



**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Financial Statements

Year ended September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

September 30, 2006 and 2005

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**KPMG LLP**  
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## **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, 2006 and 2005, 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 consolidated 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 consolidated financial statements, assessing the accounting principles used and the 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, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 9, 2007, 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 audits.

**KPMG LLP**

January 9, 2007

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Statements of Financial Position

September 30, 2006 and 2005

(In thousands)

Assets	2006	2005
Current assets:		
Cash and cash equivalents (note 4)	\$ 12,837	5,751
Investments (notes 2 and 4)	11,854	3,860
Receivables:		
Government agencies	9,355	19,538
Other (net of allowance for doubtful accounts of \$30 at 2006 and 2005)	2,134	2,493
Other current assets	667	709
Total current assets	36,847	32,351
Property (notes 3 and 4):		
Land and improvements	5,025	5,089
Building and building construction	76,752	73,543
Equipment	30,672	30,745
Total	112,449	109,377
Less accumulated depreciation on building and equipment	(43,484)	(39,215)
Property, net	68,965	70,162
Other noncurrent assets:		
Cash equivalents for investment in property and permanently restricted (note 4)	650	3,514
Investments (notes 2, 4, and 8)	43,000	51,820
Deferred bond charges (note 4)	2,414	2,564
Total other assets	46,064	57,898
Total assets	\$ 151,876	160,411
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable	\$ 5,532	14,336
Accrued vacation liability	10,755	10,032
Other accrued liabilities	5,564	9,150
Deferred revenue	6,240	3,918
Line of credit (note 5)	39	983
Current portion of bonds payable and note payable (notes 4 and 5)	4,958	4,445
Total current liabilities	33,088	42,864
Noncurrent liabilities:		
Bonds payable (note 4)	78,439	83,459
Accrued postretirement benefit obligation (note 7)	21,657	14,716
Note payable (note 5)	868	—
Total noncurrent liabilities	100,964	98,175
Net assets:		
Unrestricted	17,237	19,003
Temporarily restricted	393	310
Permanently restricted	194	59
Total net assets	17,824	19,372
Total liabilities and net assets	\$ 151,876	160,411

See accompanying notes to consolidated financial statements.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Statements of Activities

Years ended September 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Changes in unrestricted net assets:		
Revenues, gains, and other support:		
National Science Foundation Cooperative Agreement:		
National Science Foundation funds	\$ 101,464	114,299
Other government agency funds	16,733	17,364
Other government award funds	56,947	58,639
Other contract funds	10,369	9,563
Donated property	187	267
Membership fees	34	27
License fees and royalties	286	265
Investment income (note 2)	4,275	4,756
Total revenues and gains	<u>190,295</u>	<u>205,180</u>
Net assets released from restrictions	<u>36</u>	<u>90</u>
Total revenues, gains, and other support	<u>190,331</u>	<u>205,270</u>
Expenses and losses:		
Program expenses:		
Scientific programs	119,613	122,521
Scientific support facilities	<u>53,781</u>	<u>66,365</u>
Total program expenses	<u>173,394</u>	<u>188,886</u>
Management and general expenses	<u>18,682</u>	<u>17,902</u>
Total expenses (note 9)	<u>192,076</u>	<u>206,788</u>
Loss on disposal of property	46	463
Unrealized loss (gain) from derivative obligations (note 11)	<u>(30)</u>	<u>51</u>
Total expenses and losses	<u>192,092</u>	<u>207,302</u>
Decrease in unrestricted net assets	<u>(1,761)</u>	<u>(2,032)</u>
Changes in temporarily restricted net assets:		
Other contract funds	106	68
Investment income (note 2)	10	3
Net assets released from restrictions	<u>(36)</u>	<u>(90)</u>
Decrease in temporarily restricted net assets	<u>80</u>	<u>(19)</u>
Changes in permanently restricted net assets:		
Contributions	<u>133</u>	<u>59</u>
Increase in permanently restricted net assets	<u>133</u>	<u>59</u>
Change in net assets	<u>(1,548)</u>	<u>(1,992)</u>
Net assets, beginning of year	<u>19,372</u>	<u>21,364</u>
Net assets, end of year	<u>\$ 17,824</u>	<u>19,372</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Statements of Cash Flows

