds, as well as investments in timber/agricultural land, private equity, and emerging market equity.

The following section discusses the investment management approach for each of the asset classes of the GIA, as well as fiscal 2008 investment results. All returns are calculated on a time-weighted basis, with the exception of private equity, real estate, high-yield, liquid commodities, and timber/agricultural land, which are calculated on a dollar-weighted basis. Returns are net of all fees and expenses, and include the impact of revenue-sharing agreements with certain fund managers. Individual benchmarks are a broad and deep representation of each asset class.

Domestic equity

During fiscal 2008, the domestic equity program returned a negative 12.7% compared with a negative 13.1% for the domestic equity benchmark, for a positive result relative to the benchmark of 0.4%. The majority of the domestic equity portfolio is managed by external managers with varying strategies, with a smaller portion managed internally.

Foreign equity

The foreign equity program returned negative 12.1% in fiscal 2008, compared with a negative 11.1% for the foreign equity benchmark. The external managers retained for foreign equity had mixed results against their benchmarks in fiscal 2008.

Emerging market equity

Overall, the emerging market equity program returned 7.6% compared to 4.8% for the benchmark. Three strategies are used to manage equities in emerging markets. The first strategy is an internally managed fund, which outperformed its benchmark in fiscal 2008 by 2.1%. The second strategy employs a mix of external managers with various geographic expertise. These managers had mixed results versus their benchmarks in fiscal 2008. Finally, a small portion of emerging market equity is invested in international private equity funds. This strategy slightly underperformed its benchmark in fiscal 2008, although most of the funds are too new for meaningful performance measurement.

Private equity

Private equity returns in fiscal 2008 were 9.3%, compared with 6.3% for the benchmark. At the end of fiscal 2008, the private equity portfolio consisted of 210 funds across 80 different external management teams. HMC expects that, over the long term, private equity will produce returns in excess of those that are found in the public markets. However, the private equity and venture capital businesses tend to be cyclical, and returns may vary widely from one period to the next. The private equity portfolio is currently allocated 70% to corporate finance funds and 30% to venture capital funds. Geographically, the allocation is split 70% for U.S. and 30% for non-U.S. opportunities.

Domestic bonds

The domestic bond portfolio returned 16.1% in fiscal 2008 compared with 12.7% for the benchmark. The domestic bond portfolio is managed both internally and externally with a focus on arbitrage situations—the opportunity to buy relatively inexpensive securities and simultaneously sell overvalued securities with similar characteristics. The internal portion of the portfolio sharply outperformed its benchmark in fiscal 2008, and the external manager results were mixed. Since the overall maturity structure and duration of the portfolio is kept close to the benchmark index, interest rate movements typically have little influence on relative performance. The domestic bond results include some market overlay strategies intended to protect against extreme market events.

Foreign bonds

The foreign bond portfolio returned 21.3% in fiscal 2008, compared with the benchmark return of 18.5%. The entire foreign bond portfolio is managed internally. As with domestic bonds, the emphasis is on identifying arbitrage opportunities across a variety of international fixed income-related securities. Duration and country allocations do not vary substantially from the benchmark.

Inflation-indexed bonds

The inflation-indexed bond portfolio returned 20.3% in fiscal 2008, outperforming the benchmark return of 16.3%. The internal component is passively managed and performed consistently with its benchmark. The externally managed portion significantly outperformed its benchmark.

High-yield

The domestic portion of the high-yield portfolio is managed externally by firms that emphasize flexibility in assessing situations where debt securities appear to be incorrectly valued. These managers slightly outperformed their benchmark in fiscal 2008. The international portion of the portfolio consists of both developed markets and emerging market debt managers. The developed market managers focus primarily on credit opportunities in the more established markets, and results for fiscal 2008 were mixed. The emerging market debt portion underperformed its benchmark. Overall, the high-yield portfolio underperformed its benchmark in fiscal 2008 by 9.0%.

Liquid commodities

HMC has had a long-standing strategy of allocating a portion of the GIA to liquid commodities (in addition to timber/agricultural land investments, which are discussed below). The liquid commodities strategy is managed by several external managers who attempt to outperform an index of publicly traded commodities by discovering and exploiting mispricings among commodity-related securities. This strategy outperformed its benchmark by 3.6% in fiscal 2008.

Timber/agricultural land

The portfolio of global timber/agricultural land investments outperformed its benchmark by 7.7% in fiscal 2008.

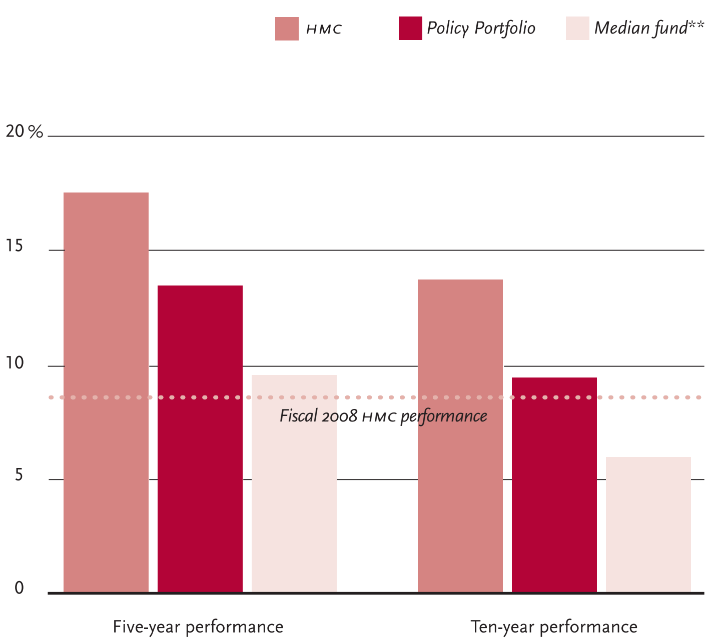
Real estate

The real estate portfolio returned 3.2% in 2008, compared with 2.4% for the benchmark. The real estate portfolio is focused primarily on opportunity funds where managers strive to find undervalued assets. A smaller portion of the real estate portfolio is composed of REITS (real estate investment trusts) traded in the public markets.

Absolute return

A diverse set of external managers is employed in order to create an absolute return portfolio that is expected to generate positive returns over the long term without regard to a specific security index. These managers typically focus on merger arbitrage, convertible arbitrage, quantitative trading, pairs trading, distressed opportunities, balance sheet arbitrage, and absolute value trading. Ideally, these managers are sufficiently hedged to generate positive returns in either up or down markets. In fiscal 2008, this program returned 0.1%, underperforming the benchmark by 1.7%.

FIVE- AND TEN-YEAR ANNUALIZED AVERAGE RETURNS*



* *Returns are net of all fees and expenses, and include the impact of revenue-sharing agreements with certain fund managers.*
** *As measured by the median of institutional funds with assets of over $1.0 billion, based on information compiled by the Trust Universe Comparison Service (TUCS).*

ANNUALIZED AVERAGE RETURNS FOR THE PERIODS ENDED JUNE 30, 2008

	Total return°	Policy Portfolio	Value added
1 year	8.6%	6.9%	1.7%
5 years	17.6	13.5	4.1
10 years	13.8	9.5	4.3
15 years	15.7	11.8	3.9
20 years	14.2	12.0	2.2
25 years	14.4	12.4	2.0
30 years	14.6	12.9	1.7
Since inception	13.2	11.8	1.4

° *Total return is net of all fees and expenses, and includes the impact of revenue-sharing agreements with certain fund managers.*

THE HISTORICAL CONTEXT

The annualized five- and ten-year performance for the GIA, after incorporating the fiscal 2008 results, is summarized in the chart on page 10. Three historical factors are worth noting:

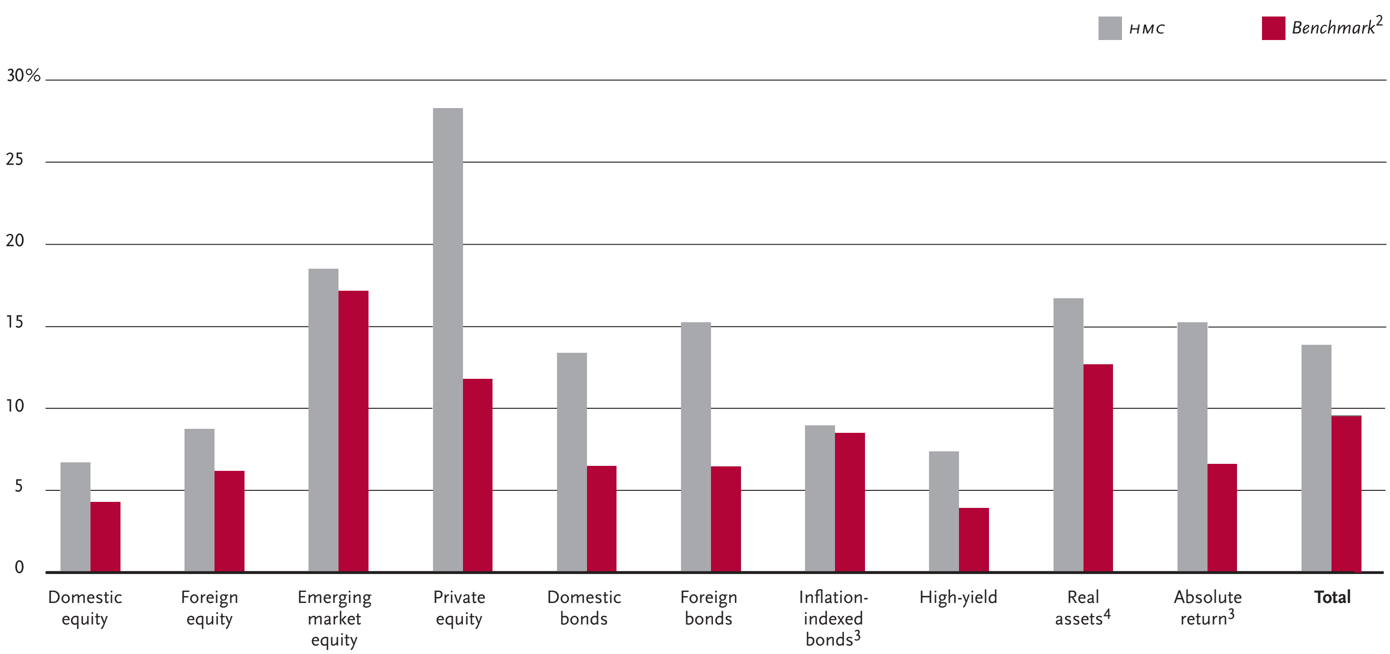
- First, by significantly outperforming the University's long-term real return target over time, the GIA has taken advantage of the opportunities present in the market to build an important margin for the future.
- Second, by having access to a mix of both internal and external investment management capabilities, the long-term outperformance margin relative to the Policy Portfolio is solidly ahead of the 1.0% level that has historically been deemed a realistic long-term objective.
- Third, relative to the long-term average for institutional funds, the GIA has maintained an outperformance margin that continues to exceed the target of 1.5%.

Historical outperformance of the GIA has been accompanied by consistently solid results at the individual asset class level.

INVESTMENT MANAGEMENT PHILOSOPHY AND PROCESS

HMC's results were achieved within the context of a disciplined investment philosophy and approach that has served the GIA well over the years. The Policy Portfolio, a long-term target asset allocation, reflects the HMC Board of Director's assessment of the best mix of investments, by asset class, for the University. This assessment is based on the long-term risk and return characteristics of different markets, and the historical and projected relationships among markets. In aligning the endowment with the Policy Portfolio, HMC uses a blend of internal and external investment management.

