

APPENDIX A

BAYLOR COLLEGE OF MEDICINE

APPENDIX A

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APPENDIX A

BAYLOR COLLEGE OF MEDICINE

General

Baylor College of Medicine (the "**College**") is one of the leading medical schools and biomedical research institutions in the United States. The College is a Texas non-profit corporation exempt from federal income taxation under Section 501(a) of the Internal Revenue Code of 1986, as amended (the "**Code**"), by reason of being an organization described in Section 501(c)(3) of the Code. The College is located in the Texas Medical Center, a 700 acre complex of 47 independent institutions, in Houston, Texas, and is the only private medical school in the Southwestern United States.

In addition to physician education, the College offers programs and postgraduate degrees in graduate biomedical sciences and the allied health fields and offers graduate medical education in 21 specialties. Further, the College is among the nation's leading biomedical research institutions. The College consistently ranks among the top of the country's 126 medical schools. For 2011, U.S. News & World Report has ranked the College as one of the top 25 medical schools for research. The College is listed 13th among all U.S. medical schools for National Institutes of Health funding, and No. 2 in the nation in federal funding for research and development in the biological sciences at universities and colleges by the National Science Foundation. The College has total annual research support of \$302 million, with \$241 million from federal sources and has 25 departments and more than 90 research and patient-care centers and units. See "**RESEARCH**." Currently, the College trains more than 3,000 medical, graduate, nurse anesthesia, and physician assistant students, as well as residents and post-doctoral fellows. See "**EDUCATION**." Finally, the College provides extensive patient care services. The College's affiliated hospitals serve over 150,000 inpatients and almost 3 million outpatients annually. See "**PATIENT CARE**."

History

In 1900, a small group of dedicated physicians and community leaders started a medical school in Dallas to improve the practice of medicine in North Texas. The fledgling school was called the University of Dallas Medical Department, although no such university existed. The school opened its doors Oct. 30, 1900, with 81 students. The young medical school needed a true affiliation with an established university to survive; an alliance was formed with Baylor University in Waco in 1903. At that time, the name changed to Baylor University College of Medicine.

In 1943, the M.D. Anderson Foundation invited Baylor University College of Medicine to join the newly formed Texas Medical Center. The College relocated to Houston in July, 1943, in a converted Sears, Roebuck & Co. building, with 131 students. Four years later, the College moved into its present site in The Roy and Lillie Cullen Building, the first building completed in the new Texas Medical Center.

In 1948, Michael E. DeBakey, M.D. joined the faculty as chair of the Department of Surgery. The Graduate School of Biomedical Sciences was established the following year. During the next several years, the College began its affiliation with a number of hospitals, which created superior training facilities for students and residents.

The College's rise in prominence began in the 1950s when Dr. DeBakey's innovative surgical techniques garnered international attention. The 1960s brought the first major expansion of College facilities, along with a major turning point for the institution. In 1969, by mutual agreement, the College separated from Baylor University to become an independent institution. This encouraged broader, nonsectarian support and provided access to federal research funding. The institution's name changed to Baylor College of Medicine.

In 1971, the State of Texas enacted legislation pursuant to which the state began appropriating funds to offset a portion of the costs of the College of the medical education of Texas residents. See "**EDUCATION**." The College has since doubled its enrollment and expanded its affiliation with medical and educational institutions in Houston and throughout Texas. Today the College enjoys an international reputation as one of the premier medical colleges in the United States.

Baylor Clinic & Hospital

In January, 2007, the Board of Trustees of the College passed a resolution to develop an integrated Baylor Clinic and Hospital. Baylor Clinic and Hospital will be located on 35 acres of College-owned land in the Texas Medical Center area. Construction commenced in May, 2007. In February 2009 the College decided because of changes in the US economy to pause construction once the building's core and shell is completed, which is expected to happen in mid fiscal year 2011. During the pause the College is considering all options including partnering with another institution.

BEST MINDS BEST MEDICINE CAMPAIGN

General. The College has embarked on a capital campaign, known as "Best Minds Best Medicine." The planned initiatives of the campaign focus on several areas, including:

- Assisting in the funding of the Baylor Clinic and Hospital;
- Investment in multidisciplinary strategic initiatives in:
 - Neuroscience and mental health,
 - Cardiovascular disease,
 - Regenerative medicine, and
 - Cancer research and treatment;
- Faculty recruitment and development, including endowed positions and research funds, junior faculty and support staff, start-up equipment and supplies for new laboratories, seed funding for novel research, and resources for conferences and community outreach; and
- Educational excellence in its student body, such as premedical summer programs, scholarships, research stipends, additional classrooms and laboratories, its combination M.D./Ph.D. and M.D./J.D. programs, the DeBakey Library and Museum, and a state-of-the-art simulation center for the U.S. Medical Licensing Exam.

Fund raising. As part of Best Minds Best Medicine, the College expects to raise \$1 billion in contributions by 2013. The campaign began July 1, 2003, in a silent phase, with the approval of the College's strategic plan by the Board. It was announced to the public in May, 2007 and has raised more than \$767 million in pledges. A portion of the funds received from these contributions may be used to prepay and redeem a portion of the principal of the Series 2007 Bonds and Series 2008 Bonds.

