California Institute of Technology

Report on Audited Financial Statements
For the Years Ended September 30, 2007 and 2006

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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, 2007 and 2006 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.

As discussed in Note B to the financial statements, the Institute applied the provisions of Statement of Financial Accounting Standards No. 158 and changed its method of recording the pension benefit obligation for the year ended September 30, 2007. In addition, the Institute applied the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 47 and changed its method of accounting for conditional asset retirement obligations for the year ended September 30, 2006.

PricewaterhouseCoopers LLP

January 29, 2008

California Institute of Technology
Balance Sheets
At September 30, 2007 and 2006
(Dollars in Thousands)

	2007	2006
ASSETS		
Cash and cash equivalents	$ 7,979	$ 13,251
Advances and deposits	5,180	4,531
Securities lending deposits	89,100	138,820
Accounts and notes receivable, net of allowance for doubtful accounts of $1,064 and $1,362, respectively:		
United States government	175,500	158,332
Other	36,028	26,643
Contributions receivable, net	248,928	328,765
Investments, including securities pledged or on loan of $87,353 and $136,097, respectively	2,327,838	1,971,561
Prepaid expenses and other assets	57,242	57,515
Deferred United States government billings	332,468	296,630
Property, plant, and equipment, net	748,933	716,159
Total assets	$ 4,029,196	$ 3,712,207
LIABILITIES and NET ASSETS		
Liabilities:		
Accounts payable and accrued expenses	$ 346,002	$ 314,548
Securities lending deposits	89,100	138,820
Deferred revenue and refundable advances	31,465	28,526
Annuities, trust agreements and agency funds	106,697	97,735
Bonds and notes payable	347,935	347,700
Accumulated postretirement benefit obligation	358,847	323,354
Total liabilities	1,280,046	1,250,683
Commitments and contingencies (Note K)		
Net assets:		
Unrestricted	1,672,559	1,391,825
Temporarily restricted	457,120	473,553
Permanently restricted	619,471	596,146
Total net assets	2,749,150	2,461,524
Total liabilities and net assets	$ 4,029,196	$ 3,712,207

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

California Institute of Technology
Statements of Activities
For the Years Ended September 30, 2007 and 2006
(Dollars in Thousands)

	2007	2006
Changes in unrestricted net assets:		
Revenues:		
Tuition and fees, net of student financial aid of $34,613 and $36,361, respectively	$ 24,701	$ 20,865
Investment return	343,568	158,652
Gifts	30,540	28,677
Grants and contracts:		
Jet Propulsion Laboratory - direct	1,745,765	1,579,703
Other United States government - direct	172,764	155,425
Non-United States government - direct	16,918	13,783
Indirect cost recovery and management allowance	103,211	97,852
Auxiliary enterprises	35,493	34,124
Other	19,181	22,212
Net assets released from restrictions	91,082	30,821
Total revenues and net assets released from restrictions	2,583,223	2,142,114
Expenses:		
Instruction and academic support	218,341	211,688
Organized research:		
Jet Propulsion Laboratory	1,745,765	1,579,703
Other Institute research	224,579	200,908
Institutional support	60,383	66,121
Auxiliary enterprises	38,223	36,160
Total expenses	2,287,291	2,094,580
Excess of revenues over expenses	295,932	47,534
Other changes in unrestricted net assets:		
Decrease in minimum pension liability	-	71
Redesignations and reclassifications of net assets	(13,625)	8,667
Loss on retirement of indebtedness	-	(5,201)
Total other changes in unrestricted net assets	282,307	51,071
Cumulative effect of change in accounting principle	(1,573)	(9,604)
Increase in unrestricted net assets	$ 280,734	$ 41,467
Changes in temporarily restricted net assets:		
Gifts	$ 45,306	$ 207,758
Investment return	5,276	3,132
Net assets released from restrictions	(91,082)	(30,821)
Redesignations and reclassifications of net assets	24,067	(8,146)
(Decrease) increase in temporarily restricted net assets	$ (16,433)	$ 171,923
Changes in permanently restricted net assets:		
Gifts	$ 32,532	$ 17,065
Investment return	1,194	786
Other income	41	43
Redesignations and reclassifications of net assets	(10,442)	(521)
Increase in permanently restricted net assets	$ 23,325	$ 17,373
Increase in total net assets	$ 287,626	$ 230,763
Net assets at beginning of year	2,461,524	2,230,761
Total net assets at end of year	$ 2,749,150	$ 2,461,524