ANNUALIZED TEN-YEAR PERFORMANCE BY ASSET CLASS[1]



[1] *Returns are calculated on a time-weighted basis with the exception of private equity, high-yield, and real assets, which are calculated on a dollar-weighted basis. Returns are net of all fees and expenses, and include the impact of revenue-sharing agreements with certain fund managers.*

[2] *Individual benchmarks are representative of each asset class and are approved by the Board.*

[3] *Inflation-indexed bonds and absolute return have been held for less than ten years. For these asset classes, the HMC return and the benchmark reflect annualized performance of 9.00 years and 9.75 years, respectively.*

[4] *Real assets consist of investments in liquid commodities, timber/agricultural land, and real estate.*

The breakdown of the GIA by asset category as of June 30, 2008 and 2007, respectively, was (in millions of dollars):

	2008	2007
Equities:		
Domestic equity	**$ 5,085**	$ 7,266
Foreign equity	**5,143**	5,932
Emerging market equity	**4,304**	4,595
Private equity	**5,163**	4,156
Total equities	**19,695**	21,949
Fixed-income:		
Domestic bonds	**1,838**	2,694
Foreign bonds	**1,331**	1,351
Inflation-indexed bonds	**3,042**	2,679
High-yield	**865**	641
Total fixed-income	**7,076**	7,365
Real assets:		
Liquid commodities	**4,217**	3,988
Timber/agricultural land	**2,620**	1,737
Real estate	**3,438**	2,722
Total real assets	**10,275**	8,447
Absolute return	**8,298**	5,063
Cash	**(2,296)**	(2,071)
TOTAL	**$ 43,048**	**$ 40,753**

HMC seeks to add value to every element of the investment process, starting at the asset allocation level. Each year, HMC's Board of Directors and management team determine an appropriate "neutral" allocation (i.e., the Policy Portfolio) of capital across various markets given the University's desired return target and risk tolerance. Currently, capital is allocated across 12 (non-cash) asset classes. While significant changes are not generally made on an annual basis, the investment mix has evolved substantially over time.

Once the neutral allocation guidelines are determined, HMC's management is charged with the selection of appropriate investment vehicles. Both internal and external vehicles are employed to optimally deploy capital across all asset classes. This active use of specific investment strategies is aimed at delivering value over and above what can be realized by investing in a passive portfolio.

HMC uses a broad array of investments to generate value added. Examples include absolute return strategies, equity and fixed-income arbitrage, enhanced cash management, and tactical adjustments to the asset allocation. All of these investment management strategies help HMC to deliver appropriate risk-adjusted returns across all of its asset classes, after all fees required to generate that return. The result is a diversified investment portfolio, managed in a responsive manner, and backed by effective risk management.

RISK MANAGEMENT

Appropriate controls and procedures are integral to mitigating risks and effectively managing the GIA. Accordingly, HMC maintains an approach aimed at monitoring and managing the factors pertaining to credit, liquidity, market, and operational risks. (A summary description of these different risk factors may be found on page 14.) Since no single indicator can reasonably be expected to capture the host of risk factors that affect the GIA, HMC utilizes a matrix approach that is subject to regular reviews by both the Board of Directors and management of HMC.

HMC's risk-mitigating measures include the use of risk limits as they pertain to investment strategies, single names (i.e., individual investments), and managers; assessment of correlations across investment strategies, managers, and asset classes; and counterparty credit evaluations, among others. By necessity, risk management is a dynamic process that takes into account general market developments, the proliferation of new instruments, and the changing nature of correlations across asset classes. This process is supported by consistent efforts to ensure that HMC has the required information inputs and management system, the appropriate analytical tools, and a robust set of checks and balances.

The effectiveness of HMC's risk management is highly dependent on manager transparency and the quality of the data inputs, particularly in terms of completeness and timeliness. In this context, and as HMC deepens and widens its relationships with external managers, efforts are being made to counteract the existing market tendency towards a lower level of information transparency.

Finally, in recognition of the increasing fluidity of the global economy, HMC has placed particular emphasis on potential cross-asset class correlations and market contagion in the global capital markets.

ORGANIZATIONAL DEVELOPMENTS

Fiscal 2008 saw important institutional changes at HMC.

Mohamed El-Erian announced his intention to leave HMC in September 2007 and formally resigned as President and CEO at the beginning of December 2007. Mohamed led HMC since February 2006.

In early November 2007, Robert S. Kaplan (one of the undersigned) became Acting President and CEO of HMC. Rob is a Professor of Management Practice at Harvard Business School and a former Vice Chairman of The Goldman Sachs Group, Inc. He led HMC until June 30, 2008 and, effective July 1, 2008, joined the Board of Directors of HMC.

Effective July 1, 2008, Jane L. Mendillo (one of the undersigned) re-joined HMC to serve as President and CEO. Jane had served since February 2002 as the Chief Investment Officer of Wellesley College. Having spent nearly 15 years at HMC earlier in her career, Jane has worked directly on many parts of the HMC portfolio and is very familiar with the hybrid investment model that has been so critical to HMC's success.

THE ROAD AHEAD

In the exhibit shown below, changes to the Policy Portfolio for fiscal 2009 have been detailed. In addition to the usual risk/return optimization methodologies, the changes reflect secular themes, which include:

- a need to think globally about asset allocation and investment alternatives;
- issues relating to flow of funds, barriers to entry, and other industry dynamics in the private equity and hedge fund asset classes;
- risk of continued inflationary pressures – exacerbated by supply and demand considerations for various commodities; and
- HMC's expectations for a continuation of the process of financial deleveraging that began in the summer of 2007.

Entering fiscal 2009, many questions remain as to the likely depth, breadth, and duration of current market deleveraging and associated disruptions. During these challenging times, the importance of HMC's hedging and risk management strategies continues to be emphasized. HMC is quite cognizant of the near-term risk of sub-par investment returns from many of the asset classes in which HMC and other investors participate. HMC is also

HISTORICAL EVOLUTION OF THE POLICY PORTFOLIO (SELECTED YEARS)

	1991	1995	1996	1998	1999	2000	2002	2007	2008	2009
Equities:										
Domestic equity	40%	38%	36%	32%	24%	22%	15%	12%	12%	11%
Foreign equity	18	15	15	15	15	15	10	11	12	11
Emerging market equity		5	9	9	9	9	5	8	10	11
Private equity	12	12	15	15	12	15	13	13	11	13
Total equities	70	70	75	71	60	61	43	44	45	46
Fixed-income:										
Domestic bonds	15	15	13	11	10	10	11	7	5	4
Foreign bonds	5	5	5	5	4	4	5	3	3	2
Inflation-indexed bonds					4	7	6	5	7	5
High-yield	2	2	2	2	3	3	5	3	1	2
Total fixed-income	22	22	20	18	21	24	27	18	16	13
Real assets:										
Liquid commodities	6	6	3	3	3	3	3	7	8	8
Timber/agricultural land				2	3	3	10	9	9	9
Real estate	7	7	7	7	7	7	10	10	9	9
Total real assets	13	13	10	12	13	13	23	26	26	26
Absolute return				4	6	5	12	17	18	18
Cash	(5)	(5)	(5)	(5)		(3)	(5)	(5)	(5)	(3)
TOTAL	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

COMPONENTS OF RISK

MARKET RISK is defined as the sensitivity of income and capital to variations in interest rates, foreign exchange rates, equity prices, commodity prices, and other market-driven rates and prices. Market risk also considers the correlation risk among investments and the liquidity of the underlying positions. Market risk is measured as the potential gain or loss resulting from a price change at a given probability over a specific time period; this is also described as value at risk. Value at risk is monitored and reviewed frequently by the Board of Directors and senior management to ensure that exposures are consistent with approved limits and guidelines. Stress and scenario tests are also conducted to determine how potential changes in market conditions could impact the fair value of the portfolio.

CREDIT RISK is defined as the risk of loss arising from a counterparty's failure or inability to meet payment or performance terms of a contract. HMC manages credit risk by establishing strict credit policies, setting concentration limits and approval procedures, and monitoring exposure continuously. HMC enters into arrangements with counterparties believed to be creditworthy and requires collateral to the maximum extent possible. Limits are established for each counterparty based on their creditworthiness.

LIQUIDITY RISK considers the risk of loss arising from the inability to meet funding commitments. The objective of liquidity risk management is to ensure the ability to meet the endowment's financial obligations. Effective management of liquidity risk requires the ability to project and understand all cash flows and potential future commitments. It also involves the identification and prioritization of sources of liquidity. Cash is actively managed by a centralized staff responsible for understanding funding requirements and evaluating sources of liquidity. Liquidity measures are employed to ensure that the University maintains adequate liquidity and is prepared for periods of stress.

OPERATIONAL RISK is the risk of loss resulting from inadequate or failed internal processes or systems, errors by employees, or external events. The management of these risks is primarily the responsibility of the business line managers in each functional area. HMC manages operational risk by identifying areas of risk, monitoring compliance, promoting best practices, and implementing internal controls and robust systems. The results of these activities are reviewed frequently by senior management.

closely monitoring the deterioration in certain underlying debt and equity markets and analyzing the potential impact of these declines on the ultimate realizable value of investments in the private equity portfolio and on certain of the investments held by HMC's hedge fund managers.

The last ten years have seen periods of extraordinary investment results. In light of recent market stress and dislocations, however, HMC is keenly aware that returns produced in the next few years may fall well short of these robust historical levels. HMC will continue to aggressively pursue its key investment strategies, as well as appropriate risk management, in order to help the endowment navigate these challenging market conditions. Even with this said, HMC's expectations for the endowment's returns in fiscal 2009 and over the next several years are very cautious.

Robert S. Kaplan
ACTING PRESIDENT AND CEO
NOVEMBER 2007 THROUGH JUNE 30, 2008
BOARD MEMBER EFFECTIVE JULY 1, 2008

Jane L. Mendillo
PRESIDENT AND CEO
EFFECTIVE JULY 1, 2008

October 5, 2008

PricewaterhouseCoopers LLP
125 High Street
Boston MA 02110
Telephone (617) 530 5000
Facsimile (617) 530 5001

Report of Independent Auditors

To the Board of Overseers of Harvard College:

In our opinion, the accompanying Balance Sheet and the related Statements of Changes in Net Assets with General Operating Account Detail, Changes in Net Assets of the Endowment, and Cash Flows, present fairly, in all material respects, the financial position of Harvard University (the "University") as of June 30, 2008, and the changes in its net assets of the General Operating Account and endowment funds and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the University's fiscal 2007 financial statements, and in our report dated September 30, 2007, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, the University changed the manner in which it accounts for defined benefit and other postretirement plans and limited partnerships held for investment in 2007.