MANAGEMENT OF THE COLLEGE

Board of Trustees

The College is governed by a 42 member Board of Trustees (the "**Board**"). Members of the Board are divided into two groups. Group One Trustees comprise a minimum of one-fourth of the Trustees. Group Two Trustees, which comprise the remainder of the Trustees, are divided into three approximately equal classes to create staggered three-year terms of office for each class. Group One Trustees are elected by the Board of Trustees of Baylor University. Group Two Trustees are elected by the Board of the College. Terms end at the annual meeting each May three years following election. Unless the Board's Executive Committee requests an individual Trustee to continue serving, a Group Two Trustee who reaches age 72 is deemed to have resigned at the first annual meeting of the Board that follows the date that such Group Two Trustee reaches that age. The Bylaws permit Trustees Emeritus, Retired Trustees and Advisory Trustees to be designated from time to time. Such persons do not have the power to vote. The Bylaws require the Board to meet at least quarterly; currently, the Board meets bimonthly.

The current members of the Board, their offices (if any), their principal outside activity and their years of service are as follows:

Mrs. Barbara B. Allbritton	Executive Vice President and Director, Allbritton Communications	19
Robert H. Allen	Private Investor	30
John H. Baker, III	Baker Managers, L.L.C.	33
John F. Bookout, III	First Reserve	10
Robert T. Brockman	Chairman & CEO, Universal Computer Systems, Inc.	4
Philip Burguières	Chairman & CEO EMC Holdings	3
Pastor Kirbyjon Caldwell	Senior Pastor of the Windsor Village United Methodist Church	9
W. Fred Cameron	Retired Partner, Fulbright & Jaworski L.L.P.	10
James Y. Chao	Chairman, Westlake Chemical Corp.	4
James C. Flores	Chairman & CEO, Plains Exploration & Production	7
James T. Hackett, Vice Chair	President & CEO, Anadarko Petroleum Corp.	6
Larry P. Heard	President & CEO, Transwestern	1
Paul W. Hobby	Chairman, Hobby Media Services, Inc.	10
Ned S. Holmes	Chairman & CEO, Parkway Investments	8
Jack Hunt	President & CEO, King Ranch, Inc.	14
Jodie Lee Jiles	Managing Director, RBC Capital Markets	8
Carolyn Dineen King	Judge, US Court of Appeals, Fifth Circuit	3
Paul Klotman, M.D.	President & CEO, Baylor College of Medicine	1
C. Berdon Lawrence	Chairman, Kirby Corporation	7
Jack E. Little, Ph.D.	Retired President & CEO, Shell Oil Company and JEL Interests	11
Fred R. Lummis, Vice Chair	Managing Director, The CapStreet Group, L.L.C.	14
Drayton McLane, Jr.	Chairman, McLane Group, Chairman & CEO, Houston Astros Baseball Club	3
Robert C. McNair, Vice Chair	Chairman & CEO, Houston Texans	16
Trinidad Mendenhall Sosa	Mendenhall Foundation	8
John L. Nau, III	President & CEO, Silver Eagle Distributors L.P.	8
Lyndon L. Olson, Jr.	Senior Advisor, Citigroup, Inc.	6
R. Randall Onstead, Jr.	Onstead Interests	12
Thomas R. Powers	President, Tom and Pat Powers Foundation	3
Harry M. Reasoner	Senior Partner, Vinson & Elkins L.L.P.	18
Williams K. Robbins, Jr.	President & CEO, North American Corporation	1
Corbin Robertson, Jr.	President, Quintana Minerals Corporation	27
J. Hugh Roff, Jr.	Chairman, Roff Resources, L.L.C.	27
Ali A. Saberioon	President & CEO, Sabco Oil and Gas Corp.	4
Marc J. Shapiro, Chair of the BCM Board	Consultant, JPMorgan Chase Bank	20
Lester H. Smith	The Smith Foundation	6
H. Ben Taub	Taub Foundation	10
J. Adan Trevino	President & CEO, Amex Investments, Inc.	16
Louis A. Waters	SimDesk Technologies	35
Chuck Watson	Chairman of the Board, Eagle Energy Partners	9
Marvin L. West	President/Consultant, Risk Management Consultants	33
Charles A. Williams	President, Chaswil, Inc.	15
Wallace S. Wilson	Private Investor	10

Committees

The Board performs many of its functions through a series of committees made up of members of the Board. In addition to the Executive Committee, which has the full authority of the Board, the following Board committees exist: Audit; Buildings and Interiors; Compensation and Employee Benefits; Endowment, Development and Fine Arts; Finance; Governance and Nominating; Government Affairs; Investment; Risk Management, Insurance and Restructuring Oversight.

Conflict of Interest Policy

The Board of the College has adopted a formal conflict of interest policy to facilitate the identification and resolution of conflicts of interest. Some of the members of the Board of the College are associated with, or are investors in, businesses or firms with which the College has, from time to time, entered into transactions to provide goods or services. An affiliate of Citigroup is a counter party to certain interest rate swap transactions with the College. JPMorgan Chase Bank serves the College in a traditional banking capacity as depository and custodian, and also serves as a lender to the College under the \$50 million loan facility dated December 21, 2007, and as provider of an irrevocable letter of credit securing the payment of the Series 2008 E Bonds. Fulbright & Jaworski L.L.P. serves as Counsel to the College and bond counsel in connection with the Series 2008 Bonds and as counsel in connection with other ongoing matters. In the opinion of management of the College ("College Management"), the transactions between businesses or firms with which members of the Board are associated and the College are conducted on an "arm's length" basis.

