California Institute of Technology

Report on Audited Financial Statements
For the Years Ended September 30, 2005 and 2004

California Institute of Technology
Index to the Report on Audited Financial Statements
For the Years Ended September 30, 2005 and 2004

	Pages
Report of Independent Auditors	1
Balance Sheets	2
Statements of Activities	3
Statements of Cash Flows	4
Notes to Financial Statements	5

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
350 South Grand Avenue
Los Angeles CA 90071
Telephone (213) 356 6000
Facsimile (813) 637 4444

Report of Independent Auditors

To the Board of Trustees of the
California Institute of Technology

In our opinion, the accompanying balance sheets and the related statements of activities and cash flows present fairly, in all material respects, the financial position of the California Institute of Technology (the "Institute") at September 30, 2005 and 2004 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Institute's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

January 13, 2006

California Institute of Technology
Balance Sheets
At September 30, 2005 and 2004
(Dollars in Thousands)

	2005	2004
ASSETS		
Cash and cash equivalents	$ 10,260	$ 6,122
Advances on grants and contracts	2,854	2,935
Security deposits	234,767	244,665
Accounts and notes receivable, net of allowance for doubtful accounts of $1,277 and $6,170 respectively:		
United States government	156,396	145,411
Other	17,605	18,884
Contributions receivable, net (Note C)	195,106	233,780
Investments, including securities pledged or on loan of $230,164 and $239,868 respectively (Note D)	1,780,900	1,540,028
Prepaid expenses and other assets	64,863	69,611
Deferred United States government billings (Note E)	276,072	249,194
Property, plant, and equipment, net (Note F)	681,786	651,985
Total assets	$ 3,420,609	$ 3,162,615
LIABILITIES and NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	$ 294,643	$ 256,941
Security deposits	234,767	244,665
Deferred revenue and refundable advances	26,730	29,140
Annuities, trust agreements and agency funds	91,324	72,549
Bonds and notes payable (Note G)	242,906	239,688
Accumulated postretirement benefit obligation (Note J)	299,478	271,910
Total liabilities	1,189,848	1,114,893
Commitments and contingencies (Note K)		
Net assets (Note H):		
Unrestricted	1,350,358	1,172,765
Temporarily restricted	301,630	315,814
Permanently restricted	578,773	559,143
Total net assets	2,230,761	2,047,722
Total liabilities and net assets	$ 3,420,609	$ 3,162,615

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

California Institute of Technology
Statements of Activities
For the Years Ended September 30, 2005 and 2004
(Dollars in Thousands)

	2005	2004
Changes in unrestricted net assets:		
Revenues:		
Tuition and fees, net of student financial aid of $33,943 and $32,795, respectively	$ 19,393	$ 17,549
Investment return	214,115	166,958
Gifts	27,383	21,342
Grants and contracts:		
Jet Propulsion Laboratory - direct	1,638,455	1,585,669
Other United States government - direct	164,641	157,145
Non-United States government - direct	10,491	9,397
Indirect cost recovery and management allowance	100,899	97,437
Auxiliary enterprises	34,546	32,881
Other	15,297	16,305
Net assets released from restrictions	87,545	29,783
Total revenues and net assets released from restrictions	2,312,765	2,134,466
Expenses:		
Instruction and academic support	211,286	200,735
Organized research:		
Jet Propulsion Laboratory	1,638,455	1,585,669
Other Institute research	185,170	189,241
Institutional support	64,135	75,920
Auxiliary enterprises	35,342	33,585
Total expenses	2,134,388	2,085,150
Excess of revenues over expenses	178,377	49,316
Other changes in net assets:		
Increase in minimum pension liability	(1,110)	-
Redesignations of net assets	326	1,571
Increase in unrestricted net assets	$ 177,593	$ 50,887
Changes in temporarily restricted net assets:		
Gifts	$ 75,021	$ 18,839
Investment return	1,341	2,717
Net assets released from restrictions	(87,545)	(29,783)
Redesignations of net assets	(3,001)	3,999
Decrease in temporarily restricted net assets	$ (14,184)	$ (4,228)
Changes in permanently restricted net assets:		
Gifts	$ 16,734	$ 39,000
Investment return	201	168
Other income	20	56
Redesignations of net assets	2,675	(5,570)
Increase in permanently restricted net assets	$ 19,630	$ 33,654
Increase in total net assets	$ 183,039	$ 80,313
Net assets at beginning of year	2,047,722	1,967,409
Total net assets at end of year	$ 2,230,761	$ 2,047,722

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

California Institute of Technology
Statements of Cash Flows
For the Years Ended September 30, 2005 and 2004
(Dollars in Thousands)