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, 2007 and 2006
(Dollars in Thousands)

	2007	2006
Cash flows from operating activities:		
Increase in net assets	$ 287,626	$ 230,763
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Depreciation, accretion and amortization	47,340	44,166
Cumulative effect of change in accounting principle	1,573	9,604
Loss on retirement of indebtedness	-	5,201
Contributions restricted for long-term investment and capital projects	(32,483)	(23,319)
Investment return restricted for long-term investment and capital projects	(3,556)	(2,059)
Realized and unrealized gains on investments	(308,938)	(130,926)
Gifts of property, plant, and equipment	(1,182)	(4,234)
Gifts and other in-kind distributions of securities	(7,431)	(4,682)
Actuarial change in trust liability	(9,238)	(1,506)
Loss on disposals of property, plant, and equipment	6,002	360
Changes in assets and liabilities:		
Accounts and notes receivable, net	(22,157)	(5,049)
Contributions receivable, net	22,128	(155,604)
Deferred United States government billings	(35,838)	(20,540)
Prepaid expenses and other assets	563	6,430
Accounts payable and accrued expenses	16,692	21,689
Deferred revenue and refundable advances	2,939	1,796
Agency funds	1,723	940
Change in advances and deposits	(649)	(1,677)
Accumulated postretirement benefit obligation	34,146	23,876
Net cash used in operating activities	(740)	(4,771)
Cash flows from investing activities:		
Purchases of investments	(906,557)	(970,331)
Proceeds from sales and maturities of investments	936,428	913,660
Purchases of property, plant, and equipment	(82,803)	(72,945)
Proceeds from sale of property, plant, and equipment	1,016	-
Net cash used in investing activities	(51,916)	(129,616)
Cash flows from financing activities:		
Contributions restricted for long-term investment and capital projects	33,732	37,641
Investment return restricted for long-term investment and capital projects	3,556	2,059
Proceeds from issuance of bonds	-	165,000
Cash paid for retirement of indebtedness	-	(75,688)
Cash received under split-interest agreements	18,818	6,410
Cash payments made under split-interest agreements	(8,722)	(8,044)
Net borrowings on lines of credit	-	10,000
Net cash provided by financing activities	47,384	137,378
Net (decrease) increase in cash and cash equivalents	(5,272)	2,991
Cash and cash equivalents at beginning of year	13,251	10,260
Cash and cash equivalents at end of year	$ 7,979	$ 13,251

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's main campus and satellite facilities ("Campus"), as well as 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 activities are reflected in the Institute's balance sheets. The direct costs of JPL's activities and the related reimbursement of those costs are segregated in the statements of activities. The management allowances earned under the NASA contract also are included as an indirect cost recovery and management allowance in the statements of activities.

The Institute (including JPL) is generally 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 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.

Reclassifications
Certain balances at September 30, 2006, and for the year then ended have been reclassified to conform to the current year presentation.

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, 2007 and 2006.

Advances and Deposits
Advances include certain cash balances, totaling $3,912 and $3,349 at September 30, 2007 and 2006, respectively, restricted for use in connection with United States government research. Deposits include $1,268 and $1,182 at September 30, 2007 and 2006, respectively, in employee cash withheld for health and dependent care spending accounts.

Investments
Investments are recorded at fair value. The fair value of marketable securities and short-term investments (other than those classified as alternative investments) is based on quoted market prices for those securities or for similar financial instruments. Alternative investments are carried at estimated fair value as provided by external investment managers at, or as of 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 investment agreements are carried at cost, which approximates fair value.

