



UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Financial Statements

September 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

September 30, 2005 and 2004

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KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

Independent Auditors' Report

The Board of Trustees
University Corporation for Atmospheric Research
Boulder, Colorado:

We have audited the accompanying consolidated statements of financial position of the University Corporation for Atmospheric Research (UCAR) as of September 30, 2005 and 2004, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of UCAR's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on UCAR'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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of UCAR as of September 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2005, on our consideration of UCAR's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

December 22, 2005

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Statements of Financial Position

September 30, 2005 and 2004

(In thousands)

Assets	2005	2004
Current assets:		
Cash and cash equivalents (note 4)	\$ 5,751	6,792
Investments (notes 2 and 4)	3,860	7,988
Receivables:		
Government agencies	19,538	10,494
Other (net of allowance for doubtful accounts of \$30 at 2005 and 2004)	2,493	4,992
Other current assets	709	689
Total current assets	32,351	30,955
Property (notes 3 and 4):		
Land and improvements	5,089	4,758
Building and building construction	73,543	51,035
Equipment	30,745	29,610
Total	109,377	85,403
Less accumulated depreciation on building and equipment	(39,215)	(35,292)
Property, net	70,162	50,111
Other noncurrent assets:		
Cash equivalents for investment in property and permanently restricted (note 4)	3,514	12,616
Investments (notes 2, 4, and 8)	51,820	55,317
Deferred bond charges (note 4)	2,720	2,877
Total other assets	58,054	70,810
Total assets	\$ 160,567	151,876
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 15,494	10,397
Accrued vacation liability	10,032	9,187
Other accrued liabilities	7,992	7,109
Deferred revenue	3,918	2,171
Line of credit (note 5)	983	917
Current portion of bonds payable (note 4)	4,445	4,460
Total current liabilities	42,864	34,241
Noncurrent liabilities:		
Bonds payable (note 4)	82,800	87,245
Accrued postretirement benefit obligation (note 7)	14,716	8,133
Other	815	893
Total noncurrent liabilities	98,331	96,271
Net assets:		
Unrestricted	19,003	21,035
Temporarily restricted	310	329
Permanently restricted	59	—
Total net assets	19,372	21,364
Total liabilities and net assets	\$ 160,567	151,876

See accompanying notes to consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Statements of Activities

Years ended September 30, 2005 and 2004

(In thousands)

	<u>2005</u>	<u>2004</u>
Changes in unrestricted net assets:		
Revenues, gains, and other support:		
National Science Foundation Cooperative Agreement:		
National Science Foundation funds	\$ 114,299	104,785
Other government award funds	17,364	16,496
Other government award funds	58,639	55,700
Other contract funds	9,563	10,045
Donated property	267	—
Membership fees	27	54
License fees and royalties	265	236
Investment income (note 2)	4,756	4,857
Total revenues and gains	<u>205,180</u>	<u>192,173</u>
Net assets released from restrictions	90	62
Total revenues, gains, and other support	<u>205,270</u>	<u>192,235</u>
Expenses and losses:		
Program expenses:		
Scientific programs	122,521	118,439
Scientific support facilities	66,365	58,420
Total program expenses	<u>188,886</u>	<u>176,859</u>
Management and general expenses	17,902	17,486
Total expenses (note 9)	<u>206,788</u>	<u>194,345</u>
Loss on disposal of property	463	53
Unrealized loss from derivative obligation (note 11)	51	—
Total expenses and losses	<u>207,302</u>	<u>194,398</u>
Decrease in unrestricted net assets	<u>(2,032)</u>	<u>(2,163)</u>
Changes in temporarily restricted net assets:		
Other contract funds	68	39
Investment income (note 2)	3	3
Net assets released from restrictions	(90)	(62)
Decrease in temporarily restricted net assets	<u>(19)</u>	<u>(20)</u>
Changes in permanently restricted net assets:		
Contributions	59	—
Increase in permanently restricted net assets	<u>59</u>	<u>—</u>
Change in net assets	(1,992)	(2,183)
Net assets, beginning of year	<u>21,364</u>	<u>23,547</u>
Net assets, end of year	\$ <u>19,372</u>	\$ <u>21,364</u>