PricewaterhouseCoopers LLP

October 5, 2008

BALANCE SHEETS

with summarized financial information as of June 30, 2007

In thousands of dollars	June 30 2008	June 30 2007
ASSETS:		
Cash	$ **27,307**	$ 39,800
Receivables, net (*Note 4*)	**249,359**	207,999
Prepayments and deferred charges	**121,834**	98,718
Notes receivable, net (*Note 5*)	**336,085**	307,643
Pledges receivable, net (*Note 6*)	**626,479**	524,972
Fixed assets, net (*Note 7*)	**4,951,329**	4,524,162
Net retirement assets (*Note 11*)	**293,560**	303,282
Interests in trusts held by others (*Notes 8 and 12*)	**341,990**	358,294
Investment portfolio, at fair value (*Notes 3 and 10*)	**50,756,944**	46,616,888
Fair value of securities pledged to counterparties (*Note 3*)	**6,398,168**	5,341,587
TOTAL ASSETS	**64,103,055**	**58,323,345**
LIABILITIES:		
Accounts payable (*Note 19*)	**413,674**	370,496
Deposits and other liabilities (*Note 7*)	**509,873**	478,471
Securities lending and other liabilities associated with the investment portfolio (*Note 3*)	**13,350,801**	10,125,587
Liabilities due under split interest agreements (*Note 9*)	**908,259**	906,581
Bonds and notes payable (*Note 10*)	**4,089,912**	3,846,978
Accrued retirement obligations (*Note 11*)	**607,427**	545,698
Government loan advances (*Note 5*)	**58,902**	57,146
TOTAL LIABILITIES	**19,938,848**	**16,330,957**
NET ASSETS	**$ 44,164,207**	**$ 41,992,388**

	Unrestricted	Temporarily restricted	Permanently restricted	June 30 2008	June 30 2007
NET ASSETS:					
General Operating Account (*Note 12*)	$ 5,367,793	$ 1,118,604	$ 88,655	$ **6,575,052**	$ 6,438,611
Endowment (*Note 8*)	6,140,748	26,169,820	4,616,125	**36,926,693**	34,912,068
Split interest agreements (*Note 9*)	0	188,537	473,925	**662,462**	641,709
TOTAL NET ASSETS	**$ 11,508,541**	**$ 27,476,961**	**$ 5,178,705**	**$ 44,164,207**	**$ 41,992,388**

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

STATEMENTS OF CHANGES IN NET ASSETS WITH GENERAL OPERATING ACCOUNT DETAIL

with summarized financial information for the year ended June 30, 2007

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2008	2007
REVENUE:					
Student income:					
Undergraduate program	$ 232,070			$ **232,070**	$ 225,690
Graduate programs	357,071			**357,071**	345,443
Board and lodging	131,061			**131,061**	123,892
Continuing education and executive programs	213,919			**213,919**	193,164
Scholarships applied to student income (*Note 13*)	(252,126)			**(252,126)**	(230,562)
Total student income	681,995	0	0	**681,995**	657,627
Sponsored support (*Notes 14 and 15*):					
Federal government - direct costs	398,084			**398,084**	376,415
Federal government - indirect costs	136,870			**136,870**	138,355
Non-federal sponsors - direct costs	42,167	$ 77,048		**119,215**	114,277
Non-federal sponsors - indirect costs	8,366	5,891		**14,257**	12,887
Total sponsored support	585,487	82,939	0	**668,426**	641,934
Gifts for current use (*Note 15*)	90,626	145,973		**236,599**	213,994
Investment income:					
Endowment income distributed for operations (*Note 8*)	204,244	997,063		**1,201,307**	1,043,755
Income on working capital investments distributed for operations	142,035	33,021		**175,056**	157,661
Interest received on student, faculty, and staff loans	8,047			**8,047**	6,962
Total investment income	354,326	1,030,084	0	**1,384,410**	1,208,378
Other operating income (*Note 16*)	510,887			**510,887**	488,573
Net assets released from restrictions	1,241,481	(1,241,481)		**0**	0
TOTAL REVENUE	**3,464,802**	**17,515**	**0**	**3,482,317**	**3,210,506**
EXPENSES:					
Salaries and wages	1,298,604			**1,298,604**	1,203,209
Employee benefits (*Note 11*)	362,067			**362,067**	341,962
Scholarships and other student awards (*Note 13*)	110,532			**110,532**	108,588
Supplies and equipment	235,031			**235,031**	216,549
Space and occupancy (*Note 10*)	411,095			**411,095**	405,156
Depreciation (*Note 7*)	246,654			**246,654**	214,318
Other expenses (*Notes 10 and 17*)	800,910			**800,910**	680,868
TOTAL EXPENSES	**3,464,893**	**0**	**0**	**3,464,893**	**3,170,650**
NET REVENUE/(DEFICIT)	**(91)**	**17,515**	**0**	**17,424**	**39,856**
OTHER PROVISIONS AND CREDITS:					
Increase in appreciation, net of operating distribution (*Note 10*)	68,321	640		**68,961**	884,404
Decrease in undistributed general investment income	(86,986)	(144,677)		**(231,663)**	(22,860)
Other changes (*Note 11*)	(29,299)			**(29,299)**	0
TOTAL OTHER PROVISIONS AND CREDITS	**(47,964)**	**(144,037)**	**0**	**(192,001)**	**861,544**
CAPITAL CHANGES:					
Increase in pledge balances (*Note 6*)		8,260		**8,260**	11,536
Increase in interests in trusts held by others (*Note 12*)		15,761		**15,761**	8,856
Capital gifts for loan funds and facilities (*Note 15*)		4,346	$ 519	**4,865**	5,596
Transfers between the General Operating Account and endowment	176,810	91,780	(529)	**268,061**	76,333
Transfers from split interest agreements (*Note 9*)		12,841	1,230	**14,071**	7,476
Non-operating net assets released from restrictions	37,087	(38,366)	1,279	**0**	0
TOTAL CAPITAL CHANGES	**213,897**	**94,622**	**2,499**	**311,018**	**109,797**
GENERAL OPERATING ACCOUNT NET CHANGE DURING THE YEAR	**165,842**	**(31,900)**	**2,499**	**136,441**	**1,011,197**
Endowment net change during the year	344,323	1,390,519	279,783	**2,014,625**	5,692,638
Split interest agreement net change during the year (*Note 9*)		(7,484)	28,237	**20,753**	38,712
NET CHANGE BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	**510,165**	**1,351,135**	**310,519**	**2,171,819**	**6,742,547**
Cumulative effect of accounting change (*Notes 2 and 11*)				**0**	311,342
NET CHANGE DURING THE YEAR	**510,165**	**1,351,135**	**310,519**	**2,171,819**	**7,053,889**
Net assets, beginning of year	10,998,376	26,125,826	4,868,186	**41,992,388**	34,938,499
NET ASSETS, end of year	**$ 11,508,541**	**$ 27,476,961**	**$ 5,178,705**	**$ 44,164,207**	**$ 41,992,388**

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

STATEMENTS OF CHANGES IN NET ASSETS OF THE ENDOWMENT

with summarized financial information for the year ended June 30, 2007

In thousands of dollars	Unrestricted	Temporarily restricted	Permanently restricted	For the year ended June 30 2008	For the year ended June 30 2007
Gifts for capital (*Note 15*)	$ 57,004	$ 77,224	$ 201,831	$ **336,059**	$ 277,626
Investment return (*Notes 3 and 8*):					
Income from general investments	41,958	206,175		**248,133**	450,178
Increase in realized and unrealized appreciation	426,196	2,206,646		**2,632,842**	6,049,375
Total investment return	468,154	2,412,821	0	**2,880,975**	6,499,553
Endowment income distributed for operations	(204,244)	(997,063)		**(1,201,307)**	(1,043,755)
Increase in undistributed general investment income	33,787	168,258		**202,045**	24,380
Net investment return after distributions	297,697	1,584,016	0	**1,881,713**	5,480,178
Transfers between endowment and the General Operating Account:					
Net transfers (to)/from unexpended endowment income	(84,568)	(98,336)	8,104	**(174,800)**	(56,185)
Gifts capitalized	627	4,811	170	**5,608**	4,285
Other transfers	(92,869)	1,745	(7,745)	**(98,869)**	(24,433)
Total transfers between endowment and the General Operating Account	(176,810)	(91,780)	529	**(268,061)**	(76,333)
Capitalization of split interest agreements (*Note 9*)		12,886	10,957	**23,843**	18,613
Change in pledge balances (*Note 6*)		8,601	84,646	**93,247**	(26,562)
Change in interests in trusts held by others (*Note 8*)		(8,683)	(23,382)	**(32,065)**	28,448
Other changes	(953)	(16,924)	(2,234)	**(20,111)**	(9,332)
Net assets released from restrictions	167,385	(174,821)	7,436	**0**	0
NET CHANGE DURING THE YEAR	**344,323**	**1,390,519**	**279,783**	**2,014,625**	**5,692,638**
Net assets of the endowment, beginning of year	5,796,425	24,779,301	4,336,342	**34,912,068**	29,219,430
NET ASSETS OF THE ENDOWMENT, end of year	**$ 6,140,748**	**$ 26,169,820**	**$ 4,616,125**	**$ 36,926,693**	**$ 34,912,068**

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

STATEMENTS OF CASH FLOWS

In thousands of dollars	For the year ended June 30 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	**$ 2,171,819**	$ 7,053,889
Adjustments to reconcile change in net assets to net cash provided by/(used in) operating activities:		
Cumulative effect of accounting change	**0**	(311,342)
Depreciation	**246,654**	214,318
Change in fair value of interest rate exchange agreements	**317,084**	(4,651)
Change in interests in trusts held by others	**16,304**	(37,304)
Increase in liabilities due under split interest agreements	**1,678**	213,198
Decrease in net retirement assets	**9,722**	0
Increase in accrued retirement obligations	**61,729**	77,158
Gain on investments, net	**(3,170,532)**	(7,286,777)
Gifts of securities	**(93,636)**	(110,649)
Gifts restricted for capital purposes	**(274,874)**	(206,673)
Changes in operating assets and liabilities:		
Receivables, net	**(41,360)**	14,794
Prepayments and deferred charges	**(23,116)**	(16,020)
Pledges receivable, net	**(101,507)**	15,651
Accounts payable	**43,269**	47,053
Deposits and other liabilities	**31,402**	68,696
NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES	**(805,364)**	**(268,659)**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans made to students, faculty, and staff	**(56,515)**	(56,338)
Payments received on student, faculty, and staff loans	**28,657**	34,681
Change in other notes receivable	**(584)**	311
Proceeds from the sales of gifts of securities	**93,636**	110,649
Proceeds from the sales and maturities of investments	**72,683,691**	41,386,657
Purchases of investments	**(71,950,544)**	(43,400,260)
Additions to fixed assets	**(680,224)**	(635,727)
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	**118,117**	**(2,560,027)**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in overdrafts included in accounts payable	**6,312**	(28,471)
Proceeds from the issuance of debt	**1,737,010**	1,122,628
Debt repayments	**(1,494,076)**	(197,897)
Gifts restricted for capital purposes	**274,874**	206,673
Change associated with securities lending agreements	**148,878**	1,721,773
Increase in government loan advances	**1,756**	186
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	**674,754**	**2,824,892**
NET CHANGE IN CASH	**(12,493)**	**(3,794)**
Cash, beginning of year	**39,800**	43,594
CASH, end of year	**$ 27,307**	**$ 39,800**

Supplemental disclosure of cash flow information:		
Change in accounts payable related to fixed asset additions	$ (6,403)	$ 24,217
Cash paid for interest	145,391	158,881

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

1. UNIVERSITY ORGANIZATION

Harvard University (the "University") is a private, not-for-profit institution of higher education with approximately 7,100 undergraduate and 12,870 graduate students. Established in 1636, the University includes the Faculty of Arts and Sciences, the School of Engineering and Applied Sciences, the Division of Continuing Education, ten graduate and professional Schools, the Radcliffe Institute for Advanced Study, a variety of research museums and institutes, and an extensive library system to support the teaching and research activities of the Harvard community. The President and Fellows of Harvard College (the "Corporation"), a governing board of the University, has oversight responsibility for all of the University's financial affairs. The Corporation delegates substantial authority to the Schools and departments for the management of their individual resources and operations.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

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

The financial statements include certain prior year summarized comparative information in total, not by net asset classification. This information is not presented in sufficient detail to conform with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2007, from which the summarized information was derived. Certain prior year amounts have been reclassified to conform to current year presentation, including reclassifying gifts of securities from operating and financing to investing activities in the *Statements of Cash Flows*.

