



**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Financial Statements

September 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

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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, 2007 and 2006, 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. 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, 2007 and 2006, 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.

As discussed in note 1 to the consolidated financial statements, effective September 30, 2007, UCAR implemented Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*.

**KPMG LLP**

January 30, 2008

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Statements of Financial Position

September 30, 2007 and 2006

(In thousands)

<b>Assets</b>	<b>2007</b>	<b>2006</b>
Current assets:		
Cash and cash equivalents (note 4)	\$ 2,772	12,837
Investments (notes 2 and 4)	8,165	11,854
Receivables:		
Government agencies	15,212	9,355
Other (net of allowance for doubtful accounts of \$30 at 2007 and 2006)	2,830	2,134
Other current assets	1,564	667
Total current assets	<u>30,543</u>	<u>36,847</u>
Property (notes 3 and 4):		
Land and improvements	5,025	5,025
Building and building construction	76,778	76,752
Equipment	30,911	30,672
Total	<u>112,714</u>	<u>112,449</u>
Less accumulated depreciation on building and equipment	<u>(48,497)</u>	<u>(43,484)</u>
Property, net	<u>64,217</u>	<u>68,965</u>
Other noncurrent assets:		
Long-term notes receivable	367	—
Cash for investment in property (note 4)	4,118	650
Investments (notes 2, 4, and 8)	49,217	43,000
Deferred bond charges and other noncurrent assets (note 4)	2,304	2,414
Total other noncurrent assets	<u>56,006</u>	<u>46,064</u>
Total assets	<u>\$ 150,766</u>	<u>151,876</u>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable	\$ 7,546	5,532
Accrued vacation liability	11,336	10,755
Other accrued liabilities (note 11)	4,486	5,564
Deferred revenue	2,725	6,240
Line of credit (note 5)	—	39
Current portion of bonds payable and note payable (notes 4 and 5)	4,223	4,958
Total current liabilities	<u>30,316</u>	<u>33,088</u>
Noncurrent liabilities:		
Bonds payable (note 4)	73,005	78,439
Accrued postretirement benefit obligation (note 7)	32,183	21,657
Note payable (note 5)	846	868
Total noncurrent liabilities	<u>106,034</u>	<u>100,964</u>
Net assets:		
Unrestricted	13,680	17,237
Temporarily restricted	402	393
Permanently restricted	334	194
Total net assets	<u>14,416</u>	<u>17,824</u>
Total liabilities and net assets	<u>\$ 150,766</u>	<u>151,876</u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Statements of Activities

Years ended September 30, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Changes in unrestricted net assets:		
Revenues, gains, and other support:		
National Science Foundation Cooperative Agreement:		
National Science Foundation funds	\$ 108,443	101,464
Other government agency funds	18,484	16,733
Other government award funds	59,193	56,947
Other contract funds	13,531	10,369
Donated property	247	187
Membership fees	30	34
License fees and royalties	139	286
Investment income (note 2)	6,614	4,275
Total revenues and gains	<u>206,681</u>	<u>190,295</u>
Net assets released from restrictions	63	36
Total revenues, gains, and other support	<u>206,744</u>	<u>190,331</u>
Expenses and losses:		
Program expenses:		
Scientific programs	127,783	119,613
Scientific support facilities	58,255	53,781
Total program expenses	<u>186,038</u>	<u>173,394</u>
Management and general expenses	19,496	18,682
Total expenses (note 9)	<u>205,534</u>	<u>192,076</u>
Loss on disposal of property	10	46
Unrealized gain from derivative obligations (note 11)	(146)	(30)
Total expenses and losses	<u>205,398</u>	<u>192,092</u>
Effect of adoption of SFAS No. 158 (note 1p)	4,910	—
Decrease in unrestricted net assets	<u>(3,564)</u>	<u>(1,761)</u>
Changes in temporarily restricted net assets:		
Other contract funds	73	106
Investment income (note 2)	19	10
Net assets released from restrictions	(63)	(36)
Increase in temporarily restricted net assets	<u>29</u>	<u>80</u>
Changes in permanently restricted net assets:		
Contributions	127	133
Increase in permanently restricted net assets	<u>127</u>	<u>133</u>
Change in net assets	(3,408)	(1,548)
Net assets, beginning of year	<u>17,824</u>	<u>19,372</u>
Net assets, end of year	\$ <u><u>14,416</u></u>	\$ <u><u>17,824</u></u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Consolidated Statements of Cash Flows