See accompanying notes to consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Consolidated Statements of Cash Flows

Years ended September 30, 2005 and 2004

(In thousands)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Change in net assets	\$ (1,992)	(2,183)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Donated property	(267)	—
Net realized and unrealized gains on investments	(2,567)	(1,624)
Depreciation and amortization	6,112	6,347
Loss on disposal of property	463	53
Changes in operating assets and liabilities:		
Receivables	(6,545)	1,038
Other current assets	21	1,218
Accounts payable and accrued liabilities	6,825	6,040
Deferred revenue	1,747	(136)
Accrued postretirement benefit obligation	6,583	6,614
Other noncurrent liabilities	(78)	127
Net cash provided by operating activities	<u>10,302</u>	<u>17,494</u>
Cash flows from investing activities:		
Purchase of property	(26,243)	(6,932)
Purchase of investments	(24,214)	(40,937)
Proceeds from sale of investments	34,406	11,205
(Increase) decrease in cash equivalents for investment in property and permanently restricted	9,102	(137)
Net cash used in investing activities	<u>(6,949)</u>	<u>(36,801)</u>
Cash flows from financing activities:		
Proceeds from bond issuance	—	25,000
Payments of bonds payable	(4,460)	(4,460)
Proceeds from line of credit	66	917
Payments for bond issuance costs	—	(909)
Net cash (used in) provided by financing activities	<u>(4,394)</u>	<u>20,548</u>
Increase (decrease) in cash and cash equivalents	(1,041)	1,241
Cash and cash equivalents, beginning of year	<u>6,792</u>	<u>5,551</u>
Cash and cash equivalents, end of year	\$ <u><u>5,751</u></u>	\$ <u><u>6,792</u></u>
Supplemental cash flow information:		
Interest paid	\$ 4,168	4,042
Other current asset reclassification from noncurrent assets	41	8
Donated property	267	—

See accompanying notes to consolidated financial statements.

UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2005 and 2004

(1) Organization and Significant Accounting Policies

(a) Organization

The University Corporation for Atmospheric Research (UCAR) is a nonprofit membership corporation engaged in scientific and educational activities in atmospheric research and related fields. UCAR operates the National Center for Atmospheric Research (NCAR) under cooperative agreement with the National Science Foundation (NSF), and also operates other scientific projects funded principally by other United States government agencies. In connection with its operations, UCAR has incurred bond indebtedness (see note 4) and other indebtedness and commitments (see notes 5, 7, and 8) for which repayment is primarily dependent upon funding by NSF and other United States government agencies. The ability of NSF and other United States government agencies in any year to provide monies to UCAR is dependent on annual Congressional appropriations.

The prior cooperative agreement with NSF became effective October 1, 1998 and had an original expiration date of September 30, 2003, which date has now been extended three years to complete expenditure of funds under that cooperative agreement. UCAR and NSF have executed the current cooperative agreement, which has a term from October 1, 2003 through September 30, 2008.

Performance of work under United States government awards may be terminated whenever the sponsoring government agency shall determine that such termination is in the best interest of the United States government. Funding under all federal awards is subject to availability of funding as determined by the United States Congress. UCAR's management is unaware of any significant changes to the cooperative agreement or other federal grants in the upcoming year that will significantly impact UCAR's cash flows and its ability to pay current obligations as they become due.

The consolidated financial statements of UCAR include the University Corporation for Atmospheric Research Foundation (Foundation) and the Foundation's subsidiary, Peak Weather Resources, Inc. (Peak). All significant intercompany transactions have been eliminated. The Foundation was incorporated by UCAR for the purpose of engaging in technology transfer and other scientific, educational, and charitable activities in support of UCAR's mission. UCAR's board of trustees approves the election of the members of the board of directors of the Foundation. The Foundation's revenues relate primarily to license fees and royalties from transferred technology. Peak was formed for the purpose of commercializing UCAR-developed technology.