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

Net asset classifications

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

UNRESTRICTED net assets are not subject to donor-imposed restrictions. Funds invested in fixed assets and unrestricted funds functioning as endowment comprise 65% of the University's unrestricted net assets as of June 30, 2008. In addition, this category includes unrestricted gifts and endowment income balances, University-designated loan funds, and other unrestricted current funds.

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

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

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

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

Net revenue/(deficit)

Revenues earned, expenses incurred, and income distributed for operations for the purpose of teaching, conducting research, and the other programs and services of the University are the components of "Net revenue/(deficit)" in the *Statements of Changes in Net Assets with General Operating Account Detail*. Net revenue/ (deficit) is the measure of the University's operating result.

Collections

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

Insurance programs

The University, together with the Harvard-affiliated teaching hospitals, has formed a captive insurance company, Controlled Risk Insurance Company (CRICO), to provide limited professional liability, general liability, and medical malpractice insurance for its shareholders. The University self insures a portion of its professional liability and general liability programs and maintains a reserve for liability claims. CRICO provides medical malpractice coverage with no deductible for Harvard University Health Services, the Harvard School of Dental Medicine, and the Harvard School of Public Health. The University also maintains self-insurance programs and reserves for claims for automobile liability, property, and workers' compensation; these programs are supplemented with commercial excess insurance above the University's self-insured limit. In addition, the University is self insured for unemployment, the primary senior health plan, and all health and dental plans for active employees. The University's claims liabilities are recognized as incurred, including claims that have been incurred but not reported, and are included in operating expenses.

Tax-exempt status

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

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

New accounting pronouncements

The Financial Accounting Standards Board (FASB) has issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and enhances disclosures regarding fair value measurements. FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) on the measurement date, in the principal or most advantageous market for the asset or liability, and in an orderly transaction between market participants. FAS 157 will be effective for the University's financial statements issued for the year beginning on July 1, 2008 and is expected to impact the valuation of the University's investments and receivables. Management is currently evaluating the impact the adoption of FAS 157 will have on the financial statements.

The FASB has issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of* FASB *Statement No. 115* (FAS 159). FAS 159 provides entities with the option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different fair value measurement attributes for similar types of assets and liabilities. FAS 159 will be effective for the University's financial statements issued for the year beginning on July 1, 2008. Management does not believe the adoption of FAS 159 will have a material impact on the financial statements.

The FASB issued Staff Position No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP FAS 117-1). FSP FAS 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This FSP also requires additional disclosures about an organization's endowment funds (both donor-restricted and board-designated endowment funds), whether or not the organization is subject to UPMIFA. FSP FAS 117-1 will be effective for the University's financial statements issued for the year beginning on July 1, 2008. Management does not believe the adoption of FSP FAS 117-1 will have a material impact on the financial statements.

Effective July 1, 2007, the University adopted FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes* (FIN 48). FIN 48 sets a minimum threshold for financial statement recognition of the benefit of a tax position taken or expected to be taken in a tax return. The implementation of FIN 48 did not result in any unrecognized tax benefits in the accompanying financial statements. Tax positions for the open tax years as of June 30, 2008 were reviewed, and it was determined that no provision for uncertain tax positions is required.

The University implemented the requirements of Financial Accounting Standard No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158) as of June 30, 2007. Under FAS 158, the funded status of each pension and other postretirement benefit plan as of June 30 is required to be reported as an asset (for overfunded plans) or a liability (for underfunded plans). FAS 158 requires disclosure of the incremental effect of adopting the standard on certain individual line items of the *Balance Sheet*. In addition, the initial implementation of this standard is recognized as a cumulative effect of a change in an accounting principle in the fiscal 2007 *Statement of Changes in Net Assets with General Operating Account Detail*. The effect of FAS 158's adoption is discussed in *Note 11*.

Effective July 1, 2006, the University implemented Emerging Issues Task Force Issue 04-5, *Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights* (EITF 04-5). Under EITF 04-5, a general partner is required to consolidate any partnership that it controls, including those interests in the partnerships in which it does not have ownership rights. A general partner is presumed to control a partnership unless the limited partners have certain rights to remove the general partner or other substantive rights to participate in partnership operations.

In accordance with EITF 04-5, the University has consolidated assets held in partnerships controlled by HMC. These assets are included in "Investment portfolio, at fair value" in the *Balance Sheets*. Liabilities of the consolidated entities and the minority interest related to the assets not owned by the University are included in "Securities lending and other liabilities associated with the investment portfolio" in the *Balance Sheets*. The effect of adopting EITF 04-5 is discussed in *Note 3*.

3. INVESTMENTS

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

A) Investments are presented at fair value based on trade date positions as of June 30. Instruments listed or traded on a securities exchange are valued at the last sale price on the primary exchange where the security is traded. Restrictions that are attached to a security are factored into the valuation of that security, reflective of the estimated impact of those restrictions. Non-exchange traded debt instruments are primarily valued using independent pricing services or by broker/dealers who actively make markets in these securities. Over-the-counter positions such as options contracts, forward contracts, exchange agreements, interest rate cap and floor agreements, and credit default swaps are primarily valued using models with externally verifiable inputs, or by using independent broker quotes. Investments in most asset classes are at least partially achieved through external managers. The majority of these external investments are not readily marketable and are valued utilizing the most current information provided by the general partner, subject to assessments that the value is representative of fair value. Direct private equity and real asset investments are valued using discounted cash flow and other industry standard methodologies. Where applicable, independent appraisers and engineers assist in the valuation. These values are determined under the direction of, and subject to approval by, the Valuation Committee of the HMC Board of Directors.

B) The preparation of financial statements requires management to make estimates and assumptions about the effects of matters that are inherently uncertain. The accounting policies considered potentially significant in this respect are the valuation of derivative instruments, absolute return funds and special situations, private equities, and certain real assets. Values for these instruments are typically estimated using techniques such as discounted cash flow analysis and comparisons to similar instruments. Estimates developed using these methods are subjective and require judgment regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Estimates, by their nature, are based on judgment and available information.

Changes in assumptions could have a significant effect on the fair value of these instruments. Actual results could differ from these estimates and could have a material impact on the financial statements.

C) The University amortizes bond premiums and accretes bond discounts when cash collection is expected.

D) The University utilizes a number of subsidiary entities to support its investment activities. The consolidated financial statements include all assets and liabilities associated with these entities.

E) The *Balance Sheets* display both the assets and corresponding liabilities generated by securities lending transactions. These transactions are executed to support the investment activities of HMC. The University also separately reports the fair value of assets for which counterparties have the right to pledge or exchange the collateral they have received; assets of the investment portfolio that are unencumbered are reported as "Investment portfolio, at fair value" in the *Balance Sheets*.

F) The collateral advanced under security borrowing agreements is in the form of cash. The minimum collateral the University requires by contract on each stock loan and repurchase agreement is 100% of the fair value of the security loaned. Collateral is moved as required by fluctuations in the fair value of the security loaned.

The majority of the University's investments are managed in the General Investment Account (GIA), a pooled fund that consists primarily of endowment assets.

Other investments are managed separately from the GIA. These investments consist primarily of fixed-income securities (principally government securities and certificates of deposit held for the University's working capital needs) and various managed bond and equity portfolios associated with split interest agreements.

The University's investments as of June 30, 2008 and 2007 are summarized in the following table (in thousands of dollars):

	2008	2007
Investment portfolio, at fair value:		
Pooled general investment assets[1]	**$ 50,000,889**	$ 45,536,634
Other investments[2]	**1,086,414**	1,093,529
Fair value of interest rate exchange agreements	**(330,359)**	(13,275)
Total investment portfolio, at fair value	**50,756,944**	46,616,888
Fair value of securities pledged to counterparties	**6,398,168**	5,341,587
Securities lending and other liabilities associated with the investment portfolio	**(13,350,801)**	(10,125,587)
TOTAL INVESTMENTS[3]	**$ 43,804,311**	**$ 41,832,888**

Investments as of June 30, 2008 and 2007 comprised the following (in thousands of dollars):

	2008	2007
Pooled general investment net assets:		
General Operating Account	**$ 5,493,884**	$ 5,264,544
Endowment	**36,193,970**	34,251,729
Split interest agreements	**1,065,564**	986,906
Other internally designated funds	**294,838**	249,455
Total pooled general investment net assets	**43,048,256**	40,752,634
Other investments[2]	**1,086,414**	1,093,529
Fair value of interest rate exchange agreements	**(330,359)**	(13,275)
TOTAL INVESTMENTS[3]	**$ 43,804,311**	**$ 41,832,888**

1 *Excludes securities pledged to counterparties.*
2 *Includes split interest agreement assets of $505,157 and $561,384 as of June 30, 2008 and 2007, respectively.*
3 *Includes cash equivalents that consist principally of funds that have maturities of 90 days or less. Cash equivalents classified as investments were $1,782,533 and $2,627,760 as of June 30, 2008 and 2007, respectively.*

A summary of the University's total return on investments for fiscal 2008 and 2007 is presented below (in thousands of dollars):

	2008	2007
Return on pooled general investments:		
Realized and unrealized gains, net	**$ 3,180,799**	$ 7,135,715
Investment income	**297,690**	535,902
Total return on pooled general investments*	**3,478,489**	7,671,617
Return on other investments:		
Realized and unrealized gains/(losses), net	**(10,267)**	151,062
Investment income	**26,674**	35,644
Total return on other investments	**16,407**	186,706
Unrealized gain on interest rate exchange agreements	**(317,084)**	4,651
TOTAL RETURN ON INVESTMENTS	**$ 3,177,812**	**$ 7,862,974**

* *Net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers.*

The University employs a unit method of accounting for pooled general investments. Each participating fund enters into and withdraws from the pooled investment account based on monthly unit values. Changes in the fair value of investments are distributed proportionately to each fund that participates in the investment pool. Net general investment income distributed during the year is allocated on a per unit basis.

The changes in the unit value and income of participating units for the years ended June 30, 2008 and 2007 were as follows:

	2008	2007
Unit value, end of year	$ **2,138.98**	$ 1,982.64
Unit value, beginning of year	**1,982.64**	1,635.04
Increase in unit value due to realized and unrealized appreciation	**156.34**	347.60
Income earned per unit on general investments	**14.64**	26.12
TOTAL UNIT RETURN OF POOLED GENERAL INVESTMENTS*	**$ 170.98**	**$ 373.72**
TOTAL UNIT RETURN PERCENTAGE USING MONTHLY COMPOUNDING*	**8.6%**	**23.0%**

* *Net of all fees and expenses, and including the impact of revenue-sharing agreements with certain fund managers.*

The University's investment strategy incorporates a diversified asset allocation approach and maintains, within defined limits, exposure to the movements of the global equity, fixed-income, real estate, commodities, and private equity markets. The core investment portfolio is structured to closely mirror the market exposures defined by the Policy Portfolio. The Policy Portfolio is the long-term asset mix that is considered most likely to meet the University's long-term return goals with the appropriate level of risk. It serves as the benchmark against which the performance of the pooled general investments is measured. In addition, the University seeks to enhance the returns of certain asset classes through strategies designed to capture mispricings in specific financial instruments without changing the fundamental risk profile of the core investment account. These strategies generally involve several distinct but highly correlated financial instruments that are weighted to neutralize market risk. Depending on the characteristics of the financial instruments, the specific positions within a given strategy may be recorded in the asset or liability sections of the table on page 25.

