

UNIVERSITY *of* HOUSTON SYSTEM



ANNUAL FINANCIAL REPORT

07
08





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ORGANIZATIONAL DATA

BOARD OF REGENTS

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

Lynden B. Rose, Houston
Term Expires August 31, 2009

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

Calvin W. Stephens, Dallas
Term Expires August 31, 2009

Jim P. Wise, Houston
Term Expires August 31, 2011

Carroll Robertson Ray, Houston
Term Expires August 31, 2011

Mica Mosbacher, Houston
Term Expires August 31, 2013

Nelda Luce Blair, The Woodlands
Term Expires August 31, 2013

Jacob M. Monty, Houston
Term Expires August 31, 2013

Tamara K. Goodwin, Austin
Term Expires May 31, 2009

OFFICERS OF THE BOARD (FISCAL YEAR 2008):

Welcome W. Wilson, Sr.
Chair

Calvin W. Stephens
Vice Chair

Jim P. Wise
Secretary

OFFICERS OF THE BOARD (FISCAL YEAR 2009):

Welcome W. Wilson, Sr.
Chair

Lynden B. Rose
Vice Chair

Jim P. Wise
Secretary

ADMINISTRATIVE OFFICERS

Renu Khator
Chancellor

Jerald W. Strickland
Interim Senior Vice Chancellor for
Academic Affairs and Provost

Carl P. Carlucci
Executive Vice Chancellor
for Administration and Finance

Elwyn C. Lee
Vice Chancellor
for Student Affairs

Grover S. Campbell
Vice Chancellor
for Governmental Relations

Donald L. Birx
Vice Chancellor for Research

Michael Rierson
Vice Chancellor
for University Advancement

Dona H. Cornell
Vice Chancellor for Legal Affairs and
General Counsel

Renu Khator
President – University of Houston

William A. Staples
President – UH Clear Lake

Max S. Castillo
President – UH Downtown

Tim Hudson
President – UH Victoria



MESSAGE FROM THE CHANCELLOR

The UH System, as a public institution, must account fully for the dollars we receive as investments in the educational future and the economic progress of the people of Houston and Texas. We are pleased to present the Annual Financial Report of the University of Houston System for Fiscal Year 2008, one way of providing assurance of such accountability.

The UH System is the only metropolitan university system in Texas, serving a region that accounts for almost a quarter of the state's population and almost a third of the gross state product. We have a \$3.1 billion yearly economic impact on the region, while providing the intellectual and human capital necessary for Houston and Texas to grow and prosper.

We have an enrollment of 59,000 students, four universities (University of Houston, University of Houston-Clear Lake, University of Houston-Downtown, University of Houston-Victoria), and two teaching centers (UH System at Cinco Ranch and UH System at Sugar Land). Each of our institutions is unique in its mission and in the communities it serves. As a group, we offer a full range of outstanding educational opportunities, preparing our students to be successful as leaders in the global marketplace.

The UH System has a remarkable past filled with great achievements and an even brighter future as we continue our focused and determined drive to achieve top-tier national status for the University of Houston, the UH System's flagship university, and the highest levels of accomplishment for UH-Clear Lake, UH-Downtown, and UH-Victoria in the respective categories.



Renu Khator
Chancellor, UH System

MESSAGE FROM THE EXECUTIVE VICE CHANCELLOR

I am pleased to present the Annual Financial Report of the University of Houston System for the year ended August 31, 2008. The University of Houston System is the state's only metropolitan higher education system, encompassing four universities, two multi-institution teaching centers, and the largest university distance learning program in Texas. This report illustrates the financial position of the UH System as of August 31, 2008, and the accompanying statements, graphs, and narratives provide a reflection of the system's financial performance and financial condition for the 2008 fiscal year.

As the global economy becomes increasingly driven by the creation of new knowledge and technological innovation, success for the Houston metropolitan area depends increasingly on the existence of a highly-skilled, professional workforce and cutting-edge research and development. The UH System has made significant progress toward meeting the needs of the region. Over the past five years, enrollment system-wide has increased more than 3 percent, and the number of degrees awarded has increased 23.1 percent. In fall 2007, the UH System's student enrollment increased to 56,772 (34,663 students at University of Houston; 7,532 at UH - Clear Lake; 11,793 at UH - Downtown; and 2,784 at UH - Victoria). System-wide enrollment surpassed 59,000 in fall 2008.

Throughout the campuses of the UH System, 2008 was a year of growth, diversity, implementation of strategic research initiatives, and the initiation of inter-campus collaboration. Most of University of Houston's research grants were in biomedical sciences, community advancement, materials, and complex systems. UH - Clear Lake research programs were focused primarily in education and scholarship, including teacher training, and the university has expanded its focus on research supporting the regional bio- and technology industries. UH - Downtown research programs continue to focus on educational outreach to the success of minority students, and UHD began exploring research partnerships with UH that would be beneficial to both campuses. UHV worked collaboratively with other universities, an industry partner, and various regional law enforcement groups to establish a DNA diagnostic laboratory for the state.

The System continued its efforts to implement projects in support of its strategic capital improvements plan. Construction continued on a new UH System classroom building in Sugar Land, a complex to be used jointly with Wharton County Junior College, when it opens in spring 2009. UH - Clear Lake continued developing designs for a branch campus in Pearland. At UH, construction of Calhoun Lofts, a graduate and professional student residential complex continued, and construction began on a new 1,500 car parking garage. Each of these UH facilities will open in 2009. Design also began on several new facilities within the UH System. UH - Victoria began design on a new Regional Economic/Allied Health Center, and UH - Clear Lake began design on renovations and additions to the Arbor building. All of these facilities are scheduled to open in 2010.



Among universities nationwide, the UH System is proud that it remains a model of diversity and a reflection of the city it serves. The universities and components of the UH System are committed to national leadership and excellence in education and research, as well as leadership in administrative and financial best practices. The UH System pledges that it will continue to fulfill its responsibility of utilizing the system's financial resources in the most efficient and effective means possible.

Carl Carlucci

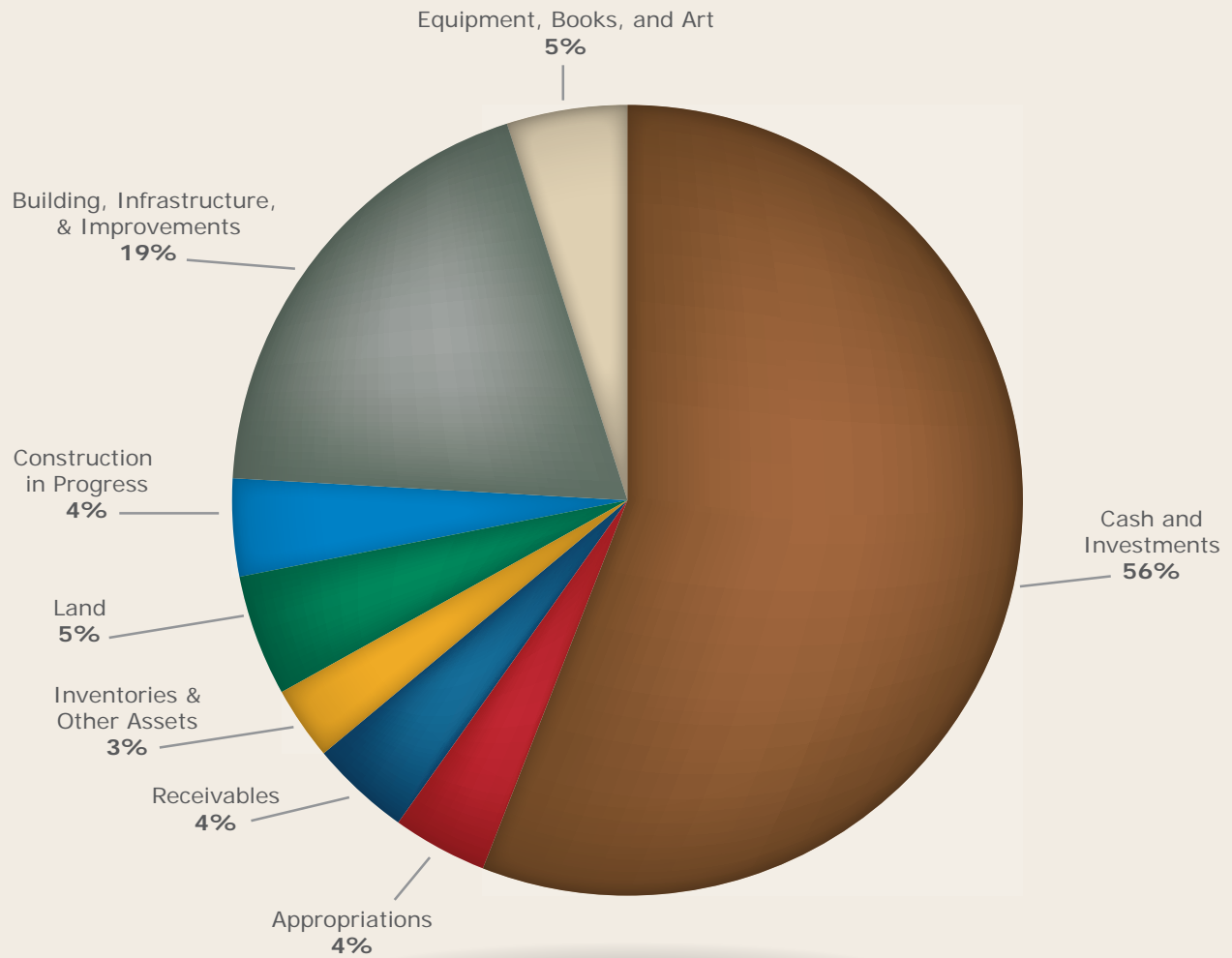
Executive Vice Chancellor, Administration and Finance



