Tufts University

Consolidated Financial Statements for the Years Ended June 30, 2004 and 2003 and Independent Auditors' Report

TUFTS UNIVERSITY

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of Tufts University:

We have audited the accompanying consolidated statements of financial position of Tufts University (the "University") as of June 30, 2004 and 2003, and the consolidated statement of activities and changes in net assets for the year ended June 30, 2004, with comparative totals for the year ended June 30, 2003, and the consolidated statements of cash flows for the years ended June 30, 2004 and 2003. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. The prior year's summarized comparative information has been derived from the University's June 30, 2003 financial statements; and in our report dated August 29, 2003, we expressed an unqualified opinion on those financial statements.

We conducted our audits 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University as of June 30, 2004 and 2003, the results of its operations for the year ended June 30, 2004, and its cash flows for the years ended June 30, 2004 and 2003 in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

September 9, 2004

TUFTS UNIVERSITY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2004 AND 2003
(In thousands)

ASSETS	2004	2003
Cash and cash equivalents	$ 37,117	$ 67,684
Receivables—net and other assets (Note 3)	23,652	23,014
Contributions receivable—net (Note 4)	39,501	38,013
Note and student loans receivables—net (Notes 5 and 12)	37,259	39,635
Funds held under bond agreements (Note 8)	3,588	3,636
Investments—at market value (Note 6)	1,023,276	907,167
Land, buildings and equipment—net (Note 7)	435,566	417,638
TOTAL ASSETS	$ 1,599,959	$ 1,496,787
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	$ 90,919	$ 87,246
Deferred revenue and deposits	41,288	39,416
Government advances for student loans	24,197	24,002
Bonds and notes payable (Note 8)	228,602	236,422
Interest rate agreement (Note 8)	2,880	
Total liabilities	387,886	387,086
NET ASSETS (Note 9):		
Unrestricted	673,243	613,504
Temporarily restricted	262,108	230,289
Permanently restricted	276,722	265,908
Total net assets	1,212,073	1,109,701
TOTAL LIABILITIES AND NET ASSETS	$ 1,599,959	$ 1,496,787

See notes to consolidated financial statements.

TUFTS UNIVERSITY

CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2004 WITH COMPARATIVE TOTALS FOR 2003
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2004	Total 2003
OPERATIONS—Revenue:					
Tuition and fees	$ 255,576	$ -	$ -	$ 255,576	$ 242,427
Less scholarships and fellowships	(59,509)			(59,509)	(54,091)
Tuition and fees, net	196,067			196,067	188,336
Government grants and contracts	110,018			110,018	97,281
Clinical and other educational activities	63,477			63,477	59,222
Auxiliary enterprises	38,778			38,778	37,533
Contributions and grants	42,609			42,609	39,814
Investment return utilized (Note 6)	44,423			44,423	43,302
Net assets released from restrictions due to investment return utilized	2,026	(2,026)		-	-
Total revenue	497,398	(2,026)	-	495,372	465,488
EXPENSES (Note 10):					
Instruction	142,209			142,209	132,127
Sponsored programs	105,719			105,719	97,474
Clinical and other educational activities	75,311			75,311	72,165
Academic and student services	65,583			65,583	61,391
Auxiliary enterprises	37,025			37,025	35,107
Institutional support	51,690			51,690	49,982
Total expenses	477,537			477,537	448,246
INCREASE (DECREASE) IN NET ASSETS FROM OPERATING ACTIVITIES	19,861	(2,026)		17,835	17,242
NONOPERATING ACTIVITIES:					
Investment return reinvested (Note 6)	38,770	32,850	2,616	74,236	12,583
Contributions and grants		3,313	8,198	11,511	47,428
Net assets released from restrictions for capital and other nonoperating purposes	2,318	(2,318)		-	-
Change in fair value of interest rate agreements (Note 8)	(2,880)			(2,880)	-
Other nonoperating activities	1,670			1,670	2,975
Increase in net assets from nonoperating activities	39,878	33,845	10,814	84,537	62,986
INCREASE IN NET ASSETS	59,739	31,819	10,814	102,372	80,228
NET ASSETS—Beginning	613,504	230,289	265,908	1,109,701	1,029,473
NET ASSETS—Ending	$ 673,243	$ 262,108	$ 276,722	$ 1,212,073	$ 1,109,701

See notes to consolidated financial statements.