The table on page 25 includes securities pledged to counterparties where the counterparty has the right, by contract or custom, to sell or repledge the securities. The fair value of collateral pledged to counterparties that cannot be sold or repledged was $910.7 million and $747.0 million as of June 30, 2008 and 2007, respectively. The fair value of collateral accepted by the University was $3,927.6 million and $2,822.6 million as of June 30, 2008 and 2007, respectively. The portion of this collateral that was sold or repledged was $1,112.0 million and $1,046.2 million as of June 30, 2008 and 2007, respectively. The cost of the net investments (the sum of total investments, total financial instruments purchased under hedge transactions, and total financial instruments sold, not yet purchased, under hedge transactions) was $38,148.3 million and $34,872.9 million as of June 30, 2008 and 2007, respectively.

As discussed in *Note 2*, in fiscal 2007, the University consolidated assets and liabilities held in partnerships controlled by HMC in accordance with EITF 04-5. The consolidation of these entities increased both the pooled general investment assets and liabilities shown in the table on page 25. Real asset investments increased by $890.0 million and $401.5 million as of June 30, 2008 and 2007, respectively. Other assets, consisting of cash, receivables, and fixed assets, increased by $410.8 million and $136.0 million as of June 30, 2008 and 2007. Other liabilities, consisting of accruals, payables, debt, and minority interests, increased by $1,300.8 million and $537.5 million as of June 30, 2008 and 2007, respectively.

The pooled general investment assets and liabilities as of June 30, 2008 and 2007 are summarized as follows (in thousands of dollars):

	2008	2007
POOLED GENERAL INVESTMENT ASSETS:		
Investment assets:		
Domestic equity and convertible securities	**$ 5,387,605**	$ 8,221,466
Foreign equity and convertible securities	**2,625,784**	4,258,479
Domestic fixed-income securities	**4,552,457**	5,469,470
Foreign fixed-income securities	**1,582,035**	1,249,067
Emerging market equity, debt, and options	**4,205,072**	3,372,244
High-yield securities	**2,064,218**	2,000,304
Absolute return funds and special situations	**8,312,518**	5,487,554
Private equities	**5,505,604**	4,178,397
Real assets[1]	**12,564,948**	10,038,467
Options	**815,102**	353,192
Total investment assets[2]	**47,615,343**	44,628,640
Collateral advanced under security borrowing agreements[3]	**2,969,522**	2,450,224
Cash and short-term investments	**1,476,434**	2,523,657
Other assets[4]	**4,337,758**	1,275,700
TOTAL POOLED GENERAL INVESTMENT ASSETS	**56,399,057**	**50,878,221**
POOLED GENERAL INVESTMENT LIABILITIES:		
Investment liabilities:		
Equity and convertible securities	**794,442**	1,044,560
Fixed-income securities	**2,435,950**	1,714,450
Real assets[1]	**2,409**	
Options	**685,889**	300,968
Total investment liabilities	**3,918,690**	3,059,978
Cash collateral held under security lending agreements[5]	**5,796,982**	5,128,807
Other liabilities[6]	**3,635,129**	1,936,802
TOTAL POOLED GENERAL INVESTMENT LIABILITIES	**13,350,801**	**10,125,587**
TOTAL POOLED GENERAL INVESTMENT NET ASSETS	**$ 43,048,256**	**$ 40,752,634**

1 *Real assets include investments in commodities, real estate, and inflation-indexed bonds.*

2 *Securities pledged to counterparties where the counterparty has the right, by contract or custom, to sell or repledge the securities were $6,398,168 and $5,341,587 as of June 30, 2008 and 2007, respectively.*

3 *The collateral advanced under security borrowing agreements is in the form of cash.*

4 *As of June 30, 2008, other assets consisted primarily of accounts receivable for the sale of securities of $3,775,723, of which gross receivables relating to off-balance sheet instruments were $1,088,741. As of June 30, 2007, other assets consisted primarily of accounts receivable for the sale of securities of $1,103,913, of which gross receivables relating to off-balance sheet instruments were $294,374.*

5 *The minimum collateral the University requires by contract on each stock loan and repurchase agreement is 100% of the fair value of the security loaned. Collateral is moved as required by fluctuations in the fair value of the security loaned.*

6 *As of June 30, 2008, other liabilities consisted primarily of accounts payable for undistributed income and the purchase of securities of $2,268,624, of which gross payables relating to off-balance sheet instruments were $430,994. As of June 30, 2007, other liabilities consisted primarily of accounts payable for undistributed income and the purchase of securities of $1,363,483, of which gross payables relating to off-balance sheet instruments were $117,001.*

The University uses a variety of financial instruments with off-balance sheet risk involving contractual or optional commitments for future settlement. These include futures, options, credit default swaps, exchange agreements, interest rate cap and floor agreements, and forward purchase and sale agreements, which are exchange traded or executed over the counter. These instruments are used in both the core portfolio to gain exposure to a given asset class and in the arbitrage strategies, with the goal of enhancing the returns of certain asset classes without increasing the market risk to the underlying asset class. The market risk of a strategy is influenced by the relationship between the financial instruments with off-balance sheet risk and the offsetting positions recorded in the *Balance Sheets*. The University manages exposure to market risk through the use of industry standard analytical tools that measure the market exposure of each position within a strategy. The strategies are monitored daily, and positions are frequently adjusted in response to changes in the financial markets.

The following table summarizes the market exposure (expressed in delta-weighted notional amounts), net ending fair value, net average fair value (an average of the five quarters ending June 30, 2008), and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2008 (in thousands of dollars):

	Market exposure		Net ending fair value of off-balance sheet positions	Net average fair value	Credit exposure*
	Long	Short			
Equity instruments:					
Equity futures	$ 413,617	$ (530,773)	$ 16,257	$ 7,683	$ 30,149
Equity options	10,615	(1,219)	12,048	7,257	
Equity exchange agreements	3,472,873	(527,118)	(74,119)	20,506	274
Total equity instruments	3,897,105	(1,059,110)	(45,814)	35,446	30,423
Fixed-income instruments:					
Fixed-income futures	499,630	(635,951)	1,871	12,823	9,590
Fixed-income options	4,562,112	(3,018,565)	(59,256)	(4,539)	963
Interest rate exchange agreements	13,457,708	(11,826,808)	(50,686)	(26,523)	1,180
Interest rate caps and floors	6,396,100	(7,754,459)	127,653	107,683	10,697
Total fixed-income instruments	24,915,550	(23,235,783)	19,582	89,444	22,430
Commodity instruments:					
Commodity options				(4,157)	
Commodity exchange agreements	3,702,822				12,353
Total commodity instruments	3,702,822	0	0	(4,157)	12,353
Currency instruments:					
Currency forwards	16,369,315	(16,358,151)	11,164	4,048	912
Currency options	1,043,132	(1,099,194)	(2,287)	(10,116)	4,256
Currency exchange agreements	115,530	(109,691)	1,932	1,099	259
Total currency instruments	17,527,977	(17,567,036)	10,809	(4,969)	5,427
Credit instruments	2,007,666	(7,918,917)	622,174	485,467	54,920
TOTAL	**$ 52,051,120**	**$ (49,780,846)**	**$ 606,751**	**$ 601,231**	**$ 125,553**

* *Credit exposure represents cash or securities advanced by the University to meet legal margin requirements in connection with future, forward, and option contracts, as well as exposure to counterparties where gains on financial instruments with off-balance sheet risk exceed collateral held by the University.*

The following table summarizes the market exposure (expressed in delta-weighted notional amounts), net ending fair value, net average fair value (an average of the five quarters ending June 30, 2007), and credit exposure relative to the financial instruments with off-balance sheet risk as of June 30, 2007 (in thousands of dollars):

	Market exposure		Net ending fair value of off-balance sheet positions	Net average fair value	Credit exposure*
	Long	Short			
Equity instruments:					
Equity futures	$ 1,314,137	$ (301,633)	$ 25,692	$ 5,760	$ 52,305
Equity options	25,262	(110,801)	12,561	24,823	1,559
Equity exchange agreements	4,134,123	(110,003)	59,499	23,391	7,616
Total equity instruments	5,473,522	(522,437)	97,752	53,974	61,480
Fixed-income instruments:					
Fixed-income futures	1,854,864	(1,164,495)	970	5,578	21,233
Fixed-income options	9,250,069	(7,934,386)	(9,063)	558	2,208
Interest rate exchange agreements	2,474,545	(1,437,842)	8,176	(7,671)	481
Interest rate caps and floors	9,883,207	(12,929,576)	55,024	20,228	16,605
Total fixed-income instruments	23,462,685	(23,466,299)	55,107	18,693	40,527
Commodity instruments:					
Commodity futures					3,968
Commodity options		(10,280)	(10,280)	(3,042)	
Commodity exchange agreements	3,293,716				32,492
Total commodity instruments	3,293,716	(10,280)	(10,280)	(3,042)	36,460
Currency instruments:					
Currency forwards	13,501,133	(13,537,807)	(36,674)	(26,258)	22,717
Currency options	259,923	(48,594)	(19,330)	(4,180)	13,961
Currency exchange agreements	2,512	(3,724)	137		137
Total currency instruments	13,763,568	(13,590,125)	(55,867)	(30,438)	36,815
Credit instruments	975,363	(4,847,940)	15,264	(9,452)	43,720
TOTAL	**$ 46,968,854**	**$ (42,437,081)**	**$ 101,976**	**$ 29,735**	**$ 219,002**

* *Credit exposure represents cash or securities advanced by the University to meet legal margin requirements in connection with future, forward, and option contracts, as well as exposure to counterparties where gains on financial instruments with off-balance sheet risk exceed collateral held by the University.*

Financial instruments with off-balance sheet risk are recorded in the table on page 25 at fair value. Fair value is a function of the characteristics of the individual financial instruments and their relationship to current market conditions, as well as the length of time each instrument has been held. For example, domestic futures contracts, which expire periodically, are subject to daily cash settlements, and as such, the end-of-day fair value of these contracts is zero. In contrast, interest rate exchange agreements may be held for the life of a strategy and may reflect significant unrealized gains and losses depending on the change in value since the inception of the contract. Market exposure represents the notional value of the off-balance sheet instrument adjusted for its correlation to its underlying index or asset. Fair value and market exposure do not accurately measure risk. A more appropriate indicator of market risk is the net exposure of all positions (on- and off-balance sheet) expressed in market-risk equivalents, or value at risk.

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

The asset allocation of the University's portfolio involves exposure to a diverse set of markets. The investments within these markets involve various risks such as interest rate, market, sovereign, and credit risks. The University anticipates that the value of its investments may, from time to time, fluctuate substantially as a result of these risks.

The University has also entered into agreements with private equity and real estate partnerships and external investment managers, which include commitments to make periodic cash contributions totaling approximately $11,028.3 million through fiscal 2018.

4. RECEIVABLES

The major components of receivables, net of reserves for doubtful accounts of $11.8 million and $3.7 million as of June 30, 2008 and 2007, respectively, were as follows (in thousands of dollars):

	2008	2007
Investment income	**$ 67,876**	$ 37,724
Federal sponsored support	**39,519**	41,072
Non-federal sponsored support	**9,841**	5,677
Tuition and fees	**9,751**	10,246
Publications	**31,274**	23,086
Rent	**2,005**	9,844
Gift receipts	**11,159**	15,246
Executive education	**23,398**	21,615
Other	**54,536**	43,489
TOTAL RECEIVABLES, NET	**$ 249,359**	**$ 207,999**

5. NOTES RECEIVABLE

Notes receivable, net of reserves for doubtful accounts of $7.6 million and $7.5 million as of June 30, 2008 and 2007, respectively, were as follows (in thousands of dollars):

	2008	2007
Student loans:		
Government revolving	**$ 72,315**	$ 63,391
Institutional	**75,703**	67,557
Federally guaranteed	**2,423**	3,085
Total student loans	**150,441**	134,033
Faculty and staff	**156,580**	145,129
Other	**29,064**	28,481
TOTAL NOTES RECEIVABLE, NET	**$ 336,085**	**$ 307,643**

Government revolving loans are funded principally with federal advances to the University under the Perkins Loan Program and certain other programs. These advances totaled $58.9 million and $57.1 million as of June 30, 2008 and 2007, respectively, and are classified as liabilities in the *Balance Sheets*. Interest earned on the revolving and institutional loan programs is reinvested to support additional loans. The repayment and interest rate terms of the institutional loans vary considerably.