Years ended September 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Change in net assets	\$ (1,548)	(1,992)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Donated property	(187)	(267)
Net realized and unrealized gains on investments	(2,242)	(2,567)
Depreciation and amortization	6,929	6,112
Loss on disposal of property	46	463
Changes in operating assets and liabilities:		
Receivables	10,542	(6,545)
Other current assets	42	(20)
Accounts payable and accrued liabilities	(11,667)	6,825
Deferred revenue	2,322	1,747
Accrued postretirement benefit obligation	6,941	6,583
Net cash provided by operating activities	<u>11,178</u>	<u>10,339</u>
Cash flows from investing activities:		
Purchase of property	(5,442)	(26,243)
Purchase of investments	(10,120)	(24,214)
Proceeds from sale of investments	13,188	34,406
(Increase) decrease in cash equivalents for investment in property and permanently restricted	2,864	9,102
Net cash (used in) provided by investing activities	<u>490</u>	<u>(6,949)</u>
Cash flows from financing activities:		
Accretion of bonds payable premiums	(85)	(37)
Payments/proceeds from note issuance	892	—
Payments of bonds payable	(4,445)	(4,460)
Payments/proceeds from line of credit	(944)	66
Net cash used in financing activities	<u>(4,582)</u>	<u>(4,431)</u>
Increase (decrease) in cash and cash equivalents	7,086	(1,041)
Cash and cash equivalents, beginning of year	<u>5,751</u>	<u>6,792</u>
Cash and cash equivalents, end of year	\$ <u><u>12,837</u></u>	<u><u>5,751</u></u>
Supplemental cash flow information:		
Interest paid	\$ 4,018	4,168
Donated property	187	267

See accompanying notes to consolidated financial statements.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

## (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 four 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 UCAR Child Care LLC and the Foundation's subsidiaries, Peak Weather Resources, Inc. (Peak) and Science and Technology in Atmospheric Research Institute (STAR). 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. UCAR Child Care LLC was formed for the purpose of overseeing UCAR's child care facility and its outside operator. Peak was formed as a Colorado for-profit entity for the purpose of commercializing UCAR-developed technology. STAR was formed as a Colorado nonprofit to conduct classified research. STAR has applied for federal tax-exempt status.

### (b) *Basis of Presentation*

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

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2006 and 2005

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.

### **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 United States generally accepted accounting principles 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. Fair value of alternative investments is based on information provided by the various fund managers. 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.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2006 and 2005

**(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.

**(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, 2006 and 2005, 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 fully funded and recorded 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.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2006 and 2005

**(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.

**(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 (IRC) 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 \$153,000 and \$282,000 in 2006 and 2005, respectively. STAR has applied for federal tax-exempt status and is currently awaiting its designation. UCAR Child Care LLC has \$0 cumulative taxable income to date.

**(p) Reclassifications**

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

**(q) New Accounting Pronouncement**

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 requires the recognition of the funded status of a defined benefit postretirement plan as an asset or liability in the statement of financial position and recognize the changes in that funded status in the year in which the changes occur through changes in unrestricted assets. SFAS No. 158 is effective for reporting periods ending after June 15, 2007. UCAR sponsors certain medical and dental benefits for employees and their eligible dependents meeting certain criteria. UCAR has completed the process of evaluating the impact that will result from adopting SFAS No. 158 and, if SFAS No. 158 was recognized as of September 30, 2006, UCAR would recognize an additional liability of \$12,026,000. This amount is equal to the difference between the accrued postretirement benefit obligation of \$33,683,000 and the net amount recognized for the plan of \$21,657,000 as of September 30, 2006.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

**(2) Investments**

UCAR's investment portfolios are pooled for investment purposes. Of UCAR's total investments, \$5.7 million is held in investments managed by the Commonfund for which readily determinable fair values are not available. 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:

	<b>Fair value</b>	
	<b>2006</b>	<b>2005</b>
	(In thousands)	
Corporate investments	\$ 43,489	37,280
Bond trustee held investments	11,365	18,400
Total	<u>\$ 54,854</u>	<u>55,680</u>
Government securities	\$ 21,809	27,244
Equity securities	26,032	22,317
Guaranteed insurance contract	3,150	3,150
Other fixed income securities	3,863	2,969
Total	<u>\$ 54,854</u>	<u>55,680</u>

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

	<b>Fair value</b>	
	<b>2006</b>	<b>2005</b>
	(In thousands)	
Interest and dividends, net	\$ 2,043	2,192
Net realized gains (losses)	1,063	(35)
Net unrealized gains	1,179	2,602
Total	<u>\$ 4,285</u>	<u>4,759</u>

**(3) Property**

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

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

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 \$7,578,000 and \$19,058,000 in 2006 and 2005, 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:

	<u>2006</u>	<u>2005</u>
	(In thousands)	
Real property – NSF titled	\$ 29,530	29,249
Equipment:		
NSF titled	151,822	150,635
Other sponsors	<u>54,627</u>	<u>52,384</u>
Total equipment	<u>206,449</u>	<u>203,019</u>
Total	\$ <u><u>235,979</u></u>	<u><u>232,268</u></u>

**(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.

As of September 30, 2006 and 2005, the outstanding balance of the 1996 Series A Bonds was \$3,410,000 and \$3,730,000, respectively. The 1996 Series A Bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2011	150
5.50% thereafter	<u>2,310</u>
Total	\$ <u><u>3,410</u></u>

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

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

As of September 30, 2006 and 2005, the outstanding balance of the 1996 Series B Bonds was \$1,195,000 and \$1,230,000, respectively. The 1996 Series B Bonds are taxable and bear interest and mature serially as follows (in thousands):

7.63% maturing September 1, 2021	\$	1,195
Total	\$	1,195

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, 2006, mandatory redemptions of bond principal for the next five years and thereafter are as follows (in thousands):

Year ending September 30:		
2007	\$	40
2008		45
2009		45
2010		50
2011		55
Thereafter		960
Total	\$	1,195

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.

**(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.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

As of September 30, 2006 and 2005, respectively, the outstanding balance of the 1999 Bonds was \$3,870,000 and \$5,035,000; the bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2011		145
4.45% – 4.63% thereafter		<u>1,540</u>
Total	\$	<u><u>3,870</u></u>

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, 2006 and 2005, respectively, the outstanding balance of the 2001 Bonds was \$25,560,000 and \$26,440,000. The bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2011		1,060
4.10% – 5.50% thereafter		<u>20,660</u>
Total	\$	<u><u>25,560</u></u>

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 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.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

**(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, 2006 and 2005, respectively, the outstanding balance of the 2002 Bonds was \$24,430,000 and \$25,810,000. The bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2011		1,240
4.00% – 5.38% thereafter		18,090
Total	\$	24,430

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.

As of September 30, 2006 and 2005, respectively, the outstanding balance of the 2003 Bonds was \$24,335,000 and \$25,000,000. The bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2011		1,205
3.80% – 5.00% thereafter		18,000
Total	\$	24,335

## UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

### Notes to Consolidated Financial Statements

September 30, 2006 and 2005

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 are being 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, 2006 and 2005, UCAR has no liability for cumulative arbitrage. UCAR has \$0 and \$3,000 in cash and cash equivalents as of September 30, 2006 and 2005, 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, 2006 and 2005 was \$0 and \$1,012,000, respectively.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