Years ended September 30, 2007 and 2006

(In thousands)

	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Change in net assets	\$ (3,408)	(1,548)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Donated property	(247)	(187)
Net realized and unrealized gains on investments	(4,258)	(2,242)
Depreciation and amortization	7,251	6,929
Loss on disposal of property	10	46
Changes in operating assets and liabilities:		
Receivables	(6,920)	10,542
Other current assets	(938)	42
Accounts payable and accrued liabilities	1,517	(11,667)
Deferred revenue	(3,515)	2,322
Accrued postretirement benefit obligation	10,526	6,941
Net cash provided by operating activities	18	11,178
Cash flows from investing activities:		
Purchase of property	(2,115)	(5,442)
Purchase of investments	(16,319)	(10,120)
Proceeds from sale of investments	18,049	13,188
(Decrease) increase in cash equivalents for investment in property and permanently restricted	(3,468)	2,864
Net cash (used in) provided by investing activities	(3,853)	490
Cash flows from financing activities:		
Net accretion of bonds payable premiums	(79)	(85)
Proceeds from note issuance	—	892
Payments of bonds and notes payable	(6,112)	(4,445)
Payments of line of credit	(39)	(944)
Net cash used in financing activities	(6,230)	(4,582)
Increase (decrease) in cash and cash equivalents	(10,065)	7,086
Cash and cash equivalents, beginning of year	12,837	5,751
Cash and cash equivalents, end of year	\$ 2,772	12,837
Supplemental cash flow information:		
Interest paid	\$ 3,952	4,018
Donated property	247	187

See accompanying notes to consolidated financial statements.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

### (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, 8, and 11) 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 five 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.

In January 2007, NSF issued solicitation NSF 07-542 Competition for the Management and Operation of the National Center for Atmospheric Research. UCAR has submitted a proposal consistent with the requirements of the solicitation. A decision by NSF is expected to occur in May 2008. This is an open competition and, as such, there are no guarantees that UCAR will be selected. However, UCAR's 47 years of experience in the management of NCAR, its record of scientific and administrative excellence, and its strong connection with universities and other organizations involved in atmospheric research make UCAR a strong contender.

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), UCAR Child Care LLC, and the Foundation's subsidiaries, Peak Weather Resources, Inc. (Peak) and Advanced Radar Corporation (ARC). 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. ARC was incorporated on November 1, 2006 as a Delaware for-profit with minority shareholders to commercialize UCAR-developed technology related to weather radars.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

**(b) Basis of Presentation**

The accompanying consolidated 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.

**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 educational activities in atmospheric research.

**(c) Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. 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 and Cash Equivalents**

UCAR considers cash as not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that UCAR may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. Cash and cash equivalents include highly liquid investments with a maturity of three months or less.

**(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.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

**(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.

**(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, 2007 and 2006, 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.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

**(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.

**(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 \$38,000 and \$153,000 in 2007 and 2006, respectively. ARC is a taxable entity and accounts for income taxes in accordance with the liability method. ARC has recorded an income tax expense of \$287,000 in 2007. UCAR Child Care LLC is a single-member LLC of UCAR and passes any income to UCAR.

**(p) Effect of New Accounting Pronouncement**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS 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 recognizes 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 adopted SFAS No. 158 in fiscal year 2007 and, as of September 30, 2007, recognized an additional liability

## UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

### Notes to Consolidated Financial Statements

September 30, 2007 and 2006

of \$4,910,000. This amount is equal to the difference between the accrued postretirement benefit obligation of \$32,183,000 and the net amount recognized for the plan of \$27,274,000 as of September 30, 2007.