In addition to administering institutional loan programs, the University participates in various federal loan programs. Federally insured loans are generally repaid over a ten-year period and earn interest at an adjustable rate that approximates the 90-day U.S. Treasury Bill rate plus 3.0%. Principal and interest payments on these loans are insured by the American Student Assistance Corporation and are reinsured by the federal government.

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

Notes receivable are presented at fair value, with the exception of those under federally guaranteed student loan programs. These notes are subject to significant restrictions, and accordingly, it is not practicable to determine their fair value.

6. PLEDGES RECEIVABLE

Unconditional promises to donate to the University in the future are recorded as pledges receivable in the years promised at the present value of expected cash flows, net of an allowance for uncollectible pledges. Pledges receivable included in the financial statements as of June 30, 2008 and 2007 are expected to be realized as follows (in thousands of dollars):

	2008	2007
Within one year	$ **103,484**	$ 86,999
Between one and five years	**413,936**	348,000
More than five years	**229,019**	172,337
Less: discount and allowance for uncollectible pledges	**(119,960)**	(82,364)
TOTAL PLEDGES RECEIVABLE, NET	**$ 626,479**	**$ 524,972**

Discounts of $64.5 million and $48.1 million for the years ended June 30, 2008 and 2007, respectively, were calculated using discount factors based on the appropriate U.S. Treasury Note rates.

Pledges receivable as of June 30, 2008 and 2007 have been designated for the following purposes (in thousands of dollars):

	2008	2007
General Operating Account balances:		
Gifts for current use	$ **150,768**	$ 119,965
Non-federal sponsored grants	**88,388**	112,533
Loan funds and facilities	**16,914**	15,312
Total General Operating Account balances	**256,070**	247,810
Endowment	**370,409**	277,162
TOTAL PLEDGES RECEIVABLE, NET	**$ 626,479**	**$ 524,972**

Because of uncertainties with regard to realizability and valuation, bequest intentions and other conditional promises are only recognized as assets if and when the specified conditions are met. Non-bequest conditional pledges totaled $24.6 million and $1.9 milion as of June 30, 2008 and 2007, respectively.

7. FIXED ASSETS

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

The major categories of fixed assets as of June 30, 2008 and 2007 are summarized as follows (in thousands of dollars):

	2008	2007	Estimated useful life (in years)
Research facilities	$ **1,812,063**	$ 1,480,450	*
Housing facilities	**1,109,710**	933,052	35
Classrooms and offices	**1,107,330**	1,065,829	35
Service facilities	**411,146**	304,753	35
Libraries	**384,993**	374,231	35
Other facilities	**372,878**	360,989	35
Museums and assembly facilities	**261,449**	254,977	35
Athletic facilities	**145,783**	129,157	35
Land	**597,910**	591,932	N/A
Construction in progress	**460,256**	585,250	N/A
Equipment	**634,021**	544,314	**
Total fixed assets, at cost	**7,297,539**	6,624,934	
Less: accumulated depreciation	**(2,346,210)**	(2,100,772)	
TOTAL FIXED ASSETS, NET	**$ 4,951,329**	**$ 4,524,162**	

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

Certain University facilities are subject to restrictions related to use, structural modifications, and ownership transfer. Included in the fixed asset balances are restricted facilities with a net book value of $171.2 million and $172.7 million as of June 30, 2008 and 2007, respectively.

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

Equipment fixed assets include general and scientific equipment, computers, software, furniture, and vehicles.

The University recognized adjustments to increase its asset retirement obligation of $4.1 million and $5.2 million in fiscal 2008 and 2007, respectively. The liability is associated with buildings that are fully depreciated, therefore no adjustment was made to the cost of the assets. The asset retirement obligation of $42.6 million and $38.5 million is included in "Deposits and other liabilities" in the *Balance Sheets* as of June 30, 2008 and 2007, respectively.

8. ENDOWMENT

The University's endowment consists of approximately 11,600 separate funds established over many years for a wide variety of purposes. Endowment fund balances, including funds functioning as endowment, are classified and reported as unrestricted, temporarily restricted, or permanently restricted net assets in accordance with donor specifications. Net unrealized losses on permanently restricted endowment funds are classified as a reduction to unrestricted net assets until such time as the fair value equals or exceeds book value. Although funds functioning as endowment are not subject to permanent donor restrictions, decisions to spend their principal require the approval of the Corporation. All but a small fraction of the endowment is invested in the GIA (*Note 3*).

The University is also the beneficiary of certain irrevocable trusts held and administered by others. The estimated fair values of trust assets, which approximate the present values of expected future cash flows from the trusts, are recognized as assets and increases in net assets when the required trust documentation is provided to the University.

The endowment consisted of the following as of June 30, 2008 and 2007 (in thousands of dollars):

	2008				2007
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Endowment funds		$ 22,897,649	$ 4,033,759	**$ 26,931,408**	$ 25,479,215
Funds functioning as endowment	$ 6,140,748	3,187,929		**9,328,677**	8,827,427
Pledge balances		65,800	304,609	**370,409**	277,162
Interests in trusts held by others		18,442	277,757	**296,199**	328,264
TOTAL ENDOWMENT	$ **6,140,748**	$ **26,169,820**	$ **4,616,125**	$ **36,926,693**	$ **34,912,068**

The University's endowment distribution policies are designed to preserve the value of the endowment in real terms (after inflation) and to generate a predictable stream of available income. Each fall, the Corporation approves the endowment distribution rate (the "endowment distribution"), stated in dollars per unit, for the following fiscal year. The endowment distribution is not based on a specific formula, nor is it directly tied to current investment returns. Rather, it reflects expectations about long-term returns, inflation rates, and the University's ongoing spending needs. For fiscal 2008, the per unit endowment distribution approved by the Corporation (prior to decapitalizations described below) was equal to 4.1% of fair value as of the beginning of the fiscal year.

In addition to the endowment distribution, the Corporation approves certain decapitalizations from the endowment to support strategic, mission-critical activities or objectives that are typically one-time or time-limited. During fiscal 2008, these additional decapitalizations, in combination with the endowment distribution, resulted in an aggregate payout rate of 4.8%. The following table displays the total return on endowment, the endowment distribution rate per unit and as a percentage of fair value as of the beginning of each fiscal year, and the aggregate payout rate (inclusive of decapitalizations) for each of the past five years.

Endowment investments are managed to achieve the maximum long-term total return. As a result of this emphasis on total return, the proportion of endowment distributions funded by dividend and interest income or by capital gains may vary significantly from year to year. Amounts withdrawn from endowment capital gains to fund the fiscal 2008 and 2007 distributions totaled $919.8 million and $709.7 million, respectively.

Endowment income capitalized to endowment principal is available to meet future spending needs, subject to the approval of the Corporation.

		Distribution rate[2]		Aggregate payout rate[3]
Fiscal year	Endowment total return %[1]	Per unit	As a % of fair value	As a % of fair value
2008	8.6%	$ 81.96	4.1%	4.8%
2007	23.0	69.73	4.3	4.6
2006	16.7	60.99	4.3	4.2
2005	19.2	54.17	4.5	4.5
2004	21.1	49.70	4.9	4.9

[1] *The endowment total return % is calculated in relation to pooled general investments, is net of all fees and expenses, and includes the impact of revenue-sharing agreements with certain fund managers.*

[2] *This data is based upon the per unit distribution rate established by the Corporation for each fiscal year.*

[3] *Aggregate payout rate percentages are based upon actual endowment distributions in combination with approved decapitalizations of endowment principal made during the fiscal year.*

9. SPLIT INTEREST AGREEMENTS

Under split interest agreements, donors enter into trust arrangements with the University in which the University receives benefits that are shared with other beneficiaries and institutions. Split interest agreement investment assets are recorded at fair value, and liabilities are recorded at the present value of estimated future payments due to beneficiaries and other institutions.

The changes in split interest agreement net assets for fiscal 2008 and 2007 were as follows (in thousands of dollars):

	2008			2007
	Temporarily restricted	Permanently restricted	Total	Total
Gifts for capital (*Note 15*)*	$ 8,695	$ 19,794	**$ 28,489**	$ 35,174
Investment return:				
Investment income	8,035	17,401	**25,436**	30,504
Increase in realized and unrealized appreciation	12,164	26,345	**38,509**	245,804
Total investment return	20,199	43,746	**63,945**	276,308
Payments to annuitants	(22,381)	(48,474)	**(70,855)**	(78,475)
Transfers to endowment	(12,886)	(10,957)	**(23,843)**	(18,613)
Transfers to the General Operating Account	(12,841)	(1,230)	**(14,071)**	(7,476)
Change in liabilities and other adjustments	11,730	25,358	**37,088**	(168,206)
NET CHANGE DURING THE YEAR	**(7,484)**	**28,237**	**20,753**	**38,712**
Total split interest agreement net assets, beginning of year	196,021	445,688	**641,709**	602,997
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS, end of year	**$ 188,537**	**$ 473,925**	**$ 662,462**	**$ 641,709**

* *Shown at net present value. The undiscounted value of these gifts was $65,771 and $89,928 for the years ended June 30, 2008 and 2007, respectively.*

Split interest agreement net assets as of June 30, 2008 and 2007 consisted of the following (in thousands of dollars):

	2008	2007
Split interest agreement investments (*Note 3*):		
Charitable remainder trusts	**$ 948,446**	$ 926,741
Charitable lead trusts	**121,400**	118,949
Charitable gift annuities	**399,295**	385,885
Pooled income funds	**101,580**	116,715
Total split interest agreement investments	**1,570,721**	1,548,290
Liabilities due under split interest agreements:		
Amounts due to beneficiaries	**(794,983)**	(785,032)
Amounts due to other institutions	**(113,276)**	(121,549)
Total liabilities due under split interest agreements	**(908,259)**	(906,581)
TOTAL SPLIT INTEREST AGREEMENT NET ASSETS	**$ 662,462**	**$ 641,709**

10. BONDS AND NOTES PAYABLE

Bonds and notes payable as of June 30, 2008 and 2007 were as follows (in thousands of dollars):

	Fiscal year of issue	Remaining years to maturity	One-year effective interest rate	Outstanding principal 2008	2007
Tax-exempt bonds and notes payable:					
Variable-rate bonds and notes payable:					
Series L - weekly	1990	16	4.4%	$ **71,140**	$ 71,140
Series R - daily	2000–2006	41	2.4	**131,200**	131,200
Series Y - weekly	2000	27	5.2	**117,905**	117,905
Series BB - weekly	2001	26	2.8	**196,700**	196,700
Series HH - weekly	2004	25	5.2	**92,235**	92,235
Series GG1 - weekly	2005	21	4.4	**205,935**	205,935
Series 2006B1 - daily	2007	28	3.3	**112,900**	112,900
Series 2006B2 - weekly	2007	28	3.1	**112,900**	112,900
Commercial paper	Various	Various*	2.8	**533,109**	546,895
Total variable-rate bonds and notes payable			3.4	**1,574,024**	1,587,810
Fixed-rate bonds:					
Series N	1992	12	6.3	**79,078****	79,002
Series Z	2001	8	5.1	**77,388****	85,413
Series AA	2001	1	5.5	**5,154****	10,213
Series DD	2002	27	5.0	**134,982****	134,949
Series FF	2003	29	5.1	**275,990****	275,984
Series 2005A	2005	28	5.0	**93,713****	93,877
Series 2005B	2006	24	5.0	**105,047****	105,234
Series 2005C	2006	27	5.0	**129,998****	130,155
Series 2008B	2008	30	5.0	**216,886****	
Total fixed-rate bonds			5.2	**1,118,236**	914,827
Total tax-exempt bonds and notes payable			**4.0**	**2,692,260**	2,502,637
Taxable bonds and notes payable:					
Series GG2	2005	5	4.7	**45,745**	45,745
Series 2006A	2006	29	6.3	**401,372****	401,350
Series 2008A	2008	30	4.9	**387,606****	
Series 2008C	2008	10	5.3	**125,205**	
Commercial paper	Various	Various*	5.1	**347,652**	807,079
Total taxable bonds and notes payable			**5.4**	**1,307,580**	1,254,174
Other notes payable	Various	Various	Various	**90,072**	90,167
TOTAL BONDS AND NOTES PAYABLE			**4.6%**	**$ 4,089,912**	**$ 3,846,978**