UNIVERSITY OF HOUSTON SYSTEM

Assets • AUGUST 31, 2008

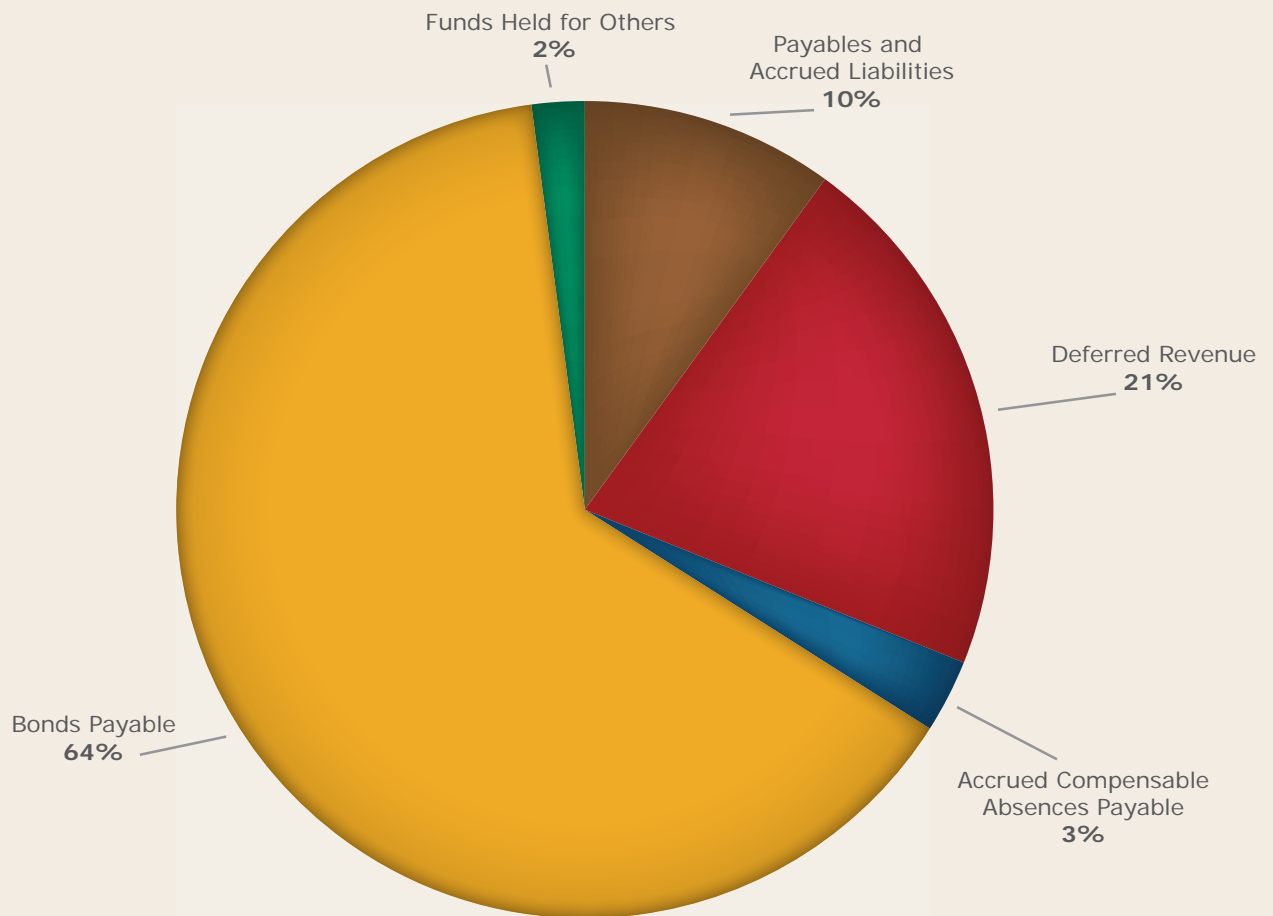
	2008	%
Cash and Investments	\$ 1,069,568,185	56%
Appropriations	76,426,016	4%
Receivables	72,948,678	4%
Inventories & Other Assets	62,584,071	3%
Land	86,245,957	5%
Construction in Progress	81,159,441	4%
Building, Infrastructure, & Improvements	361,894,499	19%
Equipment, Books, and Art	96,957,652	5%
Total Assets	\$ 1,907,784,499	100%



UNIVERSITY OF HOUSTON SYSTEM

Liabilities • AUGUST 31, 2008

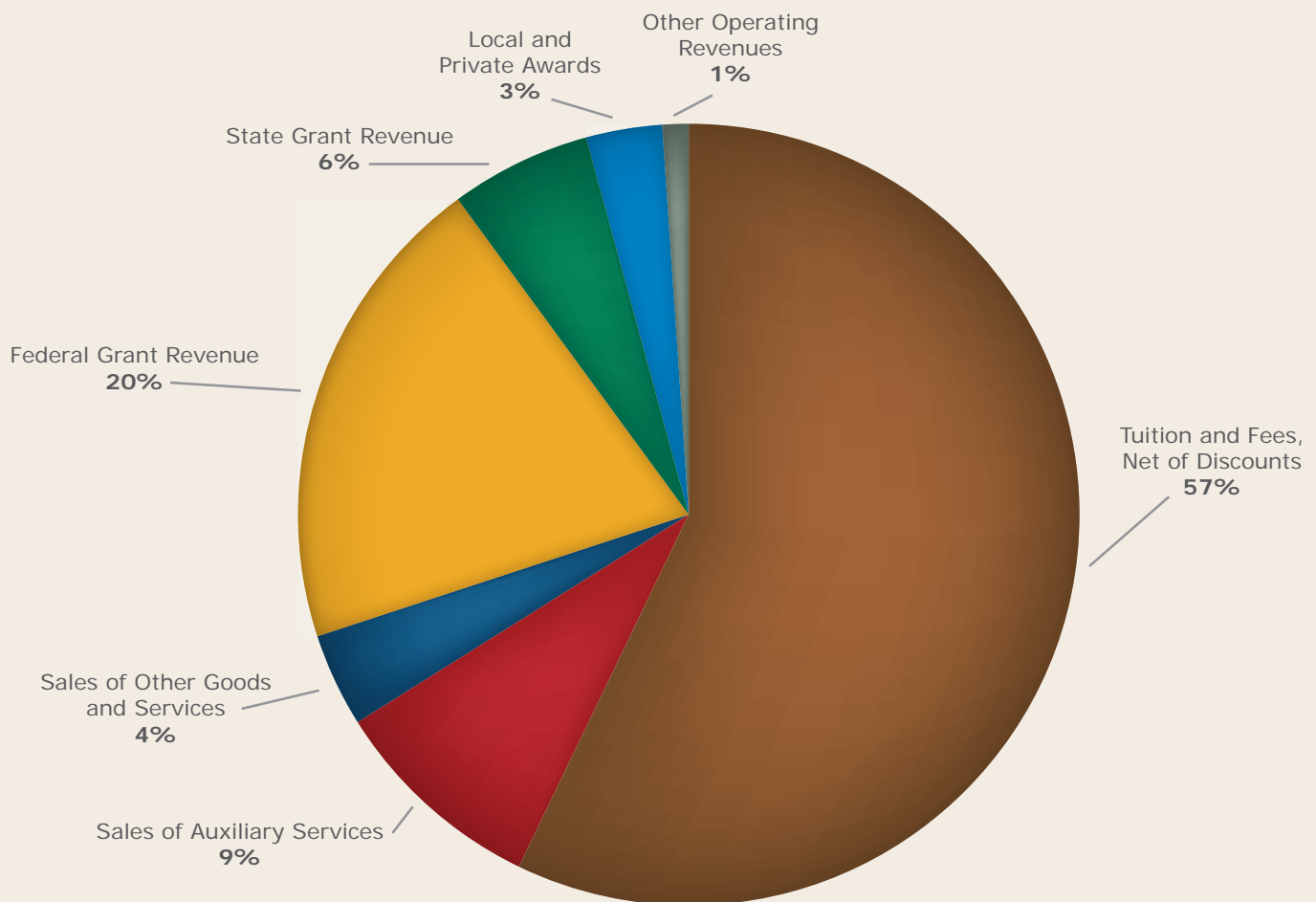
	2008	%
Payables and Accrued Liabilities	\$ 72,595,420	10%
Deferred Revenue	151,768,763	21%
Accrued Compensable Absences Payable	21,769,919	3%
Bonds Payable	464,730,182	64%
Funds Held for Others	12,497,504	2%
Total Liabilities	\$ 723,361,788	100%