(b) Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting.

The net assets, revenues, gains, and other support in the accompanying consolidated financial statements are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of UCAR and changes therein are classified and reported as follows:

Unrestricted Net Assets

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

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Notes to Consolidated Financial Statements

September 30, 2005 and 2004

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by UCAR has been limited by donors for a specific purpose, which is generally related to scientific and education activities in atmospheric research.

Permanently Restricted Net Assets

Permanently restricted net assets are those whose use by UCAR has been restricted by donors to be maintained permanently but permits UCAR to spend the income derived for a specific purpose, which is generally related to scientific and education activities in atmospheric research.

(c) *Use of Estimates*

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

(d) *Cash Equivalents*

UCAR considers money market mutual funds and all highly liquid investments purchased with a maturity of three months or less to be cash equivalents, excluding amounts for investment in property and permanently restricted cash receipts.

(e) *Investments*

Investments in equity, government, and other fixed income securities are measured at fair value in the consolidated statements of financial position. These securities are publicly traded and have readily determined fair values. The guaranteed insurance contract is not publicly traded and is recorded at cost. Investment income or loss (including realized and unrealized gains and losses, interest, and dividends) is included in the change in unrestricted net assets unless the income or loss is restricted by the donor or law.

(f) *Receivables from Government Agencies*

Receivables from government agencies consist of amounts owed to UCAR from the federal government based on costs incurred but not yet reimbursed under federal grants or cooperative agreement. No allowance is established for these receivables, as they are considered fully collectible from the federal government.

(g) *Concentrations of Credit Risk*

UCAR's credit risk is primarily concentrated in receivables from the NSF and other United States government agencies. In the opinion of management, this concentration does not result in increased credit risk due to the nature of the receivables.

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Notes to Consolidated Financial Statements

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(h) Property

Property with title vested in UCAR is capitalized and recorded at cost if the acquisition cost is \$5,000 or more. Donated property is recorded at estimated fair market value at the time of donation. Depreciation is provided using the straight-line method over the estimated useful lives of the property ranging from 3 to 40 years.

Property with title vested in the federal government and other sponsors is not recorded in the consolidated statements of financial position (see note 3).

(i) Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value. For the years ended September 30, 2005 and 2004, management believes there has been no impairment of UCAR's long-lived assets.

(j) Deferred Bond Charges

Certain costs incurred by UCAR in connection with the issuance of bonds are deferred and are amortized using the straight-line method, which approximates the effective interest method, over the period that the related bonds are outstanding.

(k) Accrued Vacation Liability

In accordance with Colorado State Statutes (*Section 8-4-101, Definitions*), UCAR is required to pay upon separation from employment all vacation and paid time off (PTO) leave earned in accordance with the terms of UCAR's leave policy. Vacation and PTO leave is 100% vested and accrues when earned based on the employee's length of service and/or job position. Earned leave is funded through an indirect cost rate application charged to scientific programs and scientific support facilities. UCAR has recorded the fully funded accrued vacation and PTO liability in the accompanying consolidated financial statements.

(l) Revenue and Expense Recognition

Funds from awards and contracts, considered to be exchange transactions, are recognized as revenues when expenses under the award or contract are incurred. Expenses charged to federal awards are subject to government agency audit and possible adjustment. In the opinion of management, such adjustments, if any, will not have a significant impact on the accompanying consolidated financial statements.

(m) Functional Expenses

UCAR's Scientific Programs encompass basic and applied research, education and training, technology transfer and fostering research and operational partnerships within the geosciences community. Scientific Support Facilities provide a host of tools and platforms for observing, computing, data access and storage, and scientific visualization including operation and maintenance of research aircraft, supercomputing, and data systems. Management and general expenses are all costs associated with the overall management of UCAR.

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(n) Donor-Restricted Contributions

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The contributions are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions. In the absence of donor specification that income and gains on donated funds are restricted, such income and gains are reported as income of unrestricted net assets.