* *All commercial paper will mature in fiscal 2009.*

** *Series N ,DD, FF, 2006A, and 2008A principal are net of $0.9 million, $0.9 million, $0.2 million, $0.6 million, and $0.4 million of discounts, respectively. Series Z, AA, 2005A, 2005B, 2005C, and 2008B principal include premiums of $1.2 million, $0.2 million, $4.6 million, $4.5 million, $4.1 million, and $8.0 million, respectively.*

Interest expense, recorded in both "Space and occupancy" and "Other expenses" in the *Statements of Changes in Net Assets with General Operating Account Detail*, was $146.1 million and $162.8 million for fiscal 2008 and 2007, respectively. Excluding maturity of commercial paper and unamortized discounts and premiums, scheduled principal payments are (in thousands of dollars):

Fiscal year	Principal payments
2009	$ 22,088
2010	17,846
2011	16,563
2012	17,353
2013	188,258
Thereafter	2,927,460
TOTAL PRINCIPAL PAYMENTS	**$ 3,189,568**

In fiscal 2008, the University issued $388.0 million of taxable fixed-rate Series 2008A bonds. The series was comprised of a $145.0 million issue that will mature in 2013 and a $243.0 million issue that will mature in 2038. Also in fiscal 2008, the University issued $208.9 million of tax-exempt fixed-rate Series 2008B bonds that will mature in 2038. Finally, in fiscal 2008, the University issued $125.2 million of taxable fixed-rate Series 2008C bonds that will mature in 2018. All bond issues were used to finance capital projects and acquisitions initially funded by the University's commercial paper programs.

In fiscal 2008, the University reauthorized its tax-exempt commercial paper program.

In fiscal 2007, the University reauthorized and increased the capacity of its taxable commercial paper program to $1.0 billion from $650.0 million. Also in fiscal 2007, the University issued $225.8 million of tax-exempt daily and weekly variable-rate reset Series 2006B bonds to finance graduate housing.

Based on quoted market prices, the estimated fair value of the University's outstanding bonds and notes payable, including accrued interest, was $4,022.3 million and $3,813.3 million as of June 30, 2008 and 2007, respectively.

In the event that the University receives notice of any optional tender on its variable-rate bonds, or if the bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a general obligation to purchase the bonds tendered.

Interest rate exchange agreements

The University has entered into various interest rate exchange agreements (interest rate swaps) in order to convert variable-rate borrowings to a fixed rate, thereby managing the interest cost and risk associated with its outstanding debt. The interest rate exchange agreements were not entered into for trading or speculative purposes. Under the terms of these agreements, the University pays a fixed rate, determined at inception, and receives a variable rate on the respective notional principal amounts. Each of these exchanges is collateralized, as described in *Note 3*. The interest rates in the preceding schedule reflect any applicable exchange agreements.

The fair value of interest rate exchange agreements is the estimated amount that the University would have received or (paid), including accrued interest, to terminate the agreements on the dates of the *Balance Sheets*, taking into account the creditworthiness of the underlying counterparties. The notional amount and fair value of interest rate exchange agreements were $3,524.7 million and $(330.4) million, respectively, as of June 30, 2008 and $3,533.9 million and $(13.3) million, respectively, as of June 30, 2007.

The fair value of these agreements is included in "Investment portfolio, at fair value" in the *Balance Sheets*. The loss realized from the monthly settling of these agreements was $15.6 million and $7.9 million for fiscal 2008 and 2007, respectively. All unrealized and realized gains and losses from interest rate exchange agreements are included in "Increase in appreciation, net of operating distribution" in the *Statements of Changes in Net Assets with General Operating Account Detail*.

11. EMPLOYEE BENEFITS

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

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

Pension benefits

Faculty members and certain long-service administrative officers participate in defined contribution plans that are funded on a current basis. All staff and hourly employees are covered by a retirement program that includes a defined benefit component, a defined contribution component, or a combination of the two.

In accordance with ERISA requirements, the University has established a trust to hold plan assets for its defined benefit pension plans. The fair values of the trust's assets were $879.9 million and $897.0 million as of June 30, 2008 and 2007, respectively. In addition, the University internally designated and invested $40.0 million and $36.7 million as of June 30, 2008 and 2007, respectively, for its defined benefit pension plans. The University recorded expenses for its defined contribution plans of $94.7 million and $87.4 million for fiscal 2008 and 2007, respectively.

Postretirement health benefits

The University provides defined benefit postretirement health coverage and life insurance to substantially all of its employees. As of June 30, 2008, the University had internally designated and invested $248.3 million to fund the postretirement health benefit accrued liability of $607.4 million. As of June 30, 2007, the University had internally designated and invested $206.7 million to fund an accrued liability of $545.7 million.

The following table provides a reconciliation of the benefit obligation for the University for fiscal 2008 and 2007 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2008	2007	2008	2007
Reconciliation of benefit obligation:				
Benefit obligation, beginning of year	**$ 593,682**	$ 583,501	**$ 545,698**	$ 505,104
Service cost	**12,121**	12,819	**25,564**	23,353
Interest cost	**36,868**	37,399	**35,164**	31,822
Plan participants' contributions			**1,927**	1,819
Federal subsidy on benefits paid			**1,528**	1,231
Plan amendments	**11**			
Gross benefits paid	**(38,529)**	(39,298)	**(18,981)**	(17,829)
Actuarial (gain)/loss	**(17,844)**	(739)	**16,527**	198
BENEFIT OBLIGATION, end of year	**$ 586,309**	**$ 593,682**	**$ 607,427**	**$ 545,698**
Accumulated benefit obligation	**$ 497,387**	$ 511,923	**N/A**	N/A
Weighted-average assumptions used to determine benefit obligation at end of year:				
Discount rate	**6.50%**	6.25%	**6.50%**	6.25%
Rate of compensation increase	**4.00%**	4.00%	**4.00%**	4.00%
Health care cost trend rate:				
– Initial rate	**N/A**	N/A	**8.50%**	9.00%
– Ultimate rate	**N/A**	N/A	**5.00%**	5.00%
– Years to ultimate rate	**N/A**	N/A	**7**	4
Effect of one-percentage-point change in assumed health care cost trend rate on postretirement benefit obligation:				
– Increase	**N/A**	N/A	**$ 109,066**	$ 95,593
– Decrease	**N/A**	N/A	**$ (86,415)**	$ (76,066)

The following table provides a reconciliation of the fair value of plan assets for the University for fiscal 2008 and 2007 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2008	2007	2008	2007
Reconciliation of fair value of plan assets:				
Fair value of plan assets, beginning of year	**$ 896,964**	$ 776,442	**$ 0**	$ 0
Actual return on plan assets	**21,434**	159,820		
Gross benefits paid	**(38,529)**	(39,298)		
FAIR VALUE OF PLAN ASSETS, end of year	**$ 879,869**	**$ 896,964**	**$ 0**	**$ 0**

The actual asset allocation of the investment portfolio for the pension plan for fiscal 2008 and 2007, along with target allocations for fiscal 2009, are as follows:

	2009 Target	2008 Actual	2007 Actual
Asset allocation by category for pension plan:			
Equity securities	45.0%	48.7%	48.1%
Fixed-income securities	17.0	19.6	21.1
Real estate	9.0	6.8	6.9
Other	29.0	24.9	23.9
TOTAL OF ASSET ALLOCATION CATEGORIES	**100.0%**	**100.0%**	**100.0%**

The University's investment strategy for the pension portfolio is to manage the assets across a broad and diversified range of investment categories, both domestic and international. The objective is to achieve a risk-adjusted return that is in line with the long-term obligations that the University has to the pension plan beneficiaries. The investment program is also managed to comply with all ERISA regulations. The "Other" asset category consists of absolute return funds, commodities, and cash.

The following tables provide the funded status at the end of the year and the related amounts recognized in the *Balance Sheets* for the University for fiscal 2008 and 2007 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2008	2007	2008	2007
Funded status, end of year:				
Fair value of plan assets	$ **879,869**	$ 896,964		
Benefit obligations	**(586,309)**	(593,682)	$ **(607,427)**	$ (545,698)
FUNDED STATUS, end of year	**293,560**	**303,282**	**(607,427)**	**(545,698)**
Amounts recognized in the *Balance Sheets*:				
Net retirement assets	$ **293,560**	$ 303,282		
Accrued retirement obligations			$ **(607,427)**	$ (545,698)
TOTAL AMOUNTS RECOGNIZED IN THE *BALANCE SHEETS*	$ **293,560**	$ **303,282**	$ **(607,427)**	$ **(545,698)**
Amounts recognized in unrestricted net assets:				
Net actuarial (gain)/loss	$ **(304,565)**	$ (320,749)	$ **(2,988)**	$ (14,521)
Prior service (credit)/cost	**(14,829)**	(19,215)	**4,974**	6,770
Transition (asset)/obligation			**30,311**	36,373
TOTAL AMOUNTS RECOGNIZED IN UNRESTRICTED NET ASSETS	$ **(319,394)**	$ **(339,964)**	$ **32,297**	$ **28,622**
Amounts recognized in changes in unrestricted net assets:				
FAS 158 change in accounting principle		$ 339,964		$ (28,622)
New prior service (credit)/cost	$ 11			
New net actuarial (gain)/loss	11,728		$ 11,253	
Amortization of:				
transition asset/(obligation)			(6,062)	
prior service credit/(cost)	4,375		(1,796)	
actuarial gain/(loss)	4,456		280	
TOTAL AMOUNTS RECOGNIZED IN CHANGES IN UNRESTRICTED NET ASSETS	$ **20,570**	$ **339,964**	$ **3,675**	$ **(28,622)**

The fiscal 2008 total amount recognized in changes in unrestricted net assets of $24.2 million is included in "Other changes" in the *Statement of Changes in Net Assets with General Operating Account Detail.*

There are no expected employer contributions for fiscal 2009 to funded pension or other benefit plans. The following table summarizes expected benefit payments and subsidies for pension and other postretirement benefits for the University (in thousands of dollars):

	Expected benefit payments		
Fiscal year	Pension	Postretirement health	Expected Medicare Part D subsidies
2009	$ 32,046	$ 20,082	$ 1,908
2010	37,822	23,195	2,216
2011	38,721	25,538	2,426
2012	39,854	28,084	2,664
2013	41,272	30,700	2,957
2014–2018	229,193	197,542	19,853

The following table summarizes the net periodic benefit (income)/cost for the University for fiscal 2008 and 2007 (in thousands of dollars):