UNIVERSITY OF HOUSTON SYSTEM

Operating Revenues • FOR THE YEAR ENDED AUGUST 31, 2008

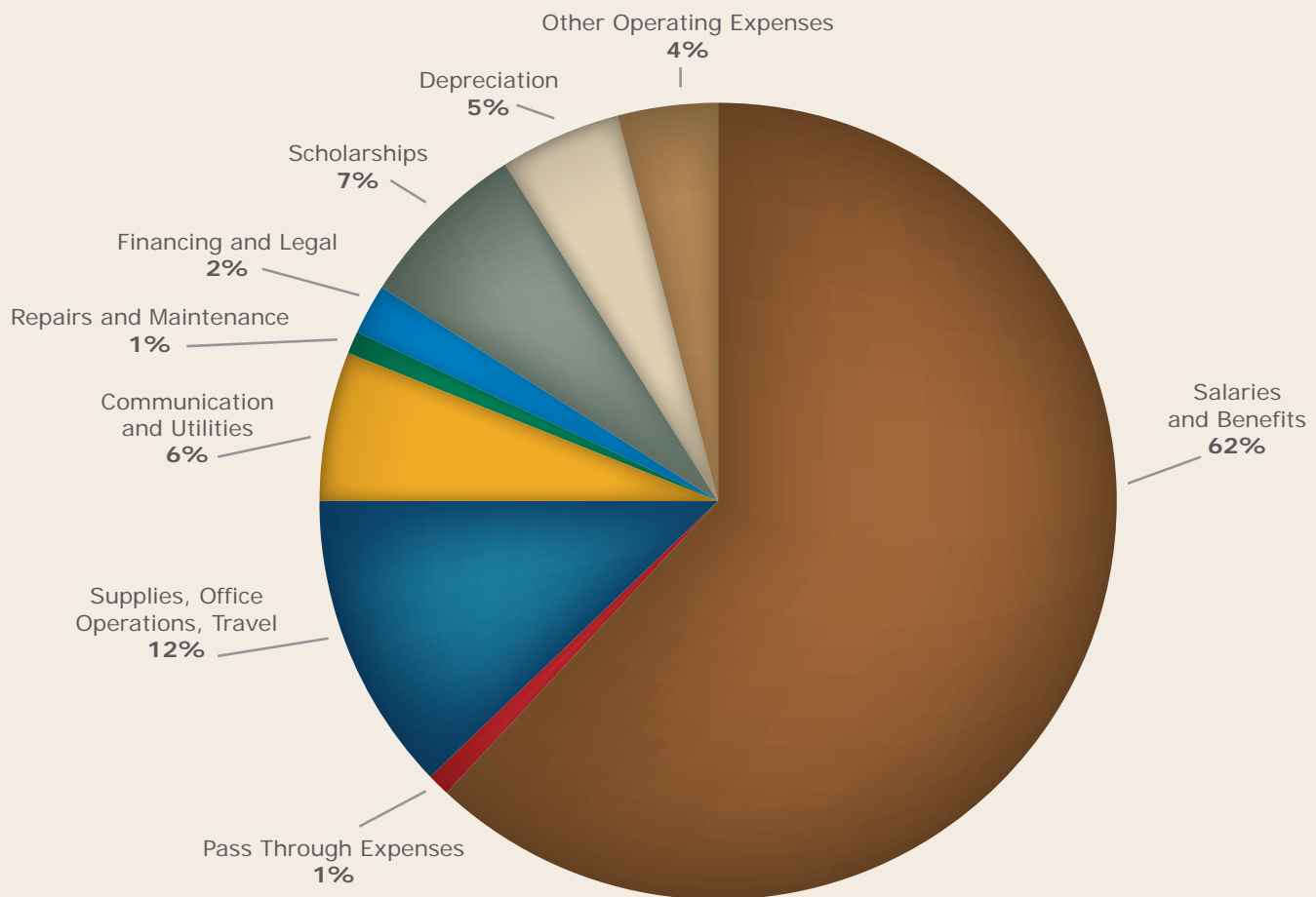
	2008	%
Tuition and Fees, Net of Discounts	\$ 308,491,079	57%
Sales of Auxiliary Services	46,478,440	9%
Sales of Other Goods and Services	20,155,405	4%
Federal Grant Revenue	106,802,211	20%
State Grant Revenue	32,426,982	6%
Local and Private Awards	14,930,317	3%
Other Operating Revenues	1,172,165	1%
Total Operating Revenues	\$ 530,456,599	100%



UNIVERSITY OF HOUSTON SYSTEM

Operating Expenses – Natural Classification • FOR THE YEAR ENDED AUGUST 31, 2008

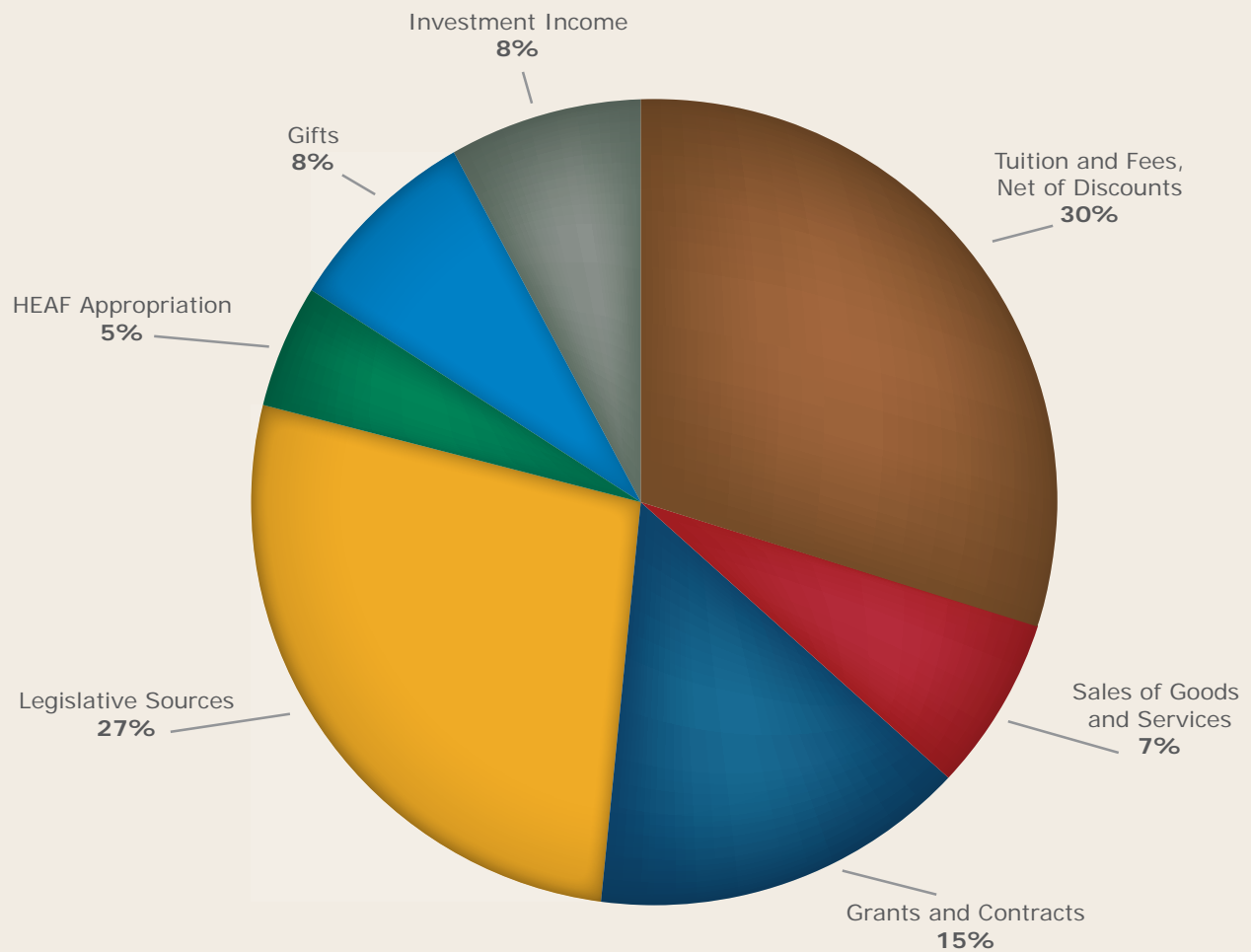
	2008	%
Salaries and Benefits	\$ 535,023,773	62%
Pass Through Expenses	3,274,049	1%
Supplies, Office Operations, Travel	104,954,206	12%
Communication and Utilities	50,298,935	6%
Repairs and Maintenance	9,603,176	1%
Financing and Legal	13,730,535	2%
Scholarships	56,621,318	7%
Depreciation	41,231,411	5%
Other Operating Expenses	34,013,597	4%
Total Operating Expenses (Natural)	\$ 848,751,000	100%



