Baylor University

Financial Statements
Years Ended May 31, 2007 and 2006, and
Independent Auditors' Report

BAYLOR UNIVERSITY

FINANCIAL STATEMENTS

Years Ended May 31, 2007 and 2006

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INDEPENDENT AUDITORS' REPORT

Board of Regents
Baylor University

We have audited the accompanying balance sheets of Baylor University (the "University") as of May 31, 2007 and 2006, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University as of May 31, 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.

As discussed in Note 13 to the financial statements, the University adopted Financial Accounting Standards Board (FASB) Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143*, as required, effective June 1, 2006.

As discussed in Note 2 to the financial statements, the financial statements include alternative assets valued at approximately $353,416,000 (25% of net assets) and $270,516,000 (21% of net assets) as of May 31, 2007 and 2006, respectively, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or general partners.

In accordance with *Government Auditing Standards,* we have also issued our report dated September 19, 2007 on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

September 19, 2007

BAYLOR UNIVERSITY
Balance Sheets

May 31, 2007 and 2006
(in thousands of dollars)

	May 31, 2007			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
ASSETS				
Cash & cash equivalents	$ 15,286	$ 20,638	$ 5,157	**$ 41,081**
Short-term investments	47,734	--	--	**47,734**
Bond proceeds held by trustees	24,000	--	--	**24,000**
Student accounts receivable, net	10,977	--	--	**10,977**
Contributions, grants & other receivables	21,558	12,545	6,473	**40,576**
Prepaid expenses & other	8,409	596	--	**9,005**
Student loans receivable, net	8,458	--	5,704	**14,162**
Long-term investments, at fair value	483,577	82,754	514,108	**1,080,439**
Property, plant & equipment, net	563,537	--	--	**563,537**
Total assets	$ 1,183,536	$ 116,533	$ 531,442	**$ 1,831,511**
LIABILITIES & NET ASSETS				
Liabilities				
Accounts payable	$ 29,439	$ 363	$ 490	**$ 30,292**
Personnel related liabilities	33,142	--	--	**33,142**
Deposits & deferred income	31,516	1,276	--	**32,792**
Notes & bonds payable	290,670	--	--	**290,670**
Interest rate swap liability	19,380	--	--	**19,380**
Other liabilities	10,585	1,284	4,518	**16,387**
Total liabilities	414,732	2,923	5,008	**422,663**
Net Assets				
Unrestricted	9,064	--	--	**9,064**
Designated for operations	26,184	--	--	**26,184**
Restricted	--	9,754	6,529	**16,283**
Endowment	289,120	62,852	497,883	**849,855**
Endowment - Board designated	153,081	11,108	--	**164,189**
Annuity & living trusts	--	15,488	22,022	**37,510**
Net invested in plant	291,355	14,408	--	**305,763**
Total net assets	768,804	113,610	526,434	**1,408,848**
Total liabilities & net assets	$ 1,183,536	$ 116,533	$ 531,442	**$ 1,831,511**

See accompanying notes to financial statements.

May 31, 2006			
Unrestricted	Temporarily Restricted	Permanently Restricted	**Total**
$ 4,871	$ 5,834	$ --	**$ 10,705**
51,606	7,070	1,548	**60,224**
63,255	--	--	**63,255**
9,532	--	--	**9,532**
19,950	10,608	7,579	**38,137**
8,186	7	--	**8,193**
9,096	--	5,349	**14,445**
356,087	70,319	486,251	**912,657**
521,255	--	--	**521,255**
$ 1,043,838	$ 93,838	$ 500,727	**$ 1,638,403**
$ 17,425	$ 390	$ 382	**$ 18,197**
29,727	--	--	**29,727**
29,109	--	--	**29,109**
301,704	--	--	**301,704**
16,413	--	--	**16,413**
7,345	1,065	4,667	**13,077**
401,723	1,455	5,049	**408,227**
1,877	--	--	**1,877**
22,263	--	--	**22,263**
--	8,162	6,251	**14,413**
208,229	49,566	467,471	**725,266**
135,643	9,259	--	**144,902**
--	13,430	21,956	**35,386**
274,103	11,966	--	**286,069**
642,115	92,383	495,678	**1,230,176**
$ 1,043,838	$ 93,838	$ 500,727	**$ 1,638,403**

BAYLOR UNIVERSITY
Statements of Activities

For the Years Ended May 31, 2007 and 2006
(in thousands of dollars)

