BOARD OF
REGENTS
Morgan Dunn O'Connor
Victoria
Robert B. Johnson
Houston
Michael J. Cemo
Houston
Raul A. Gonzalez
Austin
Leroy L. Hermes
Houston
Dennis D. Golden, O.D.
Carthage
Lynden B. Rose
Houston
Calvin W. Stephens
Dallas
Jim P. Wise
Houston
Welcome W. Wilson, Sr.
Houston

OFFICERS OF
THE BOARD
(FISCAL YEAR 2006)
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Michael J. Cemo
Vice Chair
Dennis D. Golden, O.D.
Secretary

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Elwyn C. Lee
Vice President for Student Affairs
Grover S. Campbell
Vice President for Governmental Relations
Donald L. Birx
Vice President for Research
Michael D. Rierson
Vice President for University Advancement
Donna G. Hamilton
Vice President for Legal Affairs and General Counsel

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I am pleased to present the Annual Financial Report of the University of Houston for Fiscal Year 2006. The report provides an overview of the university’s financial operations and financial position as of August 31, 2006. The University of Houston, as a public institution, must account fully for the dollars we receive as investments in the educational future of Houston and of Texas. This Annual Financial Report is one means of providing assurance of such accountability.

The University of Houston administration continually evaluates the utilization of our resources to keep us the state's premier metropolitan teaching and research institution. Our university is home to 12 degree-granting colleges and an interdisciplinary honors college. We comprise more than 40 research centers and institutes, and we sponsor more than 300 partnerships with corporate, civic, and governmental entities. More than 4,600 benefits-eligible faculty and staff members educate and support more than 34,000 students in our 105 bachelor's degree programs; 128 master’s degree programs; 50 doctoral degree programs; and three, first professional degree programs.

The University of Houston has a remarkable past filled with great achievements. Men and women from around the world continue to receive rigorous educations thanks to the outstanding support of our University family, community partners, and governmental leaders.
It is my pleasure to present the 2006 Annual Financial Report for the University of Houston. This report represents the University's financial position as of August 31, 2006.

At the University of Houston, we pride ourselves on our ability to meet the educational needs of traditional and non-traditional students and to respond to the diverse needs of a multicultural student population. We offer academic programs from the baccalaureate through the doctorate, and in FY 2006 awarded 6,732 degrees (over 2,000 were at the graduate level). In addition, no single ethnic group constitutes a majority of students at UH, and we continue to be the most ethnically diverse urban research university in the nation.

In 2006 thirteen UH researchers generated research expenditures exceeding one million dollars each. These programs were dispersed through seven of the twelve colleges on the campus. Nearly half of these programs, six, were in the area of community advancement— for education, social services and training, and business development. The remaining million dollar programs were in natural resource conservation and protection, bio-med sciences, complex systems and cognitive research.

State support from the 79th Legislature for FY2006 University operations was commendable. Formula funding was increased over 3%, Tier 1 funding, now called the Research Development Fund, was restored, and debt service for tuition revenue bonds was fully funded. The University limited tuition and fee increases for resident undergraduate students to less than 5%. About 20% of the tuition increases were set-aside for student financial aid. Despite budget pressures from increasing utility and property insurance costs, significant resources were directed toward academic excellence and toward the goal of achieving Tier 1 status.

New faculty positions were created along with additional staffing for academic support operations. Resources were applied to faculty and staff retention efforts in the form of a 4% average salary increase for faculty and staff at the start of FY2006. There were a number of major plant expansion projects completed during the year. These included the $58 million new Science and Engineering Classroom Building, the $49 million addition and renovation to the MD Anderson Library, a $26 million parking garage and Welcome Center, and a $17 million expansion to the Cullen Oaks Dormitory.

The University of Houston continued making major strides in 2006 toward updating and expanding its facilities to meet the needs of faculty, staff and students as the University works toward Tier 1 status. The $54 million renovation and expansion of M. D. Anderson Library was dedicated in February 2006, and an addition to Wortham Theater for the Cynthia Woods Mitchell Center for the Arts opened for fall classes. Work progressed on state-of-the-art research labs in the new $76 million Science Engineering Research and Classroom Complex. In addition, the new Welcome Center opened in 2006 with the 1500 car parking garage opening in January and the Academic Services Center, Visitor’s Center and Retail operations dedicated at the start of fall semester. In addition deferred maintenance continued with over $6 million spent in FY06 on life safety, disabled accessibility, energy conservation, classroom updating and building system modernization.

The highlight of Facilities in FY2006 was development of a new Framework Plan for UH—an exciting vision that outlines how to transform the University into a vibrant community with expanded on-campus housing, mixed use development, additional academic space focused on new courtyards and increased green spaces, all linked with transit and pedestrian pathways to the surrounding community and a university “new town center,” Cougar Walk. Design began on a $99 million mixed use professional and graduate housing complex, Calhoun Lofts. This project, the first to incorporate the Framework guidelines, is scheduled to open in July 2009.

As you can see, the university continues to lead the way among public, urban institutions of higher education by serving our major constituencies, our students and faculty, and also the city in which we live.

John M. Rudley
Vice President for Administration and Finance
Assets

- **Cash & Investments**: $100,285,387 (10%)
- **Appropriations**: $45,544,229 (5%)
- **Receivables**: $438,305,339 (45%)
- **Inventories & Other Assets**: $33,388,422 (3%)
- **Land**: $36,576,591 (4%)
- **Construction in Progress**: $4,169,697 (1%)
- **Buildings, Infrastructure, & Improvements**: $258,490,568 (25%)
- **Equipment, Books, and Art**: $72,633,054 (7%)

Total Assets: **$989,393,287** (100%)  
Rounded: **$989,4**

Liabilities

- **Payables & Accrued Liabilities**: $48,554,251 (14%)
- **Deferred Revenue**: $78,474,509 (22%)
- **Accrued Compensable Absences Payable**: $13,970,106 (4%)
- **Bonds Payable**: $210,219,182 (59%)
- **Funds Held For Others**: $3,759,753 (1%)

Total Liabilities: **$354,977,801** (100%)  
Rounded: **$355.0**
Operating Revenues

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>2006</th>
<th>%</th>
<th>Rounded (To Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuition and Fees, Net of Discounts</td>
<td>$188,759,941</td>
<td>53%</td>
<td>$188.8</td>
</tr>
<tr>
<td>Sales of Auxiliary Services</td>
<td>35,501,729</td>
<td>10%</td>
<td>35.5</td>
</tr>
<tr>
<td>Sales of Other Goods and Services</td>
<td>15,599,884</td>
<td>5%</td>
<td>15.6</td>
</tr>
<tr>
<td>Federal Grant Revenues</td>
<td>75,333,190</td>
<td>22%</td>
<td>75.3</td>
</tr>
<tr>
<td>State Grant Revenue</td>
<td>18,906,043</td>
<td>5%</td>
<td>18.9</td>
</tr>
<tr>
<td>Local and Private Awards</td>
<td>14,151,019</td>
<td>4%</td>
<td>14.1</td>
</tr>
<tr>
<td>Other Operating Revenues</td>
<td>1,569,009</td>
<td>1%</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>Total Operating Revenues</strong></td>
<td><strong>$349,820,815</strong></td>
<td><strong>100%</strong></td>
<td><strong>$349.8</strong></td>
</tr>
</tbody>
</table>

Operating Expenses

<table>
<thead>
<tr>
<th>Expense Source</th>
<th>2006</th>
<th>%</th>
<th>Rounded (To Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries and Benefits</td>
<td>$359,536,881</td>
<td>65%</td>
<td>$359.6</td>
</tr>
<tr>
<td>Pass Through Expenses</td>
<td>6,685,942</td>
<td>1%</td>
<td>.567</td>
</tr>
<tr>
<td>Supplies, Office Operations, Travel</td>
<td>73,114,749</td>
<td>13%</td>
<td>73.1</td>
</tr>
<tr>
<td>Communication and Utilities</td>
<td>36,698,424</td>
<td>7%</td>
<td>36.7</td>
</tr>
<tr>
<td>Repairs and Maintenance</td>
<td>5,609,944</td>
<td>1%</td>
<td>5.6</td>
</tr>
<tr>
<td>Financing and Legal</td>
<td>12,800,061</td>
<td>2%</td>
<td>12.8</td>
</tr>
<tr>
<td>Scholarships</td>
<td>27,821,398</td>
<td>5%</td>
<td>27.8</td>
</tr>
<tr>
<td>Depreciation</td>
<td>18,200,188</td>
<td>3%</td>
<td>18.2</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>16,005,184</td>
<td>3%</td>
<td>16.0</td>
</tr>
<tr>
<td><strong>Total Operating Expenses (Natural)</strong></td>
<td><strong>$556,472,771</strong></td>
<td><strong>100%</strong></td>
<td><strong>$556.5</strong></td>
</tr>
</tbody>
</table>
Total Revenues