TUFTS UNIVERSITY

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003
(In thousands)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Total increase in net assets	$ 102,372	$ 80,228
Adjustments to reconcile total increase in net assets to net cash provided by operating activities:		
Net realized and unrealized investment gains	(90,549)	(17,890)
Depreciation and amortization	27,550	27,202
Loss on disposal of fixed assets	1,231	1,308
Gifts of property and equipment	(77)	(1,338)
Decline in value of interest rate agreement	2,880	
Contributions and investment income restricted for long-term investment	(17,842)	(54,172)
Changes in operating assets and liabilities:		
Receivables and other assets—net	(638)	(997)
Contributions receivable—net	(1,488)	(6,130)
Note receivable	299	280
Accounts payable and accrued expense	3,673	3,382
Deferred revenue and deposits	1,872	7,607
Net cash provided by operating activities	29,283	39,480
CASH FLOWS FROM INVESTING ACTIVITIES:		
Student loans granted	(5,082)	(5,216)
Student loans repaid—net of reserve	7,160	6,757
Purchases of investments	(575,377)	(836,108)
Proceeds from sale of investments	549,817	815,319
Changes in funds held under bond agreements	48	47,620
Additions to land, buildings and equipment	(46,733)	(48,093)
Net cash used by investing activities	(70,167)	(19,721)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in government advances for student loans	195	942
Proceeds from issuance of bonds and notes	273	393
Repayments of bonds and notes	(7,993)	(40,207)
Proceeds from contributions and investment income restricted for long-term investment	17,842	54,172
Net cash provided by financing activities	10,317	15,300
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(30,567)	35,059
CASH AND CASH EQUIVALENTS—Beginning of year	67,684	32,625
CASH AND CASH EQUIVALENTS—End of year	$ 37,117	$ 67,684
SUPPLEMENTAL DATA— Cash paid for interest	$ 10,587	$ 11,488

See notes to consolidated financial statements.

1. ORGANIZATION

Tufts University (the "University"), founded in 1852, is a not-for-profit institution committed to education and research. The University is a complex independent nonsectarian university, with approximately 8,900 students and three campuses in Boston, Medford/Somerville and Grafton, Massachusetts. The University provides degree programs at both undergraduate and graduate levels in a variety of liberal arts and professional areas. The University has been granted a tax-exemption as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and is generally exempt from income taxes pursuant to Section 501(a) of the Code.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The accompanying consolidated financial statements have been prepared on the accrual basis with net assets and revenues, expenses, gains and losses classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the University are classified and reported as follows:

Permanently restricted—Net assets subject to donor-imposed stipulations that they be maintained in perpetuity by the University. Such net assets consist primarily of donor-restricted endowment funds.

Temporarily restricted—Net assets subject to donor-imposed stipulations that may be satisfied by actions of the University that expire with the passage of time or the occurrence of specific events.

Unrestricted—Net assets not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by the Board of Trustees.

Consolidation—The consolidated financial statements include the accounts of the University and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated.

Classifications—Expenses are reported as decreases in unrestricted net assets. 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. Contributions and investment return for operating activities subject to donor-imposed stipulations that are met in the same period are reported as unrestricted revenue. Investment return subject to donor-imposed stipulations not utilized in the current period are released from temporarily restricted net assets when spent and shown as investment return utilized. Expirations of all other temporarily restricted net assets are reported as reclassifications between the applicable classes of net assets.

