



2006-2007
**Annual
Financial Report**

UNIVERSITY OF HOUSTON SYSTEM
UNIVERSITY OF HOUSTON ■ UH-CLEAR LAKE ■ UH-DOWNTOWN ■ UH-VICTORIA

ORGANIZATIONAL DATA



OFFICERS OF THE BOARD (FISCAL YEAR 2007)

Leroy L. Hermes
Chair

Michael J. Cemo
Vice Chair

Calvin W. Stephens
Secretary

ADMINISTRATIVE OFFICERS

John M. Rudley
Interim Chancellor

Grover S. Campbell
Vice Chancellor,
Governmental Relations

Donald J. Foss
Senior Vice Chancellor,
Academic Affairs and
Provost

Donald Birx
Vice Chancellor, Research

Jim McShan
Interim Vice Chancellor,
Administration and
Finance

Michael Rierson
Vice Chancellor,
University Advancement

Elwyn C. Lee
Vice Chancellor,
Student Affairs

Dona Cornell
Vice Chancellor,
Legal Affairs and
General Counsel

BOARD OF REGENTS

Morgan Dunn O'Connor
Victoria
Term Expires August 31, 2005*

Dennis D. Golden, O.D
Houston
Term Expires August 31, 2009

Leroy L. Hermes
Houston
Term Expires August 31, 2007*

Lynden B. Rose
Houston
Term Expires August 31, 2009

Michael J. Cemo
Houston
Term Expires August 31, 2007*

Calvin W. Stephens
Dallas
Term Expires August 31, 2009

Raul A. Gonzalez
Austin
Term Expires August 31, 2007*

Welcome W. Wilson, Sr.
Houston
Term Expires August 31, 2011

Christopher Sharpe
Houston
Term Expires February 1, 2008

Jim P. Wise
Houston
Term Expires August 31, 2011

*Will remain on Board until a replacement is appointed.

PRESIDENTS

John M. Rudley
Interim President
University of Houston

Max Castillo
President-Downtown

William A. Staples
President-Clear Lake

Tim Hudson
President-Victoria

TABLE OF CONTENTS

Regents and Executive Officers	page 1
Message from the Chancellor	page 2
Message from the Vice Chancellor	page 3
Financial Highlights	pages 4 through 9
Financial Statements.	pages 10 through 13
Management's Discussion and Analysis.	pages 14 through 21
Notes to the Financial Statements	pages 22 through 30
Acknowledgements and Financial Staff	pages 31 through 32

Letter from the Chancellor

We are pleased to present the Annual Financial Report of the University of Houston System for Fiscal Year 2007. The report provides an overview of the System's financial operations and financial position as of August 31, 2007. The University of Houston System, as a public institution, must account fully for the dollars we receive as investments in the educational future of the people of the Upper Gulf Coast and of Texas. This Annual Financial Report is one means of providing assurance of such accountability.

The University of Houston System, with an enrollment of more than 56,000 students, is the state's only metropolitan higher education system. We comprise four universities and two multi-institution teaching centers: the University of Houston, the University of Houston-Clear Lake, the University of Houston-Downtown, the University



of Houston-Victoria, the University of Houston System at Cinco Ranch, and the University of Houston System at Sugar Land. The four UH System universities collaborate to offer courses leading to baccalaureate and master's degree programs at the two teaching centers.

Each of the institutions within the UH System is unique in its mission and in the communities it serves. As a group, the UH System universities offer a full range of outstanding educational opportunities to the people of the Texas Upper Gulf Coast region.

The University of Houston System has a remarkable past filled with great achievements. Men and women from around the world and across the nation continue to receive rigorous educations thanks to the outstanding support of our System family, community partners, and governmental leaders.

A handwritten signature in black ink that reads "John M. Rudley". The signature is fluid and cursive.

John M. Rudley
Interim Chancellor,
University of Houston System





Message from the Vice Chancellor

It is my pleasure to present the Annual Financial Report of the University of Houston System. This report illustrates the financial position of the UH System as of August 31, 2007.

The UH System combines the strengths of four unique and individual universities: University of Houston, University of Houston Clear Lake, University of Houston Downtown and University of Houston Victoria.

A priority of the UH System universities is to meet the needs of their diverse student populations in the Upper Gulf Coast region and Texas. In fall 2006, the UH System's student enrollment was 56,151 (34,344 students at UH; 7,706 at UH Clear Lake; 11,449 at UH Downtown; and 2,652 at UH Victoria).

In FY07 the UH System continued its efforts to implement projects in support of its Strategic Plan. At UH Downtown, the Shea Street Building housing the College of Business opened. This 130,000 square foot facility houses 44 classrooms, five laboratory areas, 100 offices for faculty and staff, four advising areas, and a 100 seat lecture hall. UH Clear Lake received approval in July 2007 from the Texas Higher Education Coordinating Board to develop a branch campus in Pearland. This initiative will be the first of its kind for UH Clear Lake. The branch campus is slated to open in 2009, and will offer nine degree programs.

In FY07, work began on several additional projects. Construction began on UH Victoria's \$35 million classroom building in Sugar Land, a complex to be used jointly with Wharton County Junior College when it opens in 2008. Construction of UH's graduate and professional lofts began as the first project to implement the new University Framework plan. Design and construction was approved by the UH System Board of Regents for the \$9 million Michael J. Cemo Hall at UH, a 33,000 square foot lecture hall and academic center. The anticipated opening of this new facility is January 2009.

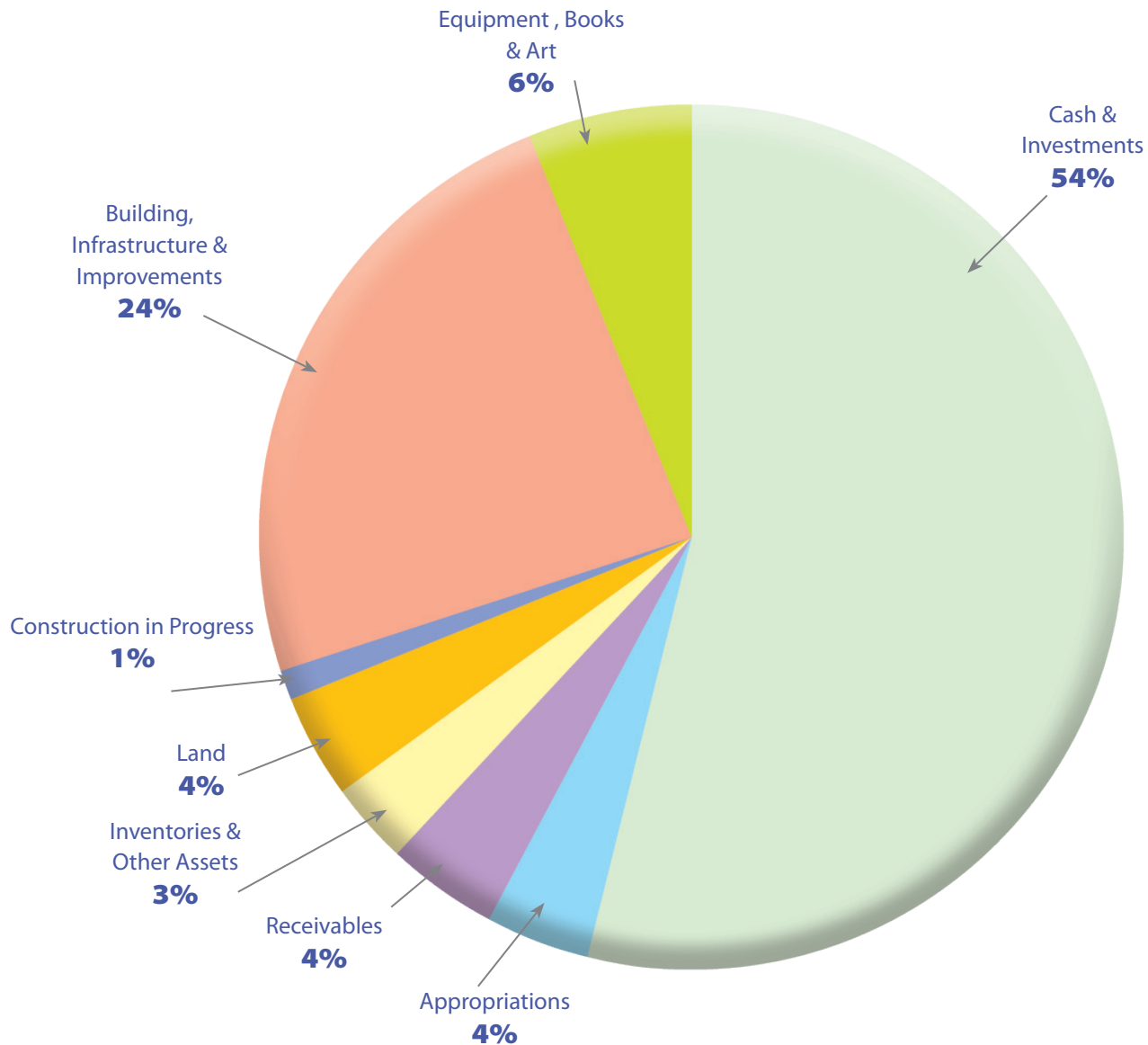
Most of the University of Houston's research programs were in one of these four areas: bio med sciences, community advancement, materials, and complex systems. Research programs at UH Clear Lake are primarily in education and teacher training. UH Downtown research programs continue to focus on educational outreach for the success of minority students.

As our financial report illustrates, UH System management understands it is our responsibility to be efficient and effective as we utilize the UH System's financial resources. We continue to adapt in a rapidly changing and unpredictable environment in the pursuit of our mission, which is to provide a growing, diverse student body with the skills that will serve them for a lifetime.