**(h) Bond Assets**

As of September 30, 2006 and 2005, 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>2006</u>	<u>2005</u>
	(In thousands)	
Cash (overdraft) and cash equivalents:		
2003 Bonds	\$ 486	(347)
2002 Bonds	(401)	(247)
2001 Bonds	644	625
1999 Bonds	(1,322)	(2,935)
1996 Series A & B Bonds	515	467
Total cash and cash equivalents	<u>(78)</u>	<u>(2,437)</u>
Cash equivalents for investment in property:		
2003 Bonds	482	1,927
2002 Bonds		174
1999 Bonds		1,374
1996 Series A & B Bonds		—
Total cash equivalents for investment in property	<u>482</u>	<u>3,475</u>
Current investments:		
2002 Bonds	861	—
2001 Bonds	2,202	75
1999 Bonds	722	—
1996 Bonds	647	—
Total current investments	<u>4,432</u>	<u>75</u>
Noncurrent investments:		
2003 Bonds	3,931	9,964
2002 Bonds	1,170	2,523
2001 Bonds	1,169	3,348
1999 Bonds	662	1,852
1996 Series A & B Bonds	—	638
Total noncurrent investments	<u>6,932</u>	<u>18,325</u>
Total	<u>\$ 11,768</u>	<u>19,438</u>

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Notes to Consolidated Financial Statements

September 30, 2006 and 2005

(i) *Unamortized Premium/Discounts on Bonds Payable*

	<u>2006</u>	<u>2005</u>
	(In thousands)	
Bonds Payable	\$ 82,800	87,245
Net unamortized premiums/discounts	<u>574</u>	<u>659</u>
Bonds Payable plus net unamortized premiums/discounts	<u><u>83,374</u></u>	<u><u>87,904</u></u>
1996 Series A & B Bonds Payable	4,605	4,960
Net unamortized premiums/discounts	<u>(46)</u>	<u>(51)</u>
Subtotal 1996 Series A & B Bonds Payable	<u>4,559</u>	<u>4,909</u>
1999 Series Bonds Payable	3,870	5,035
Unamortized discounts	<u>(6)</u>	<u>(7)</u>
Subtotal 1999 Bonds Payable	<u>3,864</u>	<u>5,028</u>
2001 Series Bonds Payable	25,560	26,440
Net unamortized premiums/discounts	<u>177</u>	<u>197</u>
Subtotal 2001 Bonds Payable	<u>25,737</u>	<u>26,637</u>
2002 Series Bonds Payable	24,430	25,810
Net unamortized premiums/discounts	<u>264</u>	<u>314</u>
Subtotal 2002 Bonds Payable	<u>24,694</u>	<u>26,124</u>
2003 Series Bonds Payable	24,335	25,000
Net unamortized premiums/discounts	<u>185</u>	<u>206</u>
Subtotal 2003 Bonds Payable	<u>24,520</u>	<u>25,206</u>
Grand Total	\$ <u><u>83,374</u></u>	<u><u>87,904</u></u>

(5) **Other Debt**

UCAR has a \$2,100,000 borrowing base under a bank line of credit agreement. The line of credit agreement matures on April 30, 2007 and borrowings thereunder will accrue interest at the variable rate of LIBOR plus 2% (8.25% at September 30, 2006). The line of credit is collateralized by investments in the amount of the current outstanding balance held at the bank. There was \$39,000 and \$983,000 outstanding on this line of credit as of September 30, 2006 and 2005, respectively.

UCAR borrowed \$900,000 on May 12, 2006 under a seven year term note for the purpose of replacing the line of credit used for the purchase of real estate. The note bears a fixed interest rate of 6.64% and requires monthly installments of approximately \$6,800, including interest. The loan is collateralized by investments in the amount of the current outstanding balance held at the bank. There was \$892,000 outstanding as of September 30, 2006.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

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The note matures as follows (in thousands):

Fiscal year:		
2007	\$	23
2008		23
2009		25
2010		27
2011		29
Thereafter		<u>765</u>
Total	\$	<u><u>892</u></u>

### (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 \$9,473,000 and \$9,538,000 for the years ended September 30, 2006 and 2005, 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.

