UNIVERSITY OF ALASKA

(A Component Unit of the State of Alaska)

Financial Statements

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

University of Alaska
(A Component Unit of the State of Alaska)
Financial Statements
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Table of Contents

Introduction

The following discussion and analysis provides an overview of the financial position and activities of the University of Alaska (university) for the years ended June 30, 2006 (fiscal year 2006) and June 30, 2005 (fiscal year 2005), with selected comparative information for the year ended June 30, 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements including the notes thereto, which follow this section.

Using the Financial Statements

The university's financial report includes the basic financial statements of the university and the financial statements of the University of Alaska Foundation (foundation), a legally separate, non profit component unit. The three basic financial statements of the university are: the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows. These statements are prepared in accordance with generally accepted accounting principles and Governmental Accounting Standards Board (GASB) pronouncements. The university is presented as a business-type activity. GASB Statement No. 35, *Basic Financial Statement—and Management's Discussion and Analysis—for Public Colleges and Universities*, establishes standards for external financial reporting for public colleges and universities and classifies resources into three net asset categories – unrestricted, restricted, and invested in capital assets, net of related debt.

The University of Alaska Foundation is presented as a component unit of the university in accordance with GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. The foundation's financial statements include the Statement of Financial Position and the Statement of Activities and these statements are presented as originally audited according to generally accepted accounting principles and Financial Accounting Standards Board (FASB) pronouncements.

The foundation was established to solicit donations and to hold and manage such assets for the exclusive benefit of the university. Resources managed by the foundation and distributions made to the university are governed by the foundation's Board of Trustees (operating independently and separately from the university's Board of Regents). The component unit status of the foundation indicates that significant resources are held by the foundation for the sole benefit of the university. However, the university is not accountable for, nor has ownership of, the foundation's resources.

Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities (net assets) is one indicator of the financial condition of the university, while the change in net assets is an indicator of whether the financial condition has improved or declined during the year.

A summarized comparison of the university's assets, liabilities and net assets at June 30, 2006, 2005 and 2004 follows ($ in thousands):

	2006	2005	2004
Assets:			
Current assets	$ 106,614	$ 119,109	$ 109,721
Other assets	251,405	194,918	182,960
Capital assets, net of depreciation	731,010	737,290	760,757
Total assets	1,089,029	1,051,317	1,053,438
Liabilities:			
Current liabilities	80,444	76,600	69,631
Noncurrent liabilities	161,730	140,658	133,576
Total liabilities	242,174	217,258	203,207
Net assets			
Invested in capital assets, net of debt	608,596	625,727	648,016
Restricted – expendable	58,590	48,969	36,591
Restricted – nonexpendable	123,275	118,462	111,142
Unrestricted	56,394	40,901	54,482
Total net assets	$ 846,855	$ 834,059	$ 850,231

The financial position of the university improved in fiscal year 2006 as indicated by the growth in net assets of $12.8 million, or 1.5 percent. Unrestricted net assets increased 38 percent to $56.4 million at June 30, 2006. Major changes to financial position during fiscal year 2006 included a reduction in cash and cash equivalents, growth in investments, and increases in noncurrent liabilities. During fiscal year 2006, management diversified investments to improve the university's financial position. Increases primarily in the net pension (NPO) and other postemployment benefit (OPEB) obligations, reduced overall growth in net assets. Each of these changes is discussed in more detail in the following sections.

Cash and cash equivalents at June 30, 2006 were $32.9 million as compared to $57.3 million in 2005 and $41.8 million in 2004. In more recent years, cash and cash equivalents have steadily increased primarily due to improved receivable collections and increases in student tuition and fees revenue. In fiscal year 2006, the university began investing more of the university's operating funds in short-term and long-term investments as summarized below:

- Short-term investments increased from $1.3 million at June 30, 2005 to $15.5 million at June 30, 2006. These funds were invested in the Common*f*und's Intermediate Term Fund which had a 2.75 percent total return for the year ended June 30, 2006.

- Long-term investments at June 30, 2006 were $62.6 million as compared to $21.4 million in 2005. Approximately, $36.7 million was invested in the Common*f*und's Absolute Return Fund, $20.1 million in the Common*f*und's Multi-Strategy Bond Fund (a new university investment as of March 31, 2006), and $5.8 million in various operating and capital bond or construction-related funds. The Absolute Return Fund had a total return of 10.77 percent for the year ended June 30, 2006.

Due to a combination of an improved cash position and the stabilization of interest rate increases by the Federal Reserve, management increased and diversified investments as a strategy in improving the university's financial position. See Note 2 of the financial statements for further information on deposits and investments.

Total liabilities increased 11.5 percent from $217.3 million at June 30, 2005 to $242.2 million at June 30, 2006. Increased liabilities are mainly attributed to:

- Long-term debt financing with issuance of Series N general revenue bonds totaling $24.4 million in fiscal year 2006. A portion of the bonds, $10.3 million, was used to advance refund other general revenue bonds and redeem a note payable. The remaining bond proceeds of $14.1 million are dedicated for capital improvement projects.

- The State of Alaska Public Employees' Retirement System (PERS) combined net pension and OPEB obligations increased from $15.4 million at June 30, 2005 to $25.4 million at June 30, 2006. The PERS-related obligations are the result of an employer required contribution rate that was lower than the full actuarial rate.

Unrestricted net assets increased $15.5 million from June 30, 2005 to June 30, 2006. At year end, $24.7 million of the $56.4 million total is designated by the Board of Regents for specific purposes or otherwise limited by contractual agreements with external parties. See Note 7 of the financial statements for a detailed list of these designations.

Fiscal Year 2005 Comparisons (Statement of Net Assets)

For comparative purposes, significant comments about changes between 2004 and 2005 that were noted in fiscal year 2005 Management's Discussion and Analysis are summarized below:

Major changes from 2004 to 2005 on the Statement of Net Assets include those with accounts receivable, endowment investments, liabilities, and unrestricted net assets. Net accounts receivable decreased 11 percent from $58.0 million at June 30, 2004 to $51.6 million at June 30, 2005. The decrease was primarily due to net sponsored programs receivables decreasing by $5.3 million to $34.6 million. For the same period, sponsored programs revenue increased 5.7 percent reflecting an improvement in the billing and collection process. Restricted expendable endowment net assets increased $13.3 million to $37.2 million at June 30, 2005. The increase was mostly due to several significant land sales and a close out payment received on the university's timber harvesting contract. Total liabilities increased by $14.1 million, to $217.3 million at June 30, 2005. The State of Alaska PERS combined $15.4 million net pension and OPEB obligations recorded at June 30, 2005 significantly contributed to increased liabilities. Overall, in fiscal year 2005, the university experienced a 25 percent, or $13.6 million, reduction in unrestricted net assets. Increased costs of $9.6 million for pension plans, $15.4 million in net pension and OPEB obligations, and $5.6 million in net health care costs were primarily responsible for the reduction. From FY04 to FY05, the university experienced an overall decrease in net assets of $16.2 million or 1.9 percent.

Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets presents the results of operations for the university as a whole. Revenues, expenses and other changes in net assets are reported as either operating or nonoperating. Significant recurring sources of university revenue, such as state appropriations and investment earnings, are defined by GASB Statement No. 35 as nonoperating.

A summarized comparison of the university's revenues, expenses and changes in net assets for the years ended June 30, 2006, 2005 and 2004 follows ($ in thousands):

	2006	2005	2004
Operating revenues	$ 341,205	$ 319,013	$ 299,677
Operating expenses	(621,373)	(592,459)	(549,236)
Operating loss	(280,168)	(273,446)	(249,559)
Net nonoperating revenues	272,422	255,112	230,706
Loss before other revenues, expenses, gains, or losses	(7,746)	(18,334)	(18,853)
Other revenues, expenses, gains or losses	20,542	2,162	86,570
Increase (decrease) in net assets	12,796	(16,172)	67,717
Net assets at beginning of year	834,059	850,231	782,514
Net assets at end of year	$ 846,855	$ 834,059	$ 850,231

The Statement of Revenues, Expenses and Changes in Net Assets reflects an overall increase in net assets of 1.5 percent, or $12.8 million. Revenue sources contributed positively to the increase in net assets. However, rising costs in pension plans and the PERS net pension and OPEB obligations offset overall growth in net assets.

- PERS, Teachers' Retirement System (TRS), and Optional Retirement Plan (ORP) costs increased by $11.8 million for the year ended June 30, 2006.

- The PERS net pension and OPEB obligations increased by $10.0 million in fiscal year 2006.

In 2006, the university recorded a $10.0 million net pension and OPEB expense (and related liability) for the state-administered PERS defined benefit plan. This expense represents the difference between contribution amounts based on actuarially determined rates and contributions actually paid to PERS. Even though the university made the contributions required by the PERS board, these amounts were based on a capped rate that was 7.47 percentage points lower than the actuarially computed rate. The rate was capped in accordance with PERS board policy that limits yearly increases in the employer contribution rate to 5 percentage points.

Capital appropriations and capital grant and contract revenue increased from $17.6 million in 2005 to $30.5 million in 2006. Revenue from capital sources is generally recognized as expenditures occur. The State of Alaska appropriated capital funds totaling $0.5 million in 2005 and $48.1 million in 2006. For further discussion on capital activity, see the *Capital and Debt Activities* section which follows.

Student enrollment and tuition rate increases for the 2005 - 2006 academic year provided for gross student tuition and fee revenue of $85.3 million in fiscal year 2006 as compared to $75.9 million in fiscal year 2005. This was due in large part to a 10 percent increase in tuition rates for students for academic year 2005 - 2006. Student full-time equivalent enrollment for Fall 2005 was 17,397, a 0.3 percent decrease from the prior Fall period.