Jim McShan
Interim Vice Chancellor for Administration and Finance

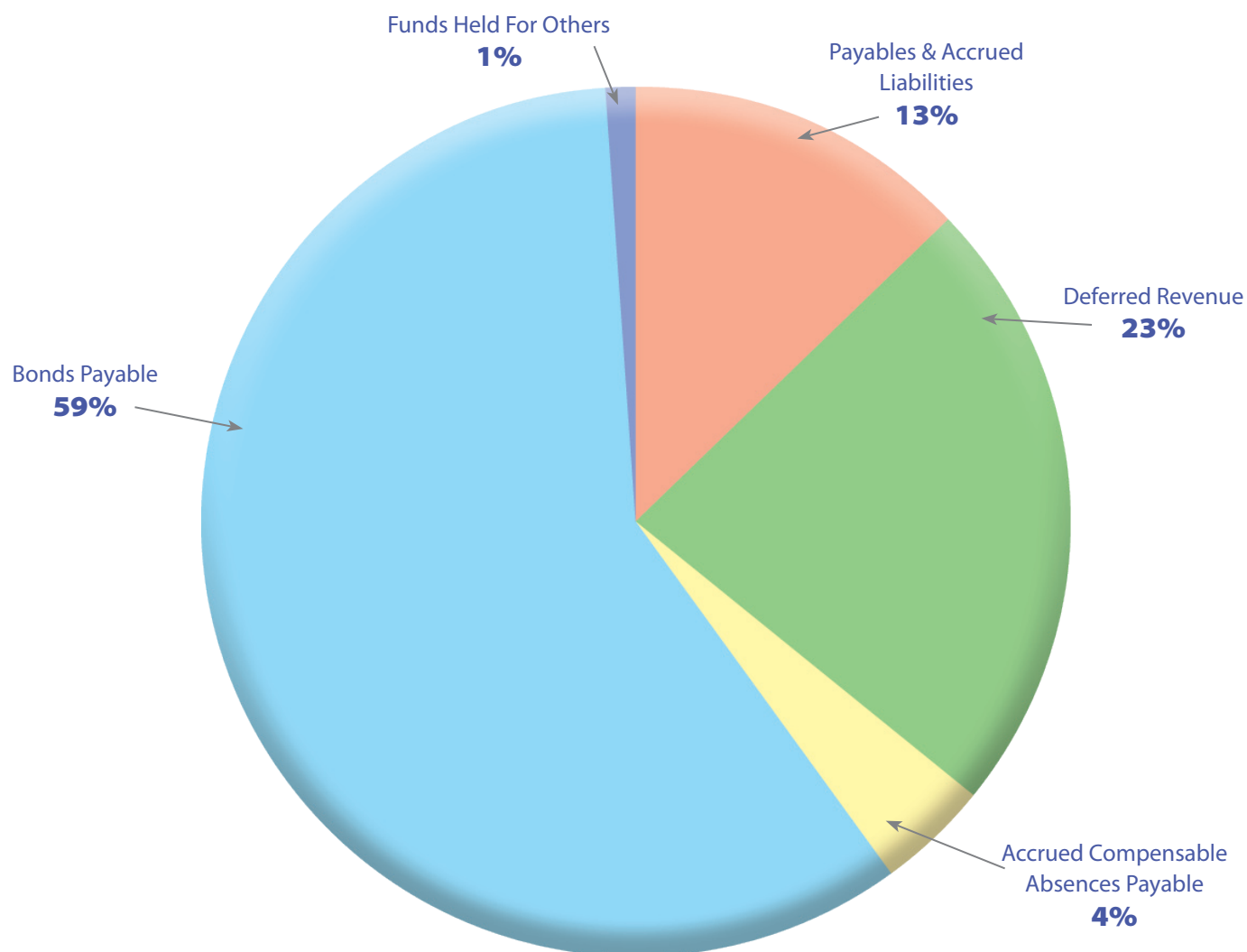
ASSETS**August 31, 2007**

	2007	%	(Millions)
Cash & Investments	\$866,173,643	54%	\$866.2
Appropriations	56,552,065	4%	56.6
Receivables	65,704,243	4%	65.7
Inventories & Other Assets	46,054,431	3%	46.1
Land	60,818,952	4%	60.8
Construction in Progress	22,392,590	1%	22.4
Building, Infrastructure, & Improvements	379,645,059	24%	379.6
Equipment, Books & Art	97,943,870	6%	97.9
Total Assets	\$1,595,284,853	100%	\$1,595.3



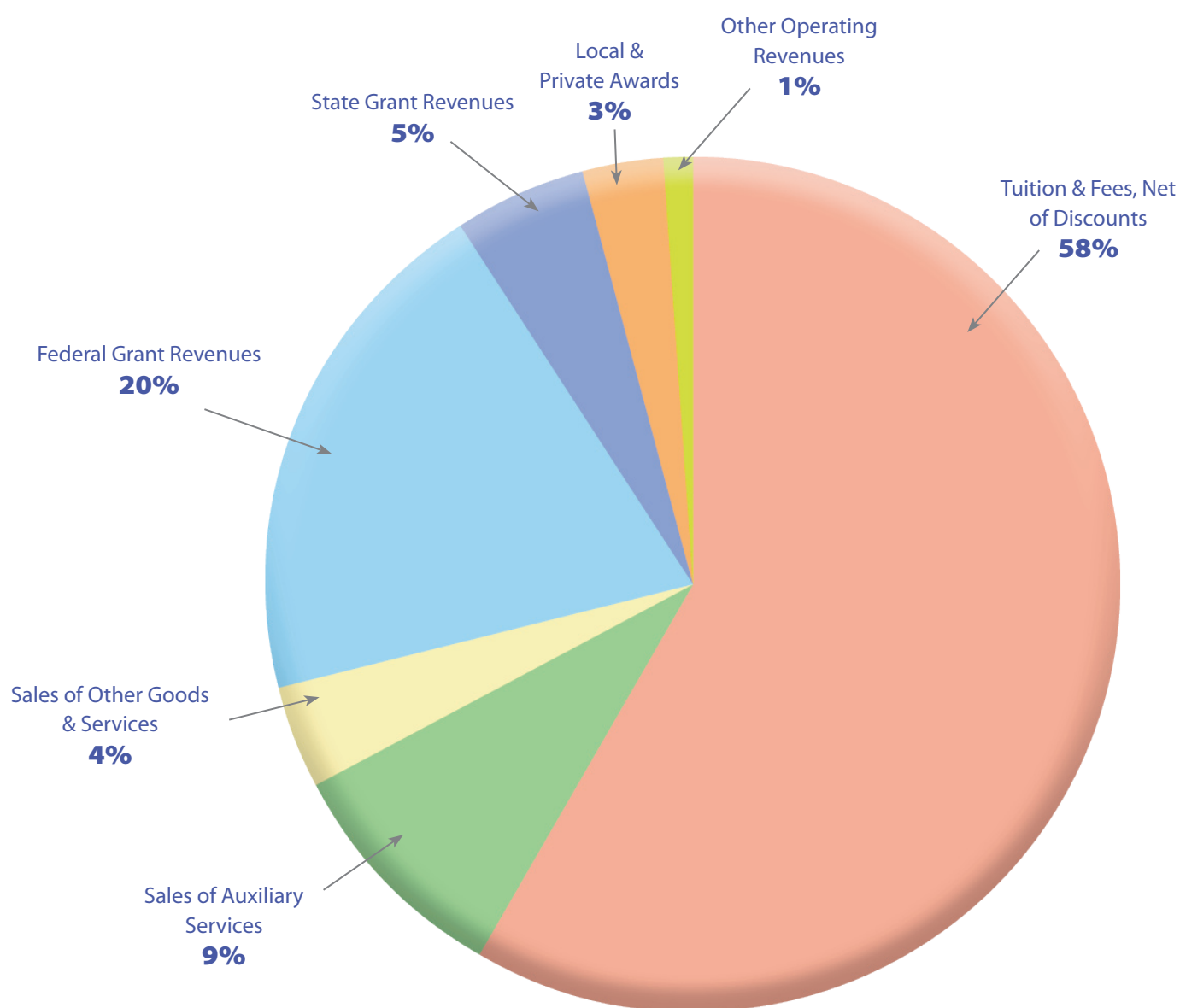
LIABILITIES**August 31, 2007**

	2007	%	(Millions)
Payables & Accrued Liabilities	\$71,187,484	13%	\$71.2
Deferred Revenue	122,526,148	23%	122.5
Accrued Compensable Absences Payable	19,869,234	4%	19.9
Bonds Payable	312,533,096	59%	312.5
Funds Held For Others	5,981,717	1%	6.0
Total Liabilities	\$532,097,679	100%	\$532.1