	Year Ended May 31, 2007			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Tuition & fees	$ 313,900	$ --	$ --	**$ 313,900**
Less scholarships	(94,187)	--	--	**(94,187)**
Net tuition & fees	219,713	--	--	**219,713**
Gifts, private grants & Baptist General Convention of Texas appropriation	15,118	16,253	18,440	**49,811**
Investment income	9,002	435	695	**10,132**
Endowment earnings distributed	39,801	5,772	2,804	**48,377**
Realized gains (losses) on investments	10,428	231	1,085	**11,744**
Government grants & contracts	3,468	8,804	--	**12,272**
Other sources - educational & general	17,499	1,130	--	**18,629**
Other sources - intercollegiate athletics	15,833	--	--	**15,833**
Sales & services of auxiliary enterprises	29,029	--	--	**29,029**
Total revenues	359,891	32,625	23,024	**415,540**
Net assets released from restrictions	27,955	(28,134)	179	**--**
Total net revenues	387,846	4,491	23,203	**415,540**
EXPENSES				
Program expenses				
Instruction	160,457			**160,457**
Academic support, research & public service	50,789			**50,789**
Student services & activities	59,218			**59,218**
Auxiliary enterprises	28,410			**28,410**
Support expenses				
Institutional support	44,451			**44,451**
Total expenses	343,325	--	--	**343,325**
Increase in net assets before other changes	44,521	4,491	23,203	**72,215**
OTHER CHANGES				
Unrealized gains on investments	90,042	14,193	4,896	**109,131**
Unrealized gain (loss) on interest rate swap	(2,967)	--	--	**(2,967)**
Loss on disposal of property & equipment	(2,222)	--	--	**(2,222)**
Change in value of split interest agreements -				
Present value adjustments	--	2,543	2,657	**5,200**
Terminated annuities	--	--	--	**--**
Total other changes	84,853	16,736	7,553	**109,142**
Increase in net assets before cumulative effect of change in accounting principle	129,374	21,227	30,756	**181,357**
Cumulative effect of change in accounting principle	(2,685)	--	--	**(2,685)**
Increase in net assets	126,689	21,227	30,756	**178,672**
Net assets at beginning of year	642,115	92,383	495,678	**1,230,176**
Net assets at end of year	$ 768,804	$ 113,610	$ 526,434	**$ 1,408,848**

See accompanying notes to financial statements.

Year Ended May 31, 2006			
Unrestricted	Temporarily Restricted	Permanently Restricted	**Total**
$ 286,798	$ --	$ --	**$ 286,798**
(86,349)	--	--	**(86,349)**
200,449	--	--	**200,449**
13,155	14,961	13,514	**41,630**
4,202	80	696	**4,978**
37,315	5,444	2,894	**45,653**
9,519	(73)	896	**10,342**
3,557	6,635	--	**10,192**
15,528	2,580	--	**18,108**
14,616	--	--	**14,616**
29,486	--	--	**29,486**
327,827	29,627	18,000	**375,454**
20,984	(20,829)	(155)	**--**
348,811	8,798	17,845	**375,454**
149,205			**149,205**
44,361			**44,361**
53,739			**53,739**
26,551			**26,551**
41,957			**41,957**
315,813	--	--	**315,813**
32,998	8,798	17,845	**59,641**
67,486	11,815	7,654	**86,955**
20,971	--	--	**20,971**
(598)	--	--	**(598)**
--	2,235	1,068	**3,303**
209	(781)	572	**--**
88,068	13,269	9,294	**110,631**
121,066	22,067	27,139	**170,272**
--	--	--	**--**
121,066	22,067	27,139	**170,272**
521,049	70,316	468,539	**1,059,904**
$ 642,115	$ 92,383	$ 495,678	**$ 1,230,176**

BAYLOR UNIVERSITY
Statements of Cash Flows

For the Years Ended May 31, 2007 and 2006
(in thousands of dollars)

	Year Ended May 31, 2007	Year Ended May 31, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in Net Assets	**$ 178,672**	**$ 170,272**
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Cumulative effect of change in accounting principle	2,685	--
Depreciation & amortization	26,458	27,148
Net realized & unrealized gains on investments	(120,875)	(97,297)
Unrealized loss (gain) on interest rate swap	2,967	(20,971)
Loss on disposal of property, plant & equipment	2,222	598
Contributions restricted for permanent investment	(18,440)	(13,514)
Decrease (increase) in:		
Short-term investments	12,490	(23,026)
Student accounts receivable	(1,445)	(2,352)
Contributions, grants & other receivables	(2,439)	(1,952)
Prepaid expenses & other	(812)	216
Increase (decrease) in:		
Accounts payable	12,095	5,405
Personnel related liabilities	3,415	706
Deposits & deferred income	3,683	2,625
Other liabilities	70	(190)
Net cash provided by operating activities	**100,746**	**47,668**
CASH FLOWS FROM INVESTING ACTIVITIES		
Student loans made	(1,241)	(2,547)
Proceeds from collections of student loans	1,524	2,577
Proceeds from sales of long-term investments	23,663	53,234
Purchases of long-term investments	(70,570)	(79,722)
Purchases of property, plant & equipment	(70,429)	(26,749)
Net cash used in investing activities	**(117,053)**	**(53,207)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions restricted for permanent investment:		
Endowment	18,289	13,241
Annuity & living trusts	151	273
Unexpended bond proceeds decrease (increase)	39,255	(55,966)
Proceeds from long-term debt	--	63,500
Repayment of long-term debt	(11,034)	(9,255)
Debt issuance costs	--	(1,027)
Increase in federal student loan funds refundable	22	16
Net cash provided by financing activities	**46,683**	**10,782**
Net increase in cash & cash equivalents	**30,376**	**5,243**
Cash & cash equivalents at beginning of year	**10,705**	**5,462**
Cash & cash equivalents at end of year	**$ 41,081**	**$ 10,705**

See accompanying notes to financial statements.