UNIVERSITY OF HOUSTON SYSTEM

Total Revenues • FOR THE YEAR ENDED AUGUST 31, 2008

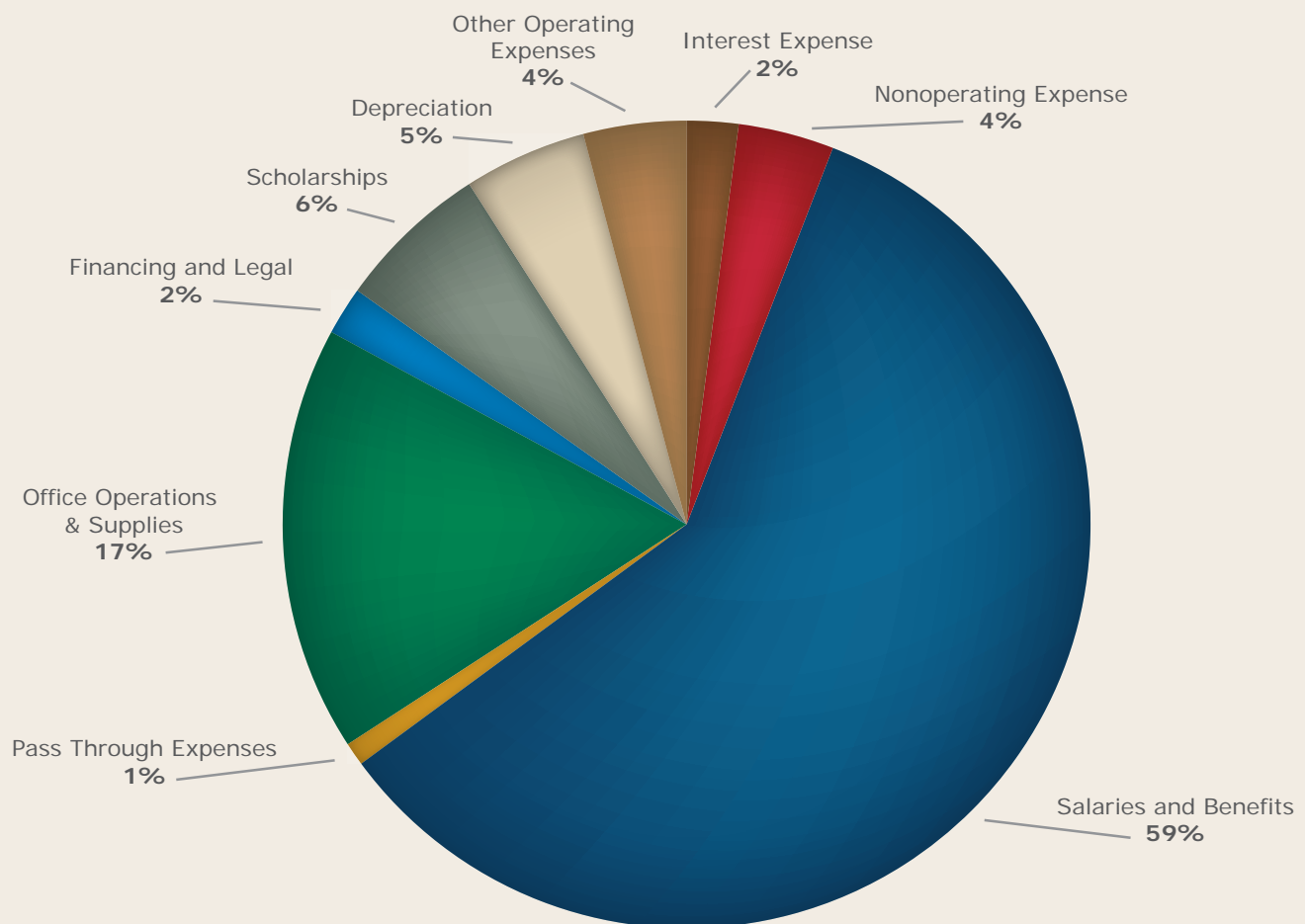
	2008	%
Operating Revenue		
Tuition and Fees, Net of Discounts	\$ 308,491,079	30%
Sales of Goods and Services	67,806,009	7%
Grants and Contracts	154,159,510	15%
Non-Operating Revenue		
Legislative Sources	278,552,154	27%
HEAF Appropriation	53,188,511	5%
Gifts	77,954,325	8%
Investment Income	79,449,168	8%
Total Revenues	\$ 1,019,600,756	100%



UNIVERSITY OF HOUSTON SYSTEM

Total Expenses • FOR THE YEAR ENDED AUGUST 31, 2008

	2008	%
Nonoperating Expenses		
Interest Expense	\$ 13,718,478	2%
Nonoperating Expense	35,196,612	4%
Operating Expenses		
Salaries and Benefits	535,023,774	59%
Pass Through Expenses	3,274,049	1%
Office Operations & Supplies	164,856,317	17%
Financing and Legal	13,730,535	2%
Scholarships	56,621,318	6%
Depreciation	41,231,411	5%
Other Operating Expenses	34,013,596	4%
Total Expenses (Natural)	\$ 897,666,090	100%



UNIVERSITY OF HOUSTON SYSTEM

Statement of Net Assets • AUGUST 31, 2008

	2008	2007
ASSETS		
Current Assets		
Cash and Cash Equivalents	\$ 166,137,744	\$ 145,968,612
Short-term Investments	131,751,149	14,886,564
Restricted Cash and Cash Equivalents	11,694,907	23,443,005
Loans and Contracts	6,640,421	9,255,099
Legislative Appropriations	76,426,016	56,552,065
Receivables	56,556,596	57,295,684
Inventories	2,330,059	3,032,432
Deferred Charges	39,439,082	23,850,353
Total Current Assets	490,975,974	334,283,814
Noncurrent Assets		
Restricted Cash and Cash Equivalents	43,671,531	39,070,336
Loans and Other Receivables	30,566,590	18,325,106
Investments	716,312,856	642,805,127
Capital Assets, Non-Depreciable	170,064,947	85,745,750
Capital Assets, Depreciable	1,169,404,294	1,178,223,604
Accumulated Depreciation	(713,211,693)	(703,168,878)
Total Noncurrent Assets	1,416,808,525	1,261,001,045
Total Assets	1,907,784,499	1,595,284,859
LIABILITIES		
Current Liabilities		
Payables	72,580,784	71,145,204
Deferred Revenues	151,768,763	122,526,148
Notes Payable	0	26,775
Employees' Compensable Leave	10,080,415	9,202,915
Revenue Bonds Payable	22,591,393	19,597,739
Funds Held for Others	12,497,504	5,981,717
Total Current Liabilities	269,518,859	228,480,498
Noncurrent Liabilities		
Payables	14,636	15,505
Employees' Compensable Leave	11,689,504	10,666,319
Revenue Bonds Payable	442,138,789	292,935,357
Total Noncurrent Liabilities	453,842,929	303,617,181
Total Liabilities	723,361,788	532,097,679
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	283,560,864	262,722,667
Restricted, Debt Retirement	5,790,181	29,756
Restricted, Capital Projects	4,140,833	593,880
Restricted, Endowment Funds	496,516,799	455,115,780
Restricted, Other	115,470,898	86,731,401
Unrestricted	278,943,136	257,993,696
Total Net Assets	\$ 1,184,422,711	\$ 1,063,187,180

UNIVERSITY OF HOUSTON SYSTEM

Statement of Revenues, Expenses and Changes in Net Assets • FOR THE YEAR ENDED AUGUST 31, 2008