Contributions—Contributions, including unconditional promises to give, are recognized as revenue in the period received. Contributions restricted for the acquisition of land, buildings and equipment are reported as increases in temporarily restricted net assets. These contributions are reclassified to unrestricted net assets as the funds are expended. Promises to give subject to donor-imposed stipulations that the corpus be maintained in perpetuity are recognized as increases in permanently restricted net assets.

Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are reported at their estimated fair value at the date of gift. Contributions scheduled to be received after one year are discounted at a rate commensurate with the risk involved. Amortization of the discount is recorded as additional contributions in the appropriate net asset class.

Investments—Investments are reported at fair value. Dividends, interest and net gains on investments are reported as follows:

- as increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment or loan fund;

- as increases in temporarily restricted net assets if the terms of the gift or relevant state law impose restrictions on the current use of the income or net gains. The University has relied on the Massachusetts Attorney General's interpretation of relevant state law that unappropriated endowment gains should generally be classified as temporarily restricted; and

- as increases in unrestricted net assets in all other cases.

Operations and Nonoperating Activities—The statement of activities and changes in net assets reports changes in unrestricted, temporarily restricted and permanently restricted net assets from operations and nonoperating activities. Operations does not include the release from restrictions of contributions restricted to the acquisition of land, buildings and equipment; investment return in excess of the University's operating needs as defined by its spending policy; unrealized gain or loss on interest rate agreements; or unrestricted bequests and gifts of property.

The University's spending policy on investments in the Total Return Pool provides for an annual increase of 5% over the previous years spending amount, adjusted for additions and withdrawals. The policy also provides for adjustments should the rate of spending not remain within a range of 3.5% to 4.5% of the investment market value as determined as of December 31 of the previous year. The University has established rates of spending ranging between 6% and 7.5% on investments in various hedge funds outside of the total return pool. The spending rate on all other investments represents the yield earned.

Tuition revenue is reported net of the discount attributable to reductions in amounts charged to students, whether as unrestricted University financial aid, distributions from endowment funds or government aid awarded to students by the University.

Revenue associated with research and other grants and contracts is recognized when related expenses are incurred. Indirect cost recovery by the University is recorded as unrestricted revenue of $27,661,000 in 2004 and $25,756,000 in 2003.

Interest, depreciation and operations and maintenance expenses have been allocated to functional expense classifications based on square footage utilized.

Cash and Cash Equivalents—For purposes of the statements of cash flows, short-term investments with maturities at the dates of purchase of three months or less are classified as cash and cash equivalents.

Financial Instruments—The University has estimated, where practicable, the fair values of its financial instruments by using appropriate valuation methodologies. Except where otherwise noted, the University determined that the differences between the carrying values and the estimated fair values of its other financial assets and liabilities are not material.

Land, Buildings and Equipment—Land, buildings and equipment are stated at cost at date of purchase or fair value at date of donation in the case of gifts. Depreciation is provided using the straight-line method over the assets' estimated useful lives, which range from 20 years for land improvements, 5 to 50 years for buildings and 3 to 25 years for equipment and furnishings.

Perpetual Trusts, Life Income and Annuity Agreements—The University has an interest in various perpetual trusts, irrevocable charitable remainder trusts, life income and annuity agreements. Assets held in these trusts and agreements, which are administered by the University or third-party trustees, are included in investments, and totaled approximately $60,300,000 and $51,100,000 for 2004 and 2003, respectively. Contributions are recognized at the date the trusts or annuity agreements are established. Liabilities associated with life income and annuity agreements are recorded at the present value of the estimated future payments to be made to the donors and/or other beneficiaries by the University. The liabilities associated with life income and annuity agreements are adjusted during the term of the life income agreement or annuity for changes in the value of the assets, accretion of the discount and other changes in the estimates of future payments. The liabilities are included in accounts payable and accrued expenses and totaled approximately $9,700,000 and $8,400,000 for 2004 and 2003, respectively.