Operating Revenue
- Tuition & Fees, Net of Discounts: $188,759,941 (29%)
- Sales of Goods & Services: $52,670,622 (8%)
- Grants & Contracts: $108,390,252 (17%)
- Non-Operating Revenue
  - Legislative Revenue: $169,136,388 (26%)
  - HEAF Appropriation: $23,517,427 (4%)
  - Gifts: $36,270,455 (6%)
  - Investment Income: $56,620,777 (9%)
  - Other Sources: $8,649,437 (1%)

Total Revenues: $644,015,299 (100%)

Total Expenses
- Non-Operating Expenses
  - Interest Expense: $9,900,000 (2%)
- Operating Expenses
  - Salaries & Benefits: $359,536,881 (61%)
  - Pass Through Expenses: $6,685,942 (1%)
  - Office Operations & Supplies: $115,423,117 (20%)
  - Financing & Legal: $12,800,061 (2%)
  - Scholarships: $27,821,398 (4%)
  - Depreciation: $18,200,188 (3%)
  - Other Operating Expenses: $16,005,184 (3%)

Total Expenses (Natural): $587,553,758 (100%)

Rounded

Total Revenues: $644.0
Total Expenses: $587.6
### University of Houston

**STATEMENT OF NET ASSETS**

**August 31, 2006**

#### Assets

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>$56,812,294</td>
<td>$37,197,718</td>
</tr>
<tr>
<td>Short-term Investments</td>
<td>$2,602,264</td>
<td>$20,925,289</td>
</tr>
<tr>
<td>Restricted Cash and Cash Equivalents</td>
<td>$21,110,666</td>
<td>$17,936,020</td>
</tr>
<tr>
<td>Restricted Loans and Contracts</td>
<td>$6,322,818</td>
<td>$5,423,614</td>
</tr>
<tr>
<td>Legislative Appropriations</td>
<td>$45,544,229</td>
<td>$51,238,153</td>
</tr>
<tr>
<td>Receivables</td>
<td>$173,342,059</td>
<td>$161,340,901</td>
</tr>
<tr>
<td>Inventories</td>
<td>$2,292,025</td>
<td>$3,054,291</td>
</tr>
<tr>
<td>Loans and Contracts, Other Assets</td>
<td>$14,889,895</td>
<td>$18,804,239</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td>$322,916,253</td>
<td>$315,920,225</td>
</tr>
<tr>
<td><strong>Non-Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restricted Cash and Cash Equivalents</td>
<td>$19,229,792</td>
<td>$15,647,570</td>
</tr>
<tr>
<td>Restricted Loans and Contracts</td>
<td>$274,846,964</td>
<td>$254,388,399</td>
</tr>
<tr>
<td>Investments</td>
<td>$530,368</td>
<td>$254,873</td>
</tr>
<tr>
<td>Capital Assets, Non-Depreciable</td>
<td>$40,746,288</td>
<td>$168,246,997</td>
</tr>
<tr>
<td>Capital Assets, Depreciable</td>
<td>$860,725,471</td>
<td>$692,089,507</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>$(529,601,849)</td>
<td>$(511,379,276)</td>
</tr>
<tr>
<td><strong>Total Noncurrent Assets</strong></td>
<td>$666,477,034</td>
<td>$619,248,070</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$989,393,287</td>
<td>$935,168,295</td>
</tr>
</tbody>
</table>

#### Liabilities

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>$48,489,106</td>
<td>$47,208,954</td>
</tr>
<tr>
<td>Deferred Revenues</td>
<td>$78,474,509</td>
<td>$74,857,078</td>
</tr>
<tr>
<td>Employees’ Compensable Leave</td>
<td>$6,426,249</td>
<td>$5,978,348</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>$65,145</td>
<td>$0</td>
</tr>
<tr>
<td>Revenue Bonds Payable</td>
<td>$13,073,295</td>
<td>$11,459,922</td>
</tr>
<tr>
<td>Funds Held for Others</td>
<td>$3,759,753</td>
<td>$2,927,316</td>
</tr>
<tr>
<td><strong>Total Current Liabilities</strong></td>
<td>$150,288,057</td>
<td>$142,431,618</td>
</tr>
<tr>
<td><strong>Noncurrent Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees’ Compensable Leave</td>
<td>$7,543,857</td>
<td>$7,018,061</td>
</tr>
<tr>
<td>Revenue Bonds Payable</td>
<td>$197,145,887</td>
<td>$207,764,671</td>
</tr>
<tr>
<td><strong>Total Noncurrent Liabilities</strong></td>
<td>$204,689,744</td>
<td>$214,782,732</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td>$354,977,801</td>
<td>$357,214,350</td>
</tr>
</tbody>
</table>

#### Net Assets

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invested in Capital Assets, Net of Related Debt</td>
<td>$173,204,663</td>
<td>$163,652,626</td>
</tr>
<tr>
<td>Restricted, Debt Retirement</td>
<td>$22,211</td>
<td>$13,945</td>
</tr>
<tr>
<td>Restricted, Capital Projects</td>
<td>$617,403</td>
<td>$2,294,651</td>
</tr>
<tr>
<td>Restricted, Other</td>
<td>$58,047,663</td>
<td>$52,306,786</td>
</tr>
<tr>
<td>Nonexpendable, Endowment Funds</td>
<td>$244,556,818</td>
<td>$211,728,613</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>$157,966,728</td>
<td>$147,957,324</td>
</tr>
<tr>
<td><strong>TOTAL NET ASSETS</strong></td>
<td>$634,415,486</td>
<td>$577,953,945</td>
</tr>
</tbody>
</table>
## University of Houston