	2005	2004
Cash flows from operating activities:		
Increase in net assets	$ 183,039	$ 80,313
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Depreciation and amortization	40,885	39,195
Contributions restricted for long-term investment and capital projects	(27,279)	(74,678)
Investment return restricted for long-term investment and capital projects	(2,157)	(1,510)
Realized and unrealized gains on investments	(189,051)	(145,839)
Gifts of property, plant, and equipment	(209)	(47)
Gifts and other in-kind distributions of securities	(5,384)	(9,679)
Actuarial change in trust liability	3,012	1,784
Gain on sales of property, plant, and equipment	(487)	(1,435)
Changes in assets and liabilities:		
Accounts and notes receivable, net	(9,706)	8,115
Contributions receivable, net	(31,589)	61,266
Deferred United States government billings	(26,878)	(31,612)
Prepaid expenses and other assets	4,311	(7,659)
Accounts payable and accrued expenses	14,129	40,987
Deferred revenue and refundable advances	(2,410)	(325)
Agency funds	1,190	(295)
Accumulated postretirement benefit obligation	27,568	39,477
Net cash used in operating activities	(21,016)	(1,942)
Cash flows from investing activities:		
Purchases of investments	(878,688)	(957,912)
Proceeds from sale of investments	929,344	1,017,494
Purchases of property, plant, and equipment	(70,510)	(54,554)
Proceeds from sale of property, plant, and equipment	2,435	4,140
Net cash (used in) provided by investing activities	(17,419)	9,168
Cash flows from financing activities:		
Change in book overdraft position	-	(19,678)
Change in advances on grants and contracts	-	(902)
Contributions restricted for long-term investment and capital projects	39,032	22,252
Investment return restricted for long-term investment and capital projects	2,157	1,510
Cash received under split-interest agreements	6,066	12,171
Cash payments made under split-interest agreements	(7,682)	(12,210)
Net borrowings (repayments) on lines of credit	3,000	(5,000)
Net cash provided by (used in) financing activities	42,573	(1,857)
Net increase in cash and cash equivalents	4,138	5,369
Cash and cash equivalents at beginning of year	6,122	753
Cash and cash equivalents at end of year	$ 10,260	$ 6,122
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest, net of amounts capitalized	$ 6,438	$ 6,506
Securities lending	$ 234,767	$ 244,665
Securities received to satisfy pledge payments	$ 49,897	$ 689
Accrued purchases of property, plant, and equipment	$ 1,697	$ 3,147

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

A. Description of the California Institute of Technology

The California Institute of Technology (the Institute) is a private, not-for-profit institution of higher education based in Pasadena, California. Founded in 1891, the Institute provides education and training services, primarily for students at the undergraduate, graduate, and postdoctoral levels, and performs research, training, and other services under grants, contracts, and similar agreements with sponsoring organizations, primarily departments and agencies of the government of the United States of America.

B. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements include the accounts of the Institute and the Jet Propulsion Laboratory (JPL), a Federally Funded Research and Development Center managed by the Institute for the National Aeronautics and Space Administration (NASA).

The Institute manages JPL under a cost-reimbursable contract with NASA. JPL's land, buildings, and equipment are owned by the United States government and are excluded from the Institute's financial statements. Receivables and liabilities arising from JPL's operating activities are reflected in the Institute's balance sheets. The direct costs of organized research and the related reimbursement of the costs arising from JPL's activities are segregated in the statements of activities. The management allowances earned under this contract also are included as an indirect cost recovery and management allowance in the statements of activities.

The Institute (including JPL) is exempt from federal income taxes under the provisions of Internal Revenue Code Section 501(c)(3). The Institute is also generally exempt from payment of California state income, gift, estate, and inheritance taxes.

The financial statements of the Institute have been prepared on the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America and with the provisions of the American Institute of Certified Public Accountants' Audit and Accounting Guide, "Not-for-Profit Organizations," which requires the Institute to classify its net assets into three categories according to donor-imposed restrictions or provisions of law: permanently restricted, temporarily restricted, and unrestricted.

> Permanently restricted net assets include gifts, charitable remainder trusts, pooled income funds, gift annuities, other split-interest agreements, and contributions receivable in which donors have stipulated that the principal be invested in perpetuity. Generally, donors permit the unrestricted use of all or part of the investment return on these assets. Investment gains or losses, both realized and unrealized, related to permanently restricted investments are reported as unrestricted revenue unless their use is restricted by donor-imposed stipulations.
>
> Temporarily restricted net assets include gifts for which donor-imposed restrictions have not been met, including funds restricted for future capital projects, charitable remainder trusts, pooled income funds, gift annuities, other split-interest agreements, and

contributions receivable upon which the donor has placed certain restrictions. These restrictions are removed either through the passage of time or when certain actions are taken by the Institute to fulfill such restrictions. Expirations of temporary restrictions on net assets due to the fulfillment of donor-imposed restrictions and/or the passage of time are reported as releases from temporarily restricted to unrestricted net assets in the statements of activities. Donor-restricted gifts that are received and either spent, or deemed spent, within the same fiscal year are reported as unrestricted revenues.

Unrestricted net assets are those not subject to donor-imposed restrictions.

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

Redesignations
Certain amounts previously received from donors have been transferred among net asset categories due to changes in donor designations.