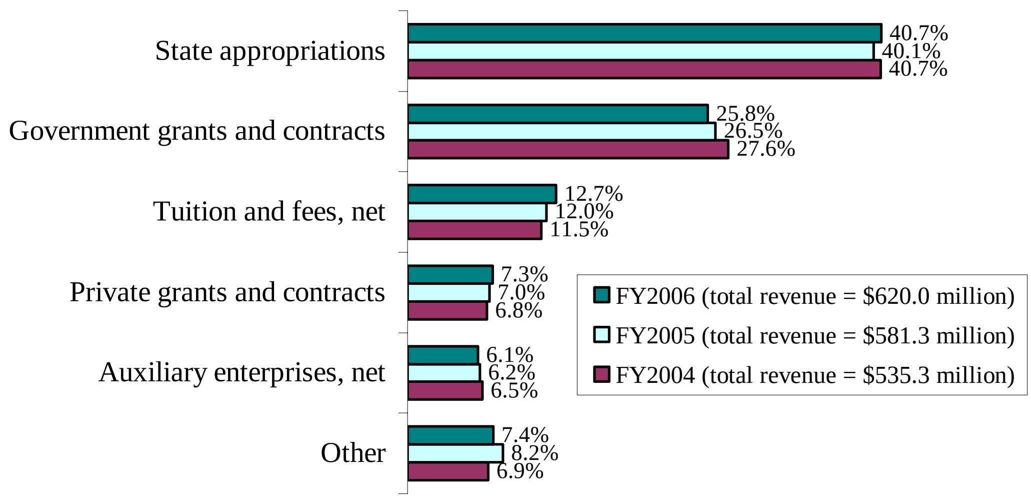
Endowment investment income was approximately $13.9 million, in 2006 as compared to $9.7 million, in the prior year. Total return was 12.3% in 2006 and 11% in 2005.

Endowment sales and other proceeds totaled $5.7 million in 2006 as compared to $16.5 million in 2005. This category includes yield from, or sales of, trust land, timber and mineral interests, the net proceeds of which are generally deposited to the land grant endowment trust fund.

State of Alaska general fund appropriations continue to be the single major source of revenue for the university, providing $252.5 million in 2006, as compared to $232.9 million in 2005. Historically, the Legislature has funded the university at an amount equal to or above the prior period's appropriation.

A comparison of operating and nonoperating revenues by source for fiscal year 2006, 2005 and 2004 follows:

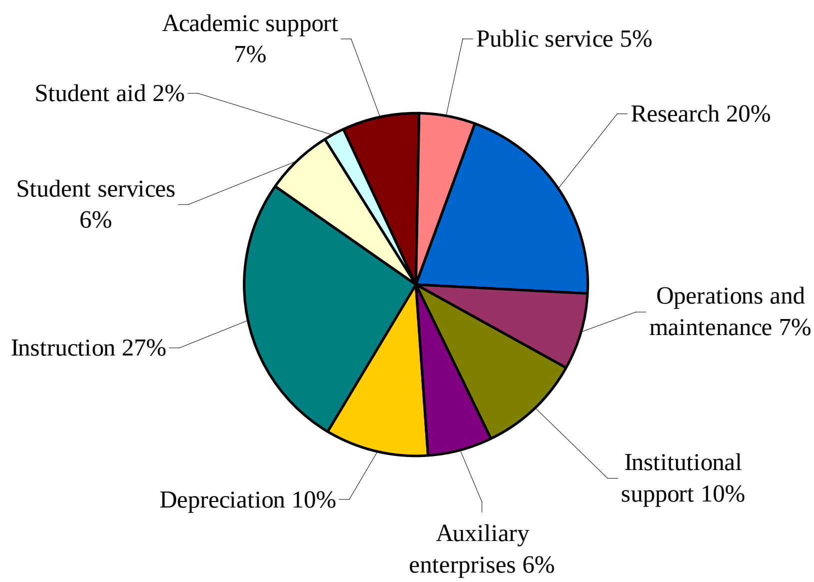
Operating and Nonoperating Revenues (excluding capital) by Year



Revenues from federal and other sources for sponsored research and education-related programs increased 5 percent, from $194.9 million in 2005 to $205.2 million in 2006. Facility and administrative cost recovery provided $32.0 million in 2006 as compared to $31.2 million in 2005. This funding enables the university to expand existing programs and start new programs, like those in health, science and basic research. In addition to supporting new programs, facility and administrative cost recovery reimburses the university for facilities and administrative costs necessary to operate and support sponsored programs, and provides cash flow to service debt on, and renew, research facilities.

A comparison of operating expenses by functional and natural classification for selected fiscal years follows (see Note 16 of the financial statements for more information):

Fiscal Year 2006
Functional Classification



Operating Expenses
Functional Classification (in millions)

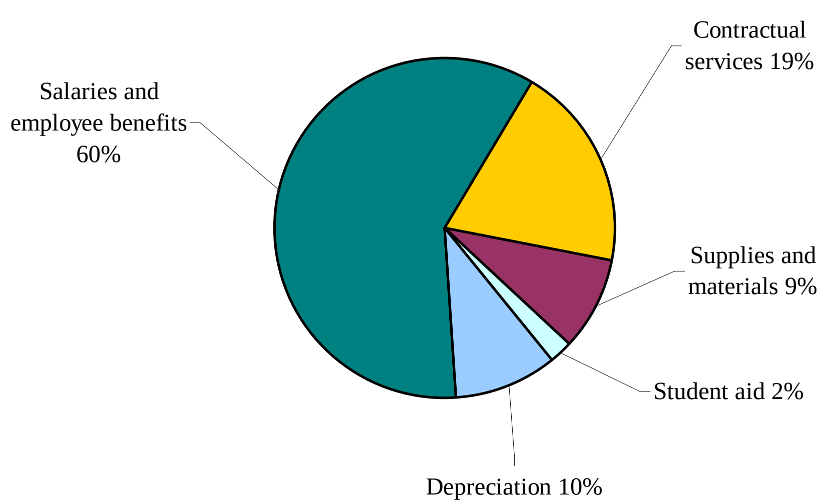
	FY2006		FY2005		FY2004	
Instruction	$163.5	26.3%	$150.0	25.3%	$144.1	26.2%
Student Services	38.5	6.2%	36.0	6.1%	33.0	6.0%
Student Aid	13.4	2.2%	12.8	2.2%	13.0	2.4%
Academic Support	44.6	7.2%	41.0	6.9%	37.1	6.8%
Student and Academic	$260.0	41.9%	$239.8	40.5%	$227.2	41.4%
Public Service	32.1	5.2%	31.2	5.3%	26.2	4.8%
Research	126.3	20.3%	119.0	20.1%	112.0	20.4%
Operations and Maintenance	44.2	7.1%	45.0	7.6%	39.2	7.0%
Institutional Support	61.8	9.9%	63.4	10.7%	50.3	9.2%
Auxiliary Enterprises	37.2	6.0%	33.9	5.7%	33.8	6.2%
Depreciation	59.8	9.6%	60.1	10.1%	60.5	11.0%
Total Operating Expenses	$621.4	100.0%	$592.4	100.0%	$549.2	100.0%

Student aid expense remained stable in fiscal year 2006. Certain amounts applied to student accounts for tuition, fees, or room and board are not reported as student aid expense, but are reported in the financial statements as an allowance, directly offsetting student tuition and fee revenue or auxiliary revenue. Allowances totaled $7.4 million in 2006 and $7.6 million in 2005.

In addition to the allowances, students participate in governmental financial aid loan programs. The loans are neither recorded as revenue nor expense in the financial statements, but are recorded in the Statements of Cash Flows as direct lending receipts totaling approximately $64 million and $57 million in fiscal year 2006 and 2005, respectively.

Institutional support expenses fluctuate due to the accounting method used to record employee benefits. The university employs a central benefits pool concept, and uses a staff benefit rate, to charge estimated employee benefits, such as pension and healthcare costs, to labor recorded in the various functional expense categories. Institutional support expenses are impacted when the amounts charged exceed, or are less than, actual benefits paid to third parties. Over recovery or under recovery of charges in one year are built into the rate building process the following year. When considered in total, operating expenses across all functional categories include the correct amount of employee benefit expense each fiscal year.

Fiscal Year 2006
Natural Classification



Operating Expenses
Natural Classification (in millions)

	FY2006		FY2005		FY2004	
Salaries and Employee Benefits	$370.3	59.8%	$347.6	58.7%	$319.2	58.1%
Contractual Services	119.7	19.3%	106.1	17.9%	102.1	18.6%
Supplies and Materials	58.2	9.1%	65.8	11.1%	54.4	9.9%
Student Aid	13.4	2.1%	12.8	2.2%	13.0	2.4%
Depreciation	59.8	9.7%	60.1	10.1%	60.5	11.0%
	$621.4	100.0%	$592.4	100.0%	$549.2	100.0%

Salaries and employee benefits increased 6.5 percent, or $22.7 million, in fiscal year 2006. Employee benefits, such as pension plan contributions increased 14 percent and comprised $12.2 million of the change. Salaries and wages increased 4 percent, or $10.5 million.

Fiscal Year 2005 Comparisons (Statement of Revenues, Expenses and Changes in Net Assets)

For comparative purposes, significant comments about changes between 2004 and 2005 that were noted in fiscal year 2005 Management's Discussion and Analysis are summarized below:

The Statement of Revenues, Expenses and Changes in Net Assets reflected an overall decrease in net assets of 1.9 percent or $16.2 million. Significant factors affecting the fiscal year 2005 decrease in net assets included the following increased costs:

- PERS, TRS, and ORP costs increased by $9.6 million for the year ended June 30, 2005.
- Net health care costs increased by $5.8 million to $34.7 million for fiscal year 2005.
- A PERS $15.4 million net pension and OPEB obligation was recorded in fiscal year 2005.

The decline in revenue recognized from capital funding sources also contributed to decreases in net assets. Capital appropriations and capital grant and contract revenue decreased from $86.6 million in 2004 to $17.6 million in 2005.

Other major revenue sources included state general fund appropriations, sponsored programs, and tuition revenue. State general fund appropriations were $232.9 million in 2005, as compared to $217.7 million in 2004. Sponsored program revenue, primarily from research and education related programs, increased 5.7 percent, from $184.4 million in 2004 to $194.9 million in 2005. Facility and administrative cost recovery provided $31.2 million in 2005 as compared to $29.7 million in 2004. Student enrollment and tuition rate increases for the 2004 - 2005 academic year provided for gross student tuition and fee revenue of $75.9 million in fiscal year 2005 as compared to $67.8 million in fiscal year 2004. This was due in large part to a 10 percent increase in tuition rates for resident students (20 percent for non-residents) for academic year 2004 - 2005. Student full-time equivalent enrollment for Fall 2004 was 17,454, a 0.8 percent increase from the prior Fall period. Additionally, endowment proceeds and investment income increased to $26.2 million in 2005 as compared to $16.2 million in 2004. Components of these amounts include investment income generated from the endowment principal and yield from, or sales of, trust land, timber and mineral interests.