(o) Tax Status

UCAR and the Foundation are exempt from income taxes under Internal Revenue Code Section 501(c)(3). Peak is a taxable entity and accounts for income taxes in accordance with the liability method. Peak had cumulative net tax losses of \$284,000 and \$265,000 in 2005 and 2004, respectively.

(p) Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation.

(2) Investments

UCAR's investment portfolios are pooled for investment purposes. Bond trustee held investments are restricted for the acquisition or construction of noncurrent assets or for the liquidation of long-term bonds payable and are classified as other noncurrent assets. UCAR's remaining investments are unrestricted. Investments consist of the following as of September 30:

	Fair value	
	2005	2004
	(In thousands)	
Corporate investments	\$ 37,280	35,672
Bond trustee held investments	18,400	27,633
Total	<u>\$ 55,680</u>	<u>63,305</u>
Government securities	\$ 27,244	35,992
Equity securities	22,317	18,969
Guaranteed insurance contract	3,150	3,150
Other fixed income securities	2,969	5,194
Total	<u>\$ 55,680</u>	<u>63,305</u>

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Notes to Consolidated Financial Statements

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UCAR's investment income for the years ended September 30 is comprised of the following:

	Fair value	
	2005	2004
	(In thousands)	
Interest and dividends, net	\$ 2,192	3,236
Net realized losses	(35)	(319)
Net unrealized gains	2,602	1,943
Total	\$ 4,759	4,860

(3) Property

Property with title vested in UCAR, including property designated as to a particular purpose, is recorded in the consolidated financial statements.

Property with title vested in the U.S. Government and other sponsors is not recorded in the consolidated statements of financial position. Purchases of such property, totaling \$19,058,000 and \$15,762,000 in 2005 and 2004, respectively, are recorded as unrestricted expenses in the consolidated statements of activities. UCAR has the responsibility of maintaining property records and reporting balances to the respective sponsors. In the normal course of business, UCAR disposes of property in accordance with funding agency agreements. Government and other sponsor-owned property at cost consists of the following as of September 30:

	2005		2004	
	(In thousands)			
Real property – NSF titled	\$ 29,249		28,958	
Equipment:				
NSF titled	150,635		149,994	
Other sponsors	52,384		56,281	
Total equipment	203,019		206,275	
Total	\$ 232,268		235,233	

(4) Bonds Payable

(a) 1996 Series A & B Bonds

UCAR borrowed \$9,410,000 in fiscal 1997 through the issuance of County of Boulder, Colorado Development Revenue Bonds, Series 1996 A & B (1996 Series A & B Bonds) to assist in the purchase of a building and to finance the costs of computer networking, maintenance, and other equipment and capital improvements.

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Notes to Consolidated Financial Statements

September 30, 2005 and 2004

As of September 30, 2005 and 2004, the outstanding balance of the 1996 Series A Bonds was \$3,730,000 and \$4,310,000, respectively. The 1996 Series A Bonds bear interest and mature serially as follows (in thousands):

5.00% maturing September 1, 2006	\$	320
5.00% maturing September 1, 2007		545
5.13% maturing September 1, 2008		130
5.50% maturing September 1, 2009		135
5.50% maturing September 1, 2010		140
5.50% thereafter		<u>2,460</u>
Total	\$	<u><u>3,730</u></u>

The 1996 Series A Bonds maturing in 2016 and 2021 are subject to mandatory redemption beginning in 2009.

As of September 30, 2005 and 2004, the outstanding balance of the 1996 Series B Bonds was \$1,230,000 and \$1,265,000, respectively. The 1996 Series B Bonds are taxable and bear interest and mature serially as follows (in thousands):

7.00% maturing September 1, 2006	\$	35
7.63% maturing September 1, 2021		<u>1,195</u>
Total	\$	<u><u>1,230</u></u>

The 1996 Series B Bonds are subject to mandatory redemption annually at a redemption price of 100% of the principal amount plus any accrued interest. Pursuant to the mandatory sinking fund requirements of the 1996 Series B Bonds, UCAR is required to make annual debt service payments to redeem portions of the 1996 Series B Bonds. As of September 30, 2005, mandatory redemptions of bond principal for the next five years and thereafter are as follows (in thousands):