Cash and Cash Equivalents
Cash and cash equivalents include resources invested in money market funds and short-term investments with original maturities of three months or less, when purchased. Any such investments held by external investment managers are classified as investments in the balance sheets and are not included in cash and cash equivalents.

Under the Institute's cash management system, checks issued but not presented to banks frequently result in overdraft balances for accounting purposes and are included in accounts payable and accrued expenses in the balance sheets if an overdraft situation exists. There were no overdrafts at September 30, 2005 and 2004.

Advances on Grants and Contracts
Advances on grants and contracts include certain cash balances, totaling \$2,854 and \$2,935 at September 30, 2005 and 2004, respectively, restricted for use in connection with United States government research.

Security Deposits
Security deposits consist of collateral related to securities lending in the Institute's investment portfolio.

Investments
Investments are stated at fair value. The fair value of marketable securities and short-term investments is based on quoted market prices. When a quoted market price is not readily determinable, quoted market prices of similar financial instruments are used. The fair value of alternative investments, including limited partnerships and similar interests, is based on information provided by external investment managers at the most recent valuation date prior to year-end. The fair value of real estate and other investments is estimated by professional appraisers or Institute management. Mortgages, notes receivable, and guaranteed investment contracts are carried at cost, which approximates fair value. Purchases and sales of securities are recorded on trade dates, and realized gains and losses are determined based on the average cost of securities sold. Amounts payable for securities purchased were $19,929 and $15,716 at September 30, 2005 and 2004, respectively.

The Institute engages a number of outside parties to manage its investment portfolio. The Institute's investment strategy incorporates certain financial instruments, which involve, to varying degrees, elements of market and credit risk in excess of amounts recorded in the financial statements.

All investments of endowment and similar funds are carried in an investment pool unless special considerations or donor stipulations require that they be held separately. Pooled endowment and similar funds are invested on a total return basis to provide both income and investment appreciation. The Institute utilizes a pooled endowment spending policy that establishes allocations for current spending, consistent with an annual budget plan approved by the Board of Trustees. The spending policy allows the expenditure of a prudent amount of the total investment return that attempts to preserve the future purchasing power of endowment principal.

As a result of market declines, the fair market value of certain donor-restricted endowment funds is less than the historical cost of such funds. As the market value of the portfolio increases, this deficiency will reverse. Unrealized losses resulting from market declines totaled $13,554 and $32,645 at September 30, 2005 and 2004, respectively, are recorded in unrestricted net assets in accordance with Statement of Financial Accounting Standards 124, "Accounting for Certain Investments Held by Not-For-Profit Organizations."

The Institute participates in a securities lending program, in which it lends a portion of its investments to third party borrowers through an agreement with its custodian bank. All securities loaned are collateralized by cash and debt instruments in amounts equal to 102% of the market value of the securities loaned. The bank monitors the value and quality of collateral and credit worthiness of borrowers. Collateral received must maintain a weighted-average maturity of 90 days or less and must meet credit quality standards defined in the lending agreement. The Institute does not have the ability to pledge or sell the securities held as collateral without a borrower default. Collateral held and the Institute's obligation to repay such collateral are recorded in the balance sheets as "security deposits."

At September 30, 2005 and 2004, investments include guaranteed investment contracts valued at $14,213 and $39,896, respectively, that were purchased with unexpended proceeds from the Series 2003A California Educational Facilities Authority revenue bonds. These assets are limited to use in specific construction projects and interest payments related to CEFA bonds.

Property, Plant, and Equipment
Campus property, plant, and equipment is recorded at the cost of construction or acquisition, or at the appraised value at the date of the gift. Interest costs related to debt used for construction of assets are included in the cost of construction. Depreciation on all assets is calculated over the estimated useful life of each class of depreciable asset, which ranges from three to fifty years, and is computed using the straight-line method. Depreciation on campus buildings used in sponsored research is calculated based on the useful lives of each major building component. The Institute provides for the renewal and replacement of campus assets from various sources set aside for this purpose. Property, plant, and equipment acquired under both federal and nonfederal grants in which title does not ultimately transfer to the Institute is not recorded in the Institute's financial statements.

The Institute reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment charge is recognized when the fair value of the asset or group of assets is less than the carrying value.

Split-Interest Agreements
The Institute's split-interest agreements with donors consist primarily of charitable gift annuities and charitable remainder trusts for which the Institute serves as trustee.

For irrevocable agreements, assets contributed are included in Institute investments and stated at fair value. Contribution revenue is recognized at the date each trust is established after recording liabilities for the actuarially determined present value of the estimated future payments to be made to the beneficiaries. The actuarial liability is based on the present value of future payments discounted at the appropriate risk free rate at the inception of each agreement and the applicable actuarial mortality tables. Discount rates on all split-interest agreements range from 3.6% to 11.2%. The Annuity 2000 Mortality Table and the 1990 Group Annuity Mortality Tables were used in 2005 and 2004, respectively. The liabilities are adjusted during the terms of the trusts for changes in the fair value of the assets, accretion of discounts, and other changes in the estimates of future benefits. Actuarial liabilities totaled $67,383 and $56,379 at September 30, 2005 and 2004, respectively.