Capital and Debt Activities

The University of Alaska has continued to modernize various facilities and to build new facilities to address emerging state needs. Net capital additions totaled $44.5 million in 2006, as compared with $28.0 million in 2005 and $110.8 million in 2004. These capital additions primarily comprise replacement, renovation and new construction of academic and research facilities, as well as investments in equipment and information technology. State capital appropriations for 2005 and 2006 were $0.5 million and $48.1 million, respectively. At June 30, 2006, $69.2 million remains unexpended from current and prior year capital appropriations and general revenue bond proceeds, of which $22.6 million is committed to existing construction contracts. The balance is for projects still in design or preconstruction, or is held for contingencies for work in progress.

The University of Alaska Museum addition and renovation on the Fairbanks campus was substantially complete by spring 2006. This $42 million expansion project doubled the size of the prior museum to 81,000 square feet. Features include a new research center to house natural and cultural history collections and research laboratories; a new art gallery; a new learning center featuring a pre-college learning center and a "smart classroom" for university students; and an enhanced visitor experience with a multimedia auditorium, lectures and performances by Alaska Native athletes and dancers.

Construction in progress at June 30, 2006 totaled $38.7 million and includes the following major projects:

- University of Alaska Fairbanks Biological Research and Diagnostics Facility: This $23 million facility adds to the nucleus of other science and research facilities located on the campus' West Ridge. The facility incorporates live animal research, program components and space for laboratories, procedure rooms, necropsy, incinerator and related administrative space. The project is being funded by $14.4 million in State of Alaska general obligation bonds, $4.78 million in university general revenue bonds and a $3.8 million National Institute of Health grant. The estimated completion date is fall 2006.

- University of Alaska Anchorage Integrated Science Facility: This $87 million facility will incorporate the existing science facility into expanded instructional, student, and administrative space. Features include state of the art science academic labs and technology associated with distance delivery. The facility will be designed to incorporate program growth in integrated sciences, including integrated science instruction for majors and non-majors, environmental studies and systems research, biomedical research, and complex system studies to prepare students to meet the employment needs of the State of Alaska. The estimated occupancy date is fall 2009.

- University of Alaska Anchorage Alaska Native Science and Engineering Building (ANSEP), Center for Innovative Learning Facility: This $6.6 million facility will house the Alaska Native Science and Engineering Program. The facility will contain a large gathering space, a collaborative learning lab, and "quiet" rooms for recitations where teams of students are engaged with industry professionals from high school on through their time at the University of Alaska. ANSEP is a collaborative effort between the University, Alaska Native communities and regional corporations, companies in the oil industry, the professional engineering and construction industry, and nonprofits. The project is funded by a variety of state and federal grants and private donations. The estimated completion date is fall 2006.

State of Alaska capital appropriations for fiscal year 2007 total $13.7 million, with $10.0 million designated for major renewal, code and safety upgrades, or other smaller projects. An additional $94.3 million was appropriated from the Northern Tobacco Securitization Corporation (NTSC) Bonds. The main components of this appropriation include $55 million for the Integrated Science Facility (Phase III) on the Anchorage campus, $8.7 million for critical building deficiencies, $10.3 million for required renewal and renovation for program delivery, and $15.3 million for code corrections and compliance.

During fiscal year 2006, the university issued Series N general revenue bonds totaling $24,355,000. The bonds mature annually each October 1, through 2035, and bear coupon interest rates ranging from 3 percent to 5 percent. Series N bond proceeds totaling $14,055,000 are being used for capital improvement projects, and the remaining $10,300,000 was used to advance refund 1997 Series G general revenue bonds and redeem a note payable originally issued for student housing in Anchorage. The advance refunding and note redemption resulted in an economic gain of approximately $971,000 and the total debt service payments over the next 20 years will decrease by $1,366,000.

At June 30, 2006, total debt outstanding was $118.4 million, comprised of $94.1 million in general revenue bonds, $22.9 million in notes payable, and $1.4 million in lease finance contracts. In August 2005, Moody's Investors Service affirmed its previous university credit rating of A1 with stable outlook and Standard & Poor's affirmed its rating of AA-. The University has maintained these ratings since its general revenue issues were first rated in 1992.

Bonds were issued in prior years to finance construction of student residences at three campuses, the West Ridge Research Building, student recreation centers, a research facility to house the International Arctic Research Center, the acquisition and renovation of several properties adjacent to or near the university's campuses, additions to the university's self-operated power, heat, water and telephone utility systems in Fairbanks, purchase of the University Center Building in Anchorage, and to refund previously issued general revenue bonds and other contractual obligations in order to realize debt service savings.

The university has traditionally utilized both tax exempt and non-tax exempt equipment lease financings to provide for its capital needs or to facilitate systematic renewals. Short-term lines of credit or working capital is available to provide interim cash flow financing for facilities intended to be funded with general revenue bond proceeds.

Other Economic and Financial Conditions

The following is a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the financial position (net assets) or results of operations (revenues, expenses, and other changes in net assets) of the university.

At their September 2005 meeting, the Board of Regents approved a 10 percent increase in tuition for the 2006 – 2007 academic year. At their September 2006 meeting, the Board of Regents approved a 7 percent increase in tuition for the 2007 – 2008 academic year.

The rising cost of participation in the state-administered defined benefit PERS and TRS will continue to be a challenge in the upcoming years. The university recorded a net pension and OPEB liability in fiscal year 2005 totaling $15.4 million. That amount increased to $25.4 million in fiscal year 2006 and is expected to rise to $30.9 million by June 30, 2007. University employer contributions for PERS and TRS totaled $29.4 million in fiscal year 2006 compared to $19.8 million in 2005 and $39.5 million anticipated for 2007. PERS and TRS employer contribution rates are expected to increase 5 percentage points in 2007 over 2006 rates to 20.58 percent and 26.0 percent of applicable gross pay, respectively. The university will continue to seek state appropriations to fund the required contributions. See Note 12 of the financial statements for more information regarding pension plans.

In September 2006, the Alaska Retirement Management Board (ARMB) set fiscal year 2008 employer contribution rates for PERS and TRS at 33.75 percent and 54.03 percent, respectively.

Beginning July 1, 2006, state legislation and changes to a university-administered plan will affect retirement benefits for new employees as discussed below:

- State legislation enacted in July 2005, requires all new eligible employees hired on or after July 1, 2006 to be participants in newly created defined contribution retirement plans. Under the new plans, public employees will contribute 8 percent of compensation and employers will contribute approximately 10 to 12 percent of compensation plus additional amounts for certain medical insurance, disability and death benefits.

- The Optional Retirement Plan (ORP) Tier 3, a university-administered single employer defined contribution plan, is effective for new participants hired on or after July 1, 2006. In fiscal year 2007, the ORP Tier 3 employee contribution rate is 8 percent and the employer contribution rate is 12 percent as compared to 21 percent for the original ORP plan. Employees are vested after three years of service.

New eligible employees will choose between the applicable state plan or ORP Tier 3.

For fiscal year 2007, state appropriations for operations and debt service reimbursement total $284.8 million, a 14.1 percent increase over fiscal year 2006. The level of annual state appropriation funding is conditional upon the legislative process, which is directly influenced by current economic conditions and other factors. The university continues to seek additional revenues from sources other than state appropriations.

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Independent Auditors' Report

The Board of Regents
University of Alaska:

We have audited the accompanying basic financial statements of the University of Alaska and its discretely presented component unit (University), a component unit of the State of Alaska, as of and for the years ended June 30, 2006 and 2005 as listed in the table of contents. 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 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 respective financial position of the University of Alaska and its discretely presented component unit at June 30, 2006 and 2005, and the respective changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The Management's Discussion and Analysis, on pages 1 through 11, and the Schedule of Funding Progress for PERS on page 44 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2006 in our consideration of the University's internal control over financial reporting and on 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.

KPMG LLP

October 16, 2006

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UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Net Assets
June 30, 2006 and 2005
(in thousands)

Assets	2006	2005
Current assets:		
Cash and cash equivalents	$ 32,885	$ 57,276
Short-term investments	15,480	1,269
Accounts receivable, less allowance of $4,096 in 2006 and $3,882 in 2005	48,127	51,622
Other assets	1,079	889
Inventories	9,043	8,053
Total current assets	106,614	119,109
Noncurrent assets:		
Restricted cash and cash equivalents	9,408	8,400
Notes receivable	5,709	6,125
Endowment investments	126,910	115,119
Endowed land and other assets	39,915	37,698
Long-term investments	62,618	21,351
Assets held in trust	6,845	6,225
Capital assets, net of accumulated depreciation of $595,629 in 2006 and $544,897 in 2005	731,010	737,290
Total noncurrent assets	982,415	932,208
Total assets	1,089,029	1,051,317
Liabilities		
Current liabilities:		
Accounts payable	10,833	10,998
Accrued expenses	4,173	4,463
Accrued payroll	22,311	19,871
Deferred revenue	4,565	4,351
Accrued annual leave	9,177	8,891
Deferred lease revenue - current portion	1,281	1,281
Long-term debt - current portion	5,200	4,864
Insurance and risk management	19,769	18,549
Deposits from students and others	3,135	3,332
Total current liabilities	80,444	76,600
Noncurrent liabilities:		
Capital appropriation advances	8,116	6,021
Deferred lease revenue	8,647	9,928
Long-term debt	113,183	103,585
Net pension and OPEB obligations	25,397	15,398
Security deposits and other liabilities	6,387	5,726
Total noncurrent liabilities	161,730	140,658
Total liabilities	242,174	217,258
Net Assets		
Invested in capital assets, net of related debt	608,596	625,727
Restricted:		
Expendable:		
Restricted funds	1,161	1,467
Student loan funds	271	271
Education Trust of Alaska	4,931	4,735
Capital projects	2,267	2,143
Debt service	3,371	3,105
Endowment	46,589	37,248
Nonexpendable	123,275	118,462
Unrestricted (see Note 7)	56,394	40,901
Total net assets	$ 846,855	$ 834,059

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

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UNIVERSITY OF ALASKA FOUNDATION
(A Component Unit of the University of Alaska)
Statements of Financial Position
June 30, 2006 and 2005
(in thousands)