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

2003 Presentation—Certain 2003 amounts have been reclassified to conform with the 2004 presentation.

3. RECEIVABLES AND OTHER ASSETS

Receivables represent amounts due from students, grants and contracts, clinic billings and other sources. Other assets include deferred charges, prepaid expenses and inventories. The components at June 30 are as follows (in thousands):

	2004	2003
Gross receivables	$ 19,107	$ 21,408
Less allowance for uncollectible amounts	(2,452)	(2,652)
Receivables—net	16,655	18,756
Other assets	6,997	4,258
Total	$ 23,652	$ 23,014

4. CONTRIBUTIONS RECEIVABLE

Contributions receivable consisted of the following at June 30 (in thousands):

	2004	2003
Unconditional promises scheduled to be collected in:		
Less than one year	$ 23,858	$ 23,708
One year to five years	18,500	16,956
More than five years	3,993	3,807
Less allowance for uncollectible amounts	(4,471)	(4,132)
Less discount to present value	(2,379)	(2,326)
Total	$ 39,501	$ 38,013

Contributions receivable were intended for the following purposes at June 30 (in thousands):

	2004	2003
Endowment for educational and general purposes	$ 16,788	$ 19,038
Construction and modernization of plant	15,194	15,104
Support of current operations	7,519	3,871
Total	$ 39,501	$ 38,013

5. NOTE AND STUDENT LOANS RECEIVABLES

Note and student loans receivables consisted of the following components at June 30 (in thousands):

	2004	2003
Student loans receivable	$ 37,853	$ 40,055
Less allowance for uncollectible amounts	(1,989)	(2,114)
Student receivables—net	35,864	37,941
TNEMC note receivable (Note 12)	1,395	1,694
Total	$ 37,259	$ 39,635

6. INVESTMENTS

Investments included commingled assets from the various net asset classes and consisted of the following market values at June 30 (in thousands):

	2004	2003
Cash and cash equivalents	$ 35,443	$ 21,873
Equity securities	342,271	304,635
Fixed income securities	217,285	249,023
Hedge funds	411,634	316,209
Private equities	16,622	15,869
Receivable for unsettled trades	21	6,312
Payable for unsettled trades		(6,754)
Total	$1,023,276	$907,167

Fair values for equity securities and fixed income securities are generally based on published market values. At June 30, 2004 and 2003, approximately $21,200,000 and $18,300,000 of equity securities are not readily marketable and are valued at management's estimate of fair value, and $3,600,000 and $5,600,000 are stated at cost. The University invests in hedge funds and private equity investments through various limited partnerships and similar vehicles. Hedge funds utilize a variety of investment strategies incorporating marketable securities and, in some cases, derivative instruments, all of which are reported at estimated fair value by the fund managers. Private equity investments consist of long-term private investment securities and have been valued based on estimates reported by fund managers. Such estimates may differ significantly from values that would have been used had a ready market for the investments existed. The University is obligated under certain limited partnership investment fund agreements to advance additional funding periodically up to specified levels. At June 30, 2004, the University had unfunded commitments of approximately $25,700,000, which are likely to be called through 2010.

The total return on investments held by the endowment and other funds for the years ended June 30 (in thousands) is as follows:

	2004			2003		
	Endowment	**Other**	**Total**	**Endowment**	**Other**	**Total**
Dividends and interest	$ 14,393	$ 13,717	$ 28,110	$ 26,331	$ 13,835	$ 40,166
Net realized and unrealized gains (losses)	91,551	(1,002)	90,549	11,604	6,286	17,890
Total return on investments	105,944	12,715	118,659	37,935	20,121	58,056
Investment return utilized	(31,603)	(12,820)	(44,423)	(31,944)	(13,529)	(45,473)
Investment return reinvested	$ 74,341	$ (105)	$ 74,236	$ 5,991	$ 6,592	$ 12,583

Endowment and other funds are described in Note 9.