The Institute is also the trustee for certain revocable agreements. Assets contributed are included in Institute investments at fair value, and amounts equal to the value of assets are included in liabilities for annuities, trust agreements, and agency funds. Total assets and liabilities for revocable agreements were $14,985 and $8,406 at September 30, 2005 and 2004, respectively.

Beneficial Interests
The Institute is the beneficiary of charitable remainder and perpetual trusts held and administered by others. The present values of the estimated future cash flows from the trusts approximates the value of the underlying assets and is included in prepaid expenses and other assets in the balance sheets. Contribution revenues are recognized at the date the trusts are established. Distributions from perpetual trusts are recorded as contribution revenues and the carrying value of the beneficial interests is adjusted for changes in the values of the underlying assets. These assets totaled $20,351 and $20,788 at September 30, 2005 and 2004, respectively.

Revenue Recognition
The Institute's revenue recognition policies are as follows:

- *Tuition and Fees* - Student tuition and fees are recorded as revenues during the year the related academic services are rendered. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue. Tuition support from Institute sources is displayed as a tuition discount.

- *Investment Return (Loss)* – Investment transactions are recorded on the trade date. Investment income and realized and unrealized gains and losses are reported as increases or decreases to the appropriate net asset category.

- *Gifts* - Gifts from donors, including contributions receivable (unconditional promises to give), are recorded as revenues in the year received. Contributions receivable are reported at their discounted present values, and an allowance for amounts estimated to be uncollectable is provided. Gift revenue from contributions payable in securities or other investments is adjusted to reflect the year end value of securities/investments to be contributed. Donor-restricted gifts, which are received and either spent, or deemed spent, within the same year, are reported as unrestricted revenue. Gifts of long-lived assets with no donor-imposed time restrictions are reported as unrestricted revenue in the year received. Gifts restricted to the acquisition or construction of long-lived assets are reported as temporarily restricted revenue. The temporarily restricted net assets resulting from these gifts are released to unrestricted net assets when the donor-imposed restrictions are fulfilled. Gifts received for endowment investment are held in perpetuity and recorded as permanently restricted. Conditional promises to give are not recorded until the conditions have been substantially met.

- *Grants and Contracts* - Revenues from grants and contracts are reported as increases in unrestricted net assets as allowable expenditures under such agreements are incurred. Certain grants and contracts provide for the reimbursement of indirect facilities and administrative costs based on rates negotiated with the Office of Naval Research, the Institute's federal cognizant agency. Amounts received in excess of expenditures are recorded as deferred revenue.

- *Auxiliary* – Revenues from supporting services, such as dining facilities, faculty and student housing, and bookstores are recorded at time of delivery of a product or service. Amounts received in advance of delivery of products or services are recorded as deferred revenue.

Expenses

Expenses are generally reported as decreases in unrestricted net assets. The statements of activities present expenses by functional classification in accordance with the overall educational and research mission of the Institute.

Building and improvements depreciation and plant operation expenses are allocated to functional classifications based on square footage occupancy of Institute facilities. Equipment depreciation is allocated to functional classifications based on each functional area's average equipment purchases. Interest expense on external debt, net of amounts capitalized, is allocated to the functional categories that have benefited from the proceeds of such debt. Interest expense, net of capitalized interest, for the years ended September 30, 2005 and 2004 was $6,811 and $6,547, respectively, and capitalized interest was $3,143 and $2,686, respectively.

Fair Value of Financial Instruments

For those financial instruments for which it is practical, the following methods and assumptions are used to estimate fair value:

- *Cash and cash equivalents* - Cost approximates fair value.

- *Accounts and notes receivable* - Amounts receivable under contracts and grants are carried at cost, less an allowance for doubtful accounts, which approximates fair value. Student accounts and notes receivable of $11,249 and $13,691 at September 30, 2005 and 2004 are carried at cost, less an allowance for doubtful accounts. Determination of the fair value of student accounts and notes receivable could not be made without incurring excessive costs.

- *Bonds and notes payable* - The fair value of bonds payable is estimated based on quoted market prices for the bonds or similar financial instruments and was $206,739 and $202,752 at September 30, 2005 and 2004, respectively. Amounts outstanding under the revolving bank credit facilities and the money market loan programs are carried at cost, which approximates fair value.

- *Contributions receivable and beneficial interests* – Determination of the fair value of contributions receivable could not be made without incurring excessive costs. The fair value of beneficial interests approximates the market value of the underlying assets.

C. Contributions Receivable, net

Contributions receivable consist of unconditional promises to give to the Institute in the future and are recorded after discounting to the present value of the future cash flows at the appropriate risk-free rate at the date of each gift. Discount rates on all outstanding contributions at September 30, 2005 and 2004, range from 2.75% to 5.84%.