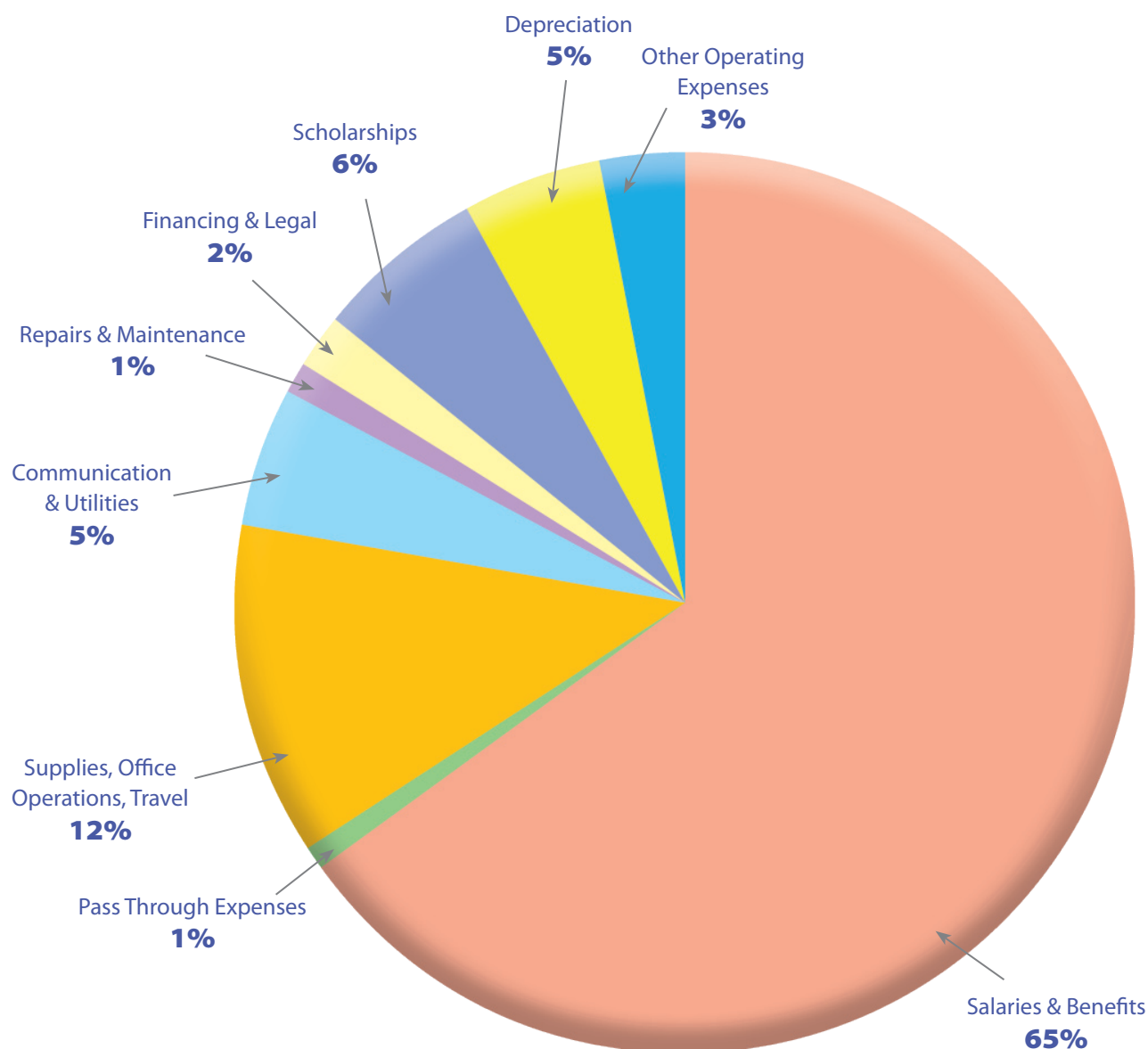
OPERATING REVENUES**For The Year Ended August 31, 2007**

	2007	%	(Millions)
Tuition and Fees, Net of Discounts	\$285,283,840	58%	\$285.3
Sales of Auxiliary Services	42,996,007	9%	42.9
Sales of Other Goods & Services	20,894,248	4%	20.9
Federal Grant Revenues	98,352,109	20%	98.4
State Grant Revenues	21,974,311	5%	22.0
Local & Private Awards	13,854,868	3%	13.9
Other Operating Revenues	835,528	1%	0.8
Total Operating Revenues	\$484,190,911	100%	\$484.2



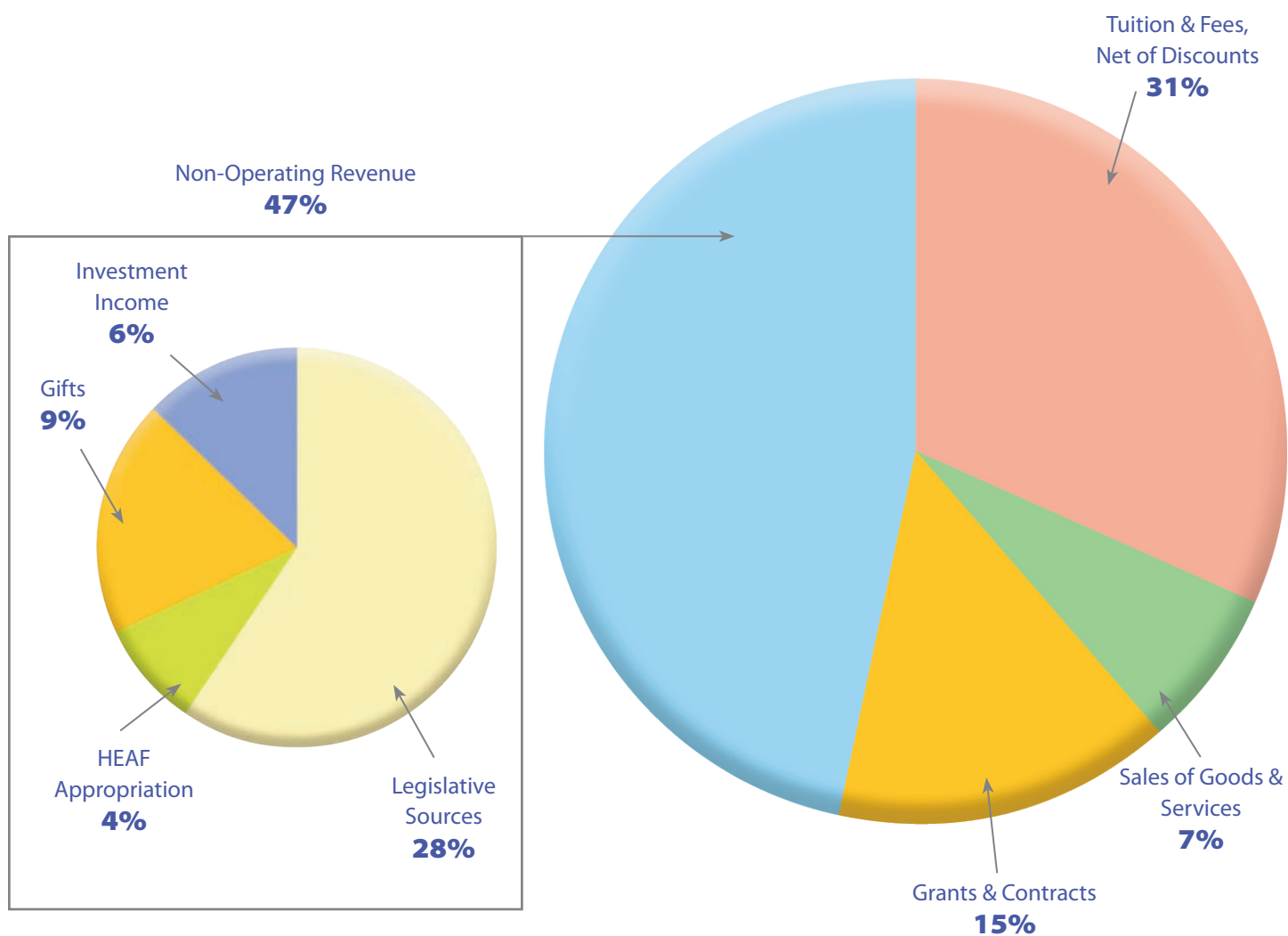
OPERATING EXPENSES - NATURAL CLASSIFICATION**For The Year Ended August 31, 2007**

	2007	%	(Millions)
Salaries & Benefits	\$502,450,075	65%	\$502.5
Pass Through Expenses	2,906,252	1%	2.9
Supplies, Office Operations, Travel	93,915,896	12%	93.9
Communication & Utilities	42,191,851	5%	42.2
Repairs & Maintenance	9,456,828	1%	9.5
Financing & Legal	16,777,545	2%	16.7
Scholarships	50,463,806	6%	50.5
Depreciation	35,674,598	5%	35.7
Other Operating Expenses	23,652,228	3%	23.6
Total Operating Expenses (Natural)	\$777,489,079	100%	\$777.5



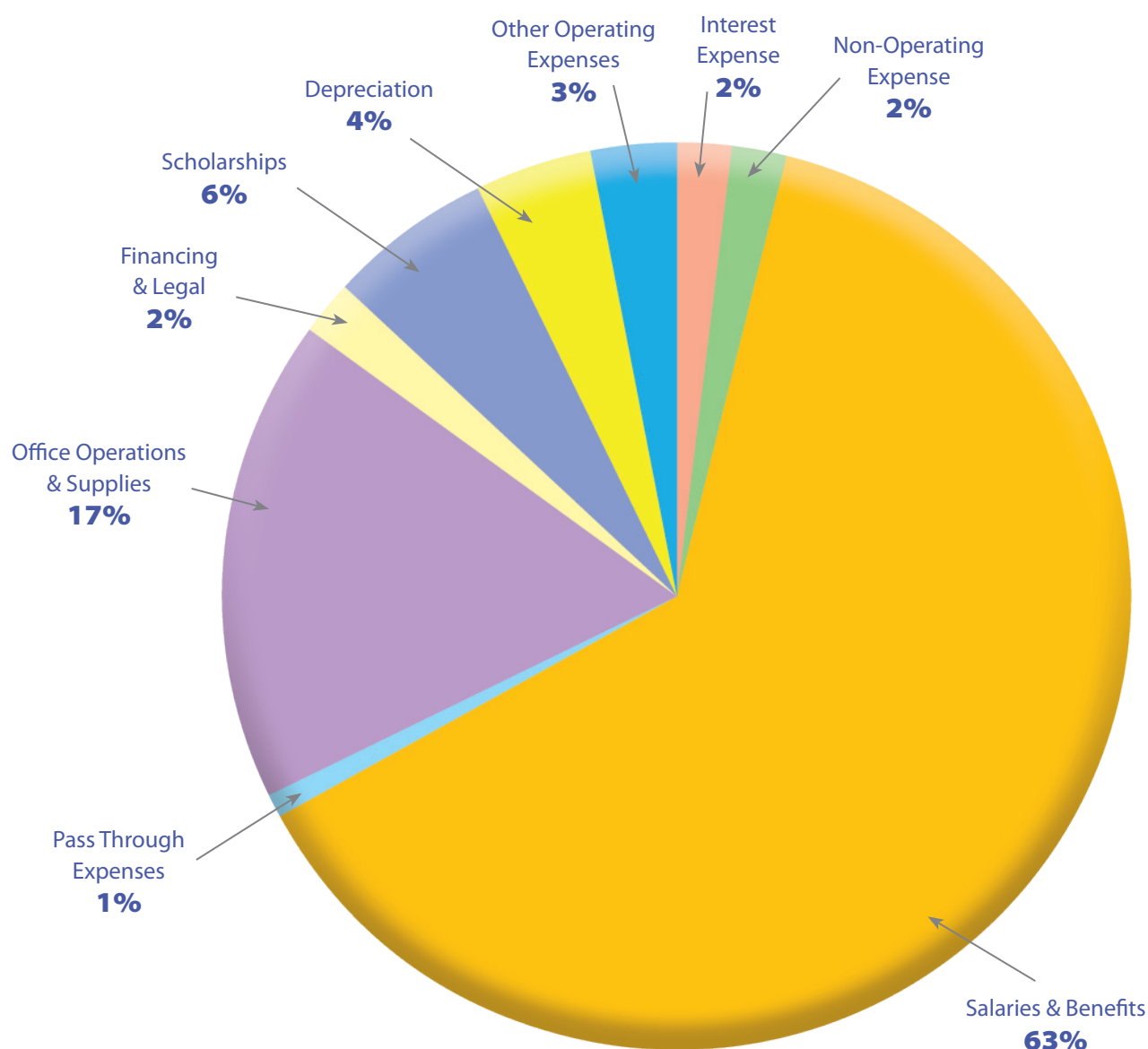
TOTAL REVENUES**For The Year Ended August 31, 2007**