Alternative investments include holdings in limited partnerships, limited liability corporations, and off-shore investment funds. These investments may not be readily marketable, and the related investment agreements may specify penalties for early liquidations from the related funds. The Institute reviews and evaluates the values provided by external investment managers and, in each case, has agreed with the valuation methods and assumptions used in determining the fair value of the alternative investments. Those estimated fair values may differ from the values that could have been determined had a ready market for these securities existed.

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. Outstanding purchases totaled $37,569 and $25,125 at September 30, 2007 and 2006, respectively, and are included in accounts payable and accrued expenses in the balance sheet. Outstanding sales totaled $10,321 and $5,924 at September 30, 2007 and 2006, respectively, and are included in accounts and notes receivable – other in the balance sheet.

The Institute uses an interest rate swap to manage the interest rate exposure of a portion of its variable rate debt. The swap is recorded at fair value, which is the estimated amount that the Institute would receive or pay to terminate the agreement taking into account current interest rates and the current credit-worthiness of the swap counterparty. Realized gains from regular settlements with the counterparty were $148 and $41 for the year ended September 30, 2007 and 2006, respectively, and are recognized in the statement of activities. Changes in the fair value at September 30, 2007 and 2006 resulted in an unrealized gain of $2,228 and unrealized loss of $732, respectively, and are recognized in the statement of activities. At September 30, 2007, the fair value of the asset due the Institute from the counterparty was $1,496, which is included in investments in the balance sheet. At September 30, 2006, the obligation to the counterparty was $732, which was included in accounts payable and accrued expenses in the balance sheet.

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 value of certain donor-restricted endowment funds is less than the historical cost of such funds. As the market value of the endowment increases, this deficiency will reverse. The aggregate deficiencies for donor-restricted endowment funds were $470 and $6,798 at September 30, 2007 and 2006, respectively, and are recorded in unrestricted net assets.

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 securities lending deposits.

At September 30, 2007 and 2006, investments include investment agreements valued at $46,007 and $82,790, respectively, that were purchased with unexpended proceeds from the 2006 Series A and 2006 Series B California Educational Facilities Authority (CEFA) revenue bonds. These assets are limited to use in specific construction projects related to CEFA bonds.

Property, Plant, and Equipment

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 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 assets from various sources set aside for this purpose. Assets acquired under both federal and nonfederal grants in which title does not ultimately transfer to the Institute are not recorded as property, plant and equipment.

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.

As of September 30, 2006, the Institute adopted Financial Accounting Standards Board (FASB) Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement No. 143" (FIN 47) which requires that asset retirement obligations that are conditional on a future event, such as the obligation to safely depose of asbestos when a building is remodeled or demolished, be recognized when the fair value of the obligation can be reasonably estimated. Upon the adoption of FIN 47, the Institute recorded $9,604 as the cumulative effect of a change in accounting principle in the statement of activities.

Had the provisions of FIN 47 been adopted at the acquisition of the related assets, the impact on unrestricted net assets for the year ended September 30, 2006 would have been approximately $580.

The asset retirement cost, net of accumulated depreciation, for the years ended September 30, 2007 and 2006 was $736 and $827, respectively, which is included in property, plant, and equipment in the balance sheet. The asset retirement obligation was $10,704 and $10,431, respectively, and is included in accounts payable and accrued expenses in the balance sheet.

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%, and the Annuity 2000 Mortality Table was used in 2007 and 2006. 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 $77,254 and $71,677 at September 30, 2007 and 2006, 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 $17,825 and $16,164 at September 30, 2007 and 2006, respectively.

Beneficial Interests

The Institute is the beneficiary of charitable remainder and perpetual trusts held and administered by others. The present value 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 $16,181 and $20,445 at September 30, 2007 and 2006, respectively.

Agency Funds

The Institute held assets totaling $11,617 and $9,894 on behalf of others at September 30, 2007 and 2006, respectively. The assets held are primarily included in investments in the balance sheet. The corresponding liability is included in annuities, trust agreements and agency funds on the balance sheet.

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 and displayed net of tuition support on the statement of activities. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue.