Executive Leadership

President Paul Klotman, M.D., and his staff conduct the day-to-day operations of the College. Descriptions of Dr. Klotman and his staff are as follows:

Paul Klotman, M.D., assumed the post of President and CEO at Baylor College of Medicine Sept. 1, 2010. Dr. Klotman received his B.S. degree in 1972 from the University of Michigan and his M.D. from Indiana University in 1976. He completed his Medicine and Nephrology training at Duke University Medical Center. He stayed at Duke as a faculty member, rising to the rank of Associate Professor of Medicine before moving to the NIH in 1988 where he became Chief of the Molecular Medicine Section in the Laboratory of Developmental Biology. In 1993, he became Chief of the Viral Pathogenesis Laboratory in the NIDR/NIH. In 1994 he moved to Mt. Sinai School of Medicine as the Irene and Dr. Arthur M. Fishberg Professor of Medicine and the Chief, Division of Nephrology. In 2001, he was selected to be the Chairman of the Samuel Bronfman Department of Medicine. Dr. Klotman is a noted scientist whose work has included both basic and clinical research in molecular virology and AIDS pathogenesis. He has been an active clinician, teacher, and mentor. Students from his laboratory have won prestigious scientific competitions. He has trained over 50 clinical fellows, postdoctoral fellows, and students in his laboratory since 1984 most of whom are independently funded. Four of his mentees are now Chairs of Medicine and four others lead major institutes or centers. He has been listed in both Castle Connelly and New York Magazine as one of the region's Best Doctors. And, he was named Physician of the Year by Mt. Sinai nurses.

Stephen B. Greenberg, M.D., Dean of Medical Education. He also serves as chief of the Medicine Service at Ben Taub General Hospital and Distinguished Service Professor. He served as the chair of the Department of Medicine from 2004-2006. Greenberg received his medical training at the University of Maryland, where he was an Alpha Omega Alpha graduate. He completed his internship and residency in medicine at the University of Maryland Hospital, and his fellowship in infectious diseases at Baylor. He became a faculty member at Baylor, where he holds appointments as professor of medicine and professor of molecular virology and microbiology, and as the Herman Brown Teaching Professor at Ben Taub General Hospital. A recipient of numerous honors, including the Distinguished Faculty Award of the Baylor Alumni Association in 1999, he has been repeatedly listed in The Best Doctors in America®.

William R. Brinkley, Ph.D., Dean of The Graduate School of Biomedical Sciences at Baylor. He is a Distinguished Service Professor in the Department of Molecular and Cellular Biology and serves as co-director of the W. M. Keck Center for Computational Biology. Brinkley began his career at Baylor in 1976, as the director of the Division of Cell Structure and Function in the Department of Cell Biology. In 1985, he became chair of the Department of Cell Biology and director of the Gregory Fleming James Cystic Fibrosis Center at the University of Alabama at Birmingham. He returned to Baylor in his present position in 1991. As dean, he is interested in the training of future scientists and active in the curriculum development and analysis of career opportunities.

David Holcomb, Ed.D., Dean for Allied Health Sciences. Dr. Holcomb received a bachelor of science and a Master's of Education degree from Stephen F. Austin University and a Doctor of Education from the University of Houston. He completed his postdoctoral work at the University of Southern California. Dr. Holcomb has served on the College faculty for over 35 years.

Stephen K. Sigworth, M.D. Dr. Sigworth currently is the director of the Department of Medicine Faculty Practice Associates at Mount Sinai School of Medicine. In that role he is responsible for managing the operations for more than 250 physicians across six practice locations. He also has served as an assistant professor of medicine at Mount Sinai since joining the medical school faculty in 2003. From 1998 to 2003, he served as the medical director, care coordination at the Medical College of Virginia Hospitals. He received a bachelor's of science degree from the University of Richmond, and a medical degree and master's of science in health administration from the Medical College of Virginia. He completed his residency training in internal medicine at the Medical College of Virginia.

Adam Kuspa, Ph.D., Vice President for Research and Chair, Department of Biochemistry and Molecular Biology. Dr. Adam Kuspa was named chair of the Verna and Marrs McLean Department of Biochemistry in March 2006. A professor of biochemistry and molecular biology, Kuspa joined the BCM faculty in 1993 as an assistant professor of biochemistry. He has been involved in several research programs, including cell and molecular biology, development biology and molecular and human genetics, as well as the Human Genome Sequencing Center at BCM. He received his doctorate in biochemistry from Stanford University. He served a postdoctoral fellowship at the University of California at San Diego. In 2005, Kuspa received a Michael E. DeBaakey, M.D. Excellence in Research Award and was elected Fellow of the American Association for the Advancement of Science.