Assets	2006	2005
Cash and cash equivalents	$ 6,169	$ 3,794
Interest receivable	135	186
Short-term investments	21	24
Contributions receivable	6,085	7,578
Escrows receivable	206	726
Inventory	79	81
Other assets	454	427
Remainder trust receivable	-	395
Pooled endowment funds	99,098	76,279
Other long-term investments	31,806	40,794
Total assets	$ 144,053	$ 130,284
Liabilities		
Due to the University of Alaska	$ 1,634	$ 2,608
Other liabilities	1	15
Remainder trust obligations	346	124
Term endowment liability	1,000	1,000
Total liabilities	2,981	3,747
Net Assets		
Unrestricted	37,229	31,521
Temporarily restricted	56,212	49,638
Permanently restricted	47,631	45,378
Total net assets	141,072	126,537
Total liabilities and net assets	$ 144,053	$ 130,284

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

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UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2006 and 2005
(in thousands)

	2006	2005
Operating revenues		
Student tuition and fees	$ 85,296	$ 75,853
less tuition allowances	(6,254)	(6,365)
	79,042	69,488
Federal grants and contracts	141,787	138,494
State grants and contracts	15,188	12,240
Local grants and contracts	2,992	3,276
Private grants and contracts	45,273	40,843
Federal appropriations	3,150	2,837
Local appropriations	717	705
Sales and services, educational departments	3,361	3,446
Sales and services, auxiliary enterprises, net of tuition allowances of $1,140 in 2006 and $1,214 in 2005	37,617	36,033
Other	12,078	11,651
Total operating revenues	341,205	319,013
Operating expenses		
Instruction	163,540	150,052
Academic support	44,624	40,990
Research	126,282	118,933
Public service	32,075	31,226
Student services	38,512	36,033
Operations and maintenance	44,166	44,953
Institutional support	61,778	63,388
Student aid	13,383	12,822
Auxiliary enterprises	37,206	33,927
Depreciation	59,807	60,135
Total operating expenses	621,373	592,459
Operating loss	(280,168)	(273,446)
Nonoperating revenues (expenses)		
State appropriations	252,512	232,868
Investment earnings	6,562	3,242
Endowment investment income	13,966	9,709
Endowment sales and other proceeds	5,725	16,454
Interest on debt	(4,148)	(4,029)
Other nonoperating expenses	(2,195)	(3,132)
Net nonoperating revenues	272,422	255,112
Loss before other revenues, expenses, gains or losses	(7,746)	(18,334)
Capital appropriations, grants and contracts	30,541	17,560
Pension expense - net pension and OPEB obligations	(9,999)	(15,398)
Net increase (decrease) in net assets	12,796	(16,172)
Net assets		
Net assets - beginning of year	834,059	850,231
Net assets - end of year	$ 846,855	$ 834,059

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

UNIVERSITY OF ALASKA FOUNDATION
(A Component Unit of the University of Alaska)
Statements of Activities
For the years ended June 30, 2006 and 2005
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2006
Revenues, gains and other support				
Contributions	$ 5,084	$ 10,868	$ 2,267	$ 18,219
Investment income	1,513	1,721	-	3,234
Net realized and unrealized investment gains (losses)	2,157	6,901	-	9,058
Other revenues	1	102	-	103
Actuarial adjustment of remainder trust obligations	-	(1)	30	29
Losses on disposition of other assets	-	(23)	-	(23)
Net assets released from restriction	13,038	(13,038)	-	-
Total revenues, gains and other support	21,793	6,530	2,297	30,620
Expenses and distributions				
Operating expenses	773	-	-	773
Distributions for the benefit of the University of Alaska	15,312	-	-	15,312
Total expenses and distributions	16,085	-	-	16,085
Excess of revenues over expenses	5,708	6,530	2,297	14,535
Transfers between net asset classes	-	44	(44)	-
Increase (decrease) in net assets	5,708	6,574	2,253	14,535
Net assets, beginning of year	31,521	49,638	45,378	126,537
Net assets, end of year	$ 37,229	$ 56,212	$ 47,631	$ 141,072

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

Unrestricted	Temporarily Restricted	Permanently Restricted	2005
$ 290	$ 10,741	$ 1,512	$ 12,543
1,405	1,755	-	3,160
1,316	4,716	-	6,032
1	89	-	90
-	(1)	80	79
-	(3)	(1)	(4)
18,620	(18,620)	-	-
21,632	(1,323)	1,591	21,900
638	-	-	638
18,912	-	-	18,912
19,550	-	-	19,550
2,082	(1,323)	1,591	2,350
-	-	-	-
2,082	(1,323)	1,591	2,350
29,439	50,961	43,787	124,187
$ 31,521	$ 49,638	$ 45,378	$ 126,537

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

UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Cash Flows
For the Years Ended June 30, 2006 and 2005
(in thousands)

	2006	2005
Cash flows from operating activities		
Student tuition and fees, net	$ 77,897	$ 71,431
Grants and contracts	207,684	198,389
Sales and services, educational departments	3,361	3,446
Sales and services, auxiliary enterprises	37,479	36,161
Federal appropriations	3,150	2,837
Local appropriations	717	705
Other operating receipts	10,796	10,370
Payments to employees for salaries and benefits	(366,640)	(340,613)
Payments to suppliers	(179,853)	(171,847)
Payments to students for financial aid	(13,353)	(12,835)
Net cash used by operating activities	(218,762)	(201,956)
Cash flows from noncapital financing activities		
State appropriations	252,714	233,487
Other receipts, net	-	79
Other payments	(330)	-
Direct lending receipts	64,328	56,558
Direct lending payments	(64,138)	(55,966)
Net cash provided by noncapital financing activities	252,574	234,158
Cash flows from capital and related financing activities		
Capital appropriations, grants and contracts	35,129	15,898
Proceeds from issuance of capital debt	24,355	-
Redemption of general revenue bonds and note payable	(10,266)	-
Purchases of capital assets	(56,871)	(40,687)
Principal paid on capital debt	(5,018)	(4,867)
Interest paid on capital debt	(3,737)	(4,289)
Net cash used by capital and related financing activities	(16,408)	(33,945)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	18,938	11,517
Purchases of investments	(73,267)	(25,448)
Interest received on investments	4,402	2,429
Interest and other sales receipts from endowment assets	9,140	17,942
Net cash provided by (used in) investing activities	(40,787)	6,440
Net increase (decrease) in cash and cash equivalents	(23,383)	4,697
Cash and cash equivalents, beginning of the year	65,676	60,979
Cash and cash equivalents, end of the year	$ 42,293	$ 65,676
Cash and cash equivalents (current)	$ 32,885	$ 57,276
Restricted cash and cash equivalents (noncurrent)	9,408	8,400
Total cash and cash equivalents	$ 42,293	$ 65,676

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

UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Cash Flows
For the Years Ended June 30, 2006 and 2005
(in thousands)

Reconciliation of operating loss to net cash used by operating activities:	2006	2005
Operating loss	$ (280,168)	$ (273,446)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	59,807	60,135
Changes in assets and liabilities:		
Accounts receivable, net	986	4,782
Other assets	(245)	(243)
Inventories	(990)	8
Accounts payable	113	(967)
Accrued expenses	(1,134)	1,237
Accrued payroll	2,440	6,308
Deferred revenue	214	798
Accrued annual leave	286	740
Deferred lease revenue - current portion	(1,281)	(1,281)
Insurance and risk management	1,220	(42)
Deposits from students and others	(10)	15
Net cash used by operating activities	$ (218,762)	$ (201,956)

Noncash Investing, Capital and Financing Activities:

For the Year Ended June 30, 2006

Additions to capital assets include $0.5 million expended and capitalized but not paid for at year end.

The university purchased equipment through a lease purchase contract totaling $0.9 million.

Losses on capital asset disposals totaled $1.5 million.

Interest expense on general revenue bond financed projects totaling $0.5 million was capitalized during the year.

The university recorded a $10.0 million pension and other postemployment benefit expense for the state-administered PERS defined benefit plan.

For the Year Ended June 30, 2005

Additions to capital assets include $2.2 million expended and capitalized but not paid for at year end.

The university purchased equipment through a lease purchase contract totaling $0.2 million.

Losses on equipment disposals totaled $2.3 million.

Interest expense on general revenue bond financed projects totaling $0.3 million was capitalized during the year.

The university recorded a $15.4 million pension and other postemployment benefit expense for the state-administered PERS defined benefit plan.

1. Organization and Summary of Significant Accounting Policies:

Organization and Basis of Presentation:

The University of Alaska (university) is a constitutionally created corporation of the State of Alaska which is authorized to hold title to real and personal property and to issue debt in its own name. The university is a component unit of the State of Alaska for purposes of financial reporting. As an instrumentality of the State of Alaska, the university is exempt from federal income tax under Internal Revenue Code Section 115, except for unrelated business activities as covered under Internal Revenue Code Sections 511 to 514.

The University of Alaska Foundation (foundation) is a legally separate, non profit component unit of the university. The foundation was established to solicit donations and to hold and manage such assets for the exclusive benefit of the university. Resources managed by the foundation and distributions made to the university are governed by the foundation's Board of Trustees. Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, required the university to include the foundation as part of its financial statements to better report resources benefiting the university. The university is not accountable for, nor has ownership of, the foundation's resources. The foundation's financial statements include the Statement of Financial Position and the Statement of Activities and these statements are presented in their original audited format according to Financial Accounting Standards Board (FASB) pronouncements.

In preparing the financial statements, management is required to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of net assets. Actual results could differ from those estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below.

GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- **Unrestricted Net Assets:** Assets, net of related liabilities, which are not subject to externally-imposed restrictions. Unrestricted net assets may be designated for specific purposes by the Board of Regents or may otherwise be limited by contractual agreements with outside parties.

- **Restricted Net Assets:**

  Expendable – Assets, net of related liabilities, which are subject to externally-imposed restrictions that may or will be met by actions of the university and/or that expire with the passage of time.

  Non-expendable – Assets, net of related liabilities, which are subject to externally-imposed restrictions requiring that they be maintained permanently by the university.

- **Invested in capital assets, net of related debt** – Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Summary of Significant Accounting Policies:

The accompanying financial statements have been prepared on the economic resources measurement focus and the accrual basis of accounting. All significant intra-university transactions have been eliminated. The university reports as a business type activity, as defined by GASB Statement No. 35. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The university has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The university has elected not to apply FASB pronouncements issued after the applicable date.