- *Investment return (loss)* - Investment transactions are recorded on the trade date. Investment income and realized and unrealized gains and losses, net of investment management fees, 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 uncollectible is provided. Gift revenue from contributions to be collected in the form of 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 or subject to other time or purpose restrictions 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 or the assets are placed in service. Gifts received for endowment investment are held in perpetuity and recorded as permanently restricted revenue. Conditional promises to give are not recorded until the conditions have been substantially met. Conditional promises to give totaled $16,870 and $13,014 at September 30, 2007 and 2006, respectively.

- *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 enterprises* - 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 classification'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, 2007 and 2006 was $13,561 and $9,742, respectively, and capitalized interest was $503 and $2,201, 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 $15,941 and $12,140 at September 30, 2007 and 2006 are carried at cost; doubtful accounts are charged to expense when they become uncollectible. 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 $297,777 and $299,961 at September 30, 2007 and 2006, respectively. Amounts outstanding under the revolving bank credit facilities and the money market loan programs totaling $54,000 at both September 30, 2007 and 2006, 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.

New Accounting Pronouncements
At September 30, 2007, the Institute adopted the provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS 158). The provisions of this new standard require the Institute to recognize the difference between the fair value of plan assets and the plan's benefit obligation for both the pension and postretirement medical and life insurance plans (see notes I and J). The standard also requires that the measurement date be the same as the Institute's year end. The change in measurement date will be effective for the year ending September 30, 2008.

The following table summarizes the incremental effects of the initial adoption of SFAS 158 on the Institute's balance sheet at September 30, 2007:

	Before application of SFAS 158	SFAS 158 Adjustment	After application of SFAS 158
Deferred United States government billings	$ 316,319	$ 16,149	$ 332,468
Total assets	4,013,047	16,149	4,029,196
Accounts payable and accrued expenses	345,139	863	346,002
Accumulated postretirement benefit obligation	341,988	16,859	358,847
Total liabilities	1,262,324	17,722	1,280,046
Unrestricted net assets	1,674,132	(1,573)	1,672,559
Total net assets	2,750,723	(1,573)	2,749,150
Total liabilities and net assets	4,013,047	16,149	4,029,196

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157, which establishes a common definition for fair value to be applied to generally accepted accounting principles requiring use of fair value; establishes a framework for measuring fair value, and expands the related disclosure requirements about fair value measurements. This accounting standard is effective for the Institute for its fiscal year ending September 30, 2009. The Institute is assessing the impact of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure eligible items at fair value at specific election dates (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected shall be reported in earnings at each subsequent reporting period. This accounting standard is effective for the Institute for its fiscal year ending September 30, 2009. The Institute is assessing the impact of adopting SFAS No. 159.

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, 2007 and 2006, range from 2.75% to 5.84%.

Contributions receivable consisted of the following at September 30, 2007 and 2006:

	2007	2006
Contributions receivable at beginning of year, net	$ 328,765	$ 195,106
Discount at beginning of year	25,765	9,785
Allowance for doubtful accounts at beginning of year	1,230	1,830
Contributions receivable at beginning of year, gross	355,760	206,721
New contributions received	14,752	231,844
Contribution payments received	(123,147)	(63,655)
Adjustments to fair value of securities to be contributed	19,435	(19,100)
Less: Write-offs and other adjustments	-	(50)
Contributions receivable at end of year, gross	266,800	355,760
Discount at end of year	(17,641)	(25,765)
Allowance for doubtful accounts at end of year	(231)	(1,230)
Contributions receivable at end of year, net	$ 248,928	$ 328,765

Gross contributions receivable carried the following restrictions at September 30, 2007 and 2006:

	2007	2006
Endowment for programs, activities, and scholarships	$ 21,285	$ 24,854
Building construction	37,195	40,395
Education, general and time restrictions	208,320	290,511
Total contributions receivable, gross	$ 266,800	$ 355,760

Gross contributions receivable are expected to be realized as follows at September 30, 2007 and 2006:

	2007	2006
Within one year	$ 123,521	$ 136,707
Between one year and five years	105,775	165,429
More than five years	37,504	53,624
Total contributions receivable, gross	$ 266,800	$ 355,760

At September 30, 2007 and 2006, $110,181 and $158,769, respectively, in contributions receivable were due from a foundation which shares a common board member with the Institute. At September 30, 2007 and 2006, contributions receivable of $77,580 and $102,897, respectively, were due from this board member in the form of securities.