7. LAND, BUILDINGS AND EQUIPMENT

Land, buildings and equipment consisted of the following at June 30 (in thousands):

	2004	2003
Land and land improvements	$ 28,237	$ 27,178
Buildings	553,667	515,850
Construction-in-progress	29,861	34,676
Equipment and furnishings	130,105	121,756
	741,870	699,460
Less accumulated depreciation	(306,304)	(281,822)
Total	$ 435,566	$ 417,638

Depreciation expense charged to operations was $27,651,000 and $27,303,000 in 2004 and 2003, respectively. Net interest cost capitalized in fiscal 2004 and 2003 was $223,000 and $1,488,000, respectively.

Equipment and furnishings includes $667,000 and $393,000 in assets recorded under capital leases in 2004 and 2003, respectively. In 2004, depreciation expense and accumulated depreciation on assets acquired under capital leases amounted to $89,000. In 2003, there was no depreciation expense due to the timing of entering into the capital lease.

8. BONDS AND NOTES PAYABLE

Bonds and notes payable consisted of the following at June 30 (in thousands):

	2004	2003
Massachusetts Industrial Finance Agency ("MIFA")—Series H, fixed rate bonds at 4.75%-5.50%, due through 2028	$ 93,600	$ 95,980
Massachusetts Health and Educational Facilities Authority ("MHEFA"):		
Series G, variable rate bonds, 1.30% average rate for 2004, due 2024-2026	35,400	40,100
Series I, fixed rate bonds at 5.25%-5.50%, due 2029-2036	50,000	50,000
Series J, fixed rate bonds at 3.50%-5.50%, due 2003-2018	33,070	33,280
United States Department of Education ("DOE"):		
Fixed rate bonds, 3.00%-3.625%, due through 2018	3,929	4,274
Fixed rate bonds, 3.00%, due through 2021	2,195	2,309
Secured note, 5.50%, due through 2020	1,415	1,466
Citizens Bank—Note:		
Rate fixed at 6.135% until 2005; rate at 7-year Eurodollar rate plus 1.00% from 2005 to maturity in 2006	7,500	7,500
Capital Leases—various imputed interest rates up to 4.63%, due through 2007	437	356
	227,546	235,265
Net unamortized bond premium	1,056	1,157
Total bonds and notes payable	$ 228,602	$ 236,422

The DOE fixed rate bonds are collateralized by certain dormitories and other buildings. The DOE secured note is collateralized with amounts included in funds held under bond agreements.

Scheduled aggregate principal repayments on bonds and notes payable are as follows (in thousands):

Fiscal Year	
2005	$ 5,886
2006	3,631
2007	11,326
2008	3,828
2009	4,166
Thereafter	198,709
Total	$ 227,546

A refunding trust was established in 1989 to retire Series A bonds. Trust funds will be applied to outstanding principal and interest through 2008. Because the refunded bonds are no longer deemed to be outstanding for financial reporting purposes, neither the debt nor the irrevocable trust assets are included in the consolidated statements of financial position.

The University's debt is stated at cost. The fair value has been calculated by determining the net present value of future cash outlays using an appropriate interest rate based on the length of time to maturity. The rates were based upon market conditions as of June 30, 2004 and 2003. The estimated fair value at June 30, 2004 and 2003 is $230,822,000 and $253,321,000, respectively.

In May 2004, the University entered into Interest Rate Agreements ("Hedge Agreements") with a financial institution that become effective on August 5, 2004 and January 15, 2006, in anticipation of issuing tax-exempt revenue bonds on those dates. The first tranche of bonds totaling $54,000,000 were issued on August 5, 2004. Payments on the Hedge Agreements do not accrue until the issue date of the anticipated bonds. Under the Hedge Agreements the University will pay a fixed rate of interest of 4.069% on $54 million of Notional Amount commencing August 5, 2004 and 4.292% on $34 million of Notional Amount commencing January 15, 2006. The Notional Amounts of the Hedge Agreements reduce in the same amounts and on the same dates as the principal payments come due on the anticipated bonds. The Hedge Agreements have been entered into to reduce the University's risk of interest rate change with respect to the anticipated bonds. The Hedge Agreements are recorded at fair value, and any gain or loss resulting from a change in the fair value is included in the statement of activities and changes in net assets as a component of nonoperating activities.