OVERVIEW OF BAYLOR UNIVERSITY

The mission of Baylor University (the "University") is to educate men and women for worldwide leadership and service by integrating academic excellence and Christian commitment within a caring community.

Chartered in 1845 by the Republic of Texas and affiliated with the Baptist General Convention of Texas, the University is both the state's oldest institution of higher learning and the world's largest Baptist university. Established to be a servant of the church and of society, the University seeks to fulfill its calling through excellence in teaching and research, in scholarship and publication, and in service to the community, both local and global.

While remaining true to its Christian heritage, the University has grown to approximately 14,000 students, and its nationally recognized academic divisions provide 146 baccalaureate degree programs at the undergraduate level. The University also offers 80 master's, 21 doctoral programs, two educational specialists, juris doctor, master of divinity, master of theological studies and doctor of ministry. The 764-acre campus is located on the banks of the Brazos River in Waco, Texas, a metropolitan area of 200,000 people.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting & Reporting

The financial statements of the University include the accounts of the University, Waco Arbors Holding Corporation and Brazos Valley Public Broadcasting Foundation (KWBU), legally separate entities, the board of directors of which are chosen by the University's Board of Regents. The University's financial statements do not include the accounts of the Baylor Foundation, Baylor Bear Foundation, Baylor-Waco Foundation or Baylor Alumni Association. These entities are excluded due to the nature of their relationship to the University or due to their aggregate assets, revenues, expenses and net assets not being significant in relation to the University.

The financial statements of the University are prepared in conformity with accounting principles generally accepted in the United States of America. The University's net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

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

Temporarily restricted -- net assets subject to donor-imposed or legal restrictions that may meet or will be met either by actions of the University and/or the passage of time.

Permanently restricted -- net assets subject to donor-imposed restrictions that the assets be maintained permanently. Generally, the donors of these assets permit the University to use all or part of the income earned on the related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless the use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as net assets released from temporary restrictions among applicable net asset classes.

Income and realized net gains and losses on investments are reported as follows:

- As changes in permanently restricted net assets if so restricted by the donor;
- As changes in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income or gains and losses; and
- As changes in unrestricted net assets in all other cases.

Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources available to the University, the internal accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes are classified into funds that are in accordance with specified activities or objectives. These financial statements, however, are prepared to focus on the entity as a whole and to present transactions according to the existence or absence of donor-imposed restrictions.

Functional Allocation of Expenses

The expenses of providing various programs and support services have been categorized on a functional basis in the statements of activities. Accordingly, expenses such as depreciation and operation and maintenance of plant have been allocated directly or based on square footage among the functional categories.

Fundraising expenses of approximately $11,350,000 and $9,676,000 incurred by the University in 2007 and 2006, respectively, are included in the institutional support category in the statements of activities.

Contributions

Contributions are recorded as revenues in the appropriate net asset class based on donor-imposed restrictions. Expiration of temporary restrictions on donor contributions are reported as net assets released from restrictions. Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the unrestricted net asset class.

Donor contributions to fund construction projects are classified as temporarily restricted net assets until the facility is placed in service. At that time, the temporarily restricted net assets are released from restriction and replenish unrestricted net asset balances designated for plant projects. The University follows the policy of recording contributions of long-lived assets directly as invested in plant assets instead of recognizing the gift over the useful life of the asset.

Cash & Cash Equivalents

Cash on deposit and all highly liquid financial instruments with maturities of three months or less are classified as cash and cash equivalents, except those amounts assigned to investment managers, which are classified as investments. Cash and cash equivalents reflected in the accompanying balance sheets as temporarily or permanently restricted are funds from contributions that have donor-imposed restrictions limiting their use to future investment in plant or are awaiting long-term investment for other long-term purposes. The fair value of cash equivalents is estimated to be the same as book value due to the short maturity of these instruments.

Short-Term Investments

Short-term investments consist of operational funds invested in bank time deposits, short-term U.S. government securities, those having maturities longer than three months but less than one year, and highly liquid money market funds. The fair value of short-term investments is estimated to be the same as book value due to the short maturity of these instruments.

Endowment

Endowment net assets classified as unrestricted include realized gains and losses and net unrealized appreciation (depreciation) on endowment assets, the earnings of which are unrestricted by the donor. Endowment net assets classified as temporarily restricted include realized gains and losses and net unrealized appreciation (depreciation) on endowment assets that are restricted by the donor for a specific purpose. Permanently restricted endowment net assets are those assets that must be invested in perpetuity to provide a permanent source of income.

Board-designated endowment net assets include gifts and funds that have been designated by the Board of Regents (the “Board”) to function as endowment. These funds may be expended at the discretion of the Board. Also included are certain temporarily restricted net assets that have not been expended for their restricted purpose but are being invested and the earnings expended for the restricted purpose.