(Dollars in Thousands)

Contributions receivable consisted of the following at September 30, 2005 and 2004:

	2005	2004
Contributions receivable at beginning of year, net	$ 233,780	$ 246,831
Discount at beginning of year	13,928	16,487
Allowance for doubtful accounts at beginning of year	2,195	1,205
Contributions receivable at beginning of year, gross	249,903	264,523
New contributions received	4,903	64,175
Contribution payments received	(76,122)	(23,661)
Adjustments to fair value of securities to be contributed	29,730	(53,900)
Less: Write-offs and other adjustments	(1,693)	(1,234)
Contributions receivable at end of year, gross	206,721	249,903
Discount at end of year	(9,785)	(13,928)
Allowance for doubtful accounts at end of year	(1,830)	(2,195)
Contributions receivable at end of year, net	$ 195,106	$ 233,780

Gross contributions receivable carried the following restrictions at September 30, 2005 and 2004:

	2005	2004
Endowment for programs, activities, and scholarships	$ 26,900	$ 36,464
Building construction	49,591	64,256
Education, general and time restrictions	130,230	149,183
Total contributions receivable, gross	$ 206,721	$ 249,903

(Dollars in Thousands)

Gross contributions receivable are expected to be realized as follows at September 30, 2005 and 2004:

	2005	2004
Within one year	$ 79,372	$ 75,283
Between one year and five years	116,340	173,205
More than five years	11,009	1,415
Total contributions receivable, gross	$ 206,721	$ 249,903

During the year ended September 30, 2002, the Gordon and Betty Moore Foundation (Foundation), which shares a common board member with the Institute, informed the Institute of its intention to fund research and educational projects totaling $300,000 over ten years. At September 30, 2005 and 2004, contributions receivable included $1,993 and $2,108 respectively, related to one research project; all other project awards made to date have been recorded as conditional gifts. At September 30, 2005, $89,130 of the intention had been received in cash.

In December 2005, the Foundation and the Institute determined that the remaining amount of the original commitment should be deemed unconditional. Therefore, the Institute plans to record additional contributions receivable and temporarily restricted revenue of approximately $196,000 in the year ending September 30, 2006.

At September 30, 2005 and 2004, $119,123 and $134,084, respectively, in contributions receivable were due from a member of the Institute's Board of Trustees.

(Dollars in Thousands)

D. Investments

Investments consisted of the following at September 30, 2005 and 2004:

	2005	2004
Short-term investments	$ 171,597	$ 174,313
Government fixed income securities	166,762	102,733
Corporate fixed income securities	69,151	66,493
Domestic equity securities	363,579	368,553
International equity securities	320,158	194,596
Guaranteed investment contracts	14,213	39,896
Alternative investments:		
Absolute return strategies	245,540	183,003
Private equity	155,309	179,029
Inflation hedges	264,848	220,055
Real estate mortgages, notes, and other investments	9,743	11,357
Total investments	$ 1,780,900	$ 1,540,028

Investments were categorized as follows at September 30, 2005 and 2004:

	2005	2004
Consolidated endowment pool	$ 1,469,455	$ 1,257,737
Separately invested endowments	51,023	49,676
Subtotal endowment investments	1,520,478	1,307,413
Trusts, annuities, and other	260,422	232,615
Total investments	$ 1,780,900	$ 1,540,028

(Dollars in Thousands)

Investment return consisted of the following for the years ended September 30, 2005 and 2004:

	2005	2004
Interest and dividend income	$ 30,420	$ 27,341
Net realized gains	124,140	36,368
Net unrealized appreciation	64,911	109,471
Less: management fees	(3,814)	(3,337)
Total investment return	$ 215,657	$ 169,843

E. Deferred United States Government Billings

Deferred United States government billings consisted of the following at September 30, 2005 and 2004:

	2005	2004
Accumulated postretirement benefit obligation - JPL	$ 230,817	$ 210,579
Pension benefit asset - JPL	-	(3,044)
Pension benefit liability - JPL	359	-
Accrued vacation benefits - JPL	44,896	41,659
Total deferred United States government billings	$ 276,072	$ 249,194

The Institute's contract with NASA provides for the reimbursement of certain employee benefit costs should the Institute's contract ever be terminated. Therefore, the Institute has recorded a deferred United States government billing related to JPL's accumulated postretirement benefit obligation, which is offset by JPL's pension benefit asset or liability, as the Institute expects to recover the net of these amounts through future charges to United States government grants and contracts. The Institute has also recorded a deferred United States government billing related to JPL's accrued vacation benefits, which are also covered by similar contract provisions. Although these deferred billing amounts may not be currently funded, and therefore may need to be funded as part of future NASA budgets, the Institute believes it has the contractual right to insist that such funding be made available.

(Dollars in Thousands)

F. Property, Plant, and Equipment, net

Property, plant, and equipment consisted of the following at September 30, 2005 and 2004:

	2005	2004
Land and land improvements	$ 55,634	$ 55,149
Buildings and building improvements	513,165	483,844
Equipment	416,306	413,021
Construction in progress	100,384	80,142
Less: accumulated depreciation	(403,703)	(380,171)
Property, plant and equipment, net	$ 681,786	$ 651,985

Depreciation expense for the years ended September 30, 2005 and 2004 was $40,667 and $38,977, respectively.