9. NET ASSETS

Net assets consisted of the following at June 30 (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	2004 Total	2003 Total
Endowment	$310,822	$207,164	$260,929	$ 778,915	$ 697,241
Invested in physical plant	206,749			206,749	187,139
Donor restricted		21,951		21,951	20,948
Operating	113,828			113,828	118,103
Building projects	25,471	32,993		58,464	55,386
Student loans	16,373		15,793	32,166	30,884
Total	$673,243	$262,108	$276,722	$1,212,073	$1,109,701

Endowment consists of resources that have been restricted by the donor, trust, split-interest agreement, or designated by the Board of Trustees for investment to provide future resources to support the University's activities. Temporarily restricted endowment consists of unapproriated gains of approximately $181 million and $157 million in 2004 and 2003, respectively. Unrestricted operating includes funds that have been designated for use by various schools, departments and programs throughout the University.

10. NATURAL CLASSIFICATION OF EXPENSES

The University reports operating expenses in its consolidated statement of activities and changes in net assets by functional category. Operating expenses by natural category consisted of the following for the years ended June 30 (in thousands):

	2004	2003
Compensation:		
Staff, student and other	$ 158,874	$ 147,318
Faculty	78,474	73,123
Benefits	51,881	46,928
Total compensation	289,229	267,369
Materials, supplies and other	80,416	80,364
Purchased services	33,134	30,321
Depreciation and loss on disposals	28,882	28,610
Maintenance and facilities costs	25,781	23,090
Interest	10,180	9,327
Travel	9,915	9,165
Total expense	$ 477,537	$ 448,246

11. BENEFIT PLANS

Defined Contribution Plan—The University sponsors a defined contribution retirement plan under Section 401(a) of the Code, which is available to eligible faculty and administrative staff. All retirement benefits are funded by the University and are subject to a vesting schedule. The University's contributions to the plan amounted to approximately $16,482,000 and $15,497,000 in 2004 and 2003, respectively.

Deferred Compensation Plans—The University maintains two separate plans under Section 457(b) of the Code for eligible officers, faculty and administrative staff. The University funded the Officers' Plan with approximately $47,000 and $56,000 in 2004 and 2003, respectively. Under the terms of the Faculty and Administrative Staff Plan, no contributions are made by the University but are fully funded by voluntary employee contributions. The assets and related liabilities of these plans are recorded in the consolidated financial statements and total approximately $970,000 and $504,000 in 2004 and 2003, respectively. The University also maintains a plan under Section 457(b) of the Code for eligible faculty and administrative staff that was closed to future participants in 1989. The University funded this plan with approximately $13,000 in both 2004 and 2003. The investment assets and related liabilities of these plans, which total approximately $9,921,000 and $9,385,000 in 2004 and 2003, respectively, are recorded in the consolidated financial statements.

Supplemental Retirement Plan—The University offers a supplemental retirement plan under Section 403(b) of the Code, which is fully funded by voluntary employee contributions.

Health and Welfare Benefit Plan—The University provides postretirement healthcare benefits to eligible retired employees and their eligible spouses. Retirees share in the cost of their healthcare benefits through co-payments and deductibles related to years of service and date of retirement. Employees who were hired after December 31, 1993 must pay for the entire cost of their benefit when they retire. The University has established a trust to fund the postretirement healthcare benefits for most of the eligible employees. The trust qualifies as a "voluntary employees' beneficiary association" under the provisions of Section 501(c)(9) of the Code in order that the trust be exempt from certain taxes. The University funded the trust with $2,283,000 and $2,833,000 in 2004 and 2003, respectively.