	2007	%	(Millions)
Operating Revenue			
Tuition & Fees, Net of Discounts	\$285,283,840	31%	\$285.3
Sales of Goods & Services	64,725,783	7%	64.7
Grants & Contracts	134,181,288	15%	134.1
Non-Operating Revenue			
Legislative Sources	251,856,963	28%	251.9
HEAF Appropriation	35,459,008	4%	35.5
Gifts	84,069,734	9%	84.1
Investment Income	49,701,385	6%	49.7
Total Revenues	\$905,278,001	100%	\$905.3



TOTAL EXPENSES**For The Year Ended August 31, 2007**

	2007	%	(Millions)
Non-Operating Expenses			
Interest Expense	\$13,771,856	2%	\$13.8
Non-Operating Expense	12,596,331	2%	12.6
Operating Expenses			
Salaries and Benefits	502,450,075	63%	502.5
Pass Through Expenses	2,906,252	1%	2.9
Office Operations & Supplies	145,564,575	17%	145.6
Financing & Legal	16,777,545	2%	16.7
Scholarships	50,463,806	6%	50.4
Depreciation	35,674,598	4%	35.7
Other Operating Expenses	23,652,228	3%	23.7
Total Expenses (Natural)	\$803,857,266	100%	\$803.9



STATEMENT OF NET ASSETS**August 31, 2007**

	2007	2006
Assets		
Current Assets		
Cash and Cash Equivalents	\$ 145,968,612	\$ 141,117,184
Short-term Investments	14,886,564	44,798,093
Restricted Cash and Cash Equivalents	23,443,005	22,456,286
Loans and Contracts	9,255,099	8,806,830
Legislative Appropriations	56,552,065	58,036,786
Receivables	65,704,243	50,577,176
Inventories	3,032,432	2,350,422
Deferred Charges	23,850,353	18,725,512
Total Current Assets	342,692,373	346,868,289
Non-Current Assets		
Restricted Cash and Cash Equivalents	39,070,336	21,604,508
Loans and Other Receivables	9,916,547	10,456,854
Investments	642,805,127	564,195,092
Capital Assets, Non-Depreciable	85,745,750	81,063,103
Capital Assets, Depreciable	1,178,223,604	1,127,695,432
Accumulated Depreciation	(703,168,884)	(669,369,441)
Total Noncurrent Assets	1,252,592,480	1,135,645,548
TOTAL ASSETS	1,595,284,853	1,482,513,837

Liabilities		
Current Liabilities		
Payables	71,145,204	51,500,998
Deferred Revenues	122,526,148	112,086,608
Notes Payable	26,775	65,145
Employees' Compensable Leave	9,202,915	8,592,090
Revenue Bonds Payable	19,597,739	18,932,739
Funds Held for Others	5,981,717	6,294,292
Total Current Liabilities	228,480,498	197,471,872
Noncurrent Liabilities		
Payables	15,505	16,597
Employees' Compensable Leave	10,666,319	10,075,832
Revenue Bonds Payable	292,935,357	313,183,096
Total Noncurrent Liabilities	303,617,181	323,275,525
TOTAL LIABILITIES	532,097,679	520,747,397

Net Assets		
Invested in Capital Assets, Net of Related Debt	262,722,667	254,154,181
Restricted, Debt Retirement	29,756	27,622
Restricted, Capital Projects	593,880	671,027
Restricted, Other	86,731,401	75,390,079
Nonexpendable, Endowment Funds	340,735,705	318,314,783
Unrestricted	372,373,765	313,208,748
TOTAL NET ASSETS	\$ 1,063,187,174	\$ 961,766,440

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**For The Year Ended August 31, 2007**

	2007	2006
Operating Revenues		
Tuition and Fees, Net of Discounts	\$ 285,283,840	\$ 255,872,144
Sales of Goods and Services	64,725,783	59,218,593
Federal Revenue	98,352,109	101,323,878
State Grant Revenue	21,974,311	22,012,665
Other Grants and Contracts	13,854,868	15,176,424
Total Operating Revenues	484,190,911	453,603,704
Operating Expenses		
Instruction	243,314,239	241,490,359
Research	74,952,195	75,564,069
Public Service	34,605,751	34,032,798
Academic Support	113,975,340	102,961,682
Student Services	31,871,801	29,781,643
Institutional Support	73,074,768	70,531,035
Operation and Maintenance of Plant	50,443,967	53,218,634
Scholarships and Fellowships	47,960,867	44,651,057
Auxiliary Enterprises	71,615,553	63,015,534
Depreciation and Amortization	35,674,598	27,648,020
Total Operating Expenses	777,489,079	742,894,831
Operating Income (Loss)	(293,298,168)	(289,291,127)
Nonoperating Revenues (Expenses)		
Legislative Revenue	254,135,704	250,342,036
Gifts	43,159,548	32,559,488
Investment Income	81,326,403	56,607,880
Interest Expense and Fiscal Charges	(13,771,856)	(13,805,066)
Gain (Loss) on Sale of Capital Assets	6,500	0
Other Nonoperating Revenues (Expenses)	(12,596,331)	(27,860,321)
Total Nonoperating Revenues (Expenses)	352,259,968	297,844,017
Income (Loss) Before Other Revenues, Expenses, Gains, Losses and Transfers	58,961,800	8,552,890
Other Revenues, Expenses, Gains, Losses and Transfers		
Capital Appropriation (Higher Education Assistance Funds)	35,459,008	35,459,008
Additions to Permanent and Term Endowments	9,278,667	9,947,173
Transfers	(2,253,072)	(1,747,727)
Legislative Appropriations Lapsed	(25,669)	(1,217,880)
Total Other Revenues, Expenses, Gains, Losses and Transfers	42,458,934	42,440,574
Change In Net Assets	101,420,734	50,993,464
Net Assets Beginning	961,766,440	910,772,976
Restatements	0	0
Net Assets Beginning, as Restated	961,766,440	910,772,976
Net Assets, Ending	\$ 1,063,187,174	\$ 961,766,440

STATEMENT OF CASH FLOWS**For The Year Ended August 31, 2007****2007****2006****Cash Flows from Operating Activities**

Proceeds Received from Students and Customers	\$ 333,499,030	\$ 283,922,870
Proceeds from Loan Programs	10,136,531	8,305,808
Proceeds from Other Revenues	162,687,987	171,371,240
Payments to Suppliers for Goods and Services	(156,697,290)	(139,703,391)
Payments to Employees	(502,159,422)	(482,437,381)
Payments for Loans Provided	(10,044,493)	(9,020,096)
Payments for Other Expenses	(91,582,915)	(82,044,671)

Net Cash Provided (Used) by Operating Activities	(254,160,572)	(249,605,621)
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Cash Flows from Noncapital Financing Activities

Proceeds from State Appropriations	253,312,571	249,450,910
Proceeds from Gifts	29,537,791	27,442,364
Proceeds from Endowments	29,370,274	27,846,837
Proceeds of Transfers from Other Funds	21,391,633	38,806,142
Proceeds from Other Revenues	(60,726)	180,468
Payments for Other Uses	(74,207,354)	(74,468,415)

Net Cash Provided by Noncapital Financing Activities	259,344,189	269,258,306
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Cash Flows from Capital and Related Financing Activities

Proceeds from Disposal of Capital Assets	1,191,566	0
Proceeds from Capital Financing Activities	43,797,575	56,489,584
Payments for Additions to Capital Assets	(34,942,316)	(44,843,850)
Payments of Principal and Interest on Debt Issuance	(34,993,770)	(33,140,939)

Net Cash Used by Capital and Related Financing Activities	(24,946,945)	(21,495,205)
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Cash Flows from Investing Activities

Proceeds from Interest and Investment Income	79,057,596	116,003,339
Payments to Acquire Investments	(35,990,293)	(120,089,003)

Net Cash Provided by Investing Activities	43,067,303	(4,085,664)
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Increase (Decrease) in Cash and Cash Equivalents	23,303,975	(5,928,184)
Cash and Cash Equivalents, September 1	185,177,978	191,106,162
Restatements to Beginning Cash and Cash Equivalents		

Cash and Cash Equivalents, August 31	208,481,953	185,177,978
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Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities

Operating Income (Loss)	(293,298,168)	(289,291,127)
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Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities

Amortization and Depreciation	35,674,598	27,648,020
Bad Debt Expense	133,337	40,363