Year ending September 30:		
2006	\$	35
2007		40
2008		45
2009		45
2010		50
Thereafter		<u>1,015</u>
Total	\$	<u><u>1,230</u></u>

The 1996 Series A & B Bonds are subject to optional redemption after September 1, 2007, in whole or in part at the option of UCAR, at a redemption price of 100% of the principal amount redeemed plus any accrued interest. The 1996 Series A & B Bonds are not collateralized by the related property. Certain costs incurred by UCAR in connection with the 1996 Series A & B Bonds were deferred and are being amortized over the period that the 1996 Series A & B Bonds are outstanding.

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Notes to Consolidated Financial Statements

September 30, 2005 and 2004

(b) 1999 Bonds

UCAR borrowed \$13,760,000 on February 25, 1999 through the issuance of County of Boulder, Colorado Industrial Development Revenue Bonds, Series 1999 (1999 Bonds) to fund the purchase of equipment, capital improvements, issuance costs, and a reserve fund.

As of September 30, 2005 and 2004, respectively, the outstanding balance of the 1999 Bonds was \$5,035,000 and \$6,645,000; the bonds bear interest and mature serially as follows (in thousands):

3.88% maturing September 1, 2006	\$	1,165
4.00% maturing September 1, 2007		735
4.38% maturing September 1, 2008		570
4.10% maturing September 1, 2009		535
4.25% maturing September 1, 2010		345
4.35% – 4.63% thereafter		1,685
Total	\$	5,035

The 1999 Bonds maturing on or after September 1, 2009 are subject to optional redemption prior to maturity on or after September 1, 2008, at the option of UCAR, at a redemption price equal to 100% of the principal plus any accrued interest. The 1999 Bonds are not collateralized by the related equipment or improvements purchased by UCAR. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and are being amortized over the period that the 1999 Bonds are outstanding.

(c) 2001 Bonds

UCAR borrowed \$30,030,000 on November 27, 2001 through the issuance of County of Boulder, Development Revenue Refunding Bonds, Series 2001 (2001 Bonds) to refund the 1991 Building Bonds and to establish an escrow account to refund the 1996 Series B Bonds on September 1, 2007.

As of September 30, 2005 and 2004, respectively, the outstanding balance of the 2001 Bonds was \$26,440,000 and \$27,295,000. The bonds bear interest and mature serially as follows (in thousands):

3.30% maturing September 1, 2006	\$	880
3.50% maturing September 1, 2007		910
3.75% maturing September 1, 2008		935
4.50% maturing September 1, 2009		975
4.00% maturing September 1, 2010		1,020
4.00% – 5.50% thereafter		21,720
Total	\$	26,440

The 2001 Bonds maturing on or after September 1, 2012 are subject to optional redemption on or after September 1, 2011, in whole or part on any date, at a redemption price equal to 100% of the principal amount plus any accrued interest. The 2001 Bonds maturing on September 1 in each of the years 2022, 2026, and 2032 are subject to mandatory sinking fund redemption at a redemption price

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of 100% of the principal amount redeemed plus interest accrued to the redemption date beginning September 1, 2021 and continuing through September 1, 2032. The 2001 Bonds are not collateralized. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and are being amortized over the period that the 2001 Bonds are outstanding.

(d) 2002 Bonds

UCAR borrowed \$29,335,000 on December 18, 2002 through the issuance of County of Boulder, Development Revenue Bonds, Series 2002 (2002 Bonds) to pay in full the \$16,500,000 bank line of credit, refurbish and equip such facilities, and build-out of a 20,000 square foot expansion, and refurbish, improve, and equip other existing facilities of UCAR. The maturity date of the 2002 Bonds is September 1, 2033.