G. Bonds and Notes Payable

Bonds and notes payable consisted of the following at September 30, 2005 and 2004:

	2005	2004
California Educational Facilities Authority (CEFA) revenue bonds:		
Series 2003A due October 2032, with interest at 5.0% (including premium of $441 and $458, respectively)	$ 70,441	$ 70,458
Series 1998 due October 2028, with interest at 4.25% (net of issue discount of $2,629 and $2,743, respectively)	47,936	47,822
Series 1998 due October 2027, with interest at 4.5% (net of issue discount of $2,771 and $2,892, respectively)	50,529	50,408
Series 1994 due January 2024, with a variable interest rate reset weekly (2.70% and 1.67%, respectively)	30,000	30,000
Total revenue bonds	198,906	198,688
Other bonds and notes payable:		
Bank of America revolving bank credit facility (uncollateralized) expiring September 2006, with variable interest rates (average 2.02% at 9/30/04)	-	32,000
Bank of America revolving bank credit facility (uncollateralized) expires September 2006, with variable interest rates	-	-
Bank of New York money market loan program (uncollateralized) with no expiration date, with variable interest rates	-	-
JPMorgan Chase money market loan program (uncollateralized) with no expiration date, with variable interest rates (average 3.94% and 2.00%, respectively)	44,000	9,000
Total other bonds and notes payable	44,000	41,000
Total bonds and notes payable	$ 242,906	$ 239,688

(Dollars in Thousands)

The CEFA Series 2003A and CEFA Series 1998 revenue bonds are subject to an early redemption premium if redeemed prior to October 11, 2011 and October 1, 2010, respectively.

The Bank of America lines of credit and Bank of New York money market program have individual limits of $50,000; the JPMorgan Chase money market program has an individual limit of $62,000. The Institute has an internal aggregate limit on borrowings under the two Bank of America lines of credit and the JPMorgan Chase and Bank of New York money market programs of $50,000 for borrowings to finance working capital and a separate $50,000 limit for borrowings to finance acquisitions of real estate and temporary funding for capital projects.

Scheduled principal repayments on bonds and notes payable were as follows at September 30, 2005:

Year Ending September 30	Amount
2006	$ 74,000
2007	-
2008	-
2009	-
2010	-
Thereafter	168,906
Total	$ 242,906

Under certain circumstances, the CEFA Series 1994 variable rate revenue bonds could fail to be remarketed, requiring the Institute to repurchase the outstanding bonds totaling approximately $30 million. Therefore, the bonds have been classified as repayable in the following year in the table above. However, the Institute believes a repurchase is unlikely.

(Dollars in Thousands)

H. Components of Net Assets

Temporarily restricted net assets were available for the following purposes at September 30, 2005 and 2004:

	2005	2004
Educational and research funds	$ 146,911	$ 163,992
Capital projects	91,368	79,849
Life income and annuity funds	36,045	37,861
Endowment and other funds functioning as endowment	27,306	34,112
Total temporarily restricted net assets	$ 301,630	$ 315,814

Permanently restricted net assets were available for the following purposes at September 30, 2005 and 2004:

	2005	2004
Student loan funds	$ 16,176	$ 15,483
Life income and annuity funds	36,531	36,558
Endowment and other funds functioning as endowment	526,066	507,102
Total permanently restricted net assets	$ 578,773	$ 559,143

I. Retirement Plans

The Institute's retirement plans cover substantially all of its employees. Except for a small number of qualified non-academic staff who participated in a defined benefit pension plan that was terminated in 1993 and who are covered by a successor defined benefit pension plan, the Institute provides a defined contribution retirement program for its qualified academic and administrative employees.

Pension costs for the defined contribution plans for the years ended September 30, 2005 and 2004 were $17,676 and $16,307, respectively, for the Campus and $54,920 and $50,396, respectively, for JPL.

Retirement benefits under the successor defined benefit plan are determined based on years of service and career average compensation, and accrued partially on a fixed dollar basis and partially on a variable dollar basis. Financial and actuarial information for the plan is based on a June 30 measurement date.

(Dollars in Thousands)

Certain financial information regarding the successor defined benefit plan was as follows for the years ended September 30, 2005 and 2004:

	2005	2004
Change in the benefit obligation:		
Benefit obligation at beginning of year	$ 32,952	$ 31,158
Service cost	55	65
Interest cost	1,887	1,788
Benefits paid	(2,828)	(2,617)
Actuarial loss	2,756	2,558
Benefit obligation at end of year	$ 34,822	$ 32,952

The accumulated benefit obligation for the defined benefit pension plan was $34,786 and $32,927 at the valuation dates.