Changes in Assets and Liabilities

(Increase) Decrease in Receivables	925,995	5,861,589
(Increase) Decrease in Inventories	(682,011)	776,638
(Increase) Decrease in Loans and Contracts	92,038	(714,288)
(Increase) Decrease in Other Assets	29,694	7,909
(Increase) Decrease in Prepaid Expenses	(5,124,840)	8,058,669
Increase (Decrease) in Payables	(4,817,468)	(12,451,745)
Increase (Decrease) in Deferred Income	10,439,540	7,373,518
Increase (Decrease) in Other Liabilities	2,466,713	3,084,833

Total Adjustments	39,137,596	39,685,506
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Net Cash Provided by Operating Activities	\$ (254,160,572)	\$ (249,605,621)
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SCHEDULE OF OPERATING EXPENSES**For The Year Ended August 31, 2007**

	2007	2006
Expenses by Natural Classification		
Cost of Goods Sold	\$ 2,891,050	\$ 1,902,807
Salaries and Wages	411,225,610	398,149,895
Payroll Related Costs	91,224,465	86,877,553
Professional Fees and Services	39,532,669	35,679,637
Federal Pass-Through Expenses	2,906,252	6,513,764
State Pass-Through Expenses	0	204,407
Travel	12,924,308	11,982,919
Materials and Supplies	33,915,529	33,843,216
Communication and Utilities	42,191,851	44,973,004
Repairs and Maintenance	9,456,828	8,198,156
Rentals and Leases	13,407,090	11,987,968
Printing and Reproduction	4,652,340	4,353,949
Depreciation and Amortization	35,674,598	27,648,020
Interest	2,456,479	2,341,330
Scholarships	50,463,806	46,990,414
Claims and Losses	913,976	1,250,300
Other Operating Expenses	23,652,228	19,997,492
Total Operating Expenses	\$ 777,489,079	\$ 742,894,831

Expenses by Functional Classification		
Instruction	\$ 243,314,239	\$ 241,490,359
Research	74,952,195	75,564,069
Public Service	34,605,751	34,032,798
Academic Support	113,975,340	102,961,682
Student Services	31,871,801	29,781,643
Institutional Support	73,074,768	70,531,035
Operation & Maintenance of Plant	50,443,967	53,218,634
Scholarships & Fellowships	47,960,867	44,651,057
Auxiliary Enterprises	71,615,553	63,015,534
Depreciation & Amortization	35,674,598	27,648,020
Total Expenses by Expenditure Function	\$ 777,489,079	\$ 742,894,831

MANAGEMENT'S DISCUSSION AND ANALYSIS**INTRODUCTION**

The following Management's Discussion and Analysis section of the University of Houston System's Annual Financial Report has been prepared to provide an overview of the activities and the financial position of the University of Houston System (the System) for the fiscal year ended August 31, 2007. This presentation 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 System's basic financial statements and the notes to the statements.

BACKGROUND

The University of Houston System (UHS) serves the nation's fourth largest metropolitan area and the upper Texas Gulf Coast, and is part of the state-supported system of higher education in Texas. The System is comprised of four universities and a supporting System Administration. The four universities are University of Houston (UH), University of Houston – Clear Lake (UHCL), University of Houston – Downtown (UHD), and University of Houston – Victoria (UHV); all of which are located along the Texas Gulf Coast. The University of Houston is a nationally recognized doctoral degree-granting, comprehensive research university, and the University of Houston – Downtown, a four-year undergraduate university, is beginning limited expansion into graduate programs. The University of Houston – Clear Lake and the University of Houston – Victoria are both upper division and master's-level institutions. The System has also established teaching centers that offer instructional opportunities at facilities at the UH System at Sugar Land,

and the UH System at Cinco Ranch in Katy, Houston and the upper Gulf Coast region represent approximately one fourth of the state's population and economy. The area is also one of the most ethnically diverse parts of the state, with UH and UHD two of the most diverse universities nationally.

The mission of the System and its universities is to educate students, create new knowledge, and foster an interactive relationship with the communities served. The System universities are the primary providers of graduate and undergraduate services for Houston and the Upper Texas Gulf Coast region. In recent years, the universities have 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, each of the System's universities has created programs of international repute that contribute greatly to the regional and state economies. The System serves over 56,000 students and employs approximately 12,000 individuals.

UH System Distance Education is a partnership of the four institutions of the System. Going beyond the traditional campus boundaries, UH, UHCL, UHD, and UHV cooperate in providing high-quality educational opportunities to the community. This collaboration delivers more than forty degree programs taught by university faculty via face-to-face instruction and electronic technologies at off-campus sites, including UHS at Cinco Ranch, UHS at Sugar Land, selected community college campuses, corporations, and organizations. A number of programs can be pursued completely through videotape and online delivery. All courses are junior, senior, and graduate level and carry all the same workloads, prerequisites, and requirements as on-campus courses. The University of Houston System universities have won national awards in distance education and are a leader among Texas universities in distance education enrollments. UH System Distance Education provides maximum access to higher education opportunities for residents throughout the Gulf Coast region.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements for fiscal year 2007 have been prepared in accordance with accounting pronouncements promulgated by the Governmental Accounting Standards Board (GASB). These include 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. The requirements focus on the preparation of financial statements that present financial operations in the aggregate, rather than accountability by individual fund group. These standards were adopted by the State of Texas and the System during the 2002 fiscal year. All financial statements for fiscal years 2002 through 2007 have been prepared in accordance with these rules.

Governmental Accounting Standards Board Statement No. 35 requires the System 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 System is part of and included in the State of Texas Comprehensive Annual Financial Report. The financial statements of the System are presented for the fiscal year ended August 31, 2007, with financial data for the fiscal year ended August 31, 2006, 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 System are considered a business-type activity because the System’s universities charge 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 System’s financial statements conform to the guidelines and presentation formats prescribed for Proprietary Funds.



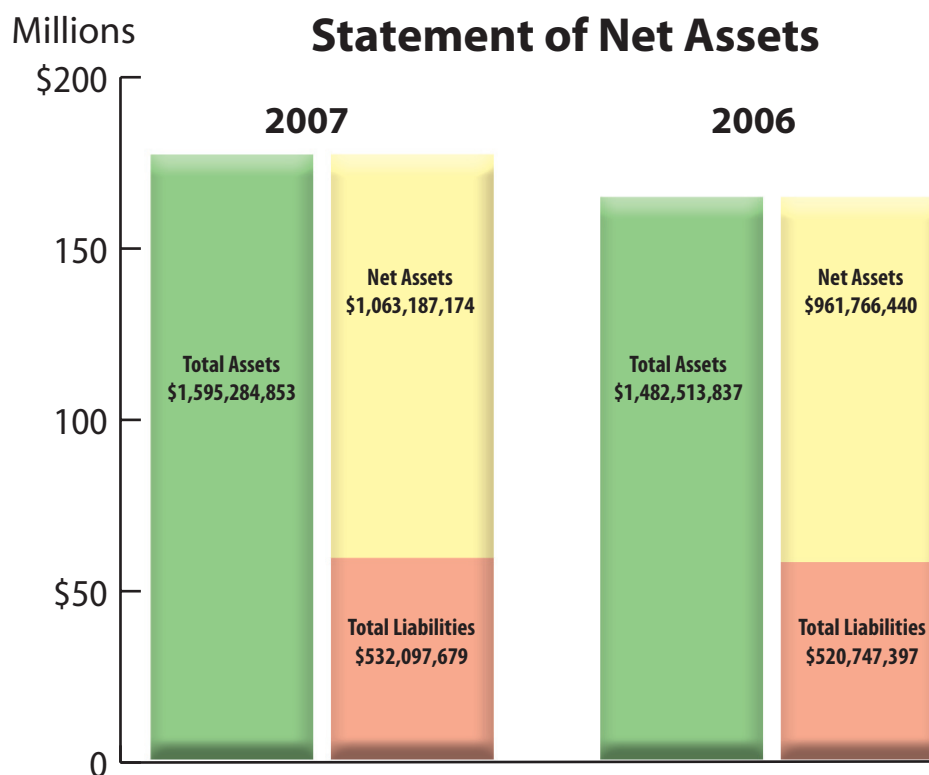
As required by GASB reporting standards, the System reports accumulated depreciation on its capital assets. Additionally, the System recognizes a current year charge for depreciation expense. Revenues and expenses are classified as either operating or non-operating in the financial statements. The statements provide a measurement of entity-wide operations. Significant portions of the System’s recurring resources are classified as non-operating by GASB Statement No. 35. Substantially all state appropriations are treated as non-operating 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 System 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 System. 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 System'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, 2007. Comparative data for the previous fiscal year has also been presented as of August 31, 2006. Assets and liabilities are presented as either current or non-current to provide an indication of their anticipated liquidation. Net Assets is equal to Assets minus Liabilities. Unrestricted Net Assets are available to the System 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, 2007, the University of Houston System's Assets totaled \$1.595 billion, and Liabilities totaled \$532 million, resulting in a Net Asset valuation of \$1.063 billion. This represents an increase in net assets of \$101 million.

The Statement of Net Assets enables the reader of the financial statements to determine the assets available for use in the continuing operations of the institutions. 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 System. 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 institution.