As of September 30, 2005 and 2004, respectively, the outstanding balance of the 2002 Bonds was \$25,810,000 and \$27,190,000. The bonds bear interest and mature serially as follows (in thousands):

2.50% maturing September 1, 2006	\$	1,380
3.88% maturing September 1, 2007		1,380
3.10% maturing September 1, 2008		1,240
5.00% maturing September 1, 2009		1,240
3.60% maturing September 1, 2010		1,240
3.80% – 5.38% thereafter		19,330
Total	\$	<u>25,810</u>

The 2002 Bonds maturing on or after September 1, 2013 are subject to optional redemption on or after September 1, 2012, in whole or part on any date, at a redemption price equal to 100% of the principal amount plus any accrued interest. The 2002 Bonds maturing on September 1 in each of the years 2016, 2018, 2021, 2027, and 2033 are subject to mandatory sinking fund redemption at a redemption price of 100% of the principal amount redeemed plus interest accrued to the redemption date beginning September 1, 2016 and continuing through September 1, 2033. The 2002 Bonds are not collateralized. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and are being amortized over the period that the 2002 Bonds are outstanding.

(e) 2003 Bonds

UCAR borrowed \$25,000,000 on December 4, 2003 through the issuance of County of Boulder, Development Revenue Bonds, Series 2003 (2003 Bonds) to construct and equip a new 80,000 square foot research laboratory and office building, and to refurbish, improve, and equip other existing facilities of UCAR. The maturity date of the 2003 Bonds is September 1, 2035.

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As of September 30, 2005 and 2004, the outstanding balance of the 2003 Bonds was \$25,000,000. The bonds bear interest and mature serially as follows (in thousands):

2.00% maturing September 1, 2006	\$	665
2.10% maturing September 1, 2007		1,325
2.45% maturing September 1, 2008		1,325
3.00% maturing September 1, 2009		1,270
3.00% maturing September 1, 2010		1,210
3.38% – 5.00% thereafter		<u>19,205</u>
Total	\$	<u><u>25,000</u></u>

The 2003 Bonds maturing on or after September 1, 2014 are subject to optional redemption on or after September 1, 2013, in whole or part on any date, at a redemption price equal to 100% of the principal amount plus any accrued interest. The 2003 Bonds maturing on September 1 in each of the years 2023, 2028, and 2035 are subject to mandatory sinking fund redemption at a redemption price of 100% of the principal amount redeemed plus interest accrued to the redemption date beginning September 1, 2023 and continuing through September 1, 2035. The 2003 Bonds are not collateralized. Certain costs incurred by UCAR in connection with the issuance of these bonds were deferred and will be amortized over the period that the 2003 Bonds are outstanding.

(f) *Arbitrage Liability*

The Internal Revenue Code (IRC), as amended, requires that cumulative income earned from investing tax-exempt bond proceeds in excess of the related bond interest expense (arbitrage) be rebated to the federal government, generally every five years or upon repayment of the underlying bonds. As of September 30, 2005 and 2004, UCAR has no liability for cumulative arbitrage. UCAR has \$3,000 and \$26,000 in cash and cash equivalents as of September 30, 2005 and 2004, respectively, that are held by the trustee for payment of such liabilities.

(g) *Capitalized Interest*

Interest cost incurred on borrowed funds during the period of construction of fixed assets is capitalized as a component of the cost of acquiring those assets. Interest cost capitalized during the years ended September 30, 2005 and 2004 is \$1,012,000 and \$750,000, respectively.

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(h) Bond Assets

As of September 30, 2005 and 2004, included in cash and cash equivalents, cash equivalents for investment in property, and investments purchased in accordance with the related bond documents, are the following amounts either held in a reserve fund for payment of bond principal for the 1996, 1999, 2001, 2002, and 2003 Bonds or otherwise restricted under the bond agreements:

	<u>2005</u>	<u>2004</u>
	(In thousands)	
Cash (overdraft) and cash equivalents:		
2003 Bonds	\$ (347)	—
2002 Bonds	(247)	(495)
2001 Bonds	625	623
1999 Bonds	(2,935)	(3,043)
1996 Series A & B Bonds	<u>467</u>	<u>753</u>
Total cash and cash equivalents	<u>(2,437)</u>	<u>(2,162)</u>
Cash equivalents for investment in property:		
2003 Bonds	1,927	7,230
2002 Bonds	174	2,682
1999 Bonds	1,374	2,059
1996 Series A & B Bonds	<u>—</u>	<u>645</u>
Total cash equivalents for investment in property	<u>3,475</u>	<u>12,616</u>
Current investments:		
2001 Bonds	75	75
1999 Bonds	<u>—</u>	<u>707</u>
Total current investments	<u>75</u>	<u>782</u>
Noncurrent investments:		
2003 Bonds	9,964	15,389
2002 Bonds	2,523	6,976
2001 Bonds	3,348	3,408
1999 Bonds	1,852	1,078
1996 Series A & B Bonds	<u>638</u>	<u>—</u>
Total noncurrent investments	<u>18,325</u>	<u>26,851</u>
Total	\$ <u><u>19,438</u></u>	\$ <u><u>38,087</u></u>

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(5) Other Debt

UCAR has a \$3,000,000 borrowing base under a bank line of credit agreement. The line of credit agreement matures on February 28, 2006 and borrowings thereunder will accrue interest at the variable rate of LIBOR plus 2% (5.86% at September 30, 2005). The line of credit is collateralized by cash equivalents held at the bank. There was \$983,000 and \$917,000 outstanding as of September 30, 2005 and 2004, respectively.

(6) Retirement Contribution Plan

UCAR has a defined contribution plan available to all regular full-time and part-time employees. Participants are required to contribute 5% of regular salary excluding overtime, and may contribute an additional amount in accordance with IRC guidelines. UCAR is required to contribute 10% of the participant's annual regular salary. UCAR reserves the right to modify or discontinue the plan at any time. Amounts paid under the plan by UCAR were \$9,538,000 and \$8,632,000 for the years ended September 30, 2005 and 2004, respectively.

(7) Postretirement Benefits

UCAR sponsors certain medical and dental benefits for employees and their eligible dependents, who were full-time employees, have worked 15 years, and have retired after age 50. Premiums for medical and dental benefits are paid by the retirees. Such premiums are, however, effectively subsidized by UCAR allowing the retirees to pay companywide rates, which are derived using actuarial assumptions attributable to both active and retired employees.

On September 30, 1998, UCAR amended its retiree medical plan (the Plan). Under the amendment, UCAR may terminate its subsidy of retiree medical premiums. Continuation of the subsidy is primarily contingent on the periodic renewal of the NSF cooperative agreement. Based on UCAR's history of providing these benefits, the postretirement benefit obligation has been calculated assuming the Plan will continue in perpetuity.

The following table sets forth the components of the accrued postretirement benefit obligation as of September 30, all of which are unfunded based on the amended plan:

	2005	2004
	(In thousands)	
Accumulated postretirement benefit obligation:		
Retirees	\$ 10,347	9,121
Fully eligible active employees	14,727	12,982
Other active participants	13,372	11,788
Total	\$ 38,446	33,891
Accrued postretirement benefit obligation	\$ 14,716	8,133

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The following table sets forth the components of UCAR's expense for postretirement benefits for the years ended September 30:

	<u>2005</u>	<u>2004</u>
	(In thousands)	
Service cost of benefits earned	\$ 2,018	1,785
Interest cost on accumulated postretirement benefit obligation	2,011	2,122
Amortization	<u>3,309</u>	<u>3,309</u>
Postretirement benefit expense	<u>\$ 7,338</u>	<u>7,216</u>
Benefit payment	<u>\$ 755</u>	<u>603</u>

UCAR's expected benefit payments are as follows (in thousands):

Year ending September 30:	
2006	\$ 793
2007	832
2008	874
2009	917
2010	963
2011-15	<u>5,589</u>
Expected benefit payments	<u>\$ 9,968</u>

For the years ended September 30, 2005 and 2004, the postretirement benefit obligation was measured using a 13% annual rate of increase in health care costs for those under age 65 and 16% for those over age 65 decreasing to 5% and 6%, respectively, in 2008. The weighted average discount rate used in determining the accumulated postretirement benefit obligations is 6% as of September 30, 2005 and 2004. A 1% increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation as of September 30, 2005 by \$6,728,000 and the aggregate service and interest cost in 2005 by \$1,329,607.