### Statement of Revenues, Expenses and Changes in Net Assets

For The Year Ended August 31, 2006

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Revenues</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tuition and Fees, Net of Discounts</td>
<td>$188,759,941</td>
<td>$179,305,726</td>
</tr>
<tr>
<td>Sales of Goods and Services</td>
<td>$52,670,622</td>
<td>$52,998,971</td>
</tr>
<tr>
<td>Federal Revenue</td>
<td>$75,333,190</td>
<td>$73,647,316</td>
</tr>
<tr>
<td>State Grant Revenue</td>
<td>$18,906,043</td>
<td>$21,279,469</td>
</tr>
<tr>
<td>Other Grants and Contracts</td>
<td>$14,151,019</td>
<td>$14,044,555</td>
</tr>
<tr>
<td><strong>Total Operating Revenues</strong></td>
<td><strong>349,820,815</strong></td>
<td><strong>341,276,037</strong></td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instruction</td>
<td>$171,518,996</td>
<td>$157,904,896</td>
</tr>
<tr>
<td>Research</td>
<td>$73,163,159</td>
<td>$77,669,115</td>
</tr>
<tr>
<td>Public Service</td>
<td>$30,396,554</td>
<td>$26,247,471</td>
</tr>
<tr>
<td>Academic Support</td>
<td>$77,918,229</td>
<td>$71,833,463</td>
</tr>
<tr>
<td>Student Services</td>
<td>$21,814,562</td>
<td>$21,342,814</td>
</tr>
<tr>
<td>Institutional Support</td>
<td>$42,461,723</td>
<td>$43,183,084</td>
</tr>
<tr>
<td>Operation and Maintenance of Plant</td>
<td>$40,149,675</td>
<td>$35,123,096</td>
</tr>
<tr>
<td>Scholarships and Fellowships</td>
<td>$26,528,032</td>
<td>$30,275,541</td>
</tr>
<tr>
<td>Auxiliary Enterprises</td>
<td>$54,321,653</td>
<td>$54,777,336</td>
</tr>
<tr>
<td>Depreciation and Amortization</td>
<td>$18,200,188</td>
<td>$19,977,794</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td><strong>556,472,771</strong></td>
<td><strong>538,334,610</strong></td>
</tr>
<tr>
<td><strong>Operating Income (Loss)</strong></td>
<td><strong>(206,651,956)</strong></td>
<td><strong>(197,058,573)</strong></td>
</tr>
<tr>
<td><strong>Nonoperating Revenues (Expenses)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislative Revenue</td>
<td>$170,343,186</td>
<td>$156,396,906</td>
</tr>
<tr>
<td>Gifts</td>
<td>$29,431,274</td>
<td>$23,370,951</td>
</tr>
<tr>
<td>Investment Income</td>
<td>$56,620,777</td>
<td>$30,338,201</td>
</tr>
<tr>
<td>Interest Expense and Fiscal Charges</td>
<td>$(9,319,201)</td>
<td>$(9,178,309)</td>
</tr>
<tr>
<td>Other Nonoperating Revenues (Expenses)</td>
<td>$(21,761,786)</td>
<td>$(27,163,927)</td>
</tr>
<tr>
<td><strong>Total Nonoperating Revenues (Expenses)</strong></td>
<td><strong>225,314,250</strong></td>
<td><strong>173,763,822</strong></td>
</tr>
<tr>
<td><strong>Income (Loss) Before Other Revenues, Expenses, Gains, Losses and Transfers</strong></td>
<td><strong>18,662,294</strong></td>
<td><strong>(23,294,751)</strong></td>
</tr>
<tr>
<td><strong>Other Revenues, Expenses, Gains, Losses and Transfers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Appropriation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Higher Education Assistance Funds)</td>
<td>$23,517,427</td>
<td>$25,986,116</td>
</tr>
<tr>
<td>Additions to Permanent and Term Endowments</td>
<td>$6,839,181</td>
<td>$7,982,284</td>
</tr>
<tr>
<td>Intercomponent Transfers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1,444,713)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislative Transfers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(130,816)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislative Appropriations Lapsed</td>
<td>(1,206,798)</td>
<td>(110,208)</td>
</tr>
<tr>
<td><strong>Total Other Revenues, Expenses, Gains, Losses &amp; Transfers</strong></td>
<td><strong>37,799,247</strong></td>
<td><strong>48,900,253</strong></td>
</tr>
<tr>
<td><strong>Change In Net Assets</strong></td>
<td><strong>56,461,541</strong></td>
<td><strong>25,605,502</strong></td>
</tr>
<tr>
<td>Net Assets Beginning</td>
<td>$577,953,945</td>
<td>$582,211,053</td>
</tr>
<tr>
<td>Restatements</td>
<td>$29,862,610</td>
<td></td>
</tr>
<tr>
<td><strong>Net Assets Beginning, as Restated</strong></td>
<td><strong>577,953,945</strong></td>
<td><strong>552,348,443</strong></td>
</tr>
<tr>
<td>Net Assets, Ending</td>
<td>$634,415,486</td>
<td>$577,953,945</td>
</tr>
</tbody>
</table>
### University of Houston

**STATEMENT OF CASH FLOWS**

**For The Year Ended August 31, 2006**

<table>
<thead>
<tr>
<th>Cash Flows from Operating Activities</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds Received from Students and Customers</td>
<td>$223,672,714</td>
<td>$215,877,735</td>
</tr>
<tr>
<td>Proceeds from Loan Programs</td>
<td>3,362,522</td>
<td>2,781,411</td>
</tr>
<tr>
<td>Proceeds from Other Revenues</td>
<td>140,748,245</td>
<td>138,150,633</td>
</tr>
<tr>
<td>Payments to Suppliers for Goods and Services</td>
<td>(128,755,081)</td>
<td>(137,047,145)</td>
</tr>
<tr>
<td>Payments to Employees</td>
<td>(359,078,091)</td>
<td>(340,165,272)</td>
</tr>
<tr>
<td>Payments for Loans Provided</td>
<td>(3,882,286)</td>
<td>(2,735,285)</td>
</tr>
<tr>
<td>Payments for Other Expenses</td>
<td>(60,319,429)</td>
<td>(62,298,660)</td>
</tr>
<tr>
<td><strong>Net Cash Provided (Used) by Operating Activities</strong></td>
<td>(184,251,406)</td>
<td>(185,436,583)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Flows from Noncapital Financing Activities</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from State Appropriations</td>
<td>174,961,128</td>
<td>146,006,659</td>
</tr>
<tr>
<td>Proceeds from Gifts</td>
<td>32,363,975</td>
<td>26,055,482</td>
</tr>
<tr>
<td>Proceeds from Endowments</td>
<td>19,356,927</td>
<td>20,950,583</td>
</tr>
<tr>
<td>Proceeds from Transfers from Other Funds</td>
<td>14,916,303</td>
<td>19,146,584</td>
</tr>
<tr>
<td>Payments for Other Uses</td>
<td>(41,287,118)</td>
<td>(50,782,938)</td>
</tr>
<tr>
<td><strong>Net Cash Provided by Noncapital Financing Activities</strong></td>
<td>200,311,215</td>
<td>161,376,370</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Flows from Capital and Related Financing Activities</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from Capital Financing Activities</td>
<td>33,196,504</td>
<td>82,383,510</td>
</tr>
<tr>
<td>Payments for Additions to Capital Assets</td>
<td>(43,006,779)</td>
<td>(68,740,045)</td>
</tr>
<tr>
<td>Payments of Principal and Interest on Debt Issuance</td>
<td>(22,855,201)</td>
<td>(19,757,137)</td>
</tr>
<tr>
<td><strong>Net Cash Used by Capital and Related Financing Activities</strong></td>
<td>(32,665,476)</td>
<td>(6,113,672)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Flows from Investing Activities</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from Interest and Investment Income</td>
<td>56,620,777</td>
<td>31,240,667</td>
</tr>
<tr>
<td>Payments to Acquire Investments</td>
<td>(13,643,663)</td>
<td>(20,819,372)</td>
</tr>
<tr>
<td><strong>Net Cash Provided by Investing Activities</strong></td>
<td>42,977,114</td>
<td>10,421,295</td>
</tr>
<tr>
<td>Increase (Decrease) in Cash and Cash Equivalents</td>
<td>26,371,447</td>
<td>(19,752,590)</td>
</tr>
<tr>
<td>Net Cash and Cash Equivalents, September 1</td>
<td>70,781,308</td>
<td>90,533,898</td>
</tr>
<tr>
<td>Restatements to Beginning Cash and Cash Equivalents</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash and Cash Equivalents, August 31</strong></td>
<td>97,152,755</td>
<td>70,781,308</td>
</tr>
</tbody>
</table>

### Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities

| Operating Income (Loss)                                | (206,651,956) | (197,058,573) |
| Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities | | |
| Amortization and Depreciation                          | 18,200,188     | 19,977,794   |
| Changes in Assets and Liabilities:                     |               |             |
| (Increase) Decrease in Receivables                     | 11,068,176     | 7,434,572    |
| (Increase) Decrease in Inventories                     | 7,622,666      | (152,959)    |
| (Increase) Decrease in Loans and Contracts             | (519,763)      | 46,127       |
| (Increase) Decrease in Prepaid Expenses                | 3,914,344      | (5,560,564)  |
| (Increase) Decrease in Payables                       | (17,381,492)   | (16,506,527) |
| Increase (Decrease) in Deferred Income                 | 3,617,432      | 5,278,618    |
| Increase (Decrease) in Other Liabilities               | 2,739,399      | 1,104,929    |
| **Total Adjustments**                                  | 22,400,550     | 11,621,990   |
| **Net Cash Provided (Used) by Operating Activities**  | $(184,251,406) | $(185,436,583)|
### Expenses by Natural Classification