Cash and Cash Equivalents

All highly liquid investments, not held for long-term investment, with original maturities of three months or less are reported as cash and cash equivalents.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Investments

Investments are stated at fair value. Investments in fixed income and equity marketable securities are stated at fair value based on quoted market prices. Investments in private partnership interests are valued using the most current information provided by the general partner. General partners typically value privately held companies at cost as adjusted based on recent arms' length transactions. Public companies are valued using quoted market prices and exchange rates, if applicable. Real estate partnerships and funds are valued based on appraisals of properties held and conducted by third-party appraisers retained by the general partner or investment manager. General partners of marketable alternatives provide values based on quoted market prices and exchange rates for publicly held securities and valuation estimates of derivative instruments. General partners of oil and gas partnerships use third-party appraisers to value properties. Valuations provided by the general partners and investment managers are evaluated by management and management believes such values are reasonable at June 30, 2006. When, in the opinion of management, there has been a permanent impairment in the asset value, the asset is written down to its fair value. Income from other investments is recognized when received.

Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the statement of net assets. Long-term investments include those restricted by outside parties as to withdrawal or use for other than current operations, or are designated for expenditure in the acquisition or construction of noncurrent assets or held with an intent not to be used for operations.

Capital Assets

Capital assets are stated at cost when purchased and at fair value when donated. Equipment with a unit value of less than $5,000 is not capitalized. Buildings and infrastructure with a unit value of less than $100,000 are not capitalized. Other capitalizable assets with a unit value of less than $50,000 are not capitalized. Certain land and other resources acquired through land grants and donated museum collections for which fair value at date of acquisition was not determinable are reported at zero basis in the financial statements.

Depreciation is computed on a straight-line basis with useful lives of building and building components ranging from 12 to 50 years, 10 to 35 years for infrastructure and other improvements, and 5 to 11 years for equipment. Library and museum collections are not depreciated because they are preserved and cared for and have an extraordinarily long useful life.

Endowments

Endowments consist primarily of the land grant endowment trust fund established pursuant to the 1929 federal land grant legislation and its related inflation proofing funds. Alaska Statute 14.40.400 provides that the net income from the sale or use of grant lands must be held in trust in perpetuity. At June 30, 2006 and 2005 the accumulated net earnings and appreciation on investments is $46.7 million and $37.3 million, respectively. These amounts, which are recorded in the restricted expendable net asset category, are available for expenditure in accordance with spending policies established by the Board of Regents in its capacity as trustee. Alaska Statute 14.40.400 provides the Board of Regents with authority to manage the endowments under the total return principles which are intended to preserve and maintain the purchasing power of the endowment principal. The investable resources of the fund are invested in the consolidated endowment fund, a unitized investment fund. The annual spending allowance is currently based on five percent of a five-year moving average of the invested balance. Withdrawals of net earnings appreciation to meet the spending allowance are limited to the unexpended accumulated net earnings of the endowments.

Operating Activities

The university's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net assets are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Certain significant revenue streams relied upon for operations are recorded as non-operating revenues, as defined by GASB Statement No. 35, including state appropriations and investment earnings.

Tuition Allowances

Student tuition and fee revenues and certain other revenues from students are reported net of tuition allowances in the statement of revenues, expenses and changes in net assets. Tuition allowances are the difference between the stated charge for tuition and room and board provided by the university and the amount paid by the student and/or third parties making payments on the students' behalf.

Lapse of State Appropriations

Alaska Statutes provide that unexpended balances of one-year appropriations will lapse on June 30 of the fiscal year of the appropriation; however, university receipts in excess of expenditures may be expended by the university in the next fiscal year. University receipts include student fees, donations, sales, rentals, facilities and administrative cost recovery, auxiliary and restricted revenues. The unexpended balances of capital appropriations lapse upon completion of the project or upon determination that the funds are no longer necessary for the project.

2. Deposits and Investments:

Deposits and investments at June 30, 2006 were as follows ($ in thousands):

Investment Type	Operating	Capital Funds	Endowment	College Savings Program	Total
Cash and Deposits	$ (4,892)	$ -	$ -	$ -	$ (4,892)
Repurchase Agreement	8,870	-	-	-	8,870
Guaranteed Investment Contract	-	2,754	-	-	2,754
Short Term Fund	31,584	2,960	5,818	-	40,362
Intermediate Term Fund	15,479	-	457	-	15,936
Multi-Strategy Bond Fund	20,075	-	-	-	20,075
Balanced Portfolio	-	-	-	90	90
Private Hedge Funds	36,662	-	6,111	-	42,773
Money Market Mutual Funds	-	3,522	651	154	4,327
Equities:					
Domestic	-	-	41,911	2,367	44,278
International	-	-	14,917	-	14,917
Emerging Markets	-	-	3,537	-	3,537
Equity Index Fund	-	-	-	100	100
Equity Funds	-	-	-	100	100
Debt-related:					
Corporate	-	-	3,715	-	3,715
Federal Agency	-	-	2,318	-	2,318
U.S. Treasury Securities	-	1,669	737	-	2,406
Fixed Income Funds	-	-	10,226	4,034	14,260
Commercial Paper	-	1,708	-	-	1,708
Alternative Investments	-	-	28,377	-	28,377
Real Estate	-	-	5,792	-	5,792
Other	-	-	2,343	-	2,343
	$ 107,778	$ 12,613	$ 126,910	$ 6,845	$ 254,146

Deposits and investments at June 30, 2005 were as follows ($ in thousands):

Investment Type	Operating	Capital Funds	Endowment	College Savings Program	Total
Cash and Deposits	$ (5,143)	$ -	$ -	$ -	$ (5,143)
Repurchase Agreement	7,895	-	-	-	7,895
Short Term Fund	58,875	2,674	7,645	-	69,194
Intermediate Term Fund	1,269	-	459	-	1,728
Private Hedge Funds	14,042	-	5,229	-	19,271
Money Market Mutual Funds	-	6,843	89	506	7,438
Equities:					
Domestic	-	-	36,230	2,131	38,361
International	-	-	12,754	-	12,754
Emerging Markets	-	-	3,231	-	3,231
Debt-related:					
Corporate	-	-	2,837	-	2,837
Federal Agency	-	-	2,222	-	2,222
U.S. Treasury Securities	-	1,841	1,027	-	2,868
Fixed Income Funds	-	-	15,553	3,588	19,141
Alternative Investments	-	-	19,082	-	19,082
Real Estate	-	-	5,676	-	5,676
Other	-	-	3,085	-	3,085
	$ 76,938	$ 11,358	$ 115,119	$ 6,225	$ 209,640

Operating funds consist of cash on hand, time deposits, an overnight repurchase agreement and investments in Common*f*und pooled investment funds. Alaska Statutes and Board of Regents' policy provide the university with broad authority to invest funds. Generally, operating funds are invested according to the university's liquidity needs. The Common*f*und is a not-for-profit provider of pooled multi-manager investment vehicles for colleges and universities. The university invests in a variety of these funds according to its investment objectives.

Capital funds include unexpended general revenue bond proceeds and related reserves, advances from state capital appropriations and other reserves designated for capital purposes. General revenue bond proceeds of $6.3 million and related reserves totaling $3.4 million are invested with a third party trustee in accordance with terms of a trust indenture, requiring purchase of investment securities that are investment grade.

Endowment funds primarily consist of $125.1 million invested in a consolidated endowment fund (fund) managed by the University of Alaska Foundation (foundation). The investable resources of the university's land grant endowment trust fund and the foundation's pooled endowment funds are combined in the fund for investment purposes. The fund is managed by the foundation's investment committee and treasurer on a total return basis in accordance with an investment policy approved by the Board of Regents.

College savings program investments include the operating funds of the Education Trust of Alaska, established pursuant to state statute by the Board of Regents to facilitate administration of the state's Internal Revenue Code Section 529 College Savings Program. Program investments are in mutual funds of T. Rowe Price Associates, Inc., the program manager. See Note 4 for further information.

Certain funds held in trust for the benefit of the university are not included in the financial statements as the university has only limited control over their administration. These funds are in the custody of independent fiduciaries and at June 30, 2006 had an estimated fair value of approximately $6.9 million.

At June 30, 2006, the university has approximately $76.8 million in investments which are not readily marketable. Approximately $40.1 million is invested in the consolidated endowment fund managed by the foundation and $36.7 million is invested in private hedge funds within the university's operating funds. These investments represent 30% of total deposits and investments and 9% of net assets at June 30, 2006. These investment instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, and nondisclosure of portfolio composition. Because these investments 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. Such difference could be material.

Disclosures for deposits and investments are presented according to GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB 40). Accordingly, the following information addresses various risk categories for university deposits and investments and the investment policies for managing that risk.

Credit Risk:

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university does not have a policy regarding credit risk since it does not normally invest its operating and capital funds in individual debt securities. The consolidated endowment fund investment policy requires all purchases of debt securities to be of investment grade and marketable at the time of purchase unless otherwise approved by the foundation's investment committee. At June 30, 2006, investments consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows ($ in thousands):

Investment Type	Rating	Operating	Capital Funds	Endowment	College Savings Program
Money Market Mutual Fund	AAA	-	$ 3,522	-	-
Money Market Mutual Funds	Not Rated	-	-	$ 651	$ 154
Short Term Fund	AAA	$ 31,584	$ 2,960	$ 5,818	-
Intermediate Term Fund	AA+	$ 15,479	-	$ 457	-
Multi-Strategy Bond Fund	AA	$ 20,075	-	-	-
Balanced Portfolio	Not Rated	-	-	-	$ 90
Private Hedge Funds	Not Rated	$ 36,662	-	$ 6,111	-
Debt-related:					
Corporate	BAA	-	-	$ 153	-
Corporate	A	-	-	$ 2,062	-
Corporate	AA	-	-	$ 1,224	-
Corporate	AAA	-	-	$ 276	-
Federal Agency	AA	-	-	$ 143	-
Federal Agency	AAA	-	-	$ 2,176	-
Fixed Income Funds	BAA	-	-	$ 279	-
Fixed Income Funds	Not Rated	-	-	$ 9,947	$ 4,034
Commercial Paper	A-1	-	$ 1,708	-	-

Concentration of Credit Risk:

Concentration of credit risk is the risk of loss attributed to the magnitude of the university's investment in a single issuer. GASB 40 requires disclosure when the amount invested with a single issuer, by investment type, exceeds 5 percent or more of that investment type. At June 30, 2006, the university did not have any material concentrations of credit risk.