(8) Commitments

As a part of its investment portfolio, UCAR has committed to invest up to \$704,000 and \$500,000 in two limited investment partnerships. As of September 30, 2005 and 2004, respectively, UCAR has invested \$204,069 and \$114,316, respectively, in one partnership and \$450,750 and \$424,500, respectively, in the second partnership. These investments are in equity securities with readily determinable fair market values. These investments are included in the equity securities line item disclosed in note 2.

UCAR leases property under operating leases. Total rental expense under all operating leases was approximately \$1,128,000 and \$1,353,000, respectively, for 2005 and 2004.

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As of September 30, 2005, UCAR's future minimum rentals under operating leases, which may be terminated by UCAR in the event of insufficient funding, are as follows (in thousands):

Year ending September 30:		
2006	\$	1,148
2007		1,177
2008		312
2009		118
2010		121
Thereafter		3,636
Total minimum lease payments required	\$	6,512

At September 30, 2005 and 2004, UCAR had unfilled purchase order commitments of approximately \$30,319,000 and \$46,246,000, respectively.

UCAR is a party to litigation arising in the normal course of business. Management does not believe that such litigation will have a material adverse impact on UCAR's consolidated financial statements.

(9) Expenses

Expenses for operating activities for the years ended September 30 are as follows:

	2005	2004
	(In thousands)	
Salaries and employee benefits	\$ 119,505	113,949
Postretirement benefit expense	7,338	7,216
Applied indirect costs (net of depreciation and amortization)	3,092	2,388
Purchased services	30,982	27,485
Purchases of property titled with the sponsor (see note 3)	19,058	15,762
Materials and supplies	7,595	7,899
Travel	10,032	10,112
Depreciation	5,996	6,231
Amortization	116	116
Interest	3,074	3,187
Total	\$ 206,788	194,345

(10) Fair Value of Financial Instruments

UCAR has estimated the fair value of its financial instruments using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates herein are not necessarily indicative of the amounts UCAR could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

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The carrying amounts reported in the consolidated statements of financial position for cash and cash equivalents, receivables, accounts payable, accrued liabilities, and the line of credit approximate fair value due to their short maturities. The fair value of investments, with the exception of the guaranteed insurance contract, is based on quoted market prices, and the fair value of bonds payable is based on current traded values. The carrying amount of the guaranteed insurance contract approximates fair value.

The carrying amounts and fair values of UCAR’s investments and bonds payable as of September 30, 2005 and 2004 are as follows:

	2005		2004	
	Carrying amount	Fair value	Carrying amount	Fair value
	(In thousands)			
Investments	\$ 55,680	55,680	63,305	63,305
Bonds payable	87,245	90,460	91,705	95,923

(11) Derivative Financial Instruments

2005 Swaption

As a means to lower its borrowing costs, UCAR entered into a swaption contract that provided UCAR with an up-front payment of \$1,123,000 on June 9, 2005. A “swap option” or swaption conveys to the purchaser the option (but not the obligation) to enter into a swap at a future date. A swap is an agreement between two parties to exchange (or swap) a set of cash flows at future points in time. The swaption gives the counterparty the option to make UCAR enter into a receive-fixed, pay-variable interest rate swap on August 31, 2011. The swaption is based on the notional amount of \$21,325,000 based on the 2001 Bond debt payment schedule. If the option is exercised in 2011, UCAR would receive interest at the fixed rate of 4.27% while paying a variable rate payment based upon the greater of 68% of USD one-month LIBOR-British Bankers’ Association (BBA) or 57% of USD one-month LIBOR-BBA plus .44%. UCAR has the option in the contract to terminate the contract at any time prior to August 31, 2011 and receive the fair market value of the swaption.

At September 30, 2005, the swaption had a fair value of \$1,174,000. The mark to market is calculated by modeling the terms and conditions of the swap and then determining the difference between the present values of the original and prevailing swap rates.