<table>
<thead>
<tr>
<th>Expense</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Goods Sold</td>
<td>$1,890,506</td>
<td>$1,674,824</td>
</tr>
<tr>
<td>Salaries and Wages</td>
<td>$296,400,424</td>
<td>$278,818,683</td>
</tr>
<tr>
<td>Payroll Related Costs</td>
<td>$63,136,457</td>
<td>$59,891,602</td>
</tr>
<tr>
<td>Professional Fees and Services</td>
<td>$32,197,582</td>
<td>$31,815,838</td>
</tr>
<tr>
<td>Federal Pass-Through Expenses</td>
<td>$6,481,535</td>
<td>$8,050,265</td>
</tr>
<tr>
<td>State Pass-Through Expenses</td>
<td>$204,407</td>
<td>$55,110</td>
</tr>
<tr>
<td>Travel</td>
<td>$10,027,630</td>
<td>$8,681,285</td>
</tr>
<tr>
<td>Materials and Supplies</td>
<td>$25,392,022</td>
<td>$30,772,148</td>
</tr>
<tr>
<td>Communication and Utilities</td>
<td>$36,698,424</td>
<td>$30,703,954</td>
</tr>
<tr>
<td>Repairs and Maintenance</td>
<td>$5,609,944</td>
<td>$6,051,745</td>
</tr>
<tr>
<td>Rentals and Leases</td>
<td>$10,532,689</td>
<td>$10,522,951</td>
</tr>
<tr>
<td>Printing and Reproduction</td>
<td>$3,607,009</td>
<td>$3,706,658</td>
</tr>
<tr>
<td>Depreciation and Amortization</td>
<td>$18,200,188</td>
<td>$19,977,794</td>
</tr>
<tr>
<td>Interest</td>
<td>$1,590,513</td>
<td>$1,711,438</td>
</tr>
<tr>
<td>Scholarships</td>
<td>$27,821,398</td>
<td>$29,263,786</td>
</tr>
<tr>
<td>Claims and Losses</td>
<td>$676,859</td>
<td>$961,856</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>$16,005,184</td>
<td>$15,674,673</td>
</tr>
<tr>
<td><strong>TOTAL OPERATING EXPENSES</strong></td>
<td><strong>$556,472,771</strong></td>
<td><strong>$538,334,610</strong></td>
</tr>
</tbody>
</table>

### Expenses by Functional Classification

<table>
<thead>
<tr>
<th>Function</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instruction</td>
<td>$171,518,996</td>
<td>$157,904,896</td>
</tr>
<tr>
<td>Research</td>
<td>$73,163,159</td>
<td>$77,669,115</td>
</tr>
<tr>
<td>Public Service</td>
<td>$30,396,554</td>
<td>$26,247,471</td>
</tr>
<tr>
<td>Academic Support</td>
<td>$77,918,229</td>
<td>$71,833,463</td>
</tr>
<tr>
<td>Student Services</td>
<td>$21,814,562</td>
<td>$21,342,814</td>
</tr>
<tr>
<td>Institutional Support</td>
<td>$42,461,723</td>
<td>$43,183,084</td>
</tr>
<tr>
<td>Operation &amp; Maintenance of Plant</td>
<td>$40,149,675</td>
<td>$35,123,096</td>
</tr>
<tr>
<td>Scholarships &amp; Fellowships</td>
<td>$26,528,033</td>
<td>$30,275,541</td>
</tr>
<tr>
<td>Auxiliary Enterprises</td>
<td>$54,321,652</td>
<td>$54,777,336</td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>$18,200,188</td>
<td>$19,977,794</td>
</tr>
<tr>
<td><strong>TOTAL EXPENSES BY EXPENDITURE FUNCTION</strong></td>
<td><strong>$556,472,771</strong></td>
<td><strong>$538,334,610</strong></td>
</tr>
</tbody>
</table>
INTRODUCTION
The following section of the University of Houston's Annual Financial Report provides an overview of the activities and the financial position of the University of Houston for the fiscal year ended August 31, 2006. This Management's Discussion and Analysis is intended to offer a summary of significant current year activities, resulting changes, and currently known economic conditions and facts. This analysis should be read in conjunction with the University's basic financial statements and the notes to the statements.

BACKGROUND
The University of Houston (UH), located in the nation's fourth largest metropolitan area, is part of the state-supported system of higher education in Texas, serving over 34,000 students and generating approximately $80 million in externally funded research awards annually. The University is the flagship institution of the University of Houston System, and is its principal doctoral degree-granting institution. As such, it has the traditional functions of a comprehensive research university including a full range of undergraduate through post-doctoral academic programs, nationally recognized quality in its programs and faculty, extensive externally funded basic and applied research, and diverse cultural and public service programs of benefit to the community and the state. The University is the largest provider of baccalaureate services for Houston and the Upper Texas Gulf Coast region.

In addition to being an important source of new teachers in Texas, the University of Houston has also developed many collaborative partnerships with public schools whereby teachers participate in professional development programs and students are provided with educational opportunities. The University is committed to the discovery, dissemination, and application of knowledge. Over the past several years, the University of Houston has built multi-disciplinary research programs in areas such as materials science, the biosciences, and the computational sciences, all of which align with major regional and state industries – energy, biotechnology, aerospace, and computers. In doing so, the University has created programs of international repute that contribute greatly to the regional and state economies.

OVERVIEW OF THE FINANCIAL STATEMENTS
During the 2002 fiscal year, the State of Texas adopted Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, and Governmental Accounting Standards Board Statement No. 35, Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities. These accounting pronouncements established new reporting requirements including the presentation of new financial information and a restructuring of the presentation of previous fiscal years. Whereas the previous standards focused on the accountability of individual fund groups, the new standards focus on the preparation of financial statements that present aggregate operations. The financial statements for fiscal years 2002 through 2006 have been prepared in accordance with these rules.

The financial statements for the fiscal year ended August 31, 2006 are presented in a significantly different format as compared to years prior to fiscal year 2002. Governmental
Accounting Standards Board Statement No. 35 requires the University to include three financial statements in the annual financial report. They are (1) the Statement of Net Assets, (2) the Statement of Revenues, Expenses, and Changes in Net Assets, and (3) the Statement of Cash Flows. The information contained in the financial statements of the University of Houston is part of and included in the State of Texas Comprehensive Annual Financial Report. The financial statements of the University are presented for the fiscal year ended August 31, 2006, with financial data for the fiscal year ended August 31, 2005, provided for comparative purposes. Prior year totals have been reclassified, when necessary, to reflect current year changes in reporting procedures and to enhance comparability of reported totals.

The format of the statewide financial statements presents a more comprehensive perspective of the state’s financial activities. The state’s activities are divided into three types for presentation in the primary financial statements. They are Governmental Activities, Business-type Activities, and Component Units. The financial operations of the University of Houston are considered a business-type activity because the University charges a fee, in the form of tuition, to customers in order to pay for a majority of the cost of the services provided. Under this classification, the University’s financial statements conform to the guidelines and presentation formats prescribed for Proprietary Funds.

As a result of the adoption of the GASB reporting standards, the University is required to report accumulated depreciation on its capital assets. Additionally, the University recognizes a current year charge for depreciation expense.

Revenues and expenses are classified as either operating or nonoperating in the financial statements. Previous reporting standards focused on the accountability of individual fund groups and did not provide a measurement of entity-wide operations. Significant portions of the University’s recurring resources are classified as nonoperating by GASB Statement No. 35. Substantially all state appropriations are treated as nonoperating revenues.

Tuition and fee revenues are reported net of any scholarship discounts and allowances. A scholarship allowance is the difference between the stated charge for services provided by the University and the amount that is paid by the student or third parties making payments on behalf of the student. Funds received to satisfy student tuition and fee charges are reported as revenue only once. Institutional resources provided to students as financial aid are reported as scholarship allowances in amounts up to and equal to amounts owed by the students to the University. This accounting procedure is known as tuition discounting.

STATEMENT OF NET ASSETS

The first schedule presented is the Statement of Net Assets. The statement reflects the University’s assets and liabilities using the full accrual basis of accounting, and represents financial position as of the conclusion of the fiscal year. This is a point in time financial presentation and presents a snapshot view of the financial status as of August 31, 2006. Comparative data for the previous fiscal year has also been presented as of August 31, 2005. Assets and liabilities are presented as either current or noncurrent to provide an indication of their anticipated liquidation. Net Assets is equal to Assets minus Liabilities. Unrestricted Net Assets are available to the University for any lawful purpose. Unrestricted Net Assets often have constraints on resources, which are imposed by management, but can be removed or modified. On August 31, 2006, the University of Houston’s Assets totaled $989 million, and Liabilities totaled $355 million, resulting in a Net Asset valuation of $634 million. This represents a increase in net assets of $56 million.