#### (2) Investments

UCAR's investment portfolios are pooled for investment purposes. Of UCAR's total investments, \$6,559,000 and \$5,524,000 for the years ended September 30, 2007 and 2006, respectively, were 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>2007</b>	<b>2006</b>
	(In thousands)	
Corporate investments	\$ 51,029	43,489
Bond trustee held investments	6,353	11,365
Total	\$ 57,382	54,854
Government securities	\$ 14,995	21,809
Equity securities	33,501	26,032
Guaranteed insurance contract	3,150	3,150
Other fixed income securities	5,736	3,863
Total	\$ 57,382	54,854

UCAR's investment income for the years ended September 30 comprises the following:

	<b>Fair value</b>	
	<b>2007</b>	<b>2006</b>
	(In thousands)	
Interest and dividends, net	\$ 2,375	2,043
Net realized gains (losses)	941	1,063
Net unrealized gains	3,317	1,179
Total	\$ 6,633	4,285

#### (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, 2007 and 2006

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 \$13,049,000 and \$7,578,000 in 2007 and 2006, 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 consist of the following as of September 30:

	<b>2007</b>	<b>2006</b>
	(In thousands)	
Real property – NSF titled	\$ 29,796	29,530
Equipment:		
NSF titled	138,754	151,822
Other sponsors	54,129	54,627
Total equipment	192,883	206,449
Total	\$ 222,679	235,979

**(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, 2007 and 2006, the outstanding balance of the 1996 Series A Bonds was \$2,865,000 and \$3,410,000, respectively. The 1996 Series A Bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2012	160
5.50% thereafter	2,150
Total	\$ 2,865

The 1996 Series A Bonds maturing in 2016 and 2021 are subject to mandatory redemption beginning in 2009. The 1996 Series A Bonds mature on September 1, 2021. The 1996 Series B Bonds were called on September 4, 2007 and paid in full.

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

The 1996 Series A 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 Bonds are not collateralized by the related property. Certain costs incurred by UCAR in connection with the 1996 Series A & B Bonds were deferred. The 1996 Series A costs are being amortized over the period that the bonds are outstanding. The 1996 Series B Bonds are now amortized to zero as of September 30, 2007.

**(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. The 1999 Bonds mature on September 1, 2014.

As of September 30, 2007 and 2006, the outstanding balance of the 1999 Bonds was \$3,135,000 and \$3,870,000, respectively, the bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2012		100
4.55% – 4.63% thereafter		<u>1,440</u>
Total	\$	<u><u>3,135</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, Colorado 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. The Series 2001 Bonds mature on September 1, 2032.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

As of September 30, 2007 and 2006, the outstanding balance of the 2001 Bonds was \$24,650,000 and \$25,560,000, respectively. The bonds bear interest and mature serially as follows (in thousands):

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% maturing September 1, 2012		1,100
4.20% – 5.50% thereafter		19,560
Total	\$	24,650

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.

**(d) 2002 Bonds**

UCAR borrowed \$29,335,000 on December 18, 2002 through the issuance of County of Boulder, Colorado 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, 2007 and 2006, the outstanding balance of the 2002 Bonds was \$23,050,000 and \$24,430,000, respectively. The bonds bear interest and mature serially as follows (in thousands):

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
5.00% maturing September 1, 2012		1,240
4.00% – 5.38% thereafter		16,850
Total	\$	23,050

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

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

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, Colorado 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, 2007 and 2006, the outstanding balance of the 2003 Bonds was \$23,010,000 and \$24,335,000, respectively. The bonds bear interest and mature serially as follows (in thousands):

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
4.00% maturing September 1, 2012		1,195
3.80% – 5.00% thereafter		16,805
Total	\$	23,010

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, 2007 and 2006, UCAR has no liability for cumulative arbitrage.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

**(g) Bond Assets**

As of September 30, 2007 and 2006, included in cash, cash 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>2007</u>	<u>2006</u>
	(In thousands)	
Cash (overdraft):		
2003 Bonds	\$ 352	486
2002 Bonds	(455)	(401)
2001 Bonds	633	644
1999 Bonds	(853)	(1,322)
1996 Series A & B Bonds	<u>211</u>	<u>515</u>
Total cash and cash equivalents	<u>(112)</u>	<u>(78)</u>
Cash for investment in property:		
2003 Bonds	4,064	482
2002 Bonds	22	—
1999 Bonds	25	—
1996 Series A & B Bonds	<u>7</u>	<u>—</u>
Total cash equivalents for investment in property	<u>4,118</u>	<u>482</u>
Current investments:		
2002 Bonds	—	861
2001 Bonds	—	2,202
1999 Bonds	—	722
1996 Bonds	<u>—</u>	<u>647</u>
Total current investments	<u>—</u>	<u>4,432</u>
Noncurrent investments:		
2003 Bonds	—	3,931
2002 Bonds	2,063	1,170
2001 Bonds	2,196	1,169
1999 Bonds	1,437	662
1996 Series A & B Bonds	<u>657</u>	<u>—</u>
Total noncurrent investments	<u>6,353</u>	<u>6,932</u>
Total	\$ <u><u>10,359</u></u>	\$ <u><u>11,768</u></u>