D. Investments

Investments consisted of the following at September 30, 2007 and 2006:

	2007	2006
Short-term investments	$ 283,876	$ 180,959
Government fixed income securities	143,307	147,466
Corporate fixed income securities	104,146	73,020
Domestic equity securities	405,282	399,700
International equity securities	537,714	381,857
Investment agreements	46,007	82,790
Alternative investments:		
Absolute return strategies	312,703	276,573
Private equity	179,841	158,399
Inflation hedges	287,424	251,612
Real estate mortgages, notes, and other investments	27,538	19,185
Total investments	$ 2,327,838	$ 1,971,561

Investments were categorized as follows at September 30, 2007 and 2006:

	2007	2006
Consolidated endowment pool	$ 1,931,757	$ 1,583,794
Separately invested endowments	45,453	40,583
Subtotal endowment investments	1,977,210	1,624,377
Trusts, annuities, and other	350,628	347,184
Total investments	$ 2,327,838	$ 1,971,561

Investment return consisted of the following for the years ended September 30, 2007 and 2006:

	2007	2006
Interest and dividend income	$ 41,100	$ 31,644
Net realized gains	80,444	78,065
Net unrealized appreciation	228,494	52,861
Total investment return	$ 350,038	$ 162,570

E. Deferred United States Government Billings

Deferred United States government billings consisted of the JPL-related portion of the following liabilities at September 30, 2007 and 2006:

	2007	2006
Accumulated postretirement benefit obligation	$ 276,821	$ 248,088
Accrued vacation benefits	53,484	47,264
Pension benefit liability	2,163	1,278
Total deferred United States government billings	$ 332,468	$ 296,630

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 the portion of both the JPL accumulated postretirement benefit obligation and the pension benefit liability attributable to JPL, 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 accrued vacation benefits for JPL staff, 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 require that such funding be made available when necessary.

F. Property, Plant, and Equipment, net

Property, plant, and equipment consisted of the following at September 30, 2007 and 2006:

	2007	2006
Land and land improvements	$ 59,174	$ 56,427
Buildings and building improvements	607,594	557,571
Equipment	452,172	449,546
Construction in progress	109,970	98,663
Less: accumulated depreciation	(479,977)	(446,048)
Property, plant, and equipment, net	$ 748,933	$ 716,159

Depreciation expense for the years ended September 30, 2007 and 2006 was $46,465 and $43,865, respectively.

G. Bonds and Notes Payable

Bonds and notes payable consisted of the following at September 30, 2007 and 2006:

Bonds Payable:	**2007**	**2006**
California Educational Facilities Authority (CEFA) revenue bonds:		
2006 Series A due October 2036, with a variable interest rate reset weekly (3.76% and 3.57%, respectively)	$ 82,500	$ 82,500
2006 Series B due October 2036, with a variable interest rate reset weekly (3.70% and 3.50%, respectively)	82,500	82,500
Series 1998 due October 2028, with interest at 4.25% (net of issue discount of $2,400 and $2,515, respectively)	48,165	48,051
Series 1998 due October 2027, with interest at 4.5% (net of issue discount of $2,530 and $2,651, respectively)	50,770	50,649
Series 1994 due January 2024, with a variable interest rate reset weekly (3.76% and 3.57%, respectively)	30,000	30,000
Total revenue bonds	293,935	293,700
Notes payable:		
Bank of America revolving bank credit facility expiring September 2008, with variable interest rates	-	-
Bank of America revolving bank credit facility expiring September 2008, with variable interest rates	-	-
Bank of New York money market loan program with no expiration date, with variable interest rates	-	-
JPMorgan Chase money market loan program with no expiration date, with variable interest rates (5.17% and 5.42%, respectively)	54,000	54,000
Total notes payable	54,000	54,000
Total bonds and notes payable	$ 347,935	$ 347,700

The CEFA Series 1998 revenue bonds are subject to an early redemption premium if redeemed prior to October 1, 2010.