The Statement of Net Assets allows the reader of the
financial statements to determine the assets available for use in the continuing operations of the University. Also, the reader will be able to determine the amounts owed to vendors, investors and lending institutions. Net Assets are presented in three major categories: invested in capital assets, net of debt; restricted net assets; and unrestricted net assets. The invested in capital assets category identifies the equity in property, plant, and equipment owned by the University. Restricted net assets are presented in two sub categories: non-expendable and expendable. Non-expendable restricted net assets are available only for endowed investment purposes. Expendable net assets are available for expenditure but must be expended for the purposes specified by the external donor/provider of the assets. Unrestricted net assets are available for any lawful purpose of the University. Although not subject to the stipulations of external requirements, a significant portion of the University’s unrestricted net assets are committed to various future operating budgets related to academic, research, and capital programs and projects.

The next statement comprising the primary financial statements is the Statement of Revenues, Expenses, and Changes in Net Assets. This schedule identifies operating and nonoperating revenues received by the University. Additionally, both the operating and nonoperating expenses incurred by the University during the fiscal year are displayed. Finally, any other gains and losses or other forms of revenue and expense are reported.

During the 2006 fiscal year, the University recognized operating revenues of $350 million and operating expenses of $556 million. After recognizing nonoperating activities and other gains and losses, the University realized a current year net increase in net assets of $56 million. During the prior fiscal year, the University experienced a decrease in net assets of $4 million, in part, as a result of the recognition of prior years’ accumulated depreciation.

Operating revenues are received and recognized as a result of providing services to the University’s customers. Operating expenses are the costs necessary to provide those services and to fulfill the mission of the University. Operating expenses are displayed in the Statement using the functional method of classification. The functional, or programmatic, classification method presents operating expenses in a manner that reflects the University’s commitments in fulfilling its mission of instruction, research, and public service, as well as the requirements of supporting and maintaining its administrative and physical structure. Nonoperating revenues are those received for which no services are directly provided. State appropriations are classified as nonoperating revenue because they are provided by the Legislature to the University without the Legislature directly receiving goods or services for those revenues. As previously mentioned, significant portions of the University’s recurring resources are classified as nonoperating. Net resources from other than operating revenues totaled $294 million for fiscal year 2006.
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Non-operating Revenues, net $4,552,321
Legislative Revenues $186,758,519
Gifts and Endowments $36,270,455
Operating Revenues $349,820,815

Increase in Net Assets $56,461,541

Operating Expenses $556,472,771
Gifts and Endowments $31,353,235
Legislative Revenues $191,339,918
Operating Revenues $341,276,037

Increase in Net Assets $25,405,362

STATEMENT OF CASH FLOWS

The third primary statement included in the financial statements is the Statement of Cash Flows. This schedule explains the change during the fiscal year in cash and cash equivalents, regardless of whether there are restrictions on their use. The Statement of Cash Flows should be used in conjunction with related disclosures and information in the other financial statements. The statement can provide relevant information about an entity, such as the ability to generate future net cash flows, the ability to meet obligations when due, or reasons for differences between operating income and expenses.

OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION

Total Expenses by Functional Classification $556,472,771

Total Expenses by Functional Classification $538,334,610
and associated cash receipts and payments. The statement is comprised of five sections. The first section recognizes the cash flows from operating activities as well as the net cash used by operating activities. The second section identifies the cash flows from noncapital financing activities. The third section reflects the cash flows from capital and related financing activities. The next section details the cash flows from investing activities. The final section reconciles net cash used to the operating loss or income reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

The cash and cash equivalents balance at the conclusion of the fiscal year totaled $97 million, which reflected a net increase in cash of $26 million.

**Operating Expenses by Natural Classification**

**Capital Assets**

Critical to maintaining the quality of academic, research, and service programs, as well as residential life, is the development and renewal of the University’s capital assets. The University continues the implementation of its long-range capital plan, with a prudent combination of renovation and modernization of older facilities, along with new construction.

As of the end of the 2006 fiscal year, the University had $372 million of capital assets, net of accumulated depreciation. These assets included land, buildings, infrastructure and improvements, furniture and equipment, library books, and works of art. Several major capital construction projects are in various stages of completion, and the cumulative investment in these assets is reported as construction in progress. Capital assets, net of accumulated depreciation, at August 31, 2005, totaled $349 million.

Construction has been completed on the renovation and expansion of the M.D. Anderson Library, which nearly doubled the size of the building. Additionally, the project provides the Honors College, housed within the library, with new and expanded classroom, seminar, and student spaces. Also completed is the initial construction phase of the Science and Engineering Research and Classroom Complex (SERCC). The structure, which was designed by internationally renowned architect Cesar Pelli, will facilitate collaborative research among scientists, engineers, and physicians. Much of the university’s joint research with
the Texas Medical Center – including bionanotechnology, drug design, and synthetic medicinal chemistry – will be conducted at the SERCC. The multifunctional parking garage, one of several new garages planned for the campus was placed in service during the spring of 2006. The facility serves as the home of the university's new Welcome Center, as well as retail outlets and dining establishments. The Welcome Center provides convenient parking, easier access to student services, and a spirited place to welcome prospective students, their parents, and returning alumni. Completion of each of these projects will provide enhanced and significant benefits to the University's students and other constituencies.

The University's new Master Plan lays a framework for a vision of growth and expansion of services. By the year 2020, the campus will have a greater number of housing facilities, improved academic buildings, with an increased amount of square footage, and new lifestyle facilities, including stores, restaurants, social and gathering places, and enhanced transportation facilities. The University maintains a goal of improving the physical condition of the campus and its various facilities, while at the same time, preserving their condition and maximizing their utilization.

DEBT ADMINISTRATION

The University believes that the prudent use of debt to finance capital projects is an effective tool in the management of its financial resources. Detailed information concerning the University's long-term debt is found in the notes to the financial statements.

The University of Houston is authorized by statute to issue long-term debt in the form of revenue bonds. Each series of revenue bonds issued is backed by a pledged revenue source specified in the bond resolution. Additionally, each issue is designed to be self-supporting from the primary revenue source. At August 31, 2006, the University of Houston had $210 million of long term bonded debt outstanding, $13 million of which will be retired during the 2007 fiscal year.

In fiscal year 2006, the University of Houston issued $45.24 million of Consolidated Revenue Refunding Bonds, Series 2006. Proceeds from this bond issue were used to refund a portion of previously issued Consolidated Revenue Bonds, Series 2000.

ECONOMIC OUTLOOK

The University of Houston is strongly committed to undergraduate education and moving students from matriculation to graduation while maintaining rigorous academic standards. As the demands and requirements of our population and economic/industrial base increase, a citizenry educated through the baccalaureate has become imperative for the future success of our state. Houston and the Upper Gulf Coast region are critical to this success, and as the region’s largest provider of baccalaureate services, the University of Houston’s responsibility is significant. Part of this responsibility includes ensuring access to all qualified students regardless of cultural/ethnic background or economic position – factors that have stood as roadblocks to participation in higher education in the past. If we do not create an environment hospitable to all people, we will not have done our job as educators, and the potential of Texas citizens will not be maximized. Part of this responsibility is also to ensure that students
have the support they need to complete their degrees in a timely manner. Currently, the University of Houston is implementing a major student retention and graduation initiative, through which we are increasing the number of academic advisors on campus and the availability of financial aid. We have also created a four-year graduation pledge and scholarship reward program for freshmen who complete at least 30 credit hours per year.

In addition to its instructional goals, the University of Houston is committed to the discovery, dissemination, and application of knowledge. In this regard, UH is unique among state research institutions because of its location in Houston – one of the most ethnically diverse, economically dynamic, and culturally rich areas of the nation. In fact, the University of Houston is the most ethnically diverse research university in the United States. Of fundamental importance to the university is its ability to capitalize on the city’s resources to improve its academic programs, the research experience of its faculty and students, and the cultural and economic development of the city, state, nation, and world. Over the past several years, the University of Houston has built multi-disciplinary research programs in areas such as materials science, the biosciences, and the computational sciences, all of which align with major regional and state industries – energy, biotechnology, aerospace, and computers. In doing so, we have created programs of international reputation that contribute greatly to the regional and state economies.