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

	<u>2007</u>	<u>2006</u>
	(In thousands)	
Bonds Payable	\$ 76,710	82,800
Net unamortized premiums/discounts	495	574
	<u>77,205</u>	<u>83,374</u>
Bonds Payable plus net unamortized premiums/discounts	\$ 77,205	83,374
1996 Series A & B Bonds Payable	\$ 2,865	4,605
Net unamortized premiums/discounts	(37)	(46)
Subtotal 1996 Series A & B Bonds Payable	<u>2,828</u>	<u>4,559</u>
1999 Series Bonds Payable	3,135	3,870
Unamortized discounts	(5)	(6)
Subtotal 1999 Bonds Payable	<u>3,130</u>	<u>3,864</u>
2001 Series Bonds Payable	24,650	25,560
Net unamortized premiums/discounts	154	177
Subtotal 2001 Bonds Payable	<u>24,804</u>	<u>25,737</u>
2002 Series Bonds Payable	23,050	24,430
Net unamortized premiums/discounts	214	264
Subtotal 2002 Bonds Payable	<u>23,264</u>	<u>24,694</u>
2003 Series Bonds Payable	23,010	24,335
Net unamortized premiums/discounts	169	185
Subtotal 2003 Bonds Payable	<u>23,179</u>	<u>24,520</u>
Grand Total	\$ <u>77,205</u>	<u>83,374</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, 2008 and borrowings thereunder will accrue interest at the variable rate of LIBOR plus 2.00% (7.23 % at September 30, 2007). The line of credit is collateralized by investments in the amount of the current outstanding balance held at the bank. There was \$0 and \$39,000 outstanding on this line of credit as of September 30, 2007 and 2006, 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 \$869,000 and \$892,000 outstanding as of September 30, 2007 and 2006, respectively.

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## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

The note matures as follows (in thousands):

Fiscal year:		
2008	\$	23
2009		25
2010		27
2011		29
2012		31
Thereafter		<u>734</u>
Total	\$	<u><u>869</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 \$10,171,000 and \$9,473,000 for the years ended September 30, 2007 and 2006, 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.

As mentioned in note 1(p), in September 2006, the FASB issued SFAS No. 158, which became effective for UCAR at September 30, 2007. SFAS No. 158 requires balance sheet recognition of the net asset or liability for the overfunded or underfunded status of the postretirement benefit plans and recognition of changes in the funded status in the year in which the changes occur.

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Notes to Consolidated Financial Statements

September 30, 2007 and 2006

The incremental effect of applying SFAS No. 158 on individual line items on the statement of position as of September 30, 2007 was as follows (in thousands):

	<u>Before application</u>	<u>Application adjustment</u>	<u>After application</u>
Accounts payable and accrued liabilities	\$ 27,274	4,910	32,183
Decrease in unrestricted net assets	1,346	(4,910)	(3,564)

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>2007</u>	<u>2006</u>
	(In thousands)	
Accumulated postretirement benefit obligation:		
Retirees	\$ 11,254	11,589
Fully eligible active employees	10,687	11,289
Other active participants	10,242	10,805
Total	<u>\$ 32,183</u>	<u>33,683</u>
Accrued postretirement benefit obligation	<u>\$ 32,183</u>	<u>21,657</u>

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

	<u>2007</u>	<u>2006</u>
	(In thousands)	
Service cost of benefits earned	\$ 1,484	2,303
Interest cost on accumulated postretirement benefit obligation	1,965	2,093
Amortization	3,309	3,309
Recognized net actuarial loss (gain)	<u>(387)</u>	<u>—</u>
Postretirement benefit expense	<u>\$ 6,371</u>	<u>7,705</u>
Benefit payment	<u>\$ 755</u>	<u>764</u>

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Notes to Consolidated Financial Statements

September 30, 2007 and 2006

Amounts included in the separate line on the statement of activities, Effect of adoption of SFAS No. 158, were as follows for the year ended September 30, 2007 (in thousands):

Prior unrecognized service cost:		
Prior year balance	\$	20,915
Current year amortization		<u>3,309</u>
		<u>17,606</u>
Net actuarial gain:		
Prior year balance		(8,889)
Current year amortization		(4,194)
Loss arising during current period		<u>387</u>
		<u>(12,696)</u>
Prior unrecognized transition obligation:		
Prior year balance		—
Current year amortization		<u>—</u>
		<u>—</u>
Total	\$	<u><u>4,910</u></u>

The estimated prior service cost, net gain, and transition obligation expected to be amortized from the separate line on the statement of activities, effect of adoption of SFAS No. 158, into net periodic benefit cost in fiscal year 2008 are \$0, \$(667), and \$3,309, respectively.