UNRESTRICTED NET ASSETS

as of August 31, 2007
(to millions)

Reserved For

Accounts Receivable	\$ 25
Encumbrances	13
Higher Education Fund	33
Future Operating Budgets	33
Other Funds	16

Unreserved

Allocated	
Capital Projects	(3)
Endowment & Loan Funds	185
Retirement of Indebtedness	(7)
Student Fees	30
Unallocated	47

Total Unrestricted Net Assets \$ 372

Although not subject to the stipulations of external requirements, a significant portion of the System's unrestricted net assets are committed to various future operating budgets related to academic, research, and capital programs and projects. These commitments are summarized in the accompanying table.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

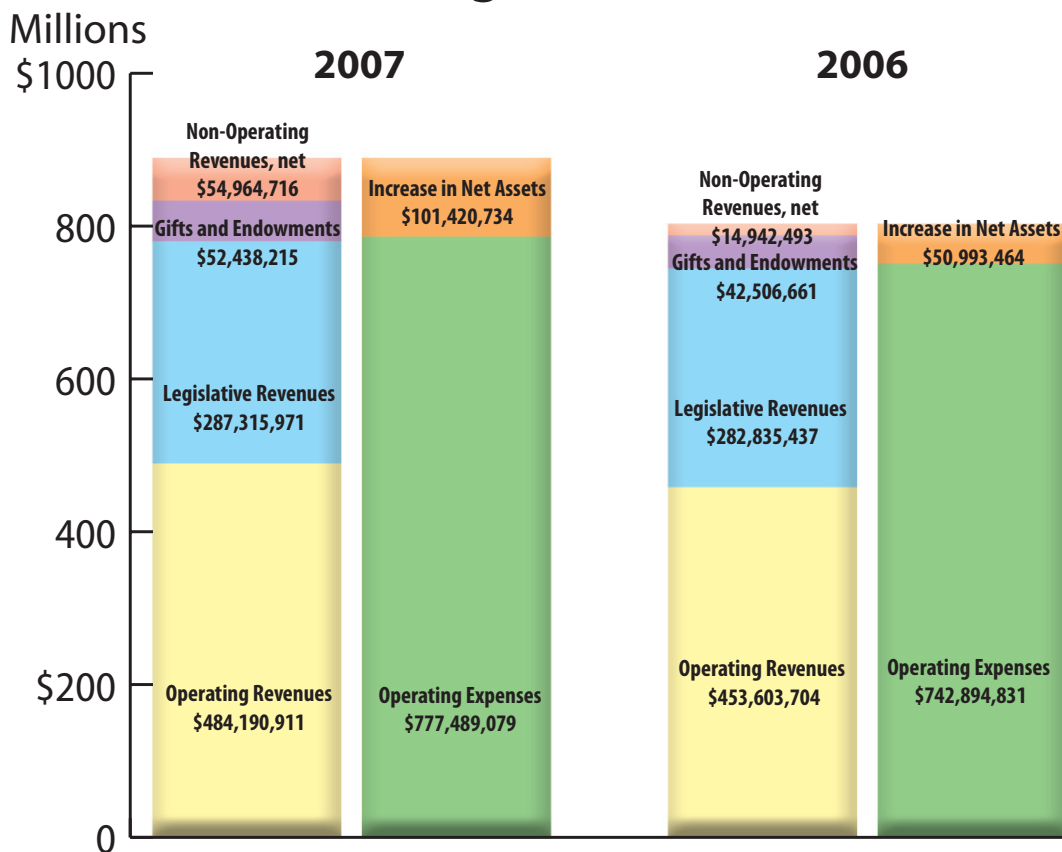
The next statement comprising the primary financial statements is the Statement of Revenues, Expenses, and Changes in Net Assets. This schedule identifies operating and non-operating revenues received by the System. Additionally, both the operating and non-operating expenses incurred by the System during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

During the 2007 fiscal year the System recognized operating revenues of \$484 million and operating expenses of \$777 million. After recognizing non-operating activities and other gains and losses, the System realized a net increase in net assets of \$101 million. During the prior fiscal year, the System experienced an increase in net assets of \$51 million.

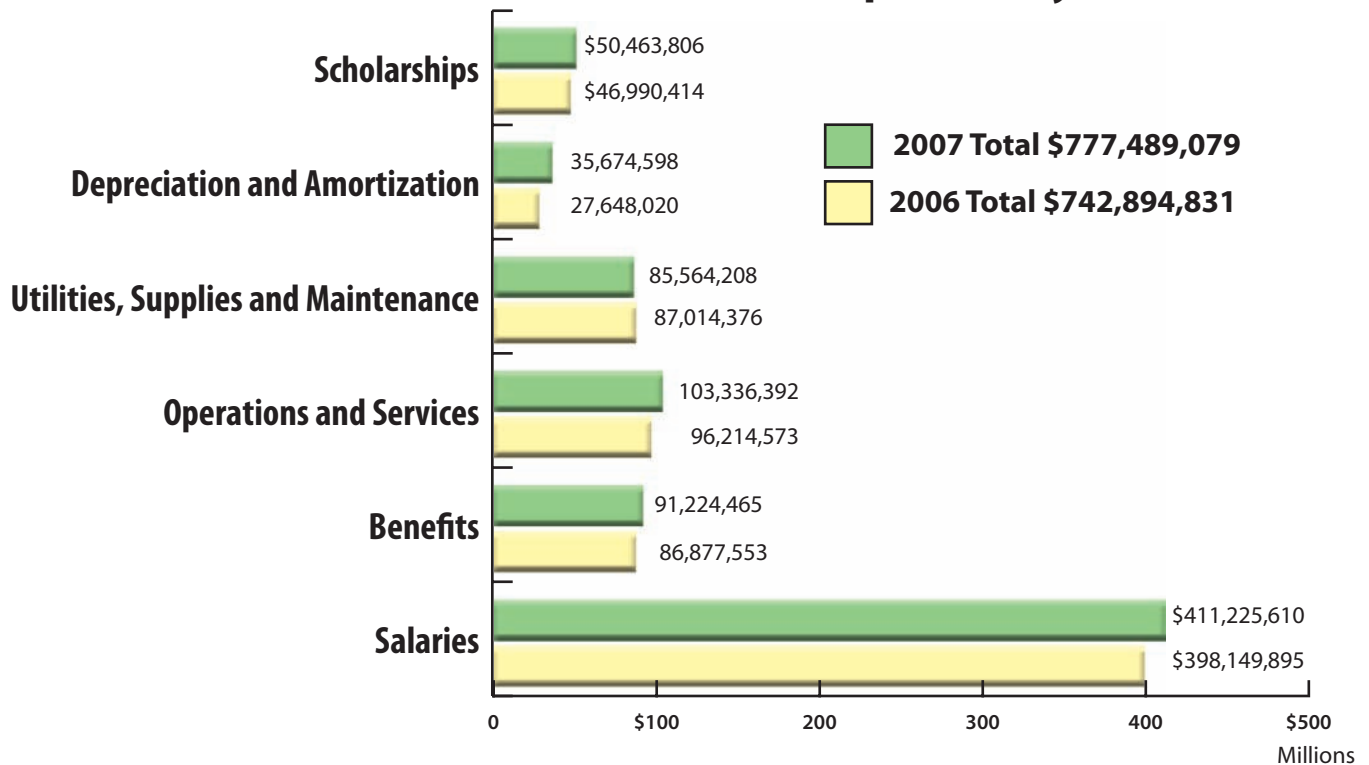
Operating revenues are received and recognized as a result of providing services to the component universities' customers. Operating expenses are the costs necessary to provide those services and to fulfill the mission of the System. Operating expenses are displayed in the Statement using the functional

method of classification. The functional, or programmatic, classification method presents operating expenses in a manner that reflects the System'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. A supplemental Schedule of Operating Expenses displays operating expenses comparing the functional classification and the natural classification methods. The natural method of presentation displays the operating expenses in a manner that categorizes the objects of expenditure within various cost centers. Non-operating revenues are those received for which no services are directly provided. State appropriations are classified as non-operating revenue because they are provided by the Legislature to the System without the Legislature directly receiving goods or services for those revenues. As previously mentioned, significant portions of the System's recurring resources are classified as non-operating. Net resources from other than operating revenues totaled \$421 million for fiscal year 2007.

Statement of Revenues, Expenses and Changes in Net Assets



Schedule of Expenses by Nature



STATEMENT OF CASH FLOWS

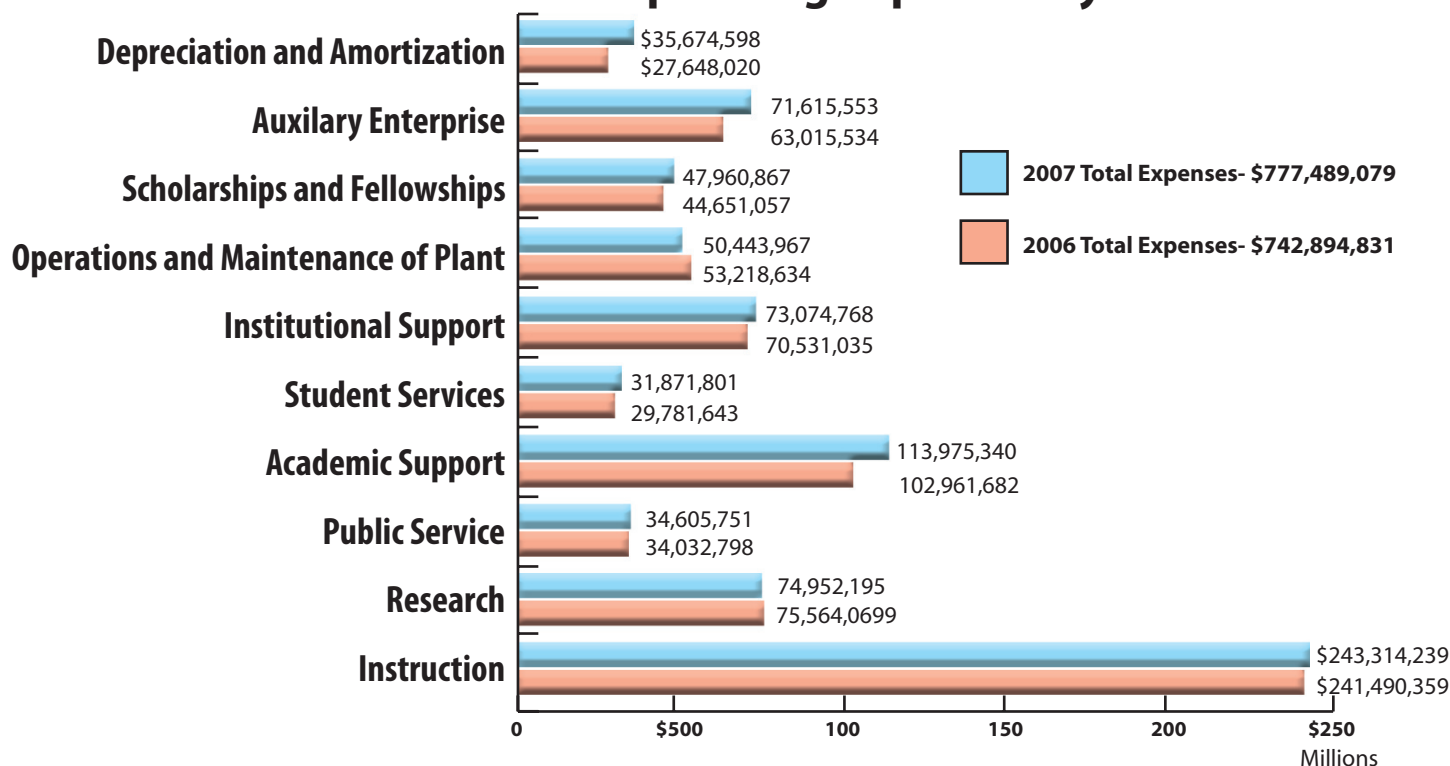
The third primary statement included in the financial statements is the Statement of Cash Flows. This schedule explains the change during the fiscal year in cash and cash equivalents, regardless of whether there are restrictions on their use. The Statement of Cash Flows should be used in conjunction 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 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 non-capital 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 2007 fiscal year totaled \$208 million, which reflected a net increase in cash of \$23 million.