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Notes to Consolidated Financial Statements

September 30, 2006 and 2005

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:

	<u>2006</u>	<u>2005</u>
	(In thousands)	
Accumulated postretirement benefit obligation:		
Retirees	\$ 11,589	10,347
Fully eligible active employees	11,289	14,727
Other active participants	<u>10,805</u>	<u>13,372</u>
Total	\$ <u>33,683</u>	<u>38,446</u>
Accrued postretirement benefit obligation	\$ <u>21,657</u>	<u>14,716</u>

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

	<u>2006</u>	<u>2005</u>
	(In thousands)	
Service cost of benefits earned	\$ 2,303	2,018
Interest cost on accumulated postretirement benefit obligation	2,093	2,011
Amortization	<u>3,309</u>	<u>3,309</u>
Postretirement benefit expense	\$ <u>7,705</u>	<u>7,338</u>
Benefit payment	\$ <u>764</u>	<u>755</u>

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

	<u>Before Medicare D Reductions</u>	<u>Medicare D</u>	<u>After Medicare D Reductions</u>
Year ending September 30:			
2007	\$ 845	(91)	754
2008	951	(103)	848
2009	1,075	(120)	955
2010	1,206	(136)	1,070
2011	1,352	(149)	1,203
2012 – 15	<u>9,337</u>	<u>(1,042)</u>	<u>8,295</u>
Expected benefit payments	\$ <u>14,766</u>	<u>(1,641)</u>	<u>13,125</u>

For the years ended September 30, 2006 and 2005, 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, 2006 and 2005.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

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A 1% increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation as of September 30, 2006 by \$6,710,000 and the aggregate service and interest cost in 2006 by \$842,000.

### (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, 2006 and 2005, respectively, UCAR has invested \$385,000 and \$204,000, respectively, in one partnership and \$466,000 and \$451,000, respectively, in the second partnership. These investments are in equity securities without 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 \$1,142,000 and \$1,128,000, respectively, for 2006 and 2005.

As of September 30, 2006, 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:		
2007	\$	1,160
2008		314
2009		126
2010		126
2011		131
Thereafter		<u>4,063</u>
Total minimum lease payments required	\$	<u><u>5,920</u></u>

At September 30, 2006 and 2005, UCAR had unfilled purchase order commitments of approximately \$33,060,000 and \$30,319,000, 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.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2006 and 2005

**(9) Expenses**

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

	<b>2006</b>	<b>2005</b>
	(In thousands)	
Salaries and employee benefits	\$ 121,240	119,505
Postretirement benefit expense	7,705	7,338
Applied indirect costs (net of depreciation and amortization)	(4,057)	3,092
Purchased services	29,778	30,982
Purchases of property titled with the sponsor (see note 3)	7,578	19,058
Materials and supplies	8,002	7,595
Travel	10,969	10,032
Depreciation	6,781	5,996
Amortization	148	116
Interest	3,932	3,074
	<b>\$ 192,076</b>	<b>206,788</b>
Total	<b>\$ 192,076</b>	<b>206,788</b>

**(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.

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 and investments managed by the Commonfund, 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, 2006 and 2005 are as follows:

	<b>2006</b>		<b>2005</b>	
	<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
Investments	\$ 54,854	54,854	55,680	55,680
Bonds payable	82,800	85,773	87,245	90,460

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2006 and 2005

### (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 0.44%. 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, 2006 and 2005, respectively, the swaption had a fair value of \$(999,000) and \$(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.

#### *2006 Constant Maturity Swap in Connection with 2005 Swaption*

As a means of taking advantage of a flat yield curve, UCAR entered into a constant maturity swap in connection with the 2005 swaption. Under the 2005 swaption, if the option is exercised in 2011, UCAR would receive from its counterparty a floating rate equal to the greater of 68% of 1-month LIBOR or 57% of 1-month LIBOR plus 44 basis points in 2011. UCAR converted that swaption rate through an amendment to the swaption known as a Constant Maturity Swap or CMS to reference the rate of 61% of the 5-year LIBOR rate without unwinding the existing swaption. In addition to the payments under the swaption, UCAR would receive interest at the variable rate based upon the greater of 68% of USD one-month LIBOR-British Bankers’ Association (BBA) or 57% of USD one-month LIBOR-BBA plus 0.44% while paying a variable rate based on 61% of the 5-year LIBOR rate. UCAR has the option to terminate the contract at any time prior to August 31, 2011 and receive the fair market value of the CMS.

At September 30, 2006 the CMS had a fair value of \$(146,000). 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.