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

	<b>Before Medicare D reductions</b>	<b>Medicare D</b>	<b>After Medicare D reductions</b>
Year ending September 30:			
2008	\$ 889	(97)	792
2009	1,002	(110)	892
2010	1,122	(123)	999
2011	1,258	(135)	1,123
2012	1,413	(151)	1,262
2013 – 17	<u>9,592</u>	<u>(1,021)</u>	<u>8,571</u>
Expected benefit payments	\$ <u><u>15,276</u></u>	<u><u>(1,637)</u></u>	<u><u>13,639</u></u>

# UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

## Notes to Consolidated Financial Statements

September 30, 2007 and 2006

For the years ended September 30, 2007 and 2006, the postretirement benefit obligation was measured using a 10% and 13% annual rate of increase in healthcare costs for those under age 65 and 10% and 16% for those over age 65, respectively, decreasing to 5% and 5%, respectively, in 2017. The weighted average discount rate used in determining the accumulated postretirement benefit obligations is 5.9% and 5.5% as of September 30, 2007 and 2006, respectively. A 1% increase in the assumed healthcare cost trend rate would increase the accumulated postretirement benefit obligation as of September 30, 2007 by \$6,199,000 and the aggregate service and interest cost in 2007 by \$797,000.

### (8) Commitments

As a part of its investment portfolio, UCAR has committed to invest up to \$704,000, \$500,000 and \$1,000,000 in three limited investment partnerships. As of September 30, 2007 and 2006, UCAR has invested \$500,000 and \$385,000, respectively, in one partnership, \$471,000 and \$466,000, respectively, in the second partnership, and \$19,000 and \$0, respectively, in the third 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 \$1,221,000 and \$1,142,000, respectively, for 2007 and 2006.

As of September 30, 2007, 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:		
2008	\$	1,179
2009		755
2010		782
2011		808
2012		835
Thereafter		<u>1,511</u>
Total minimum lease payments required	\$	<u><u>5,870</u></u>

At September 30, 2007 and 2006, UCAR had unfilled purchase order commitments of approximately \$34,289,000 and \$33,060,000, respectively.

UCAR is a party to potential litigation arising in the normal course of business. However there is no such litigation as of September 30, 2007 and 2006 which would impact UCAR's consolidated financial statements.

**UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH**

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

**(9) Expenses**

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

	<u>2007</u>	<u>2006</u>
	(In thousands)	
Salaries and employee benefits	\$ 125,548	121,240
Postretirement benefit expense	6,371	7,705
Applied indirect costs (net of depreciation and amortization)	(2,847)	(4,057)
Purchased services	33,537	29,778
Purchases of property titled with the sponsor (note 3)	13,049	7,578
Materials and supplies	7,771	8,002
Travel	11,073	10,969
Depreciation	7,101	6,781
Amortization	150	148
Interest	3,781	3,932
	<hr/>	<hr/>
Total	\$ <u>205,534</u>	<u>192,076</u>

**(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, 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, 2007 and 2006 are as follows (in thousands):

	<u>2007</u>		<u>2006</u>	
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Carrying amount</u>	<u>Fair value</u>
Investments	\$ 57,382	57,382	54,854	54,854
Bonds payable	76,710	78,851	82,800	85,773

## UNIVERSITY CORPORATION FOR ATMOSPHERIC RESEARCH

### Notes to Consolidated Financial Statements

September 30, 2007 and 2006

#### (11) Derivative Financial Instruments

##### (a) *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 pay interest at the fixed rate of 4.27% while receiving 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, 2007 and 2006, the swaption had a fair value of \$(896,000) and \$(999,000), respectively. 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.

##### (b) *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, 2007 and 2006, the CMS had a fair value of \$(102,000) and \$(146,000), respectively. 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.