The Baylor University Fund (“BUF”) is a unitized fund consisting of equities, fixed income and alternative assets and serves as the primary investment vehicle for the University’s endowment and other long-term investments. The University has adopted a spending policy for the BUF whereby the Board authorizes a dividend to be paid for endowments participating in the BUF for the purposes intended by the donors. This policy attempts to meet three objectives: (1) provide a predictable, stable stream of earnings to participating accounts; (2) ensure that the purchasing power of this revenue stream does not decline over time; and (3) ensure that the purchasing power of the endowment assets do not decline over time. Under this policy, actual earnings, as well as a prudent portion of realized and unrealized gains, may be expended for operational needs. For the years ended May 31, 2007 and 2006, this dividend was based on 5% of the previous 48 months' average market value per unit of the BUF subject to a 3% minimum and a 6% maximum dividend rate increase from the previous year. The 3% minimum dividend rate increase was utilized for both years ended May 31, 2007 and 2006. During the year ended May 31, 2007, the Board revised the spending policy of the BUF to decrease the 3% minimum dividend rate increase to 0%; this policy change will be effective with the year ended May 31, 2008.

Split Interest Agreements

Split interest agreements consist primarily of gift annuities, charitable remainder unitrusts and annuity trusts, life income funds and perpetual trusts. Assets held under these agreements are included in long-term investments (see Note 2), except for agreements administered by the Baptist Foundation of Texas ("BFT") and others as temporary trustees. The net present values of these agreements administered by the BFT and others as temporary trustees are reflected as unconditional promises to give (see Note 11). Annuities payable are recorded at the present value of future payments, based on the Internal Revenue Service ("IRS") discount rate at the time of the original gift.

Student Loans

The assets and liabilities of student loans financed primarily by the federal government and administered by the University, primarily the Federal Perkins Loan Program, are included with those of the University. The total of the federal government portion of these net assets is included in other liabilities in the accompanying balance sheets.

Property, Plant & Equipment

Property, plant & equipment valued at $5,000 or more are recorded at cost at date of acquisition or, if acquired by gift, at estimated fair value at date of gift. Additions to plant assets are capitalized, while maintenance and minor renovations are charged to operations. Plant assets are reflected net of accumulated depreciation calculated on a straight-line basis over the estimated useful lives ranging from 3 to 50 years.

Deposits & Deferred Income

Deposits & deferred income consist of amounts billed or received for educational, research or auxiliary goods and services that have not yet been earned. Tuition & fees revenues are recognized in the fiscal year during which the related semester concludes.

Use of Estimates & Assumptions

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues and expenses during the reporting period, as well as the disclosure of contingent assets and liabilities. Significant items subject to such estimates and assumptions include valuations of certain investments which do not have readily determinable fair values, allowances for uncollectible accounts and contingency reserves, calculations of asset retirement obligations and actuarially determined liabilities related to postretirement benefit plans. Actual results ultimately could differ from management's estimates and assumptions.

Other

To provide additional information in the reporting of assets and to conform to the May 31, 2007 statement presentation, the following reclassifications were made to the accompanying May 31, 2006 balance sheet. Operational funds totaling $60,224,000 invested in bank time deposits, short-term U.S. government securities and highly liquid money market funds are now reported separately as short-term investments instead of as a component of cash & cash equivalents. Also, $63,255,000 of bond proceeds held by trustees is now reported separately instead of as a component of long-term investments.

During the year ended May 31, 2007, the reporting of intercollegiate athletics revenues was changed to be reflected as a separate component of other sources, and the intercollegiate athletics expenses were moved to the student services & activities category in the statements of activities in accordance with National Association of College and University Business Officers' guidelines. As a result, $14,616,000 of intercollegiate athletics revenues, previously reported as sales & services of auxiliary enterprises, has been moved in the accompanying 2006 statement of activities to other sources – intercollegiate athletics. Also, $28,960,000 of intercollegiate athletics expenses, previously reported in the auxiliary enterprises category, has been reclassified in the accompanying 2006 statement of activities to be a component of student services & activities.

The following changes were also made to the accompanying 2006 statement of activities to enhance the functional reporting of the expenses and for comparability with the 2007 statement presentation. $1,094,000 of expenses associated with the operations of the University's living and learning centers has been reclassified from auxiliary enterprises to the instruction and student services & activities functional categories. Also, $693,000 of intercollegiate athletics' ticket sales to University departments and $697,000 of services provided by KWBU to University departments were adjusted to reflect the elimination of these as revenues and expenses.

2. LONG-TERM INVESTMENTS

The University's long-term investments are recorded at fair value. The estimated fair value of investments is based on quoted market prices, except for certain alternative assets for which quoted market prices are not available. The estimated fair value of these alternative assets is based on the most recent valuations provided by the external investment managers, adjusted for receipts and disbursements through May 31. The University reviewed and evaluated the values provided by the managers and agreed with the valuation methods and assumptions used to determine those values. Therefore, the University believes the carrying amount of these financial instruments is a reasonable estimate of the fair value. Because alternative assets are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed.