Following is the change in the University's postretirement healthcare benefit obligation for the years ended June 30 (in thousands):

	2004	2003
Benefit obligation—beginning of year	$ 42,398	$ 29,833
Service cost	475	654
Interest cost	2,269	2,630
Benefits paid	(2,652)	(2,190)
Participants' contributions	572	404
Actuarial (gain) loss	(4,539)	11,067
Amendments	(4,053)	
Benefit obligation—end of year	$ 34,470	$ 42,398

The funded status of the University's postretirement healthcare plan and the amounts recognized in the consolidated statements of financial position at June 30 were as follows (in thousands):

	2004	2003
Fair value of plan assets—beginning of year	$ 22,493	$ 20,918
Actual return on plan assets	4,779	528
Employer contributions	2,283	2,833
Plan participant contributions	572	404
Benefits paid	(2,652)	(2,190)
Fair value of plan assets—end of year	$ 27,475	$ 22,493
Funded status	$ (6,995)	$ (19,905)
Unrecognized transition obligation	7,341	12,580
Unrecognized actuarial (gain) loss	(396)	7,104
Accrued liability recognized	$ (50)	$ (221)

The 2004 and 2003 postretirement healthcare benefit expense included the following components (in thousands):

	2004	2003
Interest cost	$ 2,269	$ 2,630
Service cost	475	654
Amortization of transition obligation over 20 years	1,186	1,260
Expected return on plan assets	(1,818)	(1,701)
Net periodic benefit cost	$ 2,112	$ 2,843

The 2004 and 2003 postretirement benefit obligation amounts were measured at the end of the year using a weighted-average discount rate of 6.25%. For 2004, healthcare costs were assumed to increase 11%, grading down to 5.5% in year 2009 and thereafter. For 2003, healthcare costs were assumed to increase 12%, grading down to 5.5% in year 2009 and thereafter. The healthcare cost trend rate has a significant effect on the amounts reported. A 1% increase in the healthcare cost trend would have increased the expense and the accumulated postretirement benefit obligation for 2004 by $77,000 and $1,228,000, respectively. A 1% decrease in the healthcare cost trend would have decreased the expense and the accumulated postretirement benefit obligation for 2004 by $69,000 and $1,103,000, respectively.

The expected return on plan assets was assumed to be 8.0% per year for 2004 and 2003.

Effective May 1, 2004, the plan was amended to eliminate pre-65 subsidy for all participants who retire after May 31, 2005. This change was recognized for a pro-rata portion of the year.

The expected future benefit payments, net of participant contributions, for the next 5 years and thereafter are as follows:

2005	$ 2,294,000
2006	2,390,000
2007	2,486,000
2008	2,545,000
2009	2,528,000
2010 through 2014	13,008,000

The estimated expected contribution for fiscal 2005 is $4,818,000.

The weighted-average investment allocation of plan assets by category is as follows:

	2004	2003	Target Allocation
Equity securities	57 %	55 %	56 %
Debt securities	25	28	26
Real estate securities	15	14	15
Other	3	3	3
Total	100 %	100 %	100 %

The Health and Welfare Benefit Plan fiduciaries set the investment policy and strategy for investment of plan assets, including selecting investment managers and setting long-term risk and return objectives. The asset allocations are broadly diversified among asset category and within each category, which lowers the expected volatility of the portfolio's return and may protect against negative market environments.

To determine the expected long-term rate of return on plan assets, the University considers the target asset allocations, as well as expected returns on assets by category.

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 was enacted which provides certain prescription drug-related benefits for retirees and subsidies for employers providing actuarial equivalent subsidies to their retirees beginning in 2006. Any measures of the obligation and net periodic postretirement benefit cost do not reflect the effects of the Act on the Plan. Specific guidance on the accounting for the federal subsidy under the Act has been issued effective for reporting periods beginning after June 15, 2004. However, specific guidance on the eligibility for and amount of any employer subsidy available under the Act has not yet been finalized by the Centers for Medicare and Medicaid Services. Although the University provides significant prescription drug benefits under its Plan, and expects that it will be eligible for subsidies under the Act, the exact effect has not yet been determined. When final guidance is available, the University may change previously reported information to reflect the subsidies and other changes due to the Act.