The consolidated endowment fund investment policy limits debt investments to 5 percent by issuer (except for mutual and pooled funds and U.S. government and agencies) for each specific managed portfolio within the consolidated endowment fund unless approved by the treasurer. The university does not have a policy regarding concentration of credit risk since it does not normally invest its operating and capital funds in individual debt investments.

Interest Rate Risk:

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The university uses the modified duration measurement to evaluate interest rate risk. Modified duration measures a debt investment's exposure to fair value changes arising from changing interest rates. For example, a modified duration of 2 means that for a rise in interest rates of 1 percent, the value of the security would decrease 2 percent. The university does not have a policy regarding interest rate risk. At June 30, 2006, the university had the following debt investments and corresponding modified duration ($ in thousands):

	Fair Value				
Investment Type	Operating	Capital Funds	Endowment	College Savings Program	Modified Duration
Short Term Fund	$ 31,584	$ 2,960	$ 5,818	-	2.90
Intermediate Term Fund	$ 15,479	-	$ 457	-	1.60
Multi-Strategy Bond Fund	$ 20,075	-	-	-	4.40
Corporate	-	-	$ 3,715	-	1.70
Federal Agency	-	-	$ 2,318	-	2.43
U.S. Treasury Securities	-	-	$ 737	-	3.35
U.S. Treasury Securities	-	$ 1,669	-	-	4.65
Fixed Income Fund	-	-	-	$ 2,251	1.82
Fixed Income Fund	-	-	$ 9,947	-	4.79
Fixed Income Fund	-	-	-	$ 1,783	4.69
Collateralized Loan Obligation	-	-	$ 279	-	6.45
Commercial Paper	-	$ 1,708	-	-	.23

Private hedge funds totaling $42.7 million are exposed to interest rate risk, however, underlying fund data is not available to measure the interest rate risk.

Custodial Credit Risk:

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, the university will not be able to recover deposits or will not be able to recover collateral securities in the possession of an outside party. For investments, custodial credit risk is the risk that, in the event of failure of the counterparty to a transaction, the university will not be able to recover the value of investment or collateral securities in the possession of an outside party.

At June 30, 2006, the university does not have custodial credit risk. Deposits of the university are covered by Federal Depository Insurance or securities pledged by the university's counterparty to its repurchase agreement held at the Bank of New York. The collateral is held in the name of the university and at June 30, 2006, provided $11.5 million coverage in excess of deposits.

Foreign Currency Risk:

Foreign currency risk is the risk that changes in exchange rates could have an adverse affect on an investment's value for investments denominated in foreign currencies. GASB 40 requires disclosure of value in U.S. dollars by foreign currency denomination and investment type. The university does not have a policy regarding foreign currency risk. At June 30, 2006, the university had foreign currency risk in the endowment funds as follows ($ in thousands):

Foreign Currency	Equity Market Value
Australian Dollar	$ 137
Canadian Dollar	119
Euro Currency	1,290
Hong Kong Dollar	65
Japanese Yen	415
Korean Won	117
Mexican Nuevo Peso	100
Norwegian Krone	120
South African Rand	47
Swedish Krona	69
Swiss Franc	184
Taiwanese Dollar	110
United Kingdom Pound	421
	$ 3,194

3. Accounts Receivable:

Accounts receivable consisted of the following at June 30, 2006 and 2005 ($ in thousands):

June 30, 2006	Gross	Allowance	Net
Student tuition and fees	$ 9,440	$ (2,278)	$ 7,162
Sponsored programs	33,915	(1,721)	32,194
Auxiliary services and other operating activities	567	(97)	470
Capital appropriations, grants and contracts	8,299	-	8,299
State operating appropriation	2	-	2
	$ 52,223	$ (4,096)	$ 48,127

June 30, 2005	Gross	Allowance	Net
Student tuition and fees	$ 7,720	$ (1,937)	$ 5,783
Sponsored programs	36,359	(1,777)	34,582
Auxiliary services and other operating activities	610	(168)	442
Capital appropriations, grants and contracts	10,737	-	10,737
State operating appropriation	78	-	78
	$ 55,504	$ (3,882)	$ 51,622

4. Assets Held in Trust:

Assets held in trust include operating funds of the Education Trust of Alaska (Trust). The Trust was established pursuant to state statute on April 20, 2001 by the Board of Regents to facilitate administration of the state's Internal Revenue Code (IRC) Section 529 College Savings Program. The program is a nationally marketed college savings program developed in accordance with IRC Section 529 and includes the resources of the university's former Advance College Tuition (ACT) Program. Participant account balances of approximately $2.2 billion and $1.7 billion at June 30, 2006 and 2005, respectively, are not included in the financial statements.

Assets of the Trust are invested in various mutual funds at the direction of T. Rowe Price Associates, Inc., the program manager. The net assets of the Trust, which include a reserve for University of Alaska (UA) Tuition Value Guarantees, are available for payment of program administrative costs, benefits and other purposes of the Trust. Based on actuarial studies, management estimates reserve requirements for the UA Tuition Value Guarantees to be approximately $1.9 million and $1.5 million at June 30, 2006 and 2005, respectively.

5. Endowed Land and Other Assets:

Endowed land and other assets consist of real property and timber and other rights. By Acts of Congress in 1915 and 1929, approximately 110,000 acres of land was granted to the territory of Alaska to be held in trust for the benefit of the university. The lands were managed by the territory, and later the state of Alaska. In accordance with a 1982 agreement, the lands were subsequently transferred to the Board of Regents, as trustee. In 1982 and 1988 certain state lands including timber and other rights were transferred to the trust as replacement for lands disposed of or adversely affected during the period of administration by the territory and the state. These lands and property interests were recorded at their fair value as of the date of transfer. The net proceeds from timber, land and other rights are deposited in the land grant endowment trust fund described under Endowments in Note 1 above. At June 30, 2006 and 2005, approximately 83,400 and 83,600 acres, respectively, were held in trust at no basis because fair value at the date of transfer was not determinable.

On July 25, 2005, Alaska's governor approved a transfer of approximately 250,000 acres of State of Alaska land to the university. As provided by Alaska Statute 14.40.365, the lands will be conveyed to the university by July 1, 2008 with the exception of one 52,000 acre forestry research parcel being transferred in 50 years. The intent of the Legislature is to provide the university with an equitable land grant as originally envisioned in the federal land grant of 1915 and to provide the university ownership of a significant portfolio of income producing land to help fund public higher education in the State of Alaska. Proceeds and royalties received from property development will be deposited into the land grant trust endowment fund. The lands will be recorded at zero basis as no determinable fair value is available at the time of transfer.

6. Capital Assets:

A summary of capital assets follows ($ in thousands):

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006
Capital assets not depreciated				
Land	$ 27,360	$ 184	$ 415	$ 27,129
Construction in progress	55,018	44,553	60,849	38,722
Library and museum collections	51,402	1,951	-	53,353
Other capital assets				
Buildings	879,838	43,961	2,914	920,885
Infrastructure	42,139	7,847	-	49,986
Equipment	188,676	11,077	9,824	189,929
Leasehold improvements	16,826	8,881	-	25,707
Other improvements	20,928	-	-	20,928
Total	1,282,187	118,454	74,002	1,326,639
Less accumulated depreciation:				
Buildings	380,875	37,185	635	417,425
Infrastructure	23,786	1,546	-	25,332
Equipment	123,520	18,566	8,440	133,646
Leasehold improvements	2,928	1,635	-	4,563
Other improvements	13,788	875	-	14,663
Total accumulated depreciation	544,897	59,807	9,075	595,629
Capital assets, net	$ 737,290	$ 58,647	$ 64,927	$ 731,010

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005
Capital assets not depreciated				
Land	$ 27,281	$ 305	$ 226	$ 27,360
Construction in progress	72,123	33,204	50,309	55,018
Library and museum collections	49,646	1,756	-	51,402
Other capital assets				
Buildings	857,349	22,554	65	879,838
Infrastructure	33,514	8,625	-	42,139
Equipment	188,616	11,079	11,019	188,676
Leasehold improvements	4,845	11,981	-	16,826
Other improvements	20,769	159	-	20,928
Total	1,254,143	89,663	61,619	1,282,187
Less accumulated depreciation:				
Buildings	343,238	37,651	14	380,875
Infrastructure	22,380	1,406	-	23,786
Equipment	112,853	19,277	8,610	123,520
Leasehold improvements	2,099	829	-	2,928
Other improvements	12,816	972	-	13,788
Total accumulated depreciation	493,386	60,135	8,624	544,897
Capital assets, net	$ 760,757	$ 29,528	$ 52,995	$ 737,290

7. Unrestricted Net Assets:

At June 30, unrestricted net assets included the following ($ in thousands):

	2006	2005
Designated:		
Auxiliaries	$ 9,763	$ 9,997
Working capital fund	4,715	4,715
Working capital advances	(33)	(3,369)
Service centers	9,674	6,329
Renewal and replacement funds	4,411	3,664
Quasi-endowment funds	78	79
Net pension and OPEB obligations	(25,397)	(15,398)
Employee benefit funds	2,587	(2,802)
Endowment earnings	10,302	9,879
Encumbrances	8,566	7,764
Total designated	24,666	20,858
Undesignated	31,728	20,043
Total unrestricted net assets	$ 56,394	$ 40,901

Unrestricted net assets include non-lapsing university receipts of $49.9 million at June 30, 2006. Non-lapsing university receipts of $34.1 million from 2005 were fully expended in 2006.

At June 30, 2006 and 2005, $34.3 million and $28.7 million, respectively, of auxiliary funds, encumbrances and other unrestricted net assets were pledged as collateral for the university's general revenue bonds, as calculated under the terms of the 1992 General Revenue Bonds Trust Indenture.