Cost and estimated fair value of investments as of May 31, 2007 and 2006, are as follows:

	(in thousands of dollars)			
	2007		2006	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Investments:				
Debt securities	$ 65,230	$ 93,593	$ 66,059	$ 90,370
Equity securities	365,660	580,624	348,808	499,148
Alternative assets	220,205	353,416	182,731	270,516
Real estate	7,544	17,802	8,031	16,905
Mineral rights	13,121	34,003	9,656	34,900
Other	708	1,001	562	818
Total investments	$ 672,468	$1,080,439	$ 615,847	$ 912,657

Net appreciation (depreciation) in the fair value of investments, which consists of realized gains and losses and unrealized appreciation (depreciation) on those investments, is shown in the statements of activities.

Alternative assets are not as liquid as other University investments. Alternative assets are invested in sixty-nine different funds. The total fair values by strategy type are as follows:

	(in thousands of dollars)	
	2007	2006
Alternative assets:		
Private equity	$ 117,722	$ 81,160
Absolute return	111,015	108,822
Real assets	124,679	80,534
Total alternative assets	$ 353,416	$ 270,516

The fair value of real estate is determined from the most recent information available to the University (i.e., appraisals and/or property tax statements). The fair value of mineral rights is estimated based on the income stream generated by those assets.

Investments include interests in split interest agreements. The fair values representing interests in split interest agreements are $170,546,000 and $148,500,000 as of May 31, 2007 and 2006, respectively.

Investment returns for the years ended May 31, 2007 and 2006, consist of the following:

	(in thousands of dollars)	
	2007	2006
Endowment earnings distributed	$ 48,377	$ 45,653
Realized gains on investments	11,744	10,342
Unrealized gains on investments	109,131	86,955
Total investment returns	$ 169,252	$ 142,950

The total investment returns are net of investment expenses of $6,878,000 and $6,217,000 for the years ended May 31, 2007 and 2006, respectively.

3. PROPERTY, PLANT & EQUIPMENT

At May 31, 2007 and 2006, property, plant & equipment assets consist of the following:

	(in thousands of dollars)	
	2007	2006
Land	$ 30,755	$ 28,815
Buildings	558,322	547,679
Equipment	62,518	62,974
Other	99,100	95,804
	750,695	735,272
Less accumulated depreciation	(243,244)	(223,808)
	507,451	511,464
Construction-in-progress	56,086	9,791
Property, plant & equipment, net	$ 563,537	$ 521,255

Depreciation & amortization expense was $26,458,000 and $27,148,000 for the years ended May 31, 2007 and 2006, respectively. Real and personal property were insured for $1.3 billion at May 31, 2007 and 2006.

4. NOTES & BONDS PAYABLE

Notes & bonds payable consisting of both non-interest bearing unsecured notes and interest bearing unsecured and secured notes and bonds with varying terms and maturity dates to February 1, 2036 were $290,670,000 and $301,704,000 at May 31, 2007 and 2006, respectively. Interest payments on a cash basis totaled $13,206,000 and $11,699,000, and interest expense was $13,195,000 and $11,376,000 for the years ended May 31, 2007 and 2006, respectively.

The University issued $247,500,000 in tax-exempt and taxable revenue bonds through the Waco Education Finance Corporation during the fiscal year ended May 31, 2002, of which $47,059,000 was used to refinance Series 1997, 1998, 1999, 2000 and 2001 bonds. The University issued an additional $63,500,000 in tax-exempt revenue bonds through the Waco Education Finance Corporation in May, 2006. The University capitalized and is amortizing on a straight-line basis bond issuance costs related to the Series 2002A, 2002B, 2002C and 2006 issues over the life of the bonds. As of May 31, 2007 and 2006, unamortized bond issuance costs of $4,389,000 and $4,557,000, respectively, are included in prepaid expenses & other in the University's balance sheets. Amortization expense for issuance costs was $196,000 and $163,000 for the years ended May 31, 2007 and 2006, respectively.

Earnings of $2,423,000 and $110,000, for the years ended May 31, 2007 and 2006, respectively, on the Series 2006 Waco Education Finance Corporation Tax-Exempt Variable Rate Demand Bond proceeds, exceeded capitalizable interest expense. Therefore, no net interest expense was capitalized to projects for the years ended May 31, 2007 and 2006.

Notes & bonds payable at May 31, 2007 and 2006, consist of the following:

	(in thousands of dollars)	
	2007	2006
Non-interest bearing unsecured note payable to a foundation, due in annual installments beginning June 30, 2004 to June 30, 2013	$ 3,500	$ 4,000
Non-interest bearing unsecured note payable to a foundation, due in quarterly installments as repayments from loans to students are received	898	1,276
Non-interest bearing unsecured notes payable to a corporation, due in monthly installments through September 1, 2008	334	584
Secured note payable to a private entity (secured by land), bearing interest at 7.5%, due in annual installments of $747,314 to January 1, 2012	3,023	3,508
Non-interest bearing unsecured note payable to a private entity, due in annual installments through June 30, 2008	140	210
Secured note payable to a private entity (secured by property), bearing interest at 9.57%, due in monthly installments through July 1, 2006, paid in full August 1, 2006	--	1,801
Series 2002A Waco Education Finance Corporation Tax-Exempt Variable Rate Demand Bonds, swapped to a fixed rate of 4.91% (see Note 5), interest payable semiannually, principal payable annually to February 1, 2032	162,525	165,800
Series 2002B Waco Education Finance Corporation Tax-Exempt Select Auction Variable Rate Securities ("SAVRS"), originally bearing interest at the SAVRS rate for each 35-day auction rate period; the variable rate swapped to a synthetic fixed rate of 3.83% (see Note 5) in 2005, interest payable semiannually, principal payable annually to February 1, 2032	46,775	50,050
Series 2002C Waco Education Finance Corporation Taxable SAVRS, bearing interest at the SAVRS rate for each 35-day auction rate period (5.25% and 4.90% at May 31, 2007 and 2006, respectively), principal payable annually to February 1, 2032	10,775	10,975
Series 2006 Waco Education Finance Corporation Tax-Exempt Variable Rate Demand Bonds, swapped to a synthetic fixed rate of 3.543% (see Note 5), interest payable monthly, principal payable annually to February 1, 2036	62,700	63,500
Total notes & bonds payable	$290,670	$301,704