	2008	2007
OPERATING REVENUES		
Tuition and Fees, Net of Discounts	\$ 308,491,079	\$ 285,283,840
Sales of Goods and Services	67,806,010	64,725,783
Federal Revenue	106,802,211	98,352,109
State Grant Revenue	32,426,982	21,974,311
Other Grants and Contracts	14,930,317	13,854,868
Total Operating Revenues	530,456,599	484,190,911
OPERATING EXPENSES		
Instruction	264,505,061	243,314,239
Research	80,513,171	74,952,195
Public Service	40,319,266	34,605,751
Academic Support	128,294,875	113,975,340
Student Services	32,257,749	31,871,801
Institutional Support	76,144,247	73,074,768
Operation and Maintenance of Plant	54,324,022	45,146,019
Scholarships and Fellowships	53,455,692	47,960,867
Auxiliary Enterprises	77,705,506	71,615,553
Depreciation and Amortization	41,231,411	40,972,546
Total Operating Expenses	848,751,000	777,489,079
Operating Income (Loss)	(318,294,401)	(293,298,168)
NONOPERATING REVENUES (EXPENSES)		
Legislative Revenue	282,553,332	254,135,704
Gifts	66,127,625	43,159,548
Investment Income	79,449,168	81,326,403
Interest Expense and Fiscal Charges	(13,718,478)	(13,771,856)
Gain (Loss) on Sale of Capital Assets	0	6,500
Other Nonoperating Revenues (Expenses)	(35,196,612)	(10,818,290)
Total Nonoperating Revenues (Expenses)	379,215,035	354,038,009
Income (Loss) Before Other Revenues, Expenses, Gains, Losses and Transfers	60,920,634	60,739,841
OTHER REVENUES, EXPENSES, GAINS, LOSSES AND TRANSFERS		
Capital Appropriation (Higher Education Assistance Funds)	53,188,511	35,459,008
Additions to Permanent and Term Endowments	11,826,699	9,278,667
Transfers	(2,953,497)	(2,253,072)
Legislative Appropriations Lapsed	(1,047,681)	(25,669)
Total Other Revenues, Expenses, Gains, Losses and Transfers	61,014,032	42,458,934
Change In Net Assets	121,934,666	103,198,775
Net Assets Beginning	1,063,187,180	961,766,440
Restatements	(699,135)	(1,778,035)
Net Assets Beginning, as Restated	1,062,488,045	959,988,405
Net Assets, Ending	\$ 1,184,422,711	\$ 1,063,187,180

UNIVERSITY OF HOUSTON SYSTEM

Statement Of Cash Flows • FOR THE YEAR ENDED AUGUST 31, 2008

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Proceeds Received from Students and Customers	\$ 355,974,977	\$ 316,809,413
Proceeds from Loan Programs	63,695,517	68,829,406
Proceeds from Other Revenues	212,720,773	161,003,676
Payments to Suppliers for Goods and Services	(171,910,593)	(142,749,061)
Payments to Employees	(531,474,152)	(518,193,654)
Payments for Loans Provided	(68,822,417)	(77,663,100)
Payments for Other Expenses	(117,171,794)	(90,241,746)
Net Cash Provided (Used) by Operating Activities	(256,987,689)	(282,205,066)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from State Appropriations	262,475,209	253,181,755
Proceeds from Gifts	35,054,634	11,324,920
Proceeds from Endowments	20,289,698	19,204,381
Proceeds of Transfers from Other Funds	23,705,512	46,959,479
Proceeds from Other Revenues	0	(60,726)
Payments for Other Uses	(44,039,266)	(30,316,137)
Net Cash Provided by Noncapital Financing Activities	297,485,787	300,293,672
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from Disposal of Capital Assets	0	6,500
Proceeds from Capital Financing Activities	53,188,511	37,733,127
Payments for Additions to Capital Assets	(23,146,832)	(22,776,568)
Payments of Principal and Interest on Debt Issuance	(79,155,297)	(35,046,273)
Net Cash Used by Capital and Related Financing Activities	(49,113,618)	(20,083,214)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Interest and Investment Income	946,736,634	258,211,594
Payments to Acquire Investments	(925,098,885)	(232,913,011)
Net Cash Provided by Investing Activities	21,637,749	25,298,583
Increase (Decrease) in Cash and Cash Equivalents	13,022,229	23,303,975
Cash and Cash Equivalents, September 1	208,481,953	185,177,978
Restatements to Beginning Cash and Cash Equivalents		
Cash and Cash Equivalents, August 31	221,504,182	208,481,953
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	(318,294,401)	(293,298,168)
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Amortization and Depreciation	41,231,411	40,972,546
Bad Debt Expense	161,579	133,337
Classification Differences	(8,565,247)	(16,184,742)
Changes in Assets and Liabilities		
(Increase) Decrease in Receivables and Loans	6,135,556	(12,792,303)
(Increase) Decrease in Inventories	702,373	(682,011)
(Increase) Decrease in Other Assets	65,689	29,694
(Increase) Decrease in Prepaid Expenses	(15,588,730)	(9,373,406)
Increase (Decrease) in Payables	(367,704)	(4,742,395)
Increase (Decrease) in Deferred Income	29,296,711	10,419,334
Increase (Decrease) in Other Liabilities	8,235,074	3,313,048
Total Adjustments	61,306,712	11,093,102
Net Cash Provided by Operating Activities	\$ (256,987,689)	\$ (282,205,066)

UNIVERSITY OF HOUSTON SYSTEM

Schedule of Operating Expenses • FOR THE YEAR ENDED AUGUST 31, 2008

	2008	2007
EXPENSES BY NATURAL CLASSIFICATION		
Cost of Goods Sold	\$ 3,037,709	\$ 2,891,050
Salaries and Wages	437,260,765	411,225,610
Payroll Related Costs	97,763,008	91,224,465
Professional Fees and Services	40,597,168	39,532,669
Federal Pass-Through Expenses	3,274,049	2,906,252
Travel	14,401,032	12,924,308
Materials and Supplies	41,580,808	33,915,530
Communication and Utilities	50,298,935	42,191,851
Repairs and Maintenance	9,603,176	9,456,828
Rentals and Leases	12,706,933	13,407,090
Printing and Reproduction	5,337,489	4,652,340
Depreciation and Amortization	41,231,411	40,972,546
Interest	72,190	44,723
Scholarships	56,621,318	50,463,806
Claims and Losses	951,412	913,976
Other Operating Expenses	34,013,597	20,766,035
Total Operating Expenses	\$ 848,751,000	\$ 777,489,079

EXPENSES BY FUNCTIONAL CLASSIFICATION		
Instruction	264,505,061	243,314,239
Research	80,513,171	74,952,195
Public Service	40,319,266	34,605,751
Academic Support	128,294,875	113,975,340
Student Services	32,257,749	31,871,801
Institutional Support	76,144,247	73,074,768
Operation & Maintenance of Plant	54,324,022	45,146,019
Scholarships & Fellowships	53,455,692	47,960,867
Auxillary Enterprises	77,705,506	71,615,553
Depreciation & Amortization	41,231,411	40,972,546
Total Expenses by Expenditure Function	\$ 848,751,000	\$ 777,489,079



UNIVERSITY OF HOUSTON SYSTEM MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEAR 2008

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, 2008. 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

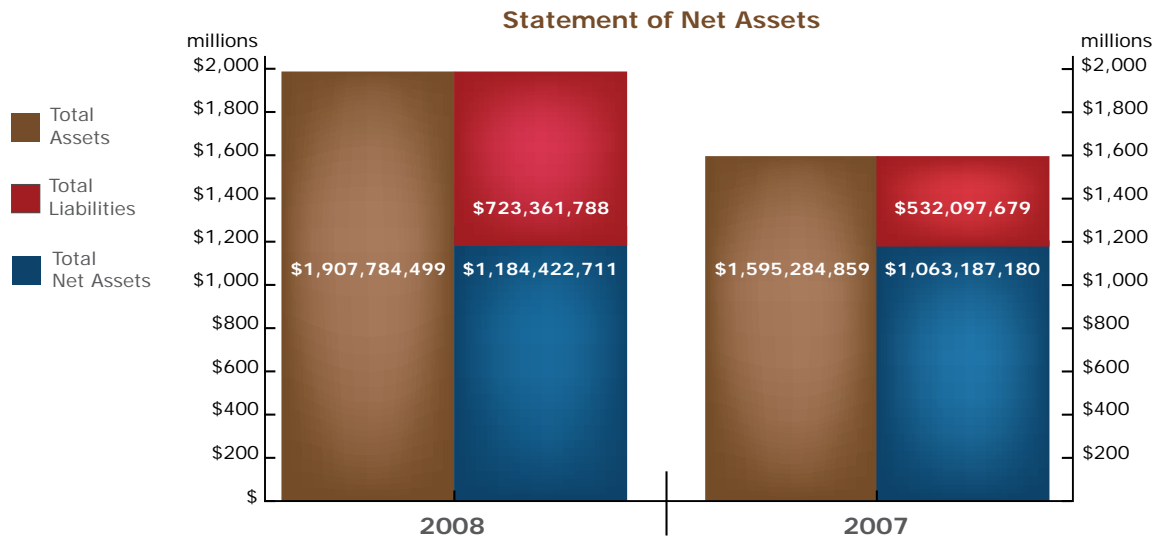
The University of Houston System (UHS) serves the nation's fourth largest metropolitan area and is part of the state-supported system of higher education in Texas. The System is comprised of four universities and a supporting System Administration. The four universities are University of Houston (UH), 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 UHD, a four-year undergraduate university, is beginning limited expansion into graduate programs. The UHCL offers upper division programs through the doctoral level. UHV is an upper division and master's level institution. 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. The Houston metropolitan region is one of the most ethnically diverse parts of the state, and the universities of the System remain a reflection of that diversity, with students from more than 125 countries.