	2005	2004
Change in the fair value of plan assets:		
Fair value of plan assets at beginning of year	$ 33,425	$ 31,510
Actual return on plan assets	3,143	4,630
Benefits paid	(2,828)	(2,617)
Plan expenses	(63)	(98)
Fair value of plan assets at end of year	$ 33,677	$ 33,425

	2005	2004
Funded status at valuation date:		
Funded status	$ (1,145)	$ 473
Unrecognized net actuarial loss	4,871	2,880
Net amount recognized at end of year	$ 3,726	$ 3,353

(Dollars in Thousands)

		2005		2004
Amounts recognized in the financial statements:				
Prepaid benefit cost	$	-	$	3,353
Accrued benefit liability		(1,109)		-
Additional minimum liability		4,835		-
Net amount recognized at end of year	$	3,726	$	3,353

The benefit obligation exceeds the fair value of plan assets at September 30, 2005. In this situation, current accounting rules require the recognition of a liability equal to the unfunded accumulated benefit obligation, which is defined as the difference between the accumulated benefit obligation and the fair value of plan assets. Accordingly, the net liability recognized at September 30, 2005 disclosed above reflects the additional minimum pension liability adjustment. The cost of the adjustment for Campus was $1,110 and is reflected in other changes in unrestricted net assets in the Statement of Activities. The cost related to JPL was $3,725 and is reflected in both JPL direct expense and revenue, as well as in deferred U.S. Government billings, as any cost associated with this adjustment related to JPL will ultimately be recoverable from NASA.

Net periodic benefit related to the plan for the years ended September 30, 2005 and 2004 included the following components:

		2005		2004
Service cost	$	55	$	65
Interest cost		1,887		1,788
Expected return on plan assets		(2,315)		(2,186)
Net periodic benefit	$	(373)	$	(333)

Estimated contributions to the retirement plan in the next fiscal year are $0.

Estimated future benefit payments are expected to be paid as follows:

Year Ending September 30	Benefit Payments
2006	$3,047
2007	3,222
2008	3,164
2009	3,089
2010	3,011
2011-2015	13,966

(Dollars in Thousands)

The Institute contributes amounts sufficient to maintain retirement plan assets at levels adequate to cover all accrued benefit obligations. Approximately 90% of the plan's assets at September 30, 2005 and 2004 were designated by the plan's funding agent to back annuity contracts distributed to retirees under the plan's immediate participation guarantee agreement with the contract issuer. Participant annuities may be fixed or variable and reflect the value of designated plan equity and fixed income securities. Assets not designated for annuity contracts are invested in separate accounts by the funding agent and carry a target allocation of 62% equities and 38% fixed income. At September 30, 2005 and 2004, total retirement plan assets were invested as follows:

	2005	2004
Equity securities	57%	56%
Fixed income securities	43%	44%

The following weighted-average assumptions were used to determine the Institute's benefit obligations under the successor defined benefit plan at September 30, 2005 and 2004:

	2005	2004
Discount rate	5.25%	6.00%
Long term rate of compensation increase	4.00%	4.00%

To develop the expected long-term rate of return on assets, the Institute considers the historical returns and future expectations for each asset class, as well as the asset allocation of the retirement plan's investment portfolio. The average investment return of the plan has been 7.81% over the past nine calendar years. Estimated future return was based on expected returns for various asset categories. The evaluation of the historical and future returns resulted in the choice of 7.25% for the expected return on plan assets.

The following weighted-average assumptions were used to determine the Institute's net periodic benefit cost under the successor defined benefit plan for the years ended September 30, 2005 and 2004:

	2005	2004
Discount rate	6.00%	6.00%
Expected return on plan assets	7.25%	7.25%
Long-term rate of compensation increase	4.00%	3.50%

(Dollars in Thousands)

J. Postretirement and Postemployment Benefits Other Than Pensions

The Institute's employees may be eligible for certain health and life insurance benefits upon retirement. The Institute's obligation related to these benefits is actuarially determined and has been recorded in the accompanying balance sheets. Any actuarial deferrals resulting from changes in the accumulated postretirement benefit obligation are amortized over the average future working lifetime of Institute employees.

The Institute's postretirement benefits are funded on a pay-as-you-go basis; therefore, there are no plan assets. As a result, a formal investment policy has not been developed.

The Institute adopted the provisions of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 during the year ended September 30, 2005. The change in the benefit obligation and costs disclosed below include an actuarial gain of $24,449 associated with the federal subsidy provided by the Act. Since the plan's measurement date of June 30, 2005, the Institute elected to provide two MA-PDP plans within the medical plans as of January 1, 2006 to eligible retirees (and their dependents) over 65 in lieu of applying for the 28% subsidy available for providing prescription drug benefits equivalent in value to Medicare Part D. This change in approach will be reflected in determining expense for the year ending September 30, 2006.