Operating Expenses by Function



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 System's capital assets. The System's institutions continue the implementation of their long-range capital plans, with a prudent combination of renovation and modernization of older facilities, along with new construction.

At the end of the 2007 fiscal year, the System had \$561 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, 2006, totaled \$539 million.

Fiscal year 2007 continued the trend of bringing major changes to UH System facilities. At the University of Houston, design and construction have begun on the Michael J. Cemo Hall. Along with a state of the art auditorium, with a seating capacity of 450, two 70-seat classrooms, and faculty offices, the multi-story building will house several departments providing vital services for students. Construction is also

under way on the UH graduate and professional students loft apartments and retail complex. This facility will be the university's first campus housing designed exclusively for graduate and professional students. The University of Houston – Clear Lake has received approval to develop a branch campus and facilities in Pearland. The University of Houston – Downtown opened the Shea Street Building, a new academic building that provides critical instructional space and student services for UH students and its College of Business. Final construction continues on the building and the adjacent parking garage facility. At the University of Houston – Victoria, construction plans are being implemented for a new academic building in Sugar Land to meet growing demands at the multi-institutional teaching facility. UHV is also designing and developing plans for a Regional Economic Development Building and a Nursing/Allied Health facility. Completion of each of these projects will provide enhanced and significant benefits to the System's students and other constituencies. The System maintains a goal of improving the physical condition of the campuses, while at the same time, preserving their condition and maximizing their utilization.



DEBT ADMINISTRATION

The System complements the management of its financial resources with the prudent use of debt to finance capital projects. Detailed information concerning the System's long-term debt is found in the Notes to the Financial Statements.

The University of Houston System 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. A portion of debt service is funded by biennial State appropriations. At August 31, 2007, the University of Houston System had \$313 million of long term bonded debt outstanding, \$20 million of which will be retired during the 2008 fiscal year.

No additional bonded indebtedness was authorized or issued during the 2007 fiscal year. The State Legislature appropriated additional funds to pay debt service during the 2008-2009 biennium for planned Consolidated Revenue Bonds. Authorization and issuance of additional long-term debt is anticipated to occur during the fourth quarter of the 2008 fiscal year.

During fiscal year 2007, the System established a commercial paper program that will permit the issuance of commercial paper notes which may not exceed, in the aggregate, the principal amount of \$50 million. It is anticipated that commercial paper, when issued, will provide interim financing for the costs of various capital projects within the System.

ECONOMIC OUTLOOK

While it is true that the UH System universities strive to make the most of available funds, the needs of our constituencies and the goals we have established for serving them necessitate greater resources than our universities currently possess. By 2015, demographic forecasts predict the Houston metropolitan area will add another 1.4 million persons, 800,000 of which will be of Hispanic descent. Accommodating a corresponding level of enrollment growth at our universities will require tremendous investments in faculty, staff, facilities and other infrastructure.

The General Appropriations Act adopted by the 80th Texas Legislature in May, 2007, resulted in overall increased funding for the 2008-2009 biennium, ranging from resources for capital improvements to support for twenty-first century research. All the universities in our system will benefit from our legislators' vision and commitment. The universities have received increases in formula funding support for core functions such as instruction, salaries, operations, scholarships, and advising services. UHD received the largest increase, an additional \$3.6 million, for the next biennium. Tier one/flagship funding is provided for research enhancements that will result in the creation of more flagship universities in Texas, including the University of Houston. UH will receive almost \$7.5 million each year of the biennium from the Research Development Fund, which supports research infrastructure. Modest amounts were provided for UH-Clear Lake, UH-Downtown, and UH-Victoria. Higher Education Funds are used to maintain and improve facilities, and purchase equipment and library books. These funds are an absolute necessity for UHS to provide its students with modern classrooms and its faculty with suitable facilities in which to conduct research. Across the state, HEF appropriations increased \$87.5 million annually. UH, with some 90 buildings and 34,000 students, will receive the largest amount of any UH System university, an increase of \$11.7 million each year during the next biennium. The Legislature increased TEXAS Grants by \$93 million statewide for the biennium, and Work-Study programs increased from \$10 million to \$15 million. These student financial aid measures have a direct impact on the System's ability to keep tuition rates as low as possible for the current and upcoming academic years, thereby ensuring access to higher education for many of our students.

As part of its strategic plan, the University of Houston System has identified accountability and administrative efficiency as one of its strategic principles. Related initiatives on which our universities are working include direct deposits for vendor payments and employee reimbursements, to cut down on the number of paper checks issued, new energy

conservation measures, and more inclusive HUB procedures. The UH System will also continue implementing and upgrading its financial, human resources, and student information systems. A major benefit of these new systems will be the availability of accurate, timely, and consistent management information, which is critical to administrative efficiency.

In November 2007, the Board of Regents unanimously appointed Dr. Renu Khator chancellor of the UH System and president of the University of Houston. Dr. Khator, who has been serving as provost and senior vice president at the University of South Florida, will take office in January 2008. She becomes the third person to hold the dual title of UH System chancellor and UH president. She follows Arthur Smith, who retired in 2003, and Jay Gogue, who became president of Auburn University, his alma mater, during the summer of 2007.

The System is not aware of any known facts or decisions that are expected to have a significant effect on the financial position or results of operations during the 2008 fiscal year. Although it is not possible to predict ultimate results, management believes the University of Houston System's financial condition and position are strong. The System's administrative and management teams realize that universities must be good stewards of the dollars with which they are entrusted. The University of Houston System is committed to this principle. Accomplishing the System's goals and mission is predicated on the effective management of resources, which the University of Houston System strives to achieve.



NOTES TO THE FINANCIAL STATEMENTS**For The Year Ended August 31, 2007****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 combined financial statements of the University of Houston System, and its related components, 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 System (the System) 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 of Houston System 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 System was established by House Bill No. 188, Sixty-Fifth Legislature, Regular Session, effective September 1, 1977. Components of the System are System Administration (1977), University of Houston (1963), Clear Lake (1973), Downtown (1974), and Victoria (1973). 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 System'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 System and its component universities are considered to be a Business-Type Activity. The System 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 System 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 library books, 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 System reports accumulated depreciation on its capital assets and recognizes depreciation expense as a current year charge.

At August 31, 2007, non-depreciable capital assets, consisting of land and construction in progress, totaled \$85,745,750. Depreciable capital assets, net of accumulated depreciation, and consisting of buildings, infrastructure, facilities, equipment, library books, and works of art totaled \$475,054,720.

DEPOSITS AND INVESTMENTS

A. Deposits of Cash in Bank

At August 31, 2007, the carrying amount of the System's cash deposits was \$4,198,983 and the bank balance was \$3,259,842. There are no deposits to foreign banks at this time.

B. Investments

The University of Houston System 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 \$842,700,034.

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, 2007, the System's credit quality distribution for securities with credit risk included significantly less than 5% of total investments that were not in the top three grade ratings.

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. As of August 31, 2007, 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 System, by statute, is authorized to enter into reverse repurchase agreements. The System did not invest in any reverse repurchase agreements during the fiscal year.

Securities Lending

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

Derivative Investing

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



SHORT TERM LIABILITIES

The University holds a short term note payable, the proceeds of which were used to complete renovations of Hofheinz Pavilion. The remaining balance as of August 31, 2007 is \$26,775.

LONG TERM LIABILITIES

A. Notes and Loans Payable

The System reported no long term notes or loans payable at the close of the period ended August 31, 2007.

B. Claims and Judgments

At August 31, 2007, various lawsuits and claims involving the System and/or its components were pending. While the ultimate liability, if any, with respect to litigation and other claims asserted against the System 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 System 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-vested accumulated 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 2007. 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 2007 fiscal year, for accrued vacation and compensatory leave, totaled \$1,562,494.



LEASE OBLIGATIONS

The System 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, 2007.

Included in expenditures reported in the financial statements for rent paid or due under operating leases is \$4,826,670. Future minimum lease rental payments under non-cancelable operating leases having an initial term in excess of one year, as of August 31, 2007, totaled \$10,548,263.

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 System 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 System were pending. While the ultimate liability, if any, remains uncertain, management does not expect any possible adverse ruling to have a material effect on System accounts.

The System 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.

The System has several contractual agreements with various external housing management entities to construct, maintain and manage off campus student housing complexes. Under certain circumstances, the System may have contingent liabilities to these entities. Based on prior experience, previous years liabilities have been immaterial, and management believes no such liabilities currently exist. Additional information is provided in the Related Parties note.