During the year ended September 30, 2006, the Institute entered into an interest rate swap agreement in conjunction with issuance of the 2006 Series A and B variable rate revenue bonds. Under the terms of the agreement, which expires October 1, 2036, the Institute pays the counterparty a fixed interest rate of 3.549% and receives a variable rate, indexed at 67% of one-month LIBOR, on a $165,000 underlying notional principal amount.

The Bank of America lines of credit and Bank of New York money market loan program have individual limits of $50,000; the JPMorgan Chase money market loan 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 loan

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. All lines of credit and money market loan program agreements are uncollateralized.

Principal repayments on bonds and notes payable were as follows at September 30, 2007:

Year Ending September 30	Amount
2008	$ 249,000
2009	-
2010	-
2011	-
2012	-
Thereafter	98,935
Total	$ 347,935

Under certain circumstances, the CEFA Series 1994 and 2006 Series A and 2006 Series B variable rate revenue bonds could fail to be remarketed, requiring the Institute to repurchase the outstanding bonds totaling approximately $195,000. Therefore, the bonds have been classified as repayable in the following year in the table above. However, the Institute believes a repurchase is unlikely.

H. Components of Net Assets

Temporarily restricted net assets were available for the following purposes at September 30, 2007 and 2006:

	2007	2006
Educational and research funds	$ 253,413	$ 303,921
Capital projects	108,751	93,879
Life income and annuity funds	35,058	38,092
Endowment and other funds functioning as endowment	59,898	37,661
Total temporarily restricted net assets	$ 457,120	$ 473,553

Permanently restricted net assets were available for the following purposes at September 30, 2007 and 2006:

	2007	2006
Student loan funds	$ 16,367	$ 16,894
Life income and annuity funds	44,626	41,008
Endowment and other funds functioning as endowment	558,478	538,244
Total permanently restricted net assets	$ 619,471	$ 596,146

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.

Contributions to the defined contribution plans for the years ended September 30, 2007 and 2006 were $18,882 and $18,131, respectively, for the Institute and $58,173 and $56,793, 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.

On December 4, 2006, the Institute entered into an agreement with an insurance company that resulted in the settlement of its liabilities to retiree participants. As a result of the settlement, the Institute reduced plan assets and benefit obligation by $34,778, incurred a settlement cost of $6,169, and recognized a loss of $1,724.

Certain financial information regarding the successor defined benefit plan was as follows for the years ended September 30, 2007 and 2006:

	2007	2006
Change in the benefit obligation:		
Benefit obligation at beginning of year	$ 36,912	$ 34,822
Service cost	48	59
Interest cost	1,034	1,749
Settlement loss	1,724	-
Settlement payments	(34,778)	-
Benefits paid	(1,655)	(3,065)
Actuarial loss	1,444	3,347
Benefit obligation at end of year	$ 4,729	$ 36,912

The accumulated benefit obligation for the defined benefit pension plan was $4,703 and $ 36,881 at September 30, 2007 and 2006.

	2007	2006
Change in fair value of plan assets:		
Fair value of plan assets beginning of year	$ 34,965	$ 33,677
Actual return on plan assets	3,046	4,426
Benefits paid	(1,655)	(3,065)
Settlement payments	(34,778)	-
Plan expenses	(5)	(73)
Fair value of plan assets	$ 1,573	$ 34,965

Upon implementation of SFAS 158, as discussed in Note B, the Institute was required to recognize the funded status of its defined benefit plan in the balance sheet and to adjust unrestricted net assets for the cumulative effect of this change in accounting principle. Accordingly, the adjustment for the Campus was $226 for the year ended September 30, 2007 and is reflected in accounts payable and accrued expenses in the balance sheet and as cumulative effect of an accounting change in the statement of activities. The change related to JPL was $637 for the year ended September 30, 2007, and is reflected in the balance sheet, as well as in both JPL direct expense and revenue, and in deferred U.S. Government billings, as any cost associated with this adjustment related to JPL will ultimately be recoverable from NASA.