Over the past five years, enrollment system-wide has increased from 54,907 to 56,772, and the number of degrees awarded has increased from 9,536 to 11,735. Research awards system-wide totaled \$95.9 million during the last year. As the region's largest provider of comprehensive (baccalaureate to doctorate) higher education services, the University of Houston System plays a primary role in meeting the needs of the Houston metropolitan area, including its highly skilled professional workforce and its technological and industrial research and development community. Toward this end, the System is striving to expand access to its universities to all qualified students; to ensure their success by the completion of a degree; to deliver programs that correspond to workforce needs; to conduct research that is relevant to industry and society; and to do it all with limited resources and in a way that demonstrates accountability to its students and the citizens of Texas.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements for fiscal year 2008 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 2008 have been prepared in accordance with these rules. Additionally, these statements conform to reporting requirements of the Texas Comptroller of Public Accounts and to guidelines issued by the



National Association of College and University Business Officers. 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, 2008, with financial data for the fiscal year ended August 31, 2007, 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 defined 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, 2008. Comparative data for the previous fiscal year has also been presented as of August 31, 2007. 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 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, 2008, the University of Houston System's Assets totaled \$1.908 billion, and Liabilities totaled \$723 million, resulting in a Net Asset valuation of \$1.185 billion. This represents an increase in net assets of \$121 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,

Unrestricted Net Assets • AS OF AUGUST 31, 2008

Reserved for:	(millions)
Accounts Receivable	\$ 36
Encumbrances	16
Higher Education Fund	45
Future Operating Budgets	43
Other Funds	32
Unreserved Allocated:	
Service Department Operating	6
Auxiliary Enterprise Operating Funds	8
Endowment and Loan Funds	13
Retirement of Indebtedness	(7)
Student Fees	30
Unallocated	57
Total Unrestricted Net Assets	\$ 279

plant, and equipment owned by the System. Restricted net assets are comprised of 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 or provider of the assets. Unrestricted net assets are available for any lawful purpose of the institution. 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 2008 fiscal year the System recognized operating revenues of \$530 million and operating expenses of \$849 million. After recognizing non-operating activities and other gains and losses, the System realized a net increase in net assets of \$121 million. During the prior fiscal year, the System experienced an increase in net assets of \$103 million.

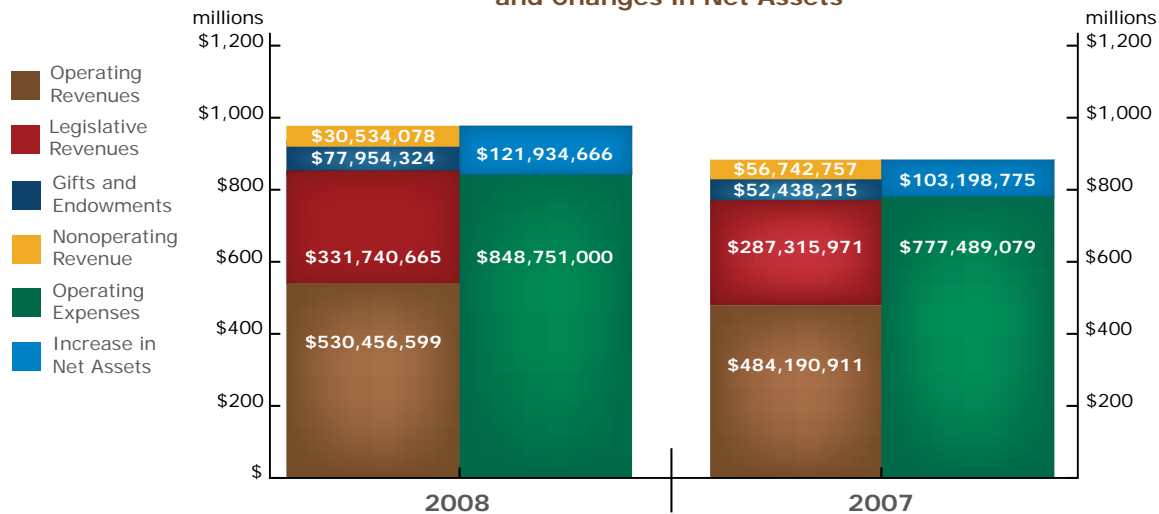
Operating revenues are received and recognized as a result of providing services to the component universities' customers. Operating expenses are the costs necessary to provide those

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 \$489 million for fiscal year 2008.

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

UHS Statement of Revenues, Expenses and Changes in Net Assets



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 2008 fiscal year totaled \$221 million, which reflected a net increase in cash of \$13 million.

CAPITAL ASSETS

Maintaining quality in classrooms, laboratories, libraries, and equipment is critical to achieving the System's goals of academic and research excellence. As the number of students and faculty at the UH institutions grow, so too does the need for expanded and better facilities and infrastructure. The System's institutions continue the implementation of their long-range capital plans, with a managed combination of renovation and modernization of older facilities, along with new construction.

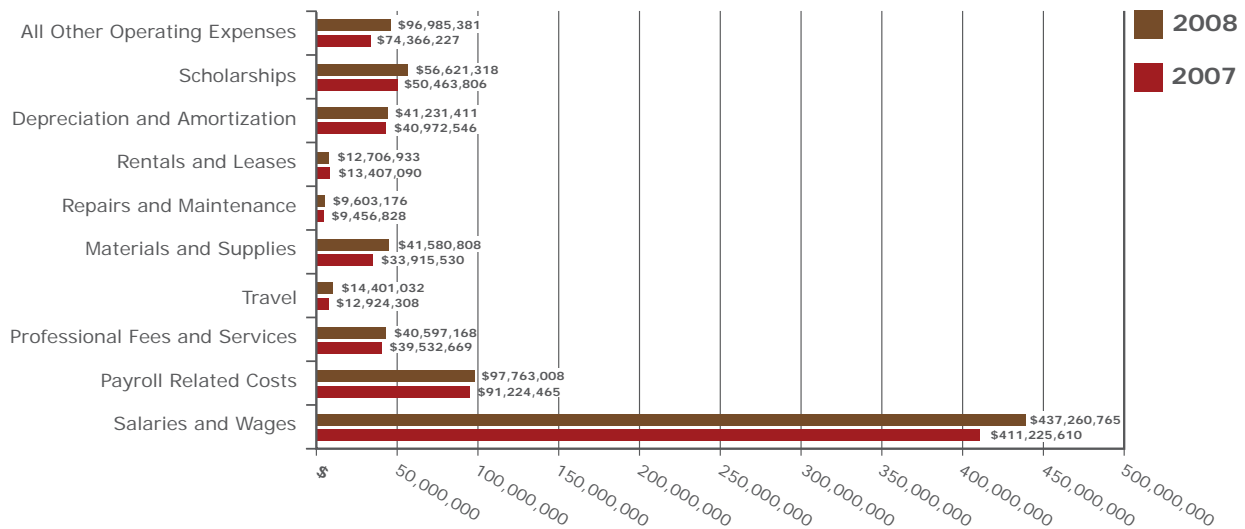
At the end of the 2008 fiscal year, the System had \$626 million of capital assets, net of accumulated depreciation. These assets included land, buildings, infrastructure and improvements, furniture and equipment, library books, and works of art. Several major capital construction projects are in various 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, 2007, totaled \$561 million.

During fiscal year 2008 the System continued its efforts to implement capital projects in support of its strategic plan. Construction continued on a new \$35 million classroom building at the UH System at Sugar Land, a complex to be used jointly with Wharton County Junior College in collaboration with the UHS multi-institution teaching center. At UH construction of Calhoun Lofts, a 982 bed graduate and professional student residential loft-style complex progressed. Construction began at UH on the Michael J. Cemo Lecture Hall and Academic Center, a 33,000 square foot classroom, testing, and career center; and on a 1,500 car parking garage on the east side of the campus. All of these facilities are slated to open in 2009. Design work

began on a new \$10.2 million regional economic and allied health center facility at University of Houston – Victoria. Design began on a \$10.6 million renovation and addition to the UHCL Arbor building. Development and design continues on a branch campus in Pearland for the UH – Clear Lake. Completion of each of these projects will provide enhanced and significant benefits to the System's students and the local communities. 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.