The fair values of notes & bonds payable are not materially different from the book values as of May 31, 2007 and 2006.

Principal and interest on notes and bonds for the periods subsequent to May 31, 2007, are as follows:

(in thousands of dollars)

	2008	2009	2010	2011	2012	2013 and Thereafter	Total
Principal	$ 7,740	$ 7,888	$ 7,950	$ 7,997	$ 7,945	$ 251,150	$ 290,670
Interest	12,700	12,386	12,058	11,714	11,354	145,363	205,575
Total	$ 20,440	$ 20,274	$ 20,008	$ 19,711	$ 19,299	$ 396,513	$ 496,245

5. DERIVATIVE FINANCIAL INSTRUMENTS

The University has entered into long-term interest rate swap agreements with a financial institution counterparty to manage the interest cost and risk associated with its outstanding debt. The purpose of these agreements is to swap the University's Series 2002A variable rate demand bonds having a balance of $162,525,000 as of May 31, 2007, for a fixed rate of 4.91% through February 1, 2032; to swap the University's Series 2002B variable rate demand bonds having a balance of $46,775,000 as of May 31, 2007, for a synthetic fixed rate of 3.83% under a BMA/LIBOR-based structure through February 1, 2032; and to swap the University's Series 2006 variable rate demand bonds having a balance of $62,700,000 as of May 31, 2007, for a synthetic fixed rate of 3.543% under a LIBOR-based structure through February 1, 2036. The University entered into these swap agreements to obtain fixed rate financing at the lowest available cost at the time of the transaction. The value of the swap instruments represents the estimated cost to terminate the swap agreement at the reporting date, taking into account current and projected interest rates. The fair value of the interest rate swaps included in the University's balance sheets as a liability at May 31, 2007 and 2006, was $19,380,000 and $16,413,000, respectively. To control credit risk, the University considered the credit rating and reputation of the counterparty before entering into the transaction and will monitor the credit standing of its counterparty during the life of the transaction. The change in net assets resulting from changes in the swaps' fair value resulted in a loss of $2,967,000 and a gain of $20,971,000, for the years ended May 31, 2007 and 2006, respectively.

Subsequent to May 31, 2007, the University entered into a $25,700,000 total return investment swap agreement with a financial institution. This swap agreement will be an investment of the BUF and has no impact on the University's financial statements for the year ended May 31, 2007.

6. EXPENSES BY NATURAL CLASSIFICATION

While the statements of activities present expenses by function, the University's expenses by natural classification are as follows:

	(in thousands of dollars)	
	2007	2006
Salaries & wages	$ 133,183	$ 124,153
Personnel benefits	42,950	38,622
Student wages & fellowships	13,881	13,070
Operating expenses	113,658	101,444
Depreciation & amortization	26,458	27,148
Interest on indebtedness	13,195	11,376
Total expenses	$ 343,325	$ 315,813

7. RETIREMENT PLAN

The University has a noncontributory retirement plan covering all full-time faculty and staff. The plan is a defined contribution plan and is administered by outside agencies. Retirement benefits equal the amount accumulated to each individual employee's credit at the date of retirement. The University's contributions to the plan for the years ended May 31, 2007 and 2006, were $10,159,000 and $9,386,000, respectively.

8. POSTRETIREMENT BENEFITS

The University provides medical and life insurance benefits for eligible retired faculty and staff. Employees are eligible for such benefits if they retire after attaining specified age and service requirements while employed by the University. Through May 31, 2002, full-time faculty and staff became eligible for these benefits upon reaching age 55 and having 20 years of full-time service at retirement. The lifetime maximum on group medical benefits is $2,000,000, and the maximum benefit for life insurance is $20,000. The factors in the calculation of medical benefits include retiree premium contributions, deductibles and coinsurance provisions that are assumed to grow with the medical inflation rate.

Effective June 1, 2002, employees attaining the age of 55 with 20 years of continuous, full-time service at the University as of May 31, 2007, will continue under the postretirement medical and life insurance programs in effect before June 1, 2002. Those employees not meeting the above eligibility requirements may still participate in the postretirement medical program but will receive no postretirement life insurance benefits and will not be reimbursed for Medicare Part B premiums. Under the new plan, all full-time faculty and staff become eligible for postretirement benefits upon reaching age 55 and having 10 years of full-time service at retirement.