As we look to fiscal years 2008 and 2009, becoming the state’s third top-tier research university will remain the University of Houston’s highest institutional priority. Over the past several years, much progress has been made in accomplishing this goal. First, the University of Houston is becoming an institution of choice for more students. UH serves more students than any other institution in the state other than University of Texas-Austin and Texas A&M University. UH enrollment for the fall 2005 semester was 34,582, and for FY05 we graduated a record 6,833 students, 1,200 more than we graduated five years earlier. Second, growth in research funding has been tremendous. Research awards for FY05 totaled $80 million (a 51 percent increase from fiscal year 2000), while federal awards – the most sought after nationally – were $37 million (up 28 percent from fiscal year 2000). None of these accomplishments would have been possible without strong support from the Texas Legislature, and as we look to the 80th session, we will again seek the investments from the state needed to build on the momentum achieved over the past several years.

The University is not aware of any known facts, decisions, or conditions that are expected to have a significant effect on the financial position or results of operations during the 2007 fiscal year. Although it is not possible to predict ultimate results, management believes the University of Houston’s financial condition and position are strong. The University’s administrative and management teams realize that universities must be good stewards of the dollars with which they are entrusted. The University of Houston is committed to this principle. Accomplishing the University’s goals and mission is predicated on the effective management of resources, which the University of Houston strives to achieve.
The University of Houston’s recently developed Master Plan lays the framework for a bold and exciting vision. By the year 2020, the University of Houston will continue to occupy its current 550 acres. The building square footage, however, will have doubled to more than 15 million. There will be as much green space and virtually no visible parking lots. UH will have 45,000 students by then, with as many as 11,000 students living on campus.

An improved transportation system establishes convenient parking integrated into academic and housing facilities and incorporates an on-campus shuttle system and expanded green space. The campus will have more housing in all areas, improved academic buildings, and new lifestyle features, such as stores, restaurants, and gathering places.

As the university implements the plan, the campus will evolve into five distinct areas. The Arts District will be in the northern quadrant, while the Professional District will be to the east. The Undergraduate District will be to the south, and to the west will be the location of the Stadium District. The Core Academic District, encompassing liberal arts and sciences, occupies the heart of the university. UH will become a more pedestrian-focused campus. Main transportation routes will surround the university with shuttle lines to provide cross-campus access.
Core Academic District

Liberal arts, sciences, and the library are literally and figuratively at the core of the institution. Students already benefit from the expanded M.D. Anderson Library, which is nearly twice as large and includes greatly enhanced computer facilities and new student gathering spaces. The Honors College moved into the new library wing, providing much-needed classroom, seminar, and student spaces. The Science and Engineering Research and Classroom Complex, completed last year, will house interdisciplinary health and nanotechnology research.

Undergraduate District

Enriching the undergraduate experience is a top priority for the University of Houston. The southern edge of campus will see an expansion of undergraduate housing designed to blend into the surrounding neighborhood while supporting our under-graduate students’ needs and interests outside the classroom. Academic and student support programs also are expanding to better accommodate full-time and part-time undergraduate students and to help them graduate on time. The Master Plan’s integration of study, entertainment, and living space assists students in receiving the most from their university experience.
Professional District

Business, engineering, optometry, and law form the heart of the Professional District – an environment including town home living, student support services, and expanded academic complexes. The C. T. Bauer College of Business is developing a Leadership Center that will support undergraduate, graduate, and executive education. The Cullen College of Engineering plans to create an academic and student life facility with space for petroleum and industrial engineering. The UH Law Center will increase and enhance its academic and library facilities, and Optometry is planning a new graduate research facility.

Arts District

The Arts District will serve arts and architecture students and welcome thousands of visitors each year. The district also will create public venues and an artistic environment that incorporates loft-style housing, academic facilities, and social spaces. The proposed John and Rebecca Moores School of Music addition will provide new classrooms and rehearsal and recital spaces. An expansion of Blaffer Gallery, the Art Museum of the University of Houston, will add modern galleries, an auditorium, and a sculpture garden. The new Burdette Keeland Jr. Design Exploration Center in the Gerald D. Hines College of Architecture will expand student workshops.
Stadium District

Cougar athletics have a rich tradition at UH. The Stadium District will combine sports venues along the campus’ west corridor and create a well-defined pedestrian area with walkways and expanded facilities. The proposed terminal for the University Light Rail line that will connect UH to the Galleria, west Houston, the downtown business district, and UH-Downtown is located in this district. The Master Plan calls for a transportation hub linked to an extended on-campus shuttle system.

When will all this happen? It has already begun. $59 million in projects are in progress now and $233 million are planned over the next five years. The plan will continue to evolve over the coming years and will help guide our future growth.
GENERAL INTRODUCTION

The State Auditor of Texas has not audited the accompanying Annual Financial Report and, therefore, an opinion has not been, nor will be, expressed on the financial statements and related information contained in this report. The information contained in the financial statements of the University of Houston is part of and included in the State of Texas Comprehensive Annual Financial Report upon which an opinion is expressed. The state’s financial statements are audited by the State Auditor.

ENTITY

The University of Houston (the University) is an agency of the State of Texas and its financial records comply with state statutes and regulations. This includes compliance with the Texas Comptroller of Public Accounts’ Reporting Requirements for Annual Financial Reports of State Agencies and Universities.

The University serves the state as the primary provider of educational and cultural opportunities, skilled employers and leaders, technical knowledge, and innovative research to the Houston metropolitan area and the upper Texas Gulf Coast region. Houston and the upper Gulf Coast region represent approximately one fourth of the state’s population and economy.

The University is a component of the University of Houston System (the System), which was established by House Bill No. 188, Sixty-Fifth Legislature, Regular Session, effective September 1, 1977. The University of Houston, previously a private university, became a state agency in 1963. The System is governed by an appointed nine member Board of Regents.

During the 2002 fiscal year, the State of Texas adopted Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements - and Management’s Discussion and Analysis - for State and Local Governments, and GASB Statement No. 35, Basic Financial Statements - and Management’s Discussion and Analysis - for Public Colleges and Universities. These accounting pronouncements established new reporting requirements including the presentation of new financial information and a restructuring of the presentation of previous fiscal years. Since the University’s annual financial report is not subject to a separate financial audit, certain information, such as a complete set of Government-Wide Financial Statements, is not included in the accompanying report. The financial statements are presented in columnar form, including totals for prior year data. Prior year totals have been restated when necessary to reflect current year changes in reporting procedures and to permit comparability of reported totals.

No component units have been identified which should have been discretely presented in the financial statements.

BASIS OF ACCOUNTING

A. Fund Structure

The accompanying financial statements are presented on the basis of funds, each of which is considered a separate accounting entity. The operations of the University are considered to be a Business-Type Activity. The University charges fees to external users for goods and services. Consequently the accompanying financial statements are presented using the Proprietary Fund type structure.
B. Basis of Accounting

The basis of accounting determines when revenues and expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

Proprietary funds are accounted for on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred. Proprietary funds distinguish operating from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the proprietary funds' principal ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets.

C. Budget and Budgetary Accounting

The budget is prepared biennially and represents appropriations authorized by the legislature and approved by the Governor (the General Appropriations Act). Additionally, the University prepares an annual budget which represents anticipated sources of revenues and authorized uses. This budget is approved by the System's Board of Regents. Unencumbered appropriations are generally subject to lapse 60 days after the end of the fiscal year for which they were appropriated.

D. Assets, Liabilities, and Net Assets

ASSETS

Significant asset categories are summarized below.

Cash and Cash Equivalents

Short-term highly liquid investments with an original maturity of three months or less are considered cash equivalents.

Restricted Assets

Restricted assets include monies or other resources restricted by legal or contractual requirements. These assets include proceeds of revenue bonds and revenues set aside for statutory or contractual requirements.