	2007	2006
Funded status at valuation date:		
Funded status	$ (3,156)	$ (1,947)
Unrecognized net actuarial loss	-	6,017
Net amount recognized at end of year	$ (3,156)	$ 4,070

	2007	2006
Amounts recognized in the financial statements:		
Accrued benefit liability	$ (3,156)	$ (1,916)
Additional minimum liability	-	5,986
Net amount recognized at end of year	$ (3,156)	$ 4,070

	2007	2006
Amounts recognized in unrestricted net assets:		
Net loss	$ 863	$ -
Total amounts recognized as unrestricted net assets	$ 863	$ -

At September 30, 2006, the benefit obligation exceeded the fair value of plan assets. The accounting rules in effect at that time required the recognition of a liability equal to the unfunded accumulated benefit obligation, which was defined as the difference between the accumulated benefit obligation and the fair value of plan assets. Accordingly, the net liability recognized at September 30, 2006 disclosed above reflects an additional minimum pension liability adjustment. The decrease in the additional minimum pension liability for the Campus was $71 for the year ended September 30, 2006, and is reflected in other changes in unrestricted net assets in the statement of activities. The change related to JPL was $1,222 for the year ended September 30, 2006, 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, 2007 and 2006 included the following components:

	2007	2006
Service cost	$ 48	$ 59
Interest cost	1,034	1,749
Recognized actuarial loss	131	181
Settlement cost	6,169	-
Expected return on plan assets	(1,020)	(2,333)
Net periodic cost (benefit)	$ 6,362	$ (344)

Estimated contributions to the retirement plan in the next year are $1,190.

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

Year Ending September 30	Benefit Payments
2008	$ 181
2009	296
2010	304
2011	317
2012	320
2013-2017	2,349

Participant annuities may be fixed or variable and reflect the value of designated plan equity and fixed income securities. Plan assets are invested in separate accounts by the funding agent and carry a target allocation of 19% equities, 76% fixed income and 5% cash. At September 30, 2007 and 2006, total retirement plan assets were invested as follows:

	2007	2006
Equity securities	19%	60%
Fixed income securities	77%	40%
Cash	4%	-

The following weighted-average assumptions were used to determine the Institute's benefit obligations under the plan at September 30, 2007 and 2006:

	2007	2006
Discount rate	6.30%	6.00%
Expected return on plan assets	5.75%	7.00%
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. Estimated future return was based on expected returns for various asset categories. The evaluation of the historical and future returns resulted in the selection of 5.75% for the expected return on plan assets. Prior to the settlement the expected return on plan assets was at 7.00%.

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, 2007 and 2006:

	2007	**2006**
Discount rate	6.00%	5.25%
Expected return on plan assets	5.75%	7.25%
Long-term rate of compensation increase	4.00%	4.00%

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.

During the year ended September 30, 2007, the Institute implemented a cost-sharing provision for retirees and their dependents. During the year ended September 30, 2006, the Institute elected to have its insurer provide qualifying prescription drug plans to eligible retirees and their dependents at reduced premium rates in lieu of applying for the government subsidy available for providing such benefits under the Medicare Prescription Drug Improvement and Modernization Act of 2003. The change in the accumulated postretirement benefit obligation for these plan amendments for years ended September 30, 2007 and 2006 was $21,465 and $10,153, respectively.

Certain financial information regarding the plan was as follows for the years ended September 30, 2007 and 2006, and is based on a June 30 measurement date:

	2007	2006
Change in the accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation at beginning of year	$ 376,090	$ 382,774
Service cost	11,754	13,569
Interest cost	22,408	19,737
Participant contributions	2,591	1,469
Plan amendments	(21,465)	(10,153)
Benefits paid	(14,729)	(14,137)
Actuarial (gain) loss	(14,677)	(17,169)
Benefit obligation at end of year	$ 361,972	$ 376,090