Lorie Tabak, MPH Prior to joining Baylor, Lorie Tabak was executive director of operations for the Department of Medicine at Mount Sinai School of Medicine. In that position she managed the comprehensive affairs of the department of more than 250 full-time faculty, 500 staff members and an annual budget in excess of \$100 million. Before accepting that post in 2006, she had served for five years as the director of operations for the Department of Medicine at Mount Sinai. Earlier positions at Mount Sinai included administrative manager of the Division of Nephrology and administrative manager the Division of Infectious Diseases. She joined Mount Sinai in 1997. Lorie Tabak, MPH received her bachelor's of science degree from McGill University in Montreal and master's in public health administration from Columbia University.

Kimberly C. David, C.P.A., M.B.A., Chief Financial Officer, has been with the College for more than nine years. Prior to joining the College in 1998, Ms. David worked at Arthur Anderson LLP for ten years in a variety of accounting and management positions. Trained as an accountant with her CPA, Ms. David graduated from Oklahoma State University with a Bachelor of Science degree in Accounting. Ms. David recently graduated from Rice University with a Masters in Business Administration.

Navneet Kathuria, M.D, MPH, MBA Earlier this year, Dr. Kathuria was named associate director of quality at Long Island Jewish Medical Center. Prior to that appointment, he had served as vice chair of the Department of Medicine at Mount Sinai School of Medicine since 2005. He has held additional faculty appointments at the College of Physicians and Surgeons of Columbia University, New York University School of Medicine and Yale University School of Medicine. He received a bachelor's of science degree from City College of New York, medical degree from Albany Medical College, master's of public health from Columbia University and

master's of business administration from the New York University. He completed residency training at New York University School of Medicine/Bellevue Hospital.

Stephen Spann, M.D., Vice President, Primary Care Network Development. Dr. Spann received his bachelor's degree at Baylor University and his medical degree at Baylor College of Medicine. He interned at Baylor affiliated hospitals and did his residency at Duke University School of Medicine in Chapel Hill, N.C. He came back to Baylor 1997 to serve as professor and chair of the school's Department of Family and Community Medicine. Prior to that, he served as an instructor in family medicine at Bowman Gray School of Medicine in Winston-Salem, N.C. He served as an assistant and then associate professor of family medicine at the Oklahoma University Health Center in Oklahoma City. From 1990-1997, he served as professor and chairman of the Department of Family Medicine at the University of Texas Medical Branch in Galveston. Spann is the author and co-author of many professional articles in his field and has written chapters in texts on family medicine in both Spanish and English.

Claire M. Bassett, Vice President for Public Affairs and Federal Government Relations. Ms Bassett, has been with the College for more than 26 years, having also served as Senior Director of Communications and Acting Chief Public Affairs Officer. She is a volunteer for the National American Heart Association and served as President of the Board of Directors of the Texas Society of Biomedical Research. In her current role, she oversees all areas of the College's Office of Public Affairs, including Media Relations and Communications, Publications and Creative Services, Institutional Web Management, and Federal Government Relations, and coordinates all international activities for the College.

Tom Kleinworth, Vice President, State Government Relations. Mr. Kleinworth joined the College in 1986. He oversees BCM's interactions with all areas of state government, including the Texas Legislature, statewide elected officials and state agencies such as the Higher Education Coordinating Board. A graduate of The University of Texas at Austin, Mr. Kleinworth worked as a newspaper reporter and editor in Memphis, Tennessee, then served five years as a legislative aide to a Texas state senator. Prior to joining the College, Mr. Kleinworth served as director of communications for the Texas Pharmacy Association.

Lisa Kennedy, Vice President of Development and Advancement. Ms. Kennedy joined the College in 1996 as Senior Director of Development. In that position, she played a key role in the successful completion of the College's Investment in Discovery Campaign. She was named Assistant Vice President and Interim Vice President in 2002 and Vice President in July 2003. Prior to joining the College, she spent four years as the Director of Corporate and Foundation Relations at Rice University and two years as the Director of Corporate Relations at Southern Methodist University. Ms. Kennedy also spent 14 years in sales, marketing, and management in the contract furniture market. She holds an undergraduate degree from Texas Tech University and an MLA from Southern Methodist University.

Rachel Caillouet, Ph.D., Vice President, Human Resources. Dr. Caillouet joined the College in 1999 after 10 years with Our Lady of the Lake Regional Medical Center ("**OLOL**"), in Baton Rouge, Louisiana, a part of the Franciscan Missionaries of Our Lady Health Care System. As Director of Human Resources for OLOL, Dr. Caillouet had responsibility for 4,000 employees. Dr. Caillouet holds a Ph.D. and M.A. in organizational communication, with specialties in crisis communication, change management, and organizational culture. Dr. Caillouet is a member of the Society of Human Resource Management and the American Society for Training and Development.

Jenifer Jarriel, M.B.A., Interim Chief Information Technology Officer. Ms. Jarriel has been with the College since May 1995. Before joining the College, she served as Vice President of Information Services for Texas Children's Hospital for four years. Prior to her work at Texas Children's, she served as Director of Information Services at Hermann Hospital, where she worked for eleven and one-half years. She is a member of the Board of Directors for LEARN (Lonestar Education and Research Network), a founding member of CHIME (College of Healthcare Information Management Executives), and a long-standing member of HIMSS (Health Information and Management Systems Society). Ms. Jarriel holds an undergraduate degree from the University of Houston Central Campus and an M.B.A. from Houston Baptist University.