Inventories and Prepaid Items

Inventories include both merchandise inventories on hand for sale and consumable inventories. Inventories are valued at cost, generally utilizing the last-in, first-out method. Prepaid items reflect payments for costs applicable to future accounting periods. The consumption method of accounting is used to account for inventories and prepaid items. The cost of these items is expensed when the items are consumed.

Capital Assets

Assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year are capitalized. These assets are capitalized at cost or, if not purchased, at appraised fair value as of the date of acquisition. Depreciation is reported on all exhaustible assets. Inexhaustible assets such as works of art and historical treasures are not depreciated. Depreciation is charged to operations over the estimated useful life of each asset, using the straight-line method.

Other Receivables

Other current receivables include year-end revenue accruals not included in any other receivable category. Non-current receivable balances are not expected to be collected within one year of fiscal year end.

LIABILITIES

Significant liability categories are summarized below.

Accounts Payable

Accounts payable represent the liability for the value of assets or services received at the balance sheet date for which payment is pending.
Other Payables
Other current payables are the accrual at year-end of expenditure transactions not included in any of the other payable descriptions. Non-current payable balances are not expected to be paid within one year of fiscal year end.

Employees’ Compensable Leave Balances
Employees’ compensable leave balances represent the liability that becomes due upon the occurrence of relevant events such as resignations, retirements, and uses of leave balances by covered employees. Liabilities are reported separately as either current or noncurrent in the Statement of Net Assets.

Bonds Payable - Revenue Bonds
The bonds payable are reported at par, less unamortized discount or plus unamortized premium. Interest expense is reported on the accrual basis, with amortization of discount or premium. Payables are reported separately as either current or noncurrent in the Statement of Net Assets.

NET ASSETS
The difference between fund assets and liabilities is Net Assets.

Invested In Capital Assets, Net Of Related Debt
Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted Net Assets
Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Assets
Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources, which are imposed by management, but can be removed or modified.

CAPITAL ASSETS
The University reports accumulated depreciation on its capital assets and recognizes depreciation expense as a current year charge.

At August 31, 2006, non-depreciable capital assets, consisting of land and construction in progress, totaled $40,746,288. Depreciable capital assets, net of accumulated depreciation, and consisting of buildings, infrastructure, facilities, equipment, library books, and works of art, totaled $331,123,622.

DEPOSITS AND INVESTMENTS

A. Deposits of Cash in Bank
At August 31, 2006, the carrying amount of the University’s cash deposits was $216,764 and the bank balance was $1,437,037. Additionally, $12,386 was deposited in foreign banks and was neither covered by insurance nor collateralized. Foreign currency risk for deposits is the risk that changes in exchange rates will adversely affect the deposit.

B. Investments
The University of Houston is authorized by statute to make investments following the prudent person rule. There were no significant violations of legal provisions during the period.

The fair value of investments, including short-term, long-term, and money market cash equivalents, as of the balance sheet date was $78,423,822.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The general investment policy of the University limits investments in debt securities that are not in the top three investment grade ratings issued by nationally recognized statistical rating organizations to 5% of total investments. As of August 31, 2006, the University had no investment securities with credit risk exposure.

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. As of August 31, 2006, the University’s concentration of credit risk in any single issuer did not exceed five percent of total investment assets as reported on the Statement of Net Assets.
C. Investment Transactions

Reverse Repurchase Agreements
The University, by statute, is authorized to enter into reverse repurchase agreements. The University did not invest in any reverse repurchase agreements during the fiscal year.

Securities Lending
Securities lending is authorized by state statutes. The University does not participate in a security-lending program.

Derivative Investing
The University did not hold any collateralized mortgage obligations at fiscal year-end. The University does not enter into forward-exchange contracts to manage exposure of foreign portfolio holdings to changes in foreign currency exchange rates.

B. Claims and Judgments
At August 31, 2006, various lawsuits and claims involving the University were pending. While the ultimate liability, if any, with respect to litigation and other claims asserted against the University cannot be reasonably estimated at this time, such liability, to the extent not provided for by insurance or otherwise, is not expected to have a material effect on University accounts.

C. Employees’ Compensable Leave
A state employee is entitled to be paid for all unused vacation time accrued, in the event of the employee’s resignation, dismissal, or separation from state employment, provided the employee has had continuous employment with the state for six months. An expense and liability are recorded as the benefits accrue to employees. The liability for unpaid benefits is recorded in the Statement of Net Assets. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits.

Full-time state employees earn annual leave from eight to twenty-one hours per month depending on the respective employees’ years of state employment. The state’s policy is that an employee may carry his accrued leave forward from one fiscal year to another fiscal year with a maximum number of hours up to 532 for those employees with 35 or more years of state service. Accrued leave in excess of the normal maximum was converted to sick leave at the conclusion of fiscal year 2006. Employees with at least six months of state service who terminate their employment are entitled to payment for all accumulated annual leave up to the maximum allowed.

Lump sum payments made to employees, who separated from state service during the 2006 fiscal year, for accrued vacation and compensatory leave, totaled $1,189,969.

SHORT TERM LIABILITIES
The University holds a short term note payable, the proceeds of which were used to complete renovations of Hofhienz Pavilion. The remaining balance as of August 31, 2006 is $65,145.

LONG TERM LIABILITIES
A. Notes and Loans Payable
The University reported no notes or loans payable at the end of the year ended August 31, 2006.

LEASE OBLIGATIONS
The University may enter into long-term leases for financing the purchase of certain fixed assets. Such leases are classified as capital leases for accounting purposes. There were no reportable outstanding capital lease payments payable at August 31, 2006.

Included in expenditures reported in the financial statements for rent paid or due under operating leases is $3,157,756. Future minimum lease rental payments under non-cancelable operating leases having an initial term in excess of one year, as of August 31, 2006, totaled $6,880,042.
INTERFUND BALANCES
There are numerous transactions between funds and state agencies. At year-end, amounts to be received or paid are reported as (1) Interfund Receivables or Payables, (2) Due From or Due To Other Agencies, (3) Due From or Due To Other Funds, (4) Transfers In or Transfers Out, and (5) Legislative Transfers In or Legislative Transfers Out.

The University experienced routine transfers with other state agencies, which were consistent with the activities of the fund making the transfer. Repayment of interfund balances will occur within one year from the date of the financial statement.

CONTINGENT LIABILITIES
Various lawsuits and claims involving the University were pending. While the ultimate liability, if any, remains uncertain, management does not expect any possible adverse ruling to have a material effect on University accounts.

The University has received several federal grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to a request for reimbursements to grantor agencies for expenditures disallowed under the terms of the grant. Based on prior experience, management believes such disallowances, if any, will be immaterial.

CONTINUANCE SUBJECT TO REVIEW
The University is not subject to the provisions of the Texas Sunset Act (Chapter 325, Texas Government Code Annotated). The Act provides for the regular assessment of the continuing need for state agencies to exist. Certain agencies, such as institutions of higher education and courts, are not subject to the Sunset Act.

RISK FINANCING AND RELATED INSURANCE
The University of Houston is exposed to a variety of civil claims resulting from the performance of its duties. It is University policy to periodically assess the proper combination of commercial insurance and retention of risk to cover losses to which it may be exposed.
BONDED INDEBTEDNESS

A. Outstanding Revenue Bonds

Consolidated Revenue Bonds, Series 1998

- To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, building, structure, activity, service, operation, or facility of the University of Houston, specifically energy conservation projects.
- Issued 1-1-98.
- $14,565,000; all bonds authorized have been issued.
- Source of revenue for debt service – Tuition, state appropriations, and various other revenues and balances that may be legally available for payment of debt obligations.

Consolidated Revenue Bonds, Series 1999

- To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, building, structure, activity, operation, or facility of the University of Houston System, specifically projects at the University of Houston, University of Houston - Downtown, University of Houston - Victoria, and the University of Houston multi-institutional teaching center in Fort Bend County.
- Issued 1-1-99.
- $33,350,000; all bonds authorized have been issued.
- Source of revenue for debt service – Tuition and various other revenues and balances that may be legally available for payment of debt obligations (funding for fiscal year 2006 from Legislative appropriation).