Expenses by Natural Classification



DEBT ADMINISTRATION

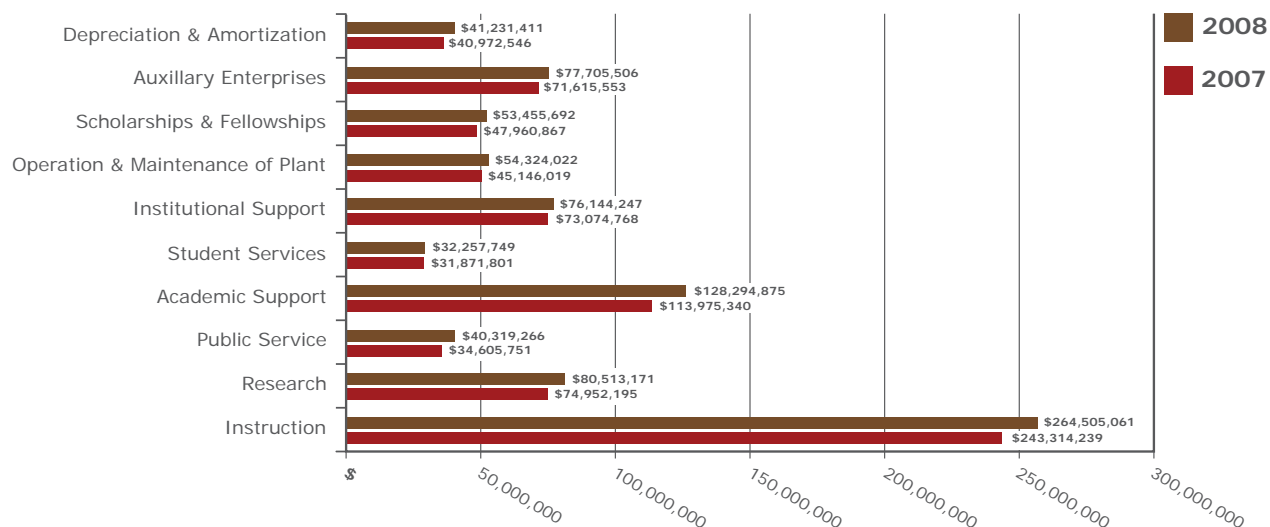
The management of financial resources is enhanced through the prudent use of debt to finance capital projects. The System has sufficient debt capacity to finance planned capital improvements and facilities. Detailed information concerning the System's long-term debt is found in the Notes to the Financial 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, 2008, the University of Houston System had \$465 million of long term bonded debt outstanding, \$23 million of which will be retired during the 2009 fiscal year.

In fiscal year 2008, the University of Houston System issued \$175.03 million of Consolidated Revenue and Refunding Bonds, Series 2008. Proceeds from this bond issue will be used to finance construction of a new residential life building and a parking garage facility at the University of Houston, a new building at the University of Houston – Victoria to house both the allied health and the economic development programs, and an additional classroom building at the multi-institution teaching center, UH System at Sugar Land. Issuance of additional long-term debt is anticipated to occur during the 2009 fiscal year. The System has requested authorization from the State Legislature for the appropriation of funds to pay debt service during the 2010-2011 biennium for additional planned Consolidated Revenue Bonds.

The System established a commercial paper program during the 2007 fiscal year, which permits the issuance of commercial paper notes which may not exceed, in the aggregate, the principal amount of \$50 million. The commercial paper program provides interim financing for the costs of various capital projects within the System. In fiscal year 2008, the University of Houston System issued and fully repaid \$48.5 million of Consolidated

Expenses by Functional Classification



Revenue Commercial Paper Notes, Series A. Subsequent to the close of the 2008 fiscal year, the System issued \$18.7 million of additional commercial paper notes.

ECONOMIC OUTLOOK

Given the breadth of the UH System institutions and the significant amount of expansion that is being undertaken, coordinated planning is essential if the System is to succeed in fully serving its constituents. Dr. Renu Khator became the eighth chancellor of the University of Houston System and the thirteenth president of the University of Houston in January 2008. In May of this year, at the conclusion of Dr. Khator's first one hundred days in office, the UH System Board of Regents met with System administrators to discuss the future direction of the UHS universities. An important outcome was the establishment of the following three UH System goals – (1) student access and success, (2) national competitiveness, and (3) community advancement.

In order to satisfy these goals, the UH System will commit to providing access to the people of the greater Houston region and the state. Each university within the System will make student success its top priority and will hold itself publicly accountable for achieving this goal. Secondly, the city of Houston, as well as the greater Houston region, will be known for having one of the best metropolitan systems of higher education in the nation. Finally, the UH System will be the engine of social and economic advancement of the metropolitan region and the state. Each university within the System will engage with its community and will hold itself accountable for contributing toward community advancement. In addition to guiding UH System planning in the coming years, these goals also further the state's goals for higher education.

As the System looks to the future, the needs of its constituents and the goals that have been established for serving them necessitate greater resources than the System universities currently possess. By 2015, demographic forecasts predict the Houston metropolitan area will add another 1.4 million persons.

Accommodating a corresponding level of enrollment growth at each of the universities will require significant investments in faculty, staff, facilities and other infrastructure. In anticipation of the convening of the Eighty-first Legislature during spring 2009 and the passage of appropriation and funding legislation for the 2010 – 2011 biennium, the System has requested that legislators consider certain items and areas of critical concern to the University of Houston System.

Beginning during the first months of the 2009 fiscal year, and subsequent to the conclusion of fiscal year 2008, the U.S. and world-wide economies began experiencing a significant down turn in their financial environments. The recessionary situation has been characterized by a contraction of credit, falling prices in housing, and deflated valuations for equities and other investment instruments. The current economic issues facing the U.S. are reflected in the performance of the capital markets in the U.S. and abroad; markets in which the System's endowment and other resources are invested. However, working with its investment consultant, the System believes important steps were taken by management over the course of the previous 18 to 36 months in expectation of a climate such as that being faced today. The duration of the economic issues facing the U.S. and the global economy cannot be predicted, however management believes that the endowment's financial condition has historically reflected strength and is capable of withstanding and adjusting to future economic uncertainties. Additionally, although it is not possible to predict ultimate results, management believes the University of Houston System continues to maintain a healthy financial position, and is administratively structured and governed in a manner that has equipped it to weather the current world-wide adverse financial situation. More so, than ever, the System stands committed to the principles of prudent and effective administration and management, while demonstrating that the universities of the System are good stewards of the dollars entrusted to them by their constituencies.



UNIVERSITY OF HOUSTON SYSTEM NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED AUGUST 31, 2008

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*. In addition to its global influence, 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 in the Houston metropolitan area. Houston and the surrounding metropolitan 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 plus a student regent.

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.

ASSETS, LIABILITIES, AND NET ASSETS

A. 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. Noncurrent receivable balances are not expected to be collected within one year of fiscal year end.

B. 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. Noncurrent 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.

C. 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, 2008, non-depreciable capital assets, consisting of land and construction in progress, totaled \$170,064,947. Depreciable capital assets, net of accumulated depreciation, and consisting of buildings, infrastructure, facilities, equipment, library books, and works of art, totaled \$456,192,601.

DEPOSITS AND INVESTMENTS

A. Deposits of Cash in Bank

At August 31, 2008, the carrying amount of the System's cash deposits was \$28,928,425 and the bank balance was \$34,121,833. There were no deposits to foreign banks.

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 \$1,023,270,946.

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, 2008, 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, 2008, 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

As of August 31, 2008 the System held no short term notes payable. During 2008 commercial paper was issued for

\$36,318,971 to facilitate the construction of the Calhoun Lofts and the purchase of a tract of land. It was entirely redeemed in 2008 by the Consolidated Revenue Refunding Bonds Series 2008.

LONG TERM LIABILITIES

A. Notes and Loans Payable

The System reported no notes or loans payable at the end of the year ended August 31, 2008.

B. Claims and Judgments

At August 31, 2008, 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-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 2008. 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 2008 fiscal year, for accrued vacation and compensatory leave, totaled \$1,609,144.

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, 2008.

Included in expenditures reported in the financial statements for rent paid or due under operating leases is \$4,655,614. Future minimum lease rental payments under non-cancelable operating leases having an initial term in excess of one year, as of August 31, 2008, totaled \$10,161,601.