CONTINUANCE SUBJECT TO REVIEW

The System 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 System is exposed to a variety of civil claims resulting from the performance of its duties. It is System policy to periodically assess the proper combination of commercial insurance and retention of risk to cover losses to which it may be exposed.

The System assumes substantially all risks associated with tort and liability claims due to the performance of its duties. Currently some commercial insurance is purchased, and the System is not involved in any risk pools with other government entities.

The System's liabilities are reported when it is both probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Liabilities are reevaluated periodically to consider current settlements, frequency of claims, past experience and economic factors.

SEGMENT INFORMATION

The System has no segment activity that requires separate disclosure in the notes to the financial statements. A segment is an identifiable activity, or group of activities, reported as or within an enterprise fund or any other stand-alone entity that has one or more bonds or other debt instruments outstanding, with a revenue stream pledged in support of that debt. In addition, the activity's revenues, expenses, gains and losses, assets, and liabilities are required to be accounted for separately.

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, service, 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 System 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 2007 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.

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 2007 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, and revenues and balances that may be legally available for payment of debt obligations (funding for fiscal year 2007 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 Bonds, Series 2006

- To finance the acquisition, purchase, construction, improvement, enlargement, and equipping of property, buildings, structures, activities, services, operations and other facilities, roads, or related infrastructure for or on behalf of the University of Houston System, and the individual campuses of the System, including construction of a new classroom and office building for the University of Houston - Downtown.
- Issued 2-1-06.
- \$35,140,000; 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.

Refunding Bonds

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 1993 and 1993-A series bonds, when the bonds were called for early redemption on 2-15-03.
- The 1993 and 1993-A series bonds are considered fully defeased and the liability for those bonds has been removed.
- Refunding of the 1993 and 1993-A series bonds reduced the System's debt service payments over the life of the bond issues by approximately \$3,228,503.
- Economic gain - \$2,733,595; the difference between the net present value of the old and new debt service payment.

Consolidated Revenue Refunding Bonds, Series 2003

- To refund \$15,975,000 of Consolidated Revenue Refunding Bonds, Series 1995 Series 1993-A.
- Issued 12-01-03
- \$16,490,000; all bonds authorized have been issued.
- Source of revenue for debt service - Tuition and various other fees, and revenues nad balances that may be legally available for payment of debt obligations (funding for fiscal year 2006, from legislative appropriation).

- Average rate of bonds refunded – 5.92%.
- Net proceeds from refunding series - \$17,419,961.18, after receipt of bond premium of \$896,716.15 and payment of \$266,453.44 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 1995 series bond, when the bonds were called for early redemption on 2-15-05.
- The 1995 series bonds are considered fully defeased and the liability for those bonds has been removed from the Investment in Plant fund group.
- Refunding of the 1995 series bonds reduced the University's debt service payments over the life of the bond issues by approximately \$1,377,275.
- Economic gain - \$1,292,003; the difference between the net present value of the old and new debt service payments.



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 02-01-06.
- \$48,450,000; all bonds authorized have been issued.
- Source of revenue for debt service – Designated tuition and various other fees, revenues and balances that may be legally available for payment of debt obligations. (Funding for fiscal year 07 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 1997 and 2000 series bonds. The refunded 1997 series will be called for early redemption on 08-15-2007, and the 2000 series bonds will be called for early redemption on 02-15-10.
- The 1997 series bonds maturing subsequent to 08-15-2007 and the 2000 series bonds maturing subsequent to 02-15-10 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 System'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.

General Obligation Bonds

At August 31, 2005, the System had no bonds payable classified as General Obligation Bonds.

B. Changes In Bonded Indebtedness

Bonds payable are due in annual installments varying from \$2,960,000 to \$20,720,000 with interest rates from 2.00% to 7.00%, with the final installment due 2-15-2030.



C. Future Debt Service Requirements

Principal and interest requirements on the obligations for the next five years were \$145,655,147 and \$287,428,393 for the remaining 20 years.

DISCOUNTS AND ALLOWANCES

The System reports revenues net of discounts and allowances in proprietary funds. Discounts and allowances are calculated based on historical experience. For the fiscal year 2005 discounts and allowances that related to tuition and fee revenues totaled \$50,514,214.

EMPLOYEES RETIREMENT PLANS

The State has joint contributory retirement plans for substantially all its employees. The System 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.

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 System 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.

RESTATEMENT OF NET ASSETS

During fiscal year 2007, no adjustments were made which required the restatement of the reported amount of fund balances and fund equity.

RELATED PARTIES

The System is affiliated with several foundations and organizations that have been created to benefit certain operations of the System. 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 System's financial statements.

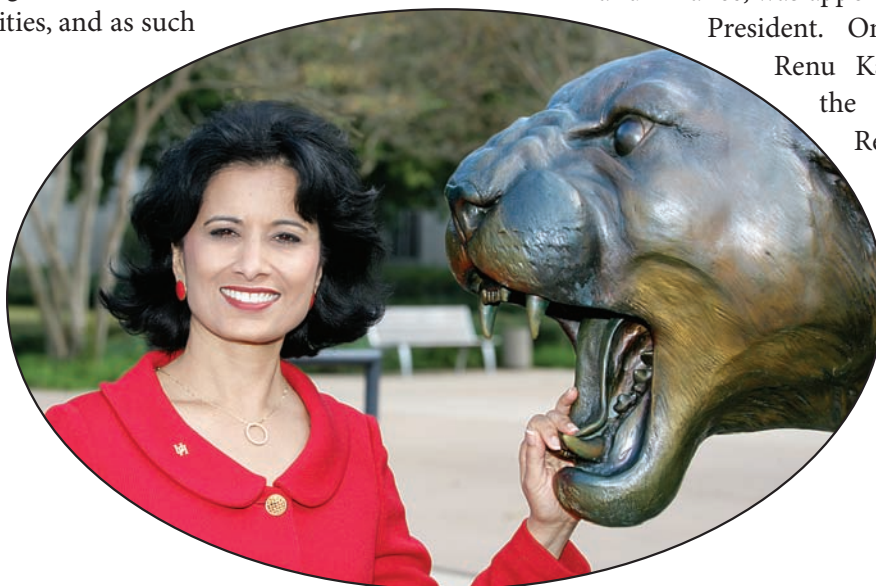
Several student housing facility projects have been constructed by private external entities in order to enhance the residential life experience of students at various System campuses. The participating entities have financed and constructed housing complexes on System owned property adjacent to the university campus. These facilities are operated under grounded 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. If cash revenues do not attain certain contractually defined thresholds, the University is liable to the external management for the deficiency. In previous fiscal years, contingent liability payments were made for \$55,850 in 2005 and \$138,405 in 2006, both in relation to the Bayou Oaks facility. During the 2007 fiscal year net cash flows were sufficiently adequate so as not to generate a liability payment. University management believes that current financial and occupancy performance indicates that future years net cash flows will be sufficient and that future contingent liabilities will not occur. 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.

SUBSEQUENT EVENTS

During the 2007 Spring Semester, University of Houston System Chancellor/President Dr. Jay Gouge resigned to accept the position of President, Auburn University. Dr. John Rudley, Vice chancellor/Vice President of Administration

and Finance, was appointed Interim Chancellor/President. On November 5, 2007 Dr.

Renu Kator was appointed by the UH System Board of Regents as the succeeding Chancellor/President of the University of Houston System. She will assume her duties in January 2008.



ACKNOWLEDGMENTS

This Annual Financial Report was prepared by the University of Houston System, Financial Reporting Department with the assistance of the Chief Accounting Officers (CAO) and Chief Reporting Officers (CRO) and their staffs across all of the University of Houston System campuses.

David Ellis, CPA,(CAO), Executive Director Financial Reporting; Kevin Draper, CPA, Director Financial Compliance; Emily Messa, Executive Director, Business Services; Linda Klemm, Manager , Financial Reporting; Phyllis Rusk; Gwendolyn Allen; Juanita Broughton; Carole Bohnert; Nakia Harrison-Lopez

University of Houston

Al Rajan, CPA,(CRO)
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Gretta McClain
Lavonda Horn
Nami Shukla

UH Clear Lake

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David Kelling,
CPA,CFE,(CRO)
Arlene Lockwood
Thinh Dang
Gregory Scoggins

UH Downtown

George Anderson, (CAO)
Jacquelyn Supensky, (CRO)
Lila Murray, CPA
Maria Cadena
Tiffany Leung
Muhammad Alam
Paul Tichenor

UH Victoria

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June Cernosek, (CRO)
Debbie Jozwiak
Sonya Barrientes
Kathy Caylor
Melody Olsen
Cassandra Clark
Rosa Muzquiz
Marci Boyd
Darlene Pullin

UH Creative Services:

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Thomas Shea
Mark Lacy
Pathik Shah

Roger Cook, Graphic Designer
Roddy Chambless and the Staff of the University Copy Center



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Administration and
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Emily Messa

*Executive Director,
Customer Service,
Business Services*



Raymond Bartlett

Treasurer



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

University of Houston



*Seated: Gretta McClain, Nami Shukla,
Second Row: Al Rajan, Lavonda Horn, Bob Lullo*

University of Houston-System



*Seated: Phyllis Rusk, Carole Bohnert
Standing left to right: Kevin Draper,
Nakia Harrison-Lopez*

University of Houston-Victoria



*Front row(seated): Debbie Jozwiak, Toni Wyer
2nd row (standing): Sonya Barrientes,
Kathy Caylor, Melody Olsen
Last row: Cassandra Clark, Rosa Muzquiz,
Marci Boyd, June Cernosek, Darlene Pullin*

University of Houston-System



*Seated: Linda Klemm,
Standing from the left: Juanita Broughton,
Gwendolyn Allen*

University of Houston-Clear Lake



*Front Row: David Kelling, Thinh Dang
Last Row: Gregory Scoggins, John Cordary,
Arlene Lockwood*

University of Houston-Downtown



*Left to right: Tiffany Leung, Paul Tichenor,
Lila Murray, Jackie Supensky, Maria Cadena,
Muhammad Alam, George Anderson*