The University follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. This statement requires that the expected cost of postretirement benefits be charged to operations on an accrual basis during the years that the faculty and staff render service. SFAS No. 106 also requires that the accumulated obligation at the implementation date be recognized as a liability and that an offsetting amount be recognized as a reduction in net assets or amortized as an expenditure over 20 years. The University chose to amortize the accumulated postretirement benefits over 20 years. The accrued post retirement benefit cost is included in personnel related liabilities in the University's balance sheets.

The following tables set forth the required disclosures and unfunded status of postretirement benefits as well as the components of net periodic benefit costs and weighted-average assumptions as of the measurement date, May 31:

	(in thousands of dollars)	
	2007	2006
Change in benefit obligation:		
Measurement date	5/31/2007	5/31/2006
Accumulated postretirement benefit obligation (APBO) at beginning of year	$ 27,052	$ 26,823
Service cost	691	907
Interest cost	1,673	1,568
Plan participants' contributions	1,138	1,079
Plan amendment	--	5,691
Actuarial (gain) loss	2,108	(6,839)
Benefit payments	(2,331)	(2,177)
Accumulated postretirement benefit obligation (APBO) at end of year	$ 30,331	$ 27,052
Change in plan assets:		
Fair value of plan assets at beginning of year	$ --	$ --
Actual return on plan assets	--	--
Employer contributions	1,193	1,098
Plan participants' contributions	1,138	1,079
Benefit payments	(2,331)	(2,177)
Fair value of plan assets at end of year	$ --	$ --

	(in thousands of dollars) 2007	2006
Excess of (benefit obligation) over/(under) plan assets	$ (30,331)	$ (27,052)
Unrecognized transition obligation	1,642	1,916
Unrecognized prior service cost	4,727	5,369
Unrecognized net loss	5,703	3,651
Accrued postretirement benefit cost	$ (18,259)	$ (16,116)

Weighted-average assumptions at measurement date:	2007	2006
Discount rate	6.09%	6.31%
Health care cost trend rate	8.50%	9.00%
Ultimate health care cost trend rate	5.00%	5.00%
Year ultimate trend rate reached	2014	2015

Projected cash flows:	Gross Benefit Payments Net of Employee Contributions	Gross Subsidy Receipts
2008 Fiscal year	$ 1,353	$ 206
2009 Fiscal year	1,433	228
2010 Fiscal year	1,532	252
2011 Fiscal year	1,626	278
2012 Fiscal year	1,720	306
2013-2017 Fiscal years	10,325	2,125

Expected employer contributions:	
2008 Fiscal year	$ 1,147

Components of net periodic postretirement benefit cost:	6/1/06-5/31/07	6/1/05-5/31/06
Measurement date	5/31/2006	5/31/2005
Service cost	$ 691	$ 907
Interest cost	1,673	1,568
Amortization of:		
Transition obligation	274	274
Prior service cost	643	321
Actuarial loss	56	393
Net periodic postretirement benefit cost	$ 3,337	$ 3,463

Weighted-average assumptions for net periodic postretirement benefit cost:		
Measurement date	5/31/2006	5/31/2005
Discount rate	6.31%	5.50%
Health care cost trend rate	9.00%	9.50%
Ultimate health care cost trend rate	5.00%	5.00%
Year ultimate trend rate reached	2015	2011

Other Information:	*(in thousands of dollars)* 6/1/06-5/31/07	6/1/05-5/31/06
1% increase in trend rates		
Effect on service + interest cost	$ 278	$ 480
Effect on APBO	2,536	3,454
1% decrease in trend rates		
Effect on service + interest cost	$ (216)	$ (371)
Effect on APBO	(2,043)	(2,769)

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act), which introduced a prescription drug benefit under Medicare, was signed into law. Effective January 1, 2006, the University adjusted the premium structure for the retiree health and welfare benefit plan in order for the retiree prescription drug plan to qualify for the federal retiree drug subsidy. The University has determined that its retiree prescription drug plan is actuarially equivalent to the Standard Medicare Part D benefit and is thus eligible for the federal retiree drug subsidy beginning in 2006. The measures of APBO and net periodic postretirement benefit cost in the financial statements and accompanying notes reflect the effects of the Act on the plan.

The University reflected the effects of the Act on the plan during the fiscal year ended May 31, 2006. The increase in the APBO as of December 1, 2005, resulting from the changes in the plan to qualify for the federal retiree drug subsidy, was $12,688,000.

In September, 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment to FASB Statements No. 87, 88, 106 and 132R. Statement No. 158 requires an employer to recognize the over funded or under funded status of a defined benefit postretirement plan (other than a multi-employer plan) as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The effective date of the recognition for non-public companies is for fiscal years ending after June 15, 2007. The University is in the process of determining the financial impact of recording the full liability and change in net assets for the year ending May 31, 2008.

9. OUTSTANDING LEGACIES

The University is the beneficiary under various wills and trust agreements, the realizable amounts of which are not presently determinable. The University's share of such bequests is recorded when the University has an irrevocable right to the bequest and the proceeds are measurable.