Consolidated Revenue Bonds, Series 2000

- To construct a recreation and wellness facility at the University of Houston.
- Issued 9-1-00.
- $52,070,000; all bonds authorized have been issued.
- Source of revenue for debt service – Tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations.
- All outstanding bonds maturing subsequent to 2-05-10 will be paid in full with the proceeds from Consolidated Revenue Refunding Bonds, Series 2006.

Consolidated Revenue Bonds, Series 2002-A

- To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, building, structure, activity, operation, or facility of the University of Houston System.
- Issued 9-1-02.
- $130,955,000; all bonds authorized have been issued.
- Source of revenue for debt service – Tuition and various other revenues and balances that may be legally available for payment of debt obligations (partial funding for fiscal year 2005 from Legislative appropriation).

Consolidated Revenue Variable Rate Demand Bonds, Series 2004

- To finance the acquisition, purchase, construction, improvement, renovation, enlargement, and equipping of any property, buildings, structures, facilities, roads or related infrastructure for the University of Houston System, including the individual campuses of the System.
- Issued 6-16-04.
- $25,000,000; all bonds authorized have been issued.
Source of revenue for debt service—Tuition and various other fees, revenues and balances that may be legally available for the payment of debt obligations (funding for fiscal year 2006, from Legislative appropriation).

**Consolidated Revenue Bonds, Series 2005**
- To construct a parking garage facility at the University of Houston.
- Issued 4-1-05.
- $25,800,000; all bonds authorized have been issued.
- Source of revenue for debt service—Tuition and various other fees, and revenues and balances that may be legally available for payment of debt obligations.

**Consolidated Revenue Refunding Bonds, Series 2002-B**
- To refund $27,415,000 of Consolidated Revenue Refunding Bonds, Series 1993 and $19,385,000 of Consolidated Revenue Bonds, Series 1993-A.
- Issued 11-1-02.
- $45,425,000; all bonds authorized have been issued.
- Source of revenue for debt service—Designated tuition and various other revenues and balances that may be legally available for payment of debt obligations.
- Average rate of bonds refunded - 5.4% (1993) and 5.5% (1993-A).
- Net proceeds from refunding series - $47,871,000, after receipt of bond premium of $2,888,998 and payment of $442,998 in underwriting fees, insurance, and other issuance costs.
- Funds were used to purchase state and local government securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt payments on the refunded 1993 and 2000 series bonds. The refunded 1997 series will be called for early redemption on 08-15-07, and the 2000 series bonds will be called for early redemption on 2-15-10.
- The 1997 series bonds maturing subsequent to 8-15-2007 and the 2000 series bonds maturing subsequent to 2-15-10 are considered fully defeased and the liability for those bonds has been removed from the Investment in Plant Fund Group.
- Refunding of the 1997 and 2000 series bonds reduced the University’s debt service payments over the life of the bond issues by approximately $4,841,586.
- Economic gain - $3,013,573; the difference between the net present value of the old and new debt service payment.

**Consolidated Revenue Refunding Bonds, Series 2006**
- To refund $3,295,000 of Consolidated Revenue Refunding Bonds, Series 1997 (University of Houston-Victoria) and $44,430,000 of Consolidated Revenue Bonds, Series 2000 (University of Houston).
- Issued 2-1-06.
- $48,450,000; all bonds authorized have been issued.
- Source of revenue for debt service—Tuition, designated tuition and various other fees, revenues and balances that may be legally available for payment of debt obligations. (Funding for fiscal year 2006 partially from Legislative appropriation).
- Average rate of bonds refunded - 5.45% (1997) and 5.45% (2000).
- Net proceeds from refunding series - $49,799,345, after receipt of bond premium of $1,823,210 and payment of $473,865 in underwriting fees, insurance, and other issuance costs.
- Funds were used to purchase state and local government securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt payments on the refunded 1997 and 2000 series bonds.
- The refunded 1997 series will be called for early redemption on 08-15-07, and the 2000 series bonds will be called for early redemption on 2-15-10.
- Economic gain - $3,013,573; the difference between the net present value of the old and new debt service payment.

**General Obligation Bonds**
At August 31, 2006, the University had no bonds payable classified as General Obligation Bonds.

**B. Changes In Bonded Indebtedness**
Bonds payable are due in annual installments varying from $2,820,000 to $14,615,442 with interest rates from 2.50% to 7.00%, with the final installment due 2-15-30.
C. Future Debt Service Requirements

Principal and interest requirements on the obligations for the next five years were $97,971,732 and $199,610,842 for all years beyond.

D. Discounts and Allowances

The University reports revenues net of discounts and allowances in proprietary funds. Discounts and allowances are calculated based on historical experience. For the fiscal year 2006 discounts and allowances that related to tuition and fee revenues totaled $40,920,823.

E. Employees Retirement Plans

The State has joint contributory retirement plans for substantially all its employees. The University participates in the plans administered by the Teachers Retirement System of Texas. Future pension costs are the liabilities of the Retirement System. The Retirement System does not account for each state agency separately. Annual financial reports prepared by the Retirement System include audited financial statements and actuarial assumptions and conclusions.

The state has also established an Optional Retirement Program for institutions of higher education. Participation in the Optional Retirement Program is in lieu of participation in the Teacher Retirement System. The Optional Retirement Program provides for the purchase of annuity or mutual fund contracts. Since these are individual investment product contracts, the state has no additional or unfunded liability for this program.

D. Deferred Compensation

State employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in the Texas Government Code Annotated, Section 609.001. Two plans are available for employees’ deferred compensation plans. Both plans are administered by the Employees Retirement System.

The State’s 457 plan complies with the Internal Revenue Code Section 457. The State also administers another plan, “TexaSaver,” created in accordance with Internal Revenue Code Sec. 401(k). The assets of this plan do not belong to the state. The state has no liability related to this plan.

The tax deferred investment program permits benefits-eligible employees of the University of Houston to purchase qualified tax deferred investments with a portion of their salaries. Participation in the program is voluntary and is a supplement to the Teacher Retirement System or the Optional Retirement Program. It is however, separate and apart from either.

R. Restatement of Net Assets

During fiscal year 2006, no adjustments were made which required the restatement of the reported amount of net assets.

R. Related Parties

The University is affiliated with several foundations and organizations that have been created to benefit certain operations of the University. These organizations are considered to be separate legal entities, and as such are not considered component units as defined by generally accepted accounting principles. Therefore, the account balances and financial transactions of these organizations are not included in the University’s financial statements.

Several student housing facility projects have been constructed by private external entities in order to enhance the residential life experience of students at various System campuses. The participating entities have financed and constructed housing complexes on System owned property adjacent to the University campus. These facilities are operated under ground leases and management agreements with the System for extended time periods. Under the terms of the agreements, cash revenues from rental income, net of operating expenses, are shared with the University. Repayment of project financing is serviced from revenues generated by the housing projects, and is the sole responsibility of the external entity. The related loans and bonds are not liabilities of the System or component universities.

S. Subsequent Events

As of the date this report was issued, there have been no occurrences since August 31, 2006 that had a significant financial impact.
Financial Staff

John M. Rudley  
Vice President for Administration and Finance

Jim C. McShan  
Associate Vice President for Finance

David J. Ellis  
Executive Director of Financial Reporting

Michael T. Glisson  
Executive Director of Finance

Beverly Ruffin  
Project Director Finance

Thomas Ehardt  
Executive Director for Budget Administration & Analysis

Emily Messa  
Executive Director, Customer Service/Business Services

Raymond Bartlett  
Treasurer

Financial Reporting Staff (from the left to right) Nakia Harrison, Linda Klemm, Carole Bohnert, Gwendolyn Jenkins Allen, Kevin Draper, Juanita Broughton and Phyllis Rusk, not available for photo.

This report was prepared with the assistance of Roddy Chambless and the staff at the University Copy Center and Roger Cook, graphics designer.

UHS Chief Accounting Officers (clockwise, from the top): Altaf Rajan, David Ellis, George Anderson (UHD), Mike Glisson, John Cordary (UHCL), Toni Wyer (UHV), and Beverly Ruffin (not available for picture).

The University of Houston System is an Equal Opportunity/ Affirmative Action institution. Minorities, women, veterans and persons with disabilities are encouraged to apply.