	Pension benefits		Postretirement health benefits	
	2008	2007	2008	2007
Components of net periodic benefit (income)/cost:				
Service cost	**$ 12,121**	$ 12,819	**$ 25,564**	$ 23,353
Interest cost	**36,868**	37,399	**35,164**	31,822
Expected return on plan assets	**(54,327)**	(48,512)	**(12,886)**	(10,111)
Amortization of the:				
Actuarial (gain)/loss	**(4,456)**	(2,857)	**(280)**	(77)
Prior service (credit)/cost	**(4,375)**	(4,696)	**1,796**	2,046
Transition (asset)/obligation			**6,062**	6,062
Net periodic benefit (income)/cost	**(14,169)**	(5,847)	**55,420**	53,095
Additional designated funding	**3,321**	7,417	**2,634**	22,493
TOTAL NET PERIODIC BENEFIT (INCOME)/COST	**$ (10,848)**	**$ 1,570**	**$ 58,054**	**$ 75,588**
Weighted-average assumptions used to determine net periodic benefit (income)/cost:				
Discount rate	**6.25%**	6.25%	**6.25%**	6.25%
Expected long-term rate of return on plan assets	**7.50%**	7.50%	**7.50%**	7.50%
Rate of compensation increase	**4.00%**	4.00%	**4.00%**	4.00%
Health care cost trend rate:				
– Initial rate	**N/A**	N/A	**9.00%**	8.00%
– Ultimate rate	**N/A**	N/A	**5.00%**	5.00%
– Years to ultimate rate	**N/A**	N/A	**4**	3
Effect of one-percentage-point change in assumed health care cost trend rate on aggregate service and interest cost:				
– Increase	**N/A**	N/A	**$ 13,778**	$ 12,607
– Decrease	**N/A**	N/A	**$ (10,576)**	$ (9,664)

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

The estimated amounts that will be amortized from unrestricted net assets into net periodic benefit cost in fiscal 2009 are as follows (in thousands of dollars):

	Pension benefits	Postretirement health benefits
Amounts amortized:		
Actuarial (gain)/loss	$ (10,103)	$ (252)
Prior service (credit)/cost	(4,374)	1,411
Transition (asset)/obligation		6,062
TOTAL AMOUNTS AMORTIZED	**$ (14,477)**	**$ 7,221**

The University's adoption of FAS 158, discussed in *Note 2*, had the following incremental effect on retirement benefit-related amounts reported in the *Balance Sheet* as of June 30, 2007 (in thousands of dollars):

	Balances before adopting FAS 158	Adjustments to adopt FAS 158	Balances after adopting FAS 158
Net retirement assets	$ 0	$ 303,282	$ 303,282
Accrued retirement obligations	553,758	(8,060)	545,698
Unrestricted net assets	10,687,034	311,342*	10,998,376

* *The $311.3 million change in unrestricted net assets is presented as "Cumulative effect of accounting change" in the fiscal 2007* Statement of Changes in Net Assets with General Operating Account Detail.

12. GENERAL OPERATING ACCOUNT

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

The major components of the GOA net asset balances as of June 30, 2008 and 2007 are summarized as follows (in thousands of dollars):

	2008				2007
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Departmental balances:					
Unexpended endowment income	$ 83,936	$ 481,620		**$ 565,556**	$ 673,104
Unexpended gift balances	63,262	262,678		**325,940**	297,720
Pledge balances		236,919		**236,919**	223,469
Interests in trusts held by others		42,537		**42,537**	25,037
Loan funds	30,741		$ 88,655	**119,396**	116,116
Funds for construction		9,162		**9,162**	13,171
Funds invested in fixed assets	1,326,368			**1,326,368**	1,360,383
Other departmental purposes	764,412			**764,412**	666,885
Total departmental balances	2,268,719	1,032,916	88,655	**3,390,290**	3,375,885
University balances*	3,099,074	85,688		**3,184,762**	3,062,726
TOTAL GOA NET ASSET BALANCES	**$ 5,367,793**	**$ 1,118,604**	**$ 88,655**	**$ 6,575,052**	**$ 6,438,611**

* *Includes interests in trusts held by others of $3,254 and $4,993 for the years ended June 30, 2008 and 2007, respectively.*

13. STUDENT FINANCIAL AID

Financial aid granted to students in fiscal 2008 and 2007 is summarized as follows (in thousands of dollars):

	2008	2007
Scholarships and other student awards:		
Scholarships applied to student income	**$ 252,126**	$ 230,562
Scholarships and other student awards paid directly to students	**110,532**	108,588
Total scholarships and other student awards	**362,658**	339,150
Student employment	**56,784**	61,233
Student loans	**32,635**	30,553
Agency financial aid*	**12,609**	12,887
TOTAL STUDENT FINANCIAL AID	**$ 464,686**	**$ 443,823**

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

Approximately 71% and 65% of total scholarships and other student awards were funded by gifts, endowment income, and sponsored support in fiscal 2008 and 2007, respectively.

14. SPONSORED SUPPORT

Total expenditures funded by U.S. government sponsors or by institutions that subcontract federally sponsored projects to the University were $535.0 million and $514.8 million in fiscal 2008 and 2007, respectively. The University's principal source of federal sponsored funds is the Department of Health and Human Services. The University also has many non-federal sources of sponsored awards and grants, including corporations, foundations, state and local governments, foreign governments, and research institutes.

Sponsored grants and contracts normally provide for the recovery of direct and indirect costs. The University recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related indirect costs is generally recorded at fixed or predetermined rates negotiated with the federal government and other sponsors. Predetermined federal indirect cost rates have been established for the University Area, the Medical School (including the School of Dental Medicine), and the School of Public Health through fiscal 2010. Funds received for federally sponsored activity are subject to audit.

15. GIFTS

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

Gifts received for the years ended June 30, 2008 and 2007 are summarized as follows (in thousands of dollars):

	2008	2007
Gifts for current use	**$ 236,599**	$ 213,994
Non-federal sponsored grants	**84,044**	82,656
Gifts for capital:		
Endowment funds	**336,059**	277,626
Split interest agreements*	**28,489**	35,174
Loan funds and facilities	**4,865**	5,596
Total gifts for capital	**369,413**	318,396
TOTAL GIFTS	**$ 690,056**	**$ 615,046**

* *Shown at net present value. The undiscounted value of these gifts was $65,771 and $89,928 for the years ended June 30, 2008 and 2007, respectively.*

16. OTHER OPERATING INCOME

The major components of other operating income for the years ended June 30, 2008 and 2007 were as follows (in thousands of dollars):

	2008	2007
Rental and parking	**$ 134,141**	$ 133,977
Publications	**85,150**	86,909
Royalties from patents, copyrights, and trademarks	**84,514**	64,490
Services income	**48,345**	48,188
Sales income	**46,634**	42,148
Non-student health and clinic fees	**24,370**	24,340
Other student income	**25,113**	22,170
Other	**62,620**	66,351
TOTAL OTHER OPERATING INCOME	**$ 510,887**	**$ 488,573**

17. OTHER EXPENSES

The major components of other expenses for the years ended June 30, 2008 and 2007 were as follows (in thousands of dollars):

	2008	2007
Services purchased	**$ 414,138**	$ 344,734
Subcontract expenses under sponsored projects	**110,019**	90,304
Travel	**78,413**	66,604
Publishing	**52,961**	62,374
Advertising	**16,610**	16,288
Taxes and fees	**24,312**	22,579
Interest	**13,326**	21,390
Postage	**22,976**	23,039
Insurance	**10,482**	13,554
Telephone	**12,017**	11,380
Other	**45,656**	8,622
TOTAL OTHER EXPENSES	**$ 800,910**	**$ 680,868**

18. FUNCTIONAL CLASSIFICATION OF EXPENSES

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

Expenses by functional classification for the years ended June 30, 2008 and 2007 were as follows (in thousands of dollars):

	2008	2007
Instruction	**$ 946,944**	$ 883,010
Research	**570,162**	559,314
Libraries	**212,334**	197,939
Academic support	**456,779**	349,504
Scholarships and other student awards	**110,532**	108,588
Student services	**125,025**	111,976
Institutional support	**625,176**	562,255
Auxiliary services	**417,941**	398,064
TOTAL EXPENSES	**$ 3,464,893**	**$ 3,170,650**

19. COMMITMENTS AND CONTINGENCIES

Sponsored support

The University receives funding from government agencies and private entities for research and other sponsored activities conducted under grants and contracts. These grants and contracts provide for reimbursement of direct and indirect costs. The costs recovered by the University in support of sponsored programs are subject to audit and adjustment.

Broad Institute

The University together with the Harvard-affiliated teaching hospitals, the Massachusetts Institute of Technology (MIT), and the Whitehead Institute for Biomedical Research jointly govern the Eli and Edythe L. Broad Institute (the "Broad Institute").

In connection with the founding of the Broad Institute, the University and MIT agreed to strive to jointly raise $20.0 million per year in gifts and non-federal grants and awards to support the Broad Institute's endeavors. In the event this fundraising goal is not reached, the University has agreed to provide MIT with a portion of the shortfall, subject to certain conditions. The University will make payments and record the corresponding expenses as these conditions are met. The University's obligation for such payments will not exceed $32.5 million over the initial five-year term, or $60.0 million in total if the term is extended for a second five years. The University had a commitment of $6.5 million as of June 30, 2008 and 2007, which is recorded in "Accounts payable" in the *Balance Sheets*.

The University and MIT will equally share certain laboratory construction fit-out costs for the Broad Institute's building. The University's portion of these costs is limited to $8.0 million. There were no payments to MIT under this commitment during fiscal 2008; fiscal 2007 payments totaled $1.2 million. If the University's participation in the collaboration terminates under certain circumstances, the University may also be obligated to pay MIT up to $5.0 million to compensate MIT for expenses incurred in connection with the lease for the building. In addition, the University expects to share with MIT in ongoing facilities improvement costs of approximately $4.0 million per year for up to ten years. Payments to MIT under this commitment totaled $0.7 million and $1.1 million in fiscal 2008 and 2007, respectively. Some of the University's contributions to the fit-out and ongoing capital costs have been and will continue to be reimbursed in the future through indirect cost recoveries associated with the Broad Institute's grant funding.

On September 4, 2008, the Broad Institute announced a $400.0 million pledge from philanthropists Eli and Edythe Broad to endow the Broad Institute and transform it into a permanent entity. In connection with this gift, the University, MIT, and the Broad Foundation have agreed to separately incorporate the Broad Institute and begin transferring employees, research agreements, and related assets and liabilities to the new entity. While separate incorporation of the new entity is expected to occur in fiscal 2009, the date of transfer of employees, research agreements, assets, and liabilities has not yet been established, nor have the University's continuing commitments to the new entity been determined.

Lease commitments

The University is the lessee of equipment and space under operating (rental) and capital leases. Rent expense related to leases was $39.9 million and $37.4 million in fiscal 2008 and 2007, respectively. Future minimum payments under these operating and capital leases are as follows (in thousands of dollars):

	Operating	Capital
2009	$ 28,483	$ 362
2010	25,508	362
2011	22,744	1,129
2012	18,845	329
2013	13,057	329
Thereafter	244,529	11,450
TOTAL FUTURE MINIMUM PAYMENTS	**$ 353,166**	**$ 13,961**

Fixed asset-related commitments

The University has various commitments for capital projects involving construction and renovation of certain facilities, real estate acquisitions, and equipment purchases, for which the outstanding commitments as of June 30, 2008 totaled approximately $470.1 million.

Environmental remediation

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

General

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

PHOTOGRAPHY:
front cover (top to bottom): **Undergraduate cellist: © Paula Lerner; Harvard College Pan-African Dance and Music Ensemble at President Drew Gilpin Faust's inauguration: Tony Rinaldo; Memorial Church spire: Kris Snibbe, Harvard University News Office; undergraduate student at a bioengineering lab: © Paula Lerner**
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