Jerry A. Bell, J.D. Interim General Counsel. Mr. Bell received a Bachelor's degree B.A. with honors from the University of Texas and a law degree from the University of Texas Law School. Jerry Bell is head of Fulbright & Jaworski L.L.P.'s Health Law Business and Regulatory Department and practices in the firm's Austin office. He practices exclusively in the health care area where he represents hospitals, medical schools, health maintenance organizations (HMO), preferred provider organizations (PPO), physician groups, and other health care entities and providers.

CORPORATE STRUCTURE

General

The following entities are affiliated with the College:

Affiliated Medical Services ("AMS") is a Texas non-profit corporation that is exempt from federal income taxation under Section 501(a) of the Code by virtue of being an entity described in Section 501(c)(3) of the Code (a "tax exempt entity"). AMS is certified by the Texas Medical Board under Section 162.001 of the Texas Occupations Code. The College and The University of Texas System are the sole members of AMS. AMS was formed in 1988 to jointly negotiate for physician services with the Harris County Hospital District. Through AMS, the College and The University of Texas System supply the majority of residents and physicians to the hospitals and other health care facilities owned by the Harris County Hospital District. See **"PATIENT CARE"** and **"FINANCIAL INFORMATION."**

Baylor College of Medicine Healthcare, d/b/a BaylorMedcare ("Medcare") is a Texas non-profit corporation and tax exempt entity. The College is the sole member of Medcare. Medcare was formed in 1994 by the College for the purpose of centralizing the professional practices of the physicians within the academic departments of the College or physicians in the community in order to contract with third parties to provide health care services within the community. Medcare currently has contracts on behalf of College physicians with health care providers, self-insured employers, health maintenance organizations, health insurers, and other managed care entities.

Baylor College of Medicine International Pediatric AIDS Initiative ("Initiative") is a Texas non-profit corporation and tax exempt entity. The College is the sole member of Initiative. Initiative was formed to provide health care support for underserved children with AIDS. Initiative currently operates clinics and programs in the following countries: Romania, Botswana, Lesotho, Swaziland, Malawi, Uganda, Burkina Faso, Kenya, and Libya.

Baylor College of Medicine Radiology Associates ("Radiology") is a Texas non-profit corporation which is in the process of applying for federal tax-exempt status. The College is Radiology's sole member. Radiology is certified by the Texas Medical Board under Section 162.001 of the Texas Occupations Code and is organized to facilitate the delivery of professional radiological services. Radiology currently has no operations.

Baylor College of Medicine Shoulder to Shoulder Foundation ("Shoulder") is a Texas non-profit corporation and tax exempt entity. Baylor College of Medicine is the sole corporate member. Shoulder is an alliance with the Health Committee of Santa Ana, Honduras, and aims to improve health and the provision of health services for underserved people in the area of Santa Ana and Intibucá in Honduras.

BCM Technologies, Inc. ("Technologies") is a Delaware business corporation. The College directly and indirectly owns all shares of Technologies. Technologies was formed in 1983 for the purpose of commercializing technology and intellectual property developed by employees of the College, including investment in start-up technology companies.

BCM Technologies I, L.P. is a Delaware limited partnership formed to make venture capital investments in start up and emerging companies in medical / biomedical and healthcare.

BCM Ventures Management I, L.P. is the general partner of BCM Technologies, I L.P.

BCM Pathology Associates ("Pathology") is a Texas non-profit corporation. The College is Pathology's sole member. Pathology is certified by the Texas Medical Board under Section 162.001 of the Texas Occupations Code and is organized to facilitate the delivery of professional pathology services. Pathology currently has no operations.

Community Pathology PLLC, ("CPPLL") a Texas professional limited liability company wholly owned by Pathology, was formed to facilitate the acquisition of a professional pathology practice. CPPLL currently has no operations.

The Menninger Clinic ("Menninger Clinic") is a Texas non-profit corporation and tax exempt entity. The Menninger Clinic is dedicated to making a positive difference in the health and lives of adolescents and adults with severe psychiatric and dual disorders. Since its founding in 1925, the Menninger Clinic has provided treatment for more than 250,000 patients from the United States and around the world. Originally located in Topeka, Kan., the Menninger Clinic partnered with the College and The Methodist Hospital in 2002 and moved to Houston in June 2003. Residents from The Menninger Department of Psychiatry and Behavioral Sciences at the College complete portions of their advanced training at the Menninger Clinic. The Menninger Clinic hosts trainees from the College from the following programs: General Psychiatry Residency, Childs Psychiatry Residency, Psychology Internship Program, Social Work Internship Program, and Postgraduate Fellowship in Clinical Social Work.