8. Long-term Debt:

Debt service requirements at June 30, 2006 were as follows ($ in thousands):

Year ended June 30,	Principal	Interest	Total
2007	$ 5,200	$ 4,557	$ 9,757
2008	5,335	4,386	9,721
2009	4,971	4,217	9,188
2010	5,091	4,049	9,140
2011	5,241	3,871	9,112
2012-2016	27,661	16,421	44,082
2017-2021	29,773	10,801	40,574
2022-2026	23,776	4,901	28,677
2027-2031	9,990	1,155	11,145
2032-2036	1,345	157	1,502
	$ 118,383	$ 54,515	$ 172,898

Long-term debt consisted of the following at June 30, 2006 and 2005 ($ in thousands):

	2006	2005
Revenue bonds payable 1.40% to 5.45% general revenue bonds due serially to 2036, secured by a pledge of unrestricted current fund revenue generated from tuition, fees, recovery of facilities and administrative costs, sales and services of educational departments, miscellaneous receipts and auxiliaries.	$ 94,090	$ 81,045
Note payable – capital construction 1.826% assisted note to the Alaska Housing Finance Corporation (AHFC) to finance construction of Anchorage campus housing, payable beginning August 1999 to February 2024.	22,924	26,614
Installment contracts 2.68% to 5.44% installment contracts for the purchase of air traffic control simulation equipment and vehicles due in quarterly installments through June 2016.	1,369	790
	$ 118,383	$ 108,449

On August 31, 2005, the university issued Series N general revenue bonds totaling $24,355,000. The bonds mature annually each October 1, through 2035 and bear coupon interest rates ranging from 3 percent to 5 percent. Series N bond proceeds totaling $14,055,000 are being used for capital improvement projects, and the remaining $10,300,000 was used to advance refund 1997 Series G general revenue bonds and redeem a note payable originally issued for student housing in Anchorage. The advance refunding and note redemption resulted in an economic gain of approximately $971,000 and total debt service payments over the next 20 years will decrease by $1,366,000.

In fiscal year 2006, the state reimbursed the university for debt service of $1,413,366 on Series K general revenue bonds. Subject to annual appropriation, the state will reimburse the university for principal and interest on $19,330,000 of the remaining bond principal. Annual debt service on this portion of the bonds is approximately $1.4 million.

Under the terms of the 1992 General Revenue Bonds Trust Indenture, the university is required to maintain a reserve account with a trustee at an amount equal to one-half of the maximum annual general revenue bond debt service. The balance in the reserve account at June 30, 2006 and 2005 was $4.0 million and $3.7 million, respectively. The reserve balance at June 30, 2006 includes a reserve fund policy, purchased with the issuance of Series L, totaling $0.6 million.

In fiscal year 2006 and prior years, the university defeased housing system revenue bonds and certain general revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Trust assets and related liabilities for the defeased bonds are not included in the university's financial statements. At June 30, 2006 and 2005, outstanding defeased bonds were $8.0 million and $0.3 million, respectively.

9. Deferred Lease Revenue:

In fiscal year 1997, the university entered into an agreement to construct a facility and establish the International Arctic Research Center (IARC). The university received $19,215,000 through a Japanese non-profit corporation to support the construction of the IARC in exchange for a commitment to provide research facilities to various Japanese research organizations and agencies for a period of 25 years, including lease extensions. The Japanese research organizations began occupying the IARC in fiscal year 1999. The deferred lease revenue at June 30, 2006 is $9,927,750 and is reduced at the rate of $1,281,000 per year with a corresponding increase to other operating revenue.

10. Long-term Liabilities:

Long-term liability activity was as follows ($ in thousands):

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Amounts due within one year
Capital appropriation advances	$ 6,021	$ 4,119	$ 2,024	$ 8,116	$ -
Deferred lease revenue	11,209	-	1,281	9,928	1,281
Long-term debt	108,449	25,218	15,284	118,383	5,200
Security deposits and other liabilities	5,726	662	1	6,387	-
Net pension and OPEB obligations	15,398	9,999	-	25,397	-
	$ 146,803	$ 39,998	$ 18,590	$ 168,211	$ 6,481

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Amounts due within one year
Capital appropriation advances	$ 8,633	$ 1,479	$ 4,091	$ 6,021	$ -
Deferred lease revenue	12,490	-	1,281	11,209	1,281
Long-term debt	113,094	221	4,866	108,449	4,864
Security deposits and other liabilities	5,495	752	521	5,726	-
Net pension and OPEB obligations	-	15,398	-	15,398	-
	$ 139,712	$ 17,850	$ 10,759	$ 146,803	$ 6,145

11. Capital Appropriations and Construction Commitments:

Major construction projects of the university are funded primarily by State of Alaska appropriations and university revenue bonds. The appropriations are financed through state-issued general obligation bonds or capital project bonds issued by the Alaska Housing Finance Corporation, a component unit of the State of Alaska, while other appropriations are received directly from the state or state agencies.

Unexpended and unbilled capital funds appropriated by the State of Alaska in prior years, which are not reflected as appropriation revenue or receivables on the university's books at June 30, 2006, totaled $64.6 million. In addition, unexpended proceeds of university-issued general revenue bonds designated for construction projects totaled $4.6 million at June 30, 2006.

Construction commitments at June 30, 2006 aggregated $22.6 million. At June 30, 2006, the university had received $8.1 million from State of Alaska capital appropriations and other sources in advance of expenditures.

12. Pension Plans:

Substantially all regular employees participate in either the State of Alaska Public Employees' Retirement System (PERS), an agent multiple-employer public employees' retirement system, the State of Alaska Teachers' Retirement System (TRS), a cost-sharing multiple-employer plan, or the University of Alaska Optional Retirement Plan (ORP), a single-employer defined contribution plan. In addition, substantially all regular employees and faculty classified as temporary participate in the University of Alaska Pension Plan, a supplemental single-employer defined contribution plan. None of the retirement systems or plans own any notes, bonds or other instruments of the university.

Defined Benefit Plans:

State of Alaska Public Employees’ Retirement System (PERS)

Plan Description

The university contributes to PERS, a defined benefit, agent multiple-employer public employee retirement system established and administered by the State of Alaska (State). PERS provides pension, postemployment health care, death and disability benefits to eligible participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, PERS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

Funding Policy and Annual Pension Cost

Employee contribution rates are 7.5% for peace officers and firefighters and 6.75% for other employees, as required by State statute. The funding policy for PERS provides for periodic employer contributions at actuarially determined rates that, expressed as a percentage of annual covered payroll, are sufficient to accumulate the assets to pay benefits when due. However, the 2006 actuarially determined rate was 23.05% of applicable gross pay and the employer contribution rate was capped at 15.58% in accordance with PERS board policy that limited yearly increases to 5 percentage points.

The university’s annual pension cost for the current year and related information is as follows:

	Pension	Postemployment healthcare	Total
Contribution rates:			
Employee:			
Peace officers and firefighters	4.50%	3.00%	7.50%
Other employees	4.05%	2.70%	6.75%
Employer	9.34%	6.24%	15.58%
Annual pension/OPEB cost	$18,116,634	$12,107,981	$30,224,615
Contributions made	$12,123,562	$8,102,600	$20,226,162
Actuarial assumptions:			
Inflation rate	3.50%	Same	
Investment return	8.25%	Same	
Projected salary increase:			
Inflation	3.50%	N/A	
Productivity and merit:			
Peace officers and firefighters	2.50%	N/A	
Others	2.00%	N/A	
Health cost trend	N/A	11.50%	

An actuarial valuation as of June 30, 2003 set the contribution rates for the year ended June 30, 2006. The projected unit credit method was used and the initial unfunded accrued liability and future gains/losses are being amortized on a 25-year fixed period level percentage of pay. Effective June 30, 2002, the asset valuation method recognizes 20 percent of the investment gain or loss in each of the current and preceding four years. This method will be phased in over the next five years.

The university's net pension obligation for fiscal year 2006 was as follows:

Annual required contribution	$ 17,936,334
Interest on net pension obligation	761,443
Adjustment to annual required contribution	(581,143)
Annual pension cost	18,116,634
Contributions made	(12,123,562)
Increase in net pension obligation	5,993,072
Net pension obligation beginning of year	9,579,149
Net pension obligation end of year	$ 15,572,221

Three year trend information for pension benefits follows:

Year ended June 30	APC	Percentage of APC contributed	NPO
2004	$4,729,156	100%	-
2005	$17,712,969	45.92%	$9,579,149
2006	$18,116,634	66.92%	$5,993,072

The university's net other post employment obligation (OPEB) for fiscal year 2006 was as follows:

Annual required contribution	$ 11,987,480
Interest on net OPEB obligation	508,899
Adjustment to annual required contribution	(388,398)
Annual pension cost	12,107,981
Contributions made	(8,102,600)
Increase in net OPEB obligation	4,005,381
Net OPEB obligation beginning of year	5,818,937
Net OPEB obligation end of year	$ 9,824,318

Three year trend information for postemployment healthcare benefits follows:

Year ended June 30	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2004	$2,002,717	100%	-
2005	$10,759,896	45.92%	$5,818,937
2006	$12,107,981	66.92%	$4,005,381

Funding Status and Funding Progress

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. A schedule of funding progress for each of the three most recent actuarial valuations is included in this report as required supplementary information, which follows these notes to the basic financial statements. The funded status of PERS for pension and other postemployment healthcare benefits (OPEB) as of June 30, 2005, was as follows ($ in thousands):

	Pension	OPEB	Total
Actuarial accrued liability (AAL)	$ 441,742	$ 424,061	$ 865,803
Actuarial value of plan assets	307,243	294,945	602,188
Unfunded actuarial accrued liability (UAAL)	$(134,499)	$(129,116)	$(263,615)
Funded ratio (actuarial value of plan assets/AAL)	70%	70%	70%
Covered payroll (active plan members)	$ 124,699	$ 124,699	$ 124,699
UAAL as a percentage of covered payroll	108%	104%	106%

State of Alaska Teachers' Retirement System (TRS)

Plan Description

TRS provides pension, postemployment health care, death and disability benefits to participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, TRS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

Funding Policy

Employees contribute 8.65% of their base salary as required by State statute. The funding policy for TRS provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. During fiscal year 2006, contractually required employee and employer contribution rates were 8.65% and 21%, respectively. The actuarially determined employer contribution rate for 2006 was 38.85%. No net pension or OPEB obligation is recorded for TRS, since according to GASB 27 and GASB 45 no such obligation is recorded for cost sharing defined benefit plans when an employer's contribution equals the contractually required contribution. The amounts contributed to TRS by the university during the years ended June 30, 2006, 2005 and 2004 were $9,167,681, $6,769,122, and $4,860,511, respectively, equal to the required employer contributions for each year.

Defined Contribution Plans:

University of Alaska Optional Retirement Plan (ORP)

Faculty classified as regular and certain administrators may make a one-time election to participate in the ORP as an alternative to participation in PERS or TRS. The ORP is an employer funded defined contribution plan which operates in conjunction with a companion mandatory tax-deferred annuity plan.