12. RELATED ORGANIZATIONS

Walnut Hill Properties Corporation ("Walnut Hill")—Walnut Hill is a not-for-profit corporation established by the University to own and manage certain investment and rental properties. The accounts of Walnut Hill are included in the accompanying consolidated financial statements of the University.

TUDC, Inc. ("TUDC")—TUDC is a for-profit real estate corporation created by the University to develop the Tufts International Center (the "Center") with the air rights over South Station in Boston. The Center, when completed, will include an office tower, hotel and conference facilities, retail space and a parking facility. In October 1997, TUDC entered into a development partnership agreement with Hines Interests Limited Partnership to co-develop the air rights. This arrangement was approved by the Boston Redevelopment Authority in July 1998. TUDC has a promissory note payable to the Massachusetts Bay Transportation Authority in the amount of $10,000,000, which remains the sole responsibility of TUDC. The University has no legal liability for the promissory note. As of June 30, 2004, there are no income tax liabilities due, as the corporation has not begun earning income yet. The accounts of TUDC are included in the accompanying consolidated financial statements of the University in investments and accounts payable and accrued expenses.

Tufts Veterinary Emergency Treatment Services ("Tufts VETS")—Tufts VETS is a not-for-profit corporation organized by the University to provide emergency and specialty veterinary services in a community environment. It provides post graduate training in its emergency and critical care training program and training to veterinary students on elective rotations. The accounts of Tufts VETS are included in the accompanying consolidated financial statements of the University.

Tufts Media LLC ("Tufts Media")—Tufts Media is a single member limited liability company created by the University to operate its consumer publishing and media capability. The accounts of Tufts Media are included in the accompanying consolidated financial statements of the University.

Tufts Biotechnology Corporation ("TBC")—TBC is a for-profit development corporation created by the University to develop 106 acres designated for commercial use on the veterinary school campus. At this time, there is no development agreement. The accounts of TBC are included in the accompanying consolidated financial statements of the University.

New England Veterinary Conference LLC ("NEVC")—NEVC is a single member limited liability company created by the University to operate The Northeast Veterinary Conference. The conference is a collaborative effort of organized veterinary medicine and the major teaching hospitals of the Northeast and Tufts University School of Veterinary Medicine which provides continuing medical education for veterinarians and technicians and is hosted by Tufts University School of Veterinary Medicine and the Rhode Island Veterinary Medical Association. The accounts of NEVC are included in the accompanying consolidated financial statements of the University.

Tufts-New England Medical Center, Inc. ("T-NEMC")—The University and New England Medical Center Hospitals, Inc. (the "Medical Center") jointly formed T-NEMC, a service corporation. T-NEMC provides parking, laboratory animal housing, and educational media services to the University and the Medical Center. The costs of these services to the University for the years ended June 30, 2004 and 2003 were approximately $6,265,000 and $4,676,000, respectively. The administrative board of T-NEMC includes equal representation from the University and the Medical Center. The University holds a mortgage note receivable that bears interest at rates varying from 5.9% to 7%, with principal and interest payable semiannually. The balance of the note at June 30, 2004 and 2003 was $1,395,000 and $1,694,000, respectively, and is included in note and student loans receivables in the consolidated statements of financial position. The accounts of T-NEMC are not included in the accompanying consolidated financial statements of the University.

The assets of any of the organizations included in the consolidated financial statements may not be available to meet the obligations of the other entities.

13. CONTINGENCIES AND COMMITMENTS

There are currently several cases pending involving labor relations and other matters related to the normal operation of the University. The University believes that the outcome of these cases will have no significant effect on the financial position or results of operations of the University.

Operating Leases—The University has several noncancelable operating lease commitments at June 30, 2004 with terms in excess of one year for equipment and office space. Expenses associated with operating leases totaled approximately $749,000 for the year ended June 30, 2004. Future minimum lease payments under operating leases are as follows (in thousands):

Fiscal Year	
2005	$ 894
2006	745
2007	679
2008	442
2009	196
Total	$ 2,956

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