National Space Biomedical Research Institute ("NSBRI") is a Texas non-profit corporation that is exempt from federal income taxation under Section 501(a) of the Code by reason of being an entity described in Section 501(c)(3) of the Code. The College is the sole member of NSBRI. NSBRI was formed in 1997 to perform biomedical and related research and to conduct educational programs at the request of the National Aeronautics and Space Administration. See "**RESEARCH.**"

In addition to the foregoing entities, the College has several unincorporated operating divisions, such as The DeBaKey Heart Center, the Children's Nutrition Research Center, the Shell Center for Gene Therapy, and the Influenza Research Center. The results of operations of these centers, along with the College's other research centers and operating divisions, are included in the Summary of Unrestricted Operating Activities of the College. See "**FINANCIAL INFORMATION.**"

In addition, the College receives support from Baylor Medical Foundation (the "**Foundation**"). The Foundation was organized in 1962 exclusively to aid, support and maintain the College. The Foundation is a Texas non-profit corporation and tax exempt entity. Income from endowment funds held by the Foundation is dedicated to the College and, historically, each year the Foundation transfers to the College all investment income of the Foundation. A separate Board governs the Foundation. In the event of the Foundation's dissolution, the Foundation is required to transfer to the College any funds or property that it then owns. The College's interest in the net assets of the Foundation of approximately \$24 million as of June 30, 2010, is included in the Balance Sheet contained in the financial statements set forth in **APPENDIX B.**

EDUCATION

Medical School Education

More than 17,000 physicians and allied health professionals have received all or part of their training, either as students or residents, at the College. These alumni are in private practice, serve on the faculty of medical schools, or conduct research throughout the 50 states and 37 foreign countries.

In 1969, the Texas Legislature enacted legislation (the "**Appropriation Legislation**") which authorizes the Texas Higher Education Coordinating Board (the "**HECB**") to contract with the College for the administration, direction, and performance of services and the provision, maintenance, operation, and repair of buildings, facilities, structures, equipment, and materials necessary to the education, training, preparation or instruction of Texas resident undergraduate medical students. Pursuant to the Appropriation Legislation, each year the College and HECB enter into a contract pursuant to which the College is paid, if such amounts are appropriated by the Texas Legislature

biannually, an amount per Texas resident undergraduate medical student enrolled at the College that is computed by reference to the amount of money appropriated to certain state-supported medical schools. Pursuant to the Appropriation Legislation and the contract in effect between the College and HECB for the two-year period commencing September 1, 2009, the College is to be paid approximately \$40.2 million in fiscal year 2010 and \$43.1 million in fiscal year 2011 based on the number of Texas resident undergraduate medical students enrolled at the College. The legislature appropriated \$40.2 million in fiscal year 2010 and \$43.1 million in fiscal year 2011 to fund the two contract years beginning September, 2009. See **"FINANCIAL INFORMATION."**

The College's excellent reputation and quality teaching facilities consistently attract the best medical students from throughout the United States. In fiscal 2010, the College received 4,588 applications for 187 positions in the entering medical class. The average grade point average for the fall 2009 entering class was 3.8. The 678 medical students currently enrolled represent more than 70 undergraduate schools.

Graduate Medical Education

Top medical school graduates from the United States and many foreign countries also are attracted to the College for advanced training in the Graduate Medical Education ("**GME**") program. With 919 resident physicians, the College's GME program is one of the largest in the country and offers training in 81 Accreditation Council for Graduate Medical Education programs.

With an enrollment of 562, the College's Graduate School for Biomedical Sciences also attracts outstanding students who are seeking advanced degrees in the biomedical sciences. The Graduate School's nine Ph.D. programs and five interdepartmental programs focus on training and research in the basic sciences for students pursuing careers in research and as medical school and university teachers. A joint M.D./Ph.D. program is also available to selected students pursuing academic careers. Currently, 78 students are enrolled in this program.

The College has 562 students enrolled in its postdoctoral research and training program and 403 clinical fellows (M.D.). This program offers postdoctoral fellowships to outstanding students who have received advanced degrees and want to pursue research and clinical activities at an even higher level.

The College also offers joint M.D./M.B.A. and Ph.D./M.B.A. programs with the Jesse H. Jones Graduate School of Management at Rice University.

Other Educational Programs

The College sponsors continuing medical education courses. These courses provide physicians with the latest information in their medical specialties. In 2010, over 3,500 practicing physicians attended formal continuing medical education courses sponsored by the College.

The College offers Masters of Science degrees in both Nurse Anesthesia and Physician Assistant Studies. Enrollment in these degree programs for the allied health professions has been stable and highly competitive.

The Medical Scholars Program, established jointly by the College and Rice University, accepts 15 outstanding high school graduates entering Rice each year. After satisfactorily completing broad-based undergraduate degree requirements at Rice, these students are automatically accepted as medical students at the College. Similar programs exist with Baylor University, the University of Houston and The University of Texas-Pan American.

The College maintains a partnership with the school districts in Houston, Mercedes, Corpus Christi and Laredo, Texas to sponsor high schools for students with career interests in medicine and science.

Student Enrollment

The College receives many more applications than there are allowable places and is thus able to be highly selective in the admissions process. With certain exceptions, the allowable places annually include: 187 medical students and 57 allied health (42 physicians assistants and 15 nurse anesthetists). The College is ranked 10th in the nation for student selectivity.

Medical Students	2008	2009	2010
Number of Applicants	4,922	4,879	4,588
Number Accepted	297	300	340
Number Admitted	172	176	187
Mean MCAT Score ⁽¹⁾	11.6	11.5	11.2
Graduate Students	2008	2009	2010
Number of Applicants	1,075	1,134	1,178
Number Accepted	201	231	220
Number Admitted	98	107	108
Allied Health	2008	2009	2010
Number of Applicants	660	831	844
Number Accepted	63	69	74
Number Enrolled	50	50	57

⁽¹⁾The Mean MCAT Score is for students admitted. The MCAT is given in three parts. The maximum score for each part is 15 points. Scores are given as an average of the three parts. For the 2009 MCAT exams, the national Mean for Matriculants was 10.3.