Certain financial information regarding the plan was as follows for the years ended September 30, 2005 and 2004, and is based on a June 30 measurement date:

	2005	2004
Change in the accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation at beginning of year	$ 406,426	$ 438,636
Service cost	11,724	14,442
Interest cost	23,386	25,861
Participant contributions	1,102	1,161
Benefits paid	(13,734)	(13,261)
Actuarial (gain) loss	(46,130)	(60,413)
Benefit obligation at end of year	$ 382,774	$ 406,426

(Dollars in Thousands)

	2005	2004
Change in the fair value of plan assets:		
Fair value of plan assets at beginning of year	$ -	$ -
Employer contributions	12,632	12,100
Participant contributions	1,102	1,161
Benefits paid	(13,734)	(13,261)
Fair value of plan assets at end of year	$ -	$ -

	2005	2004
Funded status at valuation date:		
Funded status	$ (382,774)	$ (406,426)
Unrecognized actuarial loss	83,296	134,516
Net amount recognized at end of year	$ (299,478)	$ (271,910)

Total benefit obligation at the end of 2005, excluding the Medicare Part D subsidy, was $439,662.

Net periodic benefit cost related to the plan for the years ended September 30, 2005 and 2004 includes the following components:

	Net of Medicare Part D Subsidy		Excluding Medicare Part D Subsidy	
	2005	2004	2005	2004
Service cost	$ 11,724	$ 14,442	$ 12,449	$ 14,442
Interest cost	23,386	25,861	24,914	25,861
Amortization of loss	5,090	11,274	6,644	11,274
Net periodic benefit cost	$ 40,200	$ 51,577	$ 44,007	$ 51,577

(Dollars in Thousands)

The following weighted-average assumptions were used to determine the Institute's obligation under the plan at September 30, 2005 and 2004:

	2005	**2004**
Discount rate	5.25%	6.25%
Health care cost trend rate	10.00%	10.00%

The following weighted-average assumptions were used to determine the Institute's net periodic benefit cost under the plan for the years ended September 30, 2005 and 2004:

	2005	**2004**
Discount rate	6.25%	6.00%
Health care cost trend rate	10.00%	10.00%

The health care cost trend rates for subsequent years are as follows:

Year Ending September 30	Health Care Cost Trend Rate
2006	9.00%
2007	8.00%
2008	7.00%
2009	6.00%
2010	5.50%
2011-2015	5.00%

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1% Increase	**1% Decrease**
Effect on the total of service and interest cost components	$ 6,836	$ (5,677)
Effect on accumulated postretirement benefit obligation	$ 65,395	$ (52,101)

The Institute expects to contribute approximately $15,000 (including $1,200 in retiree contributions) to the plan during the next fiscal year.

(Dollars in Thousands)

Estimated future benefit payments are as follows:

Fiscal Year	Net of Medicare Part D Subsidy	Excluding Medicare Part D Subsidy
2006	$ 13,900	$ 14,700
2007	14,400	16,200
2008	15,600	17,600
2009	16,700	18,900
2010	17,700	20,000
2011-2015	100,700	114,800

K. Commitments and Contingencies

Contingencies

The Institute receives funding or reimbursement from agencies of the United States government for various activities, which are subject to audit, and is a defendant in various legal actions incident to the conduct of its activities. Except as specifically discussed below, management does not expect that liabilities, if any, related to these audits or legal actions will have a material impact on the Institute's financial position.

The Institute has been named as a potentially responsible party (PRP) by NASA under the Comprehensive Environmental Response, Compensation, and Liability Act, as amended. As a PRP, the Institute may be jointly liable for contribution towards clean-up costs, estimated to be in excess of $100 million, of the NASA/JPL Superfund site. The Institute believes that it will have recourse to the United States government for any material liabilities it may incur in connection with being named a PRP for that site.

The Institute has been named as one of the defendants in a False Claims Act action brought by a qui tam relator corporation. The complaint, which was filed in the federal district court in Washington, D.C., and served on the Institute in July 2002, alleges that the Institute engaged in misconduct in connection with certain patents obtained relating to the DNA sequencer. Damages and penalties under the False Claims Act include fines of five thousand five hundred dollars to eleven thousand dollars per claim, treble damages, and attorneys' fees. The Department of Justice investigated the allegations of the complaint and declined to intervene in the case on behalf of the United States. The relator opted to pursue the case on its own. On July 3, 2003, the district court in Washington, D.C., granted the defendants' motion for change of venue to the central district of California. The Institute filed a motion to dismiss the complaint on July 28, 2003. After hearing oral argument, the district court granted the motion, dismissing the case in its entirety. The district court issued its opinion on October 17, 2003. On November 6, 2003, the relator filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. The matter was argued and submitted to the Ninth Circuit on October 17, 2005. On November 21, 2005 the Ninth Circuit issued its decision upholding dismissal of the suit.

Officials of the Institute presently are not able to predict the impact, if any, that final resolution of the matters discussed in the preceding two paragraphs will have on the Institute's financial position or changes in its net assets.

Commitments

At September 30, 2005, the Institute was committed under certain construction contracts in the amount of approximately $35,000.

At September 30, 2005 and 2004, the Institute had committed to invest $223,700 and $129,300, respectively, with alternative investment managers and/or limited partnerships over the next ten years.