The ORP is comprised of two layers of participants, the original ORP or ORP Tier 1, and ORP Tier 2 which was created for new participants hired on or after July 1, 2005.

ORP Tier 1

The ORP Tier 1 participants are required to make employee contributions to one of the plan's authorized tax-deferred annuity programs at a rate equivalent to the TRS employee contribution rate of 8.65%. The university makes matching employer contributions to one of the plan's authorized employee-selected annuity providers or investment managers at a rate equal to the three-year moving average of the TRS employer contribution rates (16.33% for FY06 and 13.00% for FY05).

In fiscal year 2006 and 2005, the university's total covered payroll for the ORP Tier 1 plan was approximately $54.6 million and $54.9 million, respectively. The amounts contributed to the ORP Tier 1 by the university during the years ended June 30, 2006, 2005, and 2004 were $8,907,978, $7,133,412 and $5,761,999, respectively.

ORP Tier 2

The ORP Tier 2 was created in June 2005 for new participants hired on or after July 1, 2005. Participants are required to make employee contributions to one of the plan's authorized tax-deferred annuity programs at a rate equivalent to the TRS employee contribution rate of 8.65%. The university makes matching employer contributions to one of the plan's authorized employee-selected annuity providers or investment managers at a rate of 12% for fiscal year 2006.

In fiscal year 2006, the university's total covered payroll for the ORP Tier 2 plan was approximately $4.0 million. The amount contributed to the ORP Tier 2 by the university during the year ended June 30, 2006 was $484,288.

As of July 1, 2006, the ORP Tier 2 plan will no longer be available to newly-hired ORP benefit-eligible employees.

Plan Assets

At June 30, 2006 and 2005, plan assets (participants' accounts attributable to employer contributions) had a net value of approximately $70.2 million for ORP Tier 1 and ORP Tier 2, and $57.8 million for ORP Tier 1, respectively. Each participant is 100% vested at all times.

University of Alaska Pension Plan (Pension)

In addition to the other retirement plans, substantially all regular employees and faculty classified as temporary participate in the Pension plan which was established effective January 1, 1982, when the university withdrew from the federal social security program. Effective January 1, 2006, employer contributions for regular employees were 7.65% of covered wages up to a maximum of $42,000 and $94,200 for certain faculty classified as temporary. The plan provides for employer contributions to be invested in accordance with participant-directed investment elections to the plan's fixed income and/or equity funds. Each participant is 100% vested at all times.

In 2006 and 2005, the university's total covered payroll for the Pension plan was approximately $173.5 million and $168.5 million, respectively. The university's costs to fund and administer the plan totaled $13.3 million, or 7.67% of covered payroll. At June 30, 2006 and 2005, plan assets (participants' accounts) had a net value of approximately $275.7 million and $261.5 million, respectively.

Upcoming Pension Plan Changes:

State legislation enacted in July 2005 requires all new eligible employees hired on or after July 1, 2006 to be participants in newly created defined contribution retirement plans. Under the new plans, employers contribute approximately 10 to 12 percent of compensation plus additional amounts for certain medical insurance, disability and death benefits. As part of the legislation, the PERS and TRS boards were eliminated and replaced with the Alaska Retirement Management Board (ARMB).

University of Alaska ORP Tier 3, an employer funded defined contribution plan, is effective for new participants hired on or after July 1, 2006. The ORP Tier 3 employee contribution rate is 8% and the employer contribution rate is 12%. Employees are vested after 3 years of service.

On or after July 1, 2006, each new eligible employee will have a choice to participate in the applicable state plan or ORP Tier 3.

13. Insurance and Risk Management:

The university is exposed to a wide variety of risks including property loss, bodily and personal injury, intellectual property, errors and omissions, aviation and marine. Exposures are handled with a combination of self-insurance, commercial insurance, and membership in a reciprocal risk retention group. The university is self-insured up to the maximum of $2 million per occurrence for casualty claims and $250,000 for property claims. Commercial carriers provide coverage in excess of these amounts. Health care, workers' compensation and unemployment claims are fully self-insured.

Liabilities have been established to cover estimates for specific reported losses, estimates for unreported losses based upon past experience modified for current trends, and estimates of expenses for investigating and settling claims.

Changes in applicable liability amounts follow ($ in thousands):

	Balance July 1, 2005	Provision for Claims	Claims Payment	Balance June 30, 2006
Health	$ 6,259	$ 41,359	$ (41,214)	$ 6,404
General liability	7,134	1,110	(726)	7,518
Workers' compensation	5,036	2,068	(1,326)	5,778
Unemployment	120	383	(434)	69
	$ 18,549	$ 44,920	$ (43,700)	$ 19,769

	Balance July 1, 2004	Provision for Claims	Claims Payment	Balance June 30, 2005
Health	$ 6,505	$ 39,412	$ (39,658)	$ 6,259
General liability	7,267	625	(758)	7,134
Workers' compensation	4,686	1,784	(1,434)	5,036
Unemployment	133	584	(597)	120
	$ 18,591	$ 42,405	$ (42,447)	$ 18,549

14. Commitments and Contingencies:

Amounts received and expended by the university under various federal and state grants, contracts and other programs are subject to audit and potential disallowance. From time to time the university is named as a defendant in legal proceedings or cited in regulatory actions related to the conduct of its operations. In the normal course of business, the university also has various other commitments and contingent liabilities which are not reflected in the accompanying financial statements. In the opinion of management, the university will not be affected materially by the final outcome of any of these legal proceedings, environmental investigations, audit adjustments, or other commitments and contingent liabilities.

In addition, the university received a vendor claim in June 2006 for approximately $16.4 million in excess of contractual agreements for the university's Museum of the North construction project on the Fairbanks Campus. Resolution of the claim will go through the university's administrative processes. The claim's resolution is not determinable.

15. University of Alaska Foundation:

The University of Alaska Foundation (foundation) is a legally separate, non profit organization formed in 1974 to solicit donations for the exclusive benefit of the University of Alaska. During 2006 and 2005, the university transferred $430,647 and $386,760 respectively, to the foundation. For the same periods, distributions and expenditures by the foundation for the benefit of the university totaled $15.3 million and $18.9 million, of which $14.7 million and $18.8 million were direct reimbursements to the university. At June 30, 2006 and 2005 the foundation owed the university $1.6 million and $2.6 million, respectively, primarily for reimbursement of other grant and contract and scholarship expenditures in 2006, and for reimbursement of museum construction expenditures in 2005. The university provides administrative and accounting support for the foundation. Reimbursements to the university for these services were $0.7 million and $0.6 million for the years ended June 30, 2006 and 2005, respectively.

The investable resources of the university's land grant endowment trust fund and the foundation's pooled endowment funds are combined into a consolidated endowment fund for investment purposes. At June 30, 2006 and 2005, the fair value of the fund was $224.2 million and $189.5 million, respectively. The university's share of this fund was $125.1 million and $113.3 million, which is reflected in endowment investments. The fund is managed by the foundation's investment committee and treasurer on a total return basis in accordance with an investment policy approved by the Board of Regents. The net assets and related activity for the university's land grant endowment trust's investment in the fund is reflected in the university's financial statements.

16. Functional Classifications with Natural Classifications:

The university's operating expenses by natural classification were as follows ($ in thousands):

	Year ended June 30, 2006						
	Compensation & Benefits	Contractual Services	Supplies & Materials	Other	Student Aid	Depre-ciation	Total
Instruction	$ 131,966	$ 22,093	$ 9,303	$ 178	$ -	$ -	$ 163,540
Academic support	33,324	6,156	5,115	29	-	-	44,624
Research	77,635	39,911	8,609	127	-	-	126,282
Public service	20,662	9,284	1,917	212	-	-	32,075
Student services	28,062	7,848	2,507	95	-	-	38,512
Operations and maintenance	22,947	9,281	10,756	1,182	-	-	44,166
Institutional support	46,862	10,659	4,129	128	-	-	61,778
Student aid	-	-	-	-	13,383	-	13,383
Auxiliary enterprises	8,793	14,448	13,857	108	-	-	37,206
Depreciation	-	-	-	-	-	59,807	59,807
	$ 370,251	$ 119,680	$ 56,193	$ 2,059	$ 13,383	$ 59,807	$ 621,373

	Year ended June 30, 2005						
	Compensation & Benefits	Contractual Services	Supplies & Materials	Other	Student Aid	Depre-ciation	Total
Instruction	$ 120,892	$ 19,191	$ 9,688	$ 281	$ -	$ -	$ 150,052
Academic support	30,019	5,960	4,975	36	-	-	40,990
Research	74,189	34,917	9,819	8	-	-	118,933
Public service	19,101	9,544	2,397	184	-	-	31,226
Student services	25,734	7,674	2,769	(144)	-	-	36,033
Operations and maintenance	20,446	10,138	13,569	800	-	-	44,953
Institutional support	49,368	5,864	7,127	1,029	-	-	63,388
Student aid	-	-	-	-	12,822	-	12,822
Auxiliary enterprises	7,884	12,766	13,112	165	-	-	33,927
Depreciation	-	-	-	-	-	60,135	60,135
	$ 347,633	$ 106,054	$ 63,456	$ 2,359	$ 12,822	$ 60,135	$ 592,459

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress for PERS
($ in thousands):

	Actuarial valuation year ended June 30	Actuarial value of plan assets	Actuarial accrued liability (AAL)	(Unfunded) overfunded actuarial accrued liability (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
Pension benefits:							
	2003	$ 313,807	$ 419,463	$ (105,656)	75%	$ 113,096	93%
	2004	$ 326,815	$ 444,092	$ (117,277)	74%	$ 116,156	101%
	2005	$ 307,243	$ 441,742	$ (134,499)	70%	$ 124,699	108%
Postemployment healthcare benefits:							
	2003	$ 209,738	$ 280,355	$ (70,617)	75%	$ 113,096	62%
	2004	$ 230,444	$ 313,137	$ (82,693)	74%	$ 116,156	71%
	2005	$ 294,945	$ 424,061	$ (129,116)	70%	$ 124,699	104%
Total:							
	2003	$ 523,545	$ 699,818	$ (176,273)	75%	$ 113,096	81%
	2004	$ 557,259	$ 757,229	$ (199,970)	74%	$ 116,156	89%
	2005	$ 602,188	$ 865,803	$ (263,615)	70%	$ 124,699	106%