	2007	2006
Components of net periodic postretirement benefit cost:		
Service cost	$ 11,754	$ 13,569
Interest cost	22,408	19,737
Amortization of prior year service credit	(2,204)	-
Amortization of loss	1,939	3,237
Net periodic benefit cost	$ 33,897	$ 36,543

	2007	2006
Change in the fair value of plan assets:		
Employer contributions	$ 12,138	$ 12,668
Participant contributions	2,591	1,469
Benefits paid	(14,729)	(14,137)
Fair value of plan assets at end of year	$ -	$ -

Upon implementation of SFAS 158, as discussed in Note B, the Institute was required to recognize the funded status of its postretirement benefit plan in the balance sheet and to adjust unrestricted net assets for the cumulative effect of this change in accounting principle. Accordingly, the adjustment for the Campus was $1,347 for the year ended September 30, 2007, and is reflected in the accumulated postretirement benefit obligation in the balance sheet and as cumulative effect of an accounting change in the statement of activities. The change related to JPL was $15,512 for year ended September 30, 2007, and is reflected in the balance sheet, as well

as in both JPL direct expense and revenue, and in Deferred U.S. Government billings, as any cost associated with this adjustment related to JPL will ultimately be recoverable from NASA.

	2007	2006
Funded status at valuation date:		
Funded status	$ (361,972)	$ (376,090)
Unrecognized prior service cost	-	(10,153)
Unrecognized actuarial loss	-	62,889
Net amount recognized at end of year	$ (361,972)	$ (323,354)

	2007	2006
Amounts recognized in the balance sheet:		
Accrued postretirement obligation	$ (361,972)	$ (376,090)
Employer contribution between measurement date and year end	3,125	-
Total amounts recognized in balance sheet	$ (358,847)	$ (376,090)

	2007	2006
Amounts recognized as changes in unrestricted net assets:		
Prior service credit	$ (29,414)	$ -
Net loss	46,273	-
Total amounts recognized as unrestricted net assets	$ 16,859	$ -

In 2008, an estimated prior service credit of $3,337 and a net loss of $834 will be amortized from unrestricted net assets into the net periodic benefit cost.

The following weighted-average assumptions were used to determine the Institute's obligation under the plan at September 30, 2007 and 2006:

	2007	**2006**
Discount rate	6.30%	6.25%
Health care cost trend rate	9.00%	9.00%

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, 2007 and 2006:

	2007	**2006**
Discount rate	6.25%	5.25%
Health care cost trend rate	12.00%	10.00%

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

Year Ending September 30	Health Care Cost Trend Rate
2008	8.00%
2009	7.00%
2010	6.00%
2011	5.50%
2012	5.00%
2013-2017	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	$ 6,568	$ (5,167)
Effect on accumulated postretirement benefit obligation	$ 55,015	$ (44,609)

In 2008, the Institute and its retirees are expected to contribute approximately $14,946, and $2,804, respectively.

Estimated future benefit payments are as follows:

Year Ending September 30	Benefit Payments
2008	$ 14,900
2009	16,800
2010	17,700
2011	19,000
2012	20,100
2013-2017	113,100

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.

In 1997, the Institute was 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 $100,000, 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.

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

Commitments

The Institute was committed under certain construction and services contracts in the amount of approximately $60,515 and $54,969 at September 30, 2007 and 2006, respectively.

At September 30, 2007 and 2006, the Institute had committed to invest $214,618 and $198,832, respectively, with alternative investment managers and/or limited partnerships over the next ten years.

The Institute is currently providing funding for the operation of certain local water treatment facilities, subject to receipt of funding from NASA. Annual costs are not expected to exceed $5,000.

L. Supplemental Cash Flow Information

The following are additional supplemental disclosures related to the statements of cash flows:

	2007	2006
Cash paid during the year for interest, net of amounts capitalized	$ 13,743	$ 9,503
Securities lending	89,100	138,820
Securities received to satisfy pledge payments	51,931	629
Accrued purchases of property, plant, and equipment	1,136	297

M. Subsequent Event

Subsequent to September 30, 2007, the Institute received a commitment of $100,000 to fund a telescope project from a foundation which shares a common board member with the Institute.