Source: College Management

Faculty

As of June 30, 2010, the College employed 2,003 full-time faculty members and 338 part-time faculty members. The following table depicts the number of faculty members in each position for June 30, 2009 and June 30, 2010:

	June 30, 2009	June 30, 2010	Change
Professor-Tenured	355	349	-6
Professor-Non-Tenured	46	48	2
Associate Professor-Tenured	183	158	-25
Associate Professor-Non-Tenured	237	255	18
Assistant Professor-Tenured-Track	447	465	18
Assistant Professor-Non-Tenured-Track	688	737	49
Instructors	<u>345</u>	<u>329</u>	<u>-16</u>
TOTAL	<u>2,301</u>	<u>2,341</u>	<u>40</u>

Source: College Management

Accreditation

The College is accredited by:

- The Liaison Committee on Medical Education, joint committee representing American Medical Association and Association of American Medical Colleges,
- The Commission on Colleges of the Southern Association of Colleges and Schools to award masters and doctorate degrees (M.D., Ph.D., M.S.),
- The Accreditation Review Committee on Education for the Physician Assistant, Inc.,
- The American College of Nurse Midwives,
- The Council on Accreditation of Nurse Anesthesia Educational Programs,
- The Accreditation Council for Continuing Medical Education, and
- The Accreditation Council for Graduate Medical Education.

RESEARCH

For more than 30 years, the College has been recognized as a national leader in biomedical research. The College's total research expenditures have grown from \$17 million in 1971 to more than \$302 million in 2010. The College consistently ranks in the top 10% of the 126 U.S. medical schools in competitive research grants to faculty. The College ranks first among medical schools in Texas in research expenditures.

Much of the research is performed in the College's national research centers, the privately-funded Howard Hughes Medical Institute and the College's more than 70 specialty centers:

- The Influenza Research Center, located at the College since 1974, conducts studies on the ever-changing flu and respiratory viruses that affect people throughout the world.
- The Children's Nutrition Research Center is the only federally-funded nutrition center devoted to studying the nutritional needs of children. Its annual funding exceeds \$11 million.
- The DeBakey Heart Center, established in 1985 and supported in part by private endowment, is the site of some of the country's most intensive research on cardiovascular disease.
- The Shell Center for Gene Therapy, established in 1993 and supported in part by private endowment, combines basic research on gene therapy with clinical applications.

The Howard Hughes Medical Institute (the "***Institute***") conducts research activities in Institute laboratories at over 60 medical centers, teaching hospitals and university campuses, including the College. Currently, the Institute employs four faculty members at the College. Pursuant to a collaborative research agreement with the College, research is conducted by Institute investigators at the College primarily in the fields of genetics and structural biology and, more recently, in immunology and neuroscience.

The College is also the site of major ongoing national research projects funded by the federal government.

The College is:

- One of only three U.S. institutions to house two NIH Heart, Lung and Blood Special Centers of Research;
- One of two NIH-funded Specialized Programs of Research Excellence to study prostate cancer through the Matsunaga-Conte Prostate Cancer Research Center; and

- One of 40 centers chosen by the NIH to participate in the Women's Health Initiative-the first comprehensive study of women's health undertaken in the United States.

The Dan L. Duncan Cancer Center at Baylor College of Medicine (the "***Duncan Cancer Center***") is organized around eight major programs of excellence, including cell and gene therapy, cancer prevention and population sciences, molecular carcinogenesis, nuclear receptor biology, breast cancer, pediatric oncology, cancer biology and prostate cancer. Faculty members represent 28 departments or centers from across the College. The College has been developing its cancer center since 1997, building programs in research and patient care. In early 2006, Dan L. Duncan, businessman and philanthropist, contributed \$100 million to the center. More than 100,000 square feet is currently dedicated to cancer research and additional space has been established in the new Margaret M. Alkek Building for Biomedical Research. The College receives approximately \$100 million per year in cancer-related research funding with about \$37.8 million from the National Cancer Institute ("***NCI***"). The Duncan Cancer Center has been named a designated cancer center by the NCI. The NCI designation is a milestone for cancer programs across the country and recognizes the College's scientific and clinical excellence. Only 63 cancer centers have achieved such status in the United States, and only three are in Texas. The Duncan Cancer Center joins M.D. Anderson Cancer Center in Houston as the only two designated cancer centers in Houston. As part of the designation, the Duncan Cancer Center will receive up to \$3 million over the next three years. Cancer treatment will be one of the major patient services at the new Baylor Clinic and Hospital, which will open in 2011.

The College is the lead institution and home of the National Space Biomedical Research Institute, a consortium of academic institutions charged with enhancing the nation's expertise in the space life sciences through understanding the basic mechanisms that produce the biological and physiological effects of microgravity; and producing countermeasures to mitigate these effects and ensure safe, long duration human space flight.

College Management believes the College's relationships with entities providing research funding are positive and does not anticipate a decrease in such funding.