10. TAX STATUS

The University is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code. The University has been classified as an organization that is not a private foundation, and contributions to it qualify for deduction as charitable contributions. The University files unrelated business income tax and other information returns as required by government authorities.

11. UNCONDITIONAL PROMISES TO GIVE

As pledges are made to the University, the intent of the donor, the circumstances surrounding the pledge and any action taken by the University in response to the pledge are considered in determining whether the pledge is an "intent to give" or an "unconditional promise to give." An intent to give is not recorded as revenue until collected or when converted to an unconditional promise to give. An unconditional promise to give is recorded as a contribution receivable and as revenue at the present value of the estimated future cash flows.

Intents to give total $24,796,000 and $24,647,000 as of May 31, 2007 and 2006, respectively. Payments on these intents to give are due in varying periods.

As of May 31, 2007 and 2006, unconditional promises to give consist of the following:

	(in thousands of dollars)	
	2007	2006
Restricted current funds	$ 426	$ --
Endowment funds	--	500
Plant projects:		
Due in 1 year	550	1,023
Due in 1 to 5 years	3,600	865
Split interest agreements	23,967	24,206
Less: Present value adjustment	(10,186)	(10,104)
Total contributions receivable	$ 18,357	$ 16,490

The unconditional promises to give related to split interest agreements are discounted based on life expectancies of the annuity recipients.

12. COMMITMENTS AND CONTINGENCIES

Capital Expenditures

The University is contractually obligated for amounts aggregating a maximum of approximately $16,184,000 and $50,082,000 at May 31, 2007 and 2006, respectively. Such obligations relate primarily to capital projects.

Energy Purchase Agreement

On December 22, 2006, the University entered into a ten year fixed-price purchase agreement with an energy company to purchase, beginning in July, 2008, approximately 100,000,000 kilowatt-hours of electricity per year at a fixed rate of approximately $.07 per kilowatt-hour. No amounts were paid for this agreement up front. Payments under this agreement will be made based upon the volume ordered at the contract price in the applicable periods. The cost of the electricity purchased through this agreement will be recorded as an expense in the period that the electricity is delivered.

Leases

The University incurred $637,000 and $195,000 in operating lease expenses for facilities and equipment in the fiscal years ended May 31, 2007 and 2006, respectively. As of May 31, 2007, the University has lease commitments for future periods totaling approximately $2,557,000.

(in thousands of dollars)

	2008	2009	2010	2011	2012	2013 and Thereafter	Total
Equipment	$ 576	$ 514	$ 514	$ 514	$ 164	$ 55	$ 2,337
Vehicles	11	5	--	--	--	--	16
Other	115	29	7	8	8	37	204
Total	$ 702	$ 548	$ 521	$ 522	$ 172	$ 92	$ 2,557

Investments

As part of the University's alternative assets program, the University is obligated under certain limited partnership agreements to advance funding up to specified levels upon the request of the general partner. The

University had unfunded commitments of $150,974,000 and $151,656,000 at May 31, 2007 and 2006, respectively, which are expected to be called over the next five years.

Contingencies

The University is a party to various legal proceedings and complaints arising in the ordinary course of operations, some of which are covered by insurance. The administration is not aware of any claims or contingencies, which are not covered by insurance, that would be material to the financial position of the University.

The University participates in several state and federal grant programs and must comply with requirements of the grantor agencies. The administration is of the opinion that the University is in compliance with these grantor requirements.

13. ASSET RETIREMENT OBLIGATIONS

In March 2005, the Financial Accounting Standards Board (FASB) issued Interpretation No. 47 (“FIN 47”), *Accounting for Conditional Asset Retirement Obligations* (an interpretation of FASB Statement No. 143). This interpretation provided clarification with respect to the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. This interpretation requires that the fair value of a liability for a conditional asset retirement obligation be recognized in the period in which it occurred if a reasonable estimate of fair value can be made. Upon adoption of FIN 47 in the year ended May 31, 2007, the University recognized asset retirement obligations related primarily to asbestos contamination in buildings and recorded a non-cash transition charge of $2,685,000, which is reported as a cumulative effect of a change in accounting principle in the statements of activities. The liability for conditional asset retirement obligations was $3,218,000 as of May 31, 2007 and is included in other liabilities in the accompanying balance sheets. Had FIN 47 been adopted prior to May 31, 2007, the liability for conditional asset retirement obligations would have been $2,807,000 at June 1, 2005 and $3,038,000 at May 31, 2006. In addition, upon adoption of FIN 47, the University capitalized $989,000 of asset retirement costs with an accumulated depreciation balance of $635,000.

14. NEW ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”), which prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The interpretation is effective for fiscal years beginning after December 15, 2006. The University is in the process of determining the financial impact of FIN 48.

In September 2006, FASB issued Statement No. 157, *Fair Value Measurements*. The statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The University is in the process of determining the financial impact of Statement No. 157.

In February 2007, FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, including an amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The statement permits entities to choose to measure financial instruments and other items at fair value that are not currently required to be measured at fair value. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The University is in the process of determining the financial impact of Statement No. 159.