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.

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 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 2008 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 2008 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 2008 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 that may be legally available for payment of debt obligations (funding for fiscal year 2008 partially from Legislative appropriation).

Consolidated Revenue and Refunding Bonds, Series 2008

- To (a) refund and defease certain outstanding commercial paper notes of the System. And (b) finance the acquisition, purchase, improvement, enlargement and equipping of property, buildings, structures, activities, services, operations and other facilities, roads or related infrastructure for or on behalf of the System, including individual campuses of the System.
- Issued 7-1-08.
- \$175,030,000; 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 (funding for fiscal 2008 partially from legislative appropriation).

General Obligation Bonds

At August 31, 2008, the System had no bonds payable classified as General Obligation Bonds.

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
- Issued 12-01-03.
- \$16,490,000; 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 2008 from legislative appropriation).
- Average rate of bonds refunded - 5.92%.
- Net proceeds from refunding series - \$17,419,961 after receipt of bond premium of \$896,716. and payment of \$266,453 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 bonds, 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 System'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 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 2-01-2006.
- \$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 2008 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 2000 series bonds will be called for early redemption on 2-15-2010.
- The 1997 series bonds maturing subsequent to 8-15-2007 and the 2000 series bonds maturing subsequent to 2-15-2010 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.

B. Changes In Bonded Indebtedness

Bonds payable are due in annual installments varying from \$5,005,000 to \$28,170,000 with interest rates from 2.50% to 7.00%, with the final installment due 2-15-38.

C. Future Debt Service Requirements

Principal and interest requirements on the obligations for the next five years were \$191,745,760 and \$514,690,365 for all years beyond.

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 2008 discounts and allowances that related to tuition and fee revenues totaled \$52,586,025.

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 2008 a restatement of the prior year's net assets/fund equity was required. The restatements represent prior period adjustments to beginning net assets related to capital assets and accumulated depreciation changes.

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. 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. If cash revenues do not attain certain contractually defined thresholds, the University is liable to the external management entity for the deficiency. In previous fiscal years (2005 and 2006) contingent liability payments were made, both in relation to the Bayou Oaks facility. During the 2007-2008 fiscal years 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

The University of Houston System has established a commercial paper program (Consolidated Revenue Commercial Paper Notes, Series A) that permits the issuance of commercial paper notes which may not exceed, in the aggregate, the principal amount of \$50,000,000 at any one time. Commercial paper is issued to provide interim financing for the costs of various capital projects within the System. The maximum maturity for the commercial paper is 270 days and is issued at tax exempt interest rates. As of the date of the issuance of this financial report, the System had no outstanding commercial paper liabilities. During November 2008, the System issued \$18,700,000 of commercial paper notes.



UNIVERSITY OF HOUSTON SYSTEM GREEN VISTAS

The University of Houston System encompasses four universities, two multi-institution teaching centers, a Public Broadcast System educational television station, and the largest university distance learning program in Texas. With more than 56,000 students and 3,000 faculty, it is the largest metropolitan public system of higher education in Texas. The UH System universities have distinctive and complementary missions and programs aimed at educating students, creating and imparting knowledge, and fostering partnerships and service initiatives within their communities. The facilities and grounds of each of our campuses are equally distinctive, and have been carefully designed to enhance and complement our students' academic and social experience, as well as providing a beautiful and attractive environment in which to study, work, or visit. As you read through this year's financial report, we would like to take the opportunity to share with you some of the highlights and scenery that members of the UH System community have the benefit of experiencing every day on our campuses.

The University of Houston is the largest component of the UH System and is located in the heart of the city. Students take courses in modern classroom and laboratory facilities located on a beautiful 550 acre campus dotted with parks, fountains, and plazas. Well manicured lawns and shrubbery, seasonal flowers, and stately trees, including the oldest honey mesquite tree in the county, offer a tranquil and uplifting environment.

The University of Houston – Clear Lake is an upper-level educational institution that serves a diverse student population. UHCL has a well-established reputation as a community minded, partnership-oriented university, and is located in the midst of Clear Lake's high-technology community. The campus is adjacent to NASA's Johnson Space Center, and borders the Armand Bayou Nature Center. The university is nestled within a 524 acre wildlife and nature preserve featuring picturesque park-like settings and

scenic nature trails, with Horsepen Bayou winding through heavily wooded areas abundant with wildlife.

The University of Houston – Downtown is the second largest of the four universities in the UH System. This dynamic campus is located in downtown Houston. At UHd, the emphasis is on excellence in teaching and student success. The principal activities of the campus are located in the historic Merchants and Manufacturers Building, named to the National Register of Historic Places, as well as being recorded as a Texas Historic Landmark. The campus sits across from Allen's Landing, the birthplace of Houston. The downtown location in no way inhibits the natural beauty, park areas, and tranquil settings that are found on this campus situated at the confluence of Buffalo and White Oak Bayous.

The University of Houston – Victoria, located in the heart of the Texas Coastal Bend region, is an upper-level institution. The university has a history of taking instruction to where the students are and offering it at times and in ways that recognize student obligations to work, family, and society. The UHV campus is adjacent to the campus of Victoria College. The campus master plan has taken advantage of the climate and terrain of the Gulf Coast plain, and has led to the development of walkways lined with trees and benches, and the planting of native trees accented by seasonal flowers. Pedestrian amenities are emphasized, and expansive green spaces abound throughout the campus.

Each of our campuses prides itself in promoting sustainability projects including energy management, environment enhancement measures, and the development of parks and green areas. Engaging in such conservation opportunities also maximizes financial resources. New, forward thinking, sustainability programs are complementing our students' academic and social experiences, while enhancing their lifestyles, as well as those of our faculty and staff.



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PHOTO DESCRIPTIONS

Cover front to back: A strategically placed bench on a walkway between the Moore's School of Music and the Wortham Theater Complex, beckons students to stop and enjoy the shade and cool surroundings.

Front Cover clockwise from lower right – Walkways leading to the UHV University Center are lined with lush lawns and bordered by trees and beds of annuals. Randomly placed seats integrated into the artwork makes stopping to enjoy the sites an experience.

The UHD Jesse H. Jones Student Life Center sports freshly planted trees and crepe myrtles surrounded by verdant green lawns.

UHCL provides elegant greenery consisting of many different subtropical plants as well as annuals bordered by benches at the entrances to the Bayou Building.

Page 2 – Upper left: Rows of trees line the walkways at UHV leading to conveniently placed gathering areas.

Upper right – Picnic benches outside the Jesse H. Jones Student Life Center at UHD are shaded by magnolias and live oaks that enhance the beauty of the gathering area along the banks of White Oak Bayou.

Page 3 – Upper left: Mature oak trees shade the walkways and benches between the new Science and Engineering Research Complex and the UH Science Center. In the spring masses of azaleas bloom abundantly. For year round interest hostas, native grasses and daylilies provide color.

Upper right – Plantings of Southern Magnolia, oak trees and a variety of other trees shade cool green lawns behind the Bayou Building at UHCL.

Page 16 – Outside the cafeteria in the Bayou Building at UHCL sub-tropical plants including calla and canna lilies, firecracker bush and oleander along a seating wall bring color to an outdoor gathering spot.

Page 19 – UHCL Student Services and Classroom Building is situated among newly planted and old growth trees. Beds of hostas, azaleas and native grasses surrounded by seating walls provide places for study and collaboration.

Page 20 – The main entrance to UHV is enhanced by a water feature that is host to native grasses, annuals and daylilies.

Page 22 – Bright red geraniums and variegated petunias fill the annual beds outside the UH Cullen College of Engineering, a well respected center for seven different engineering disciplines.

Page 25 – Beds of Nearly Wild Rose, dwarf oleander, agapanthus and a variety of annuals line the walkways near the UHV-University West Building.

Page 26 – The plans for the new UHD Shea Street Building included beautiful landscaping. Trees of several varieties have been planted to shade beds of annuals that will provide color to enhance student gathering areas and bring a sense of cool beauty.

Page 27 – The walks to the University Center at UHV are lined with crepe myrtles that shade beds filled with year round annuals. Strategically placed benches invite students and staff alike to stop and enjoy.

Page 29 – UHCL Liberty Park Pond and the fountain within provide green space for people and animals alike. As a wildlife sanctuary the animals who call UHCL home are welcome to share outdoor spaces with students and visitors.

Page 31 – A view of the Gerald D. Hines College of Architecture Building from the top of the Burdette Keeland Design and Exploration Center shows the green roof planted with Texas Bluebonnets. A green roof serves to reduce flooding, clean the air and minimize the effects of a city's heat island. The green roof on the Keeland Building is the only roof of this type in the city. The building itself, a former auto shop training center, then band annex is now a design center for architecture students.



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ANNUAL FINANCIAL REPORT