PATIENT CARE

Affiliated Hospitals

The College's undergraduate medical students and resident physicians in the Graduate Medical Education training program learn and work primarily in eight teaching hospitals with which the College has contracts to provide residents and physicians. These eight affiliated teaching hospitals have a combined total of approximately 4,600 licensed beds. These state-of-the-art facilities provide the College's students and residents unsurpassed educational surroundings for clinical and research training.

The College's physicians, students, and residents see inpatients and outpatients each year in these affiliated teaching hospitals and their clinics. Set forth below is a list of the affiliated teaching hospitals with which the College has contractual agreements to supply physicians and services. Information in the following descriptions is derived from the websites of the respective institutions and other public information.

Ben Taub General Hospital ("***Ben Taub***"), part of the Harris County Hospital District, is a 650-bed medical and surgical hospital that is nationally recognized for its Level I trauma center. The acute care facilities have psychiatric and pediatric emergency centers, and 12 operating rooms. Nearly 40 percent of the College's resident physicians are trained at Ben Taub and 11 community centers, which are also part of the Harris County Hospital District.

Memorial Hermann - The Institute for Rehabilitation and Research ("***TIRR***") is a 116-bed rehabilitation hospital located in the Texas Medical Center, with associated outpatient services in the community. One of the top five rehabilitation facilities in the country, TIRR focuses on providing care to individuals who have experienced catastrophic injuries or illnesses.

St. Luke's Episcopal Hospital ("***St. Luke's***"), founded by the Episcopal Diocese of Texas in 1954, delivers primary and tertiary health care to patients throughout the Houston metropolitan area and from around the world. St. Luke's

is licensed for 912 beds with 718 beds in service; the nonprofit hospital cares for more than 30,000 inpatients and 220,000 outpatients each year. St. Luke's is a teaching hospital with a medical staff of nearly 600 physicians.

Texas Children's Hospital, licensed for 639 beds, is one of the nation's largest pediatric hospitals. Its physicians treat infants, children, and adolescents, and its units specialize in the diagnosis and treatment of rare disorders. Almost all of the geographically based physicians at Texas Children's Hospital are members of the College's full-time faculty. More than 40 medical and surgical outpatient services are available to children. On April 10, 2008 Ralph Feigin announced that he has approached the leadership of Texas Children's Hospital and Baylor College of Medicine about seeking his successor as Physician-in-Chief of Texas Children's Hospital and Chair of the Department of Pediatrics at Baylor College of Medicine. Dr. Feigin will continue to serve as Physician-in-Chief and Chair of Pediatrics until a successor is named. Following the naming of a successor, he will continue to serve as a professor in the Department of Pediatrics at Baylor and as a pediatrician at Texas Children's Hospital.

The Methodist Hospital ("**Methodist**") is one of the nation's largest private, non-profit hospitals with 1,269 beds. The hospital records approximately 40,500 inpatients each year, and another 327,000 outpatients receive care annually.

The Michael E. DeBakey Veterans Affairs Medical Center ("**MEDVAMC**") has been affiliated with the College since 1949. Today, with 319 acute care, medical, intermediate medicine, and surgical beds and a 120-bed nursing home, it is one of the Veteran's Administration's largest hospitals, serving Harris County and 27 surrounding counties.

Baylor department chairmen and top administrators from the Veteran's Administration serve on the Deans Committee at MEDVAMC to set medical care standards and advise on education and research programs at MEDVAMC. The committee recommends measures to assure that the highest quality of medical care is delivered to the veteran patients. Members of the College's faculty serve as medical service chiefs at the hospital.

M. D. Anderson Cancer Center is one of the world's most respected centers devoted exclusively to cancer patient care, research, education, and prevention. It has ranked among the nation's top two cancer hospitals in U.S. News & World Report's "America's Best Hospitals" survey since the survey's inception 17 years ago.

The College and its affiliated teaching hospitals have entered into formal contracts that govern the payments to be made to the College and other matters. These contracts are negotiated and renewed on a periodic basis. In fiscal year 2010, payments made to the College pursuant to these agreements accounted for 31% of the College's operating revenues, with no more than 33% of these payments coming from any one entity. In addition, certain members of the College's Executive Leadership have medical staff or management appointments at the affiliated teaching hospitals. The following information for the College's affiliated teaching hospitals includes patients who are not treated by the College's physicians and students. The most recent admissions and visit information available from the College's affiliated hospitals is summarized in the table below:

<u>Hospital Name</u>	<u>Total Admissions</u>	<u>Outpatient Visits</u>
St. Luke's Episcopal Hospital	29,000	200,000
The Methodist Hospital	39,525	308,749
Texas Children's Hospital	22,000	330,000
M.D. Anderson Cancer Center	23,277	1,055,092
Ben Taub General Hospital ⁽¹⁾	24,600	184,000
MEDVAMC	13,399	815,695
Memorial Hermann-TIRR	1,181	56,181
Menninger	1,010	N/A

Source: Teaching Hospitals' Records for each Hospital's most current fiscal year

⁽¹⁾ Although the College provides services to multiple facilities of the Harris County Hospital District, information shown above is solely for Ben Taub General Hospital and does not include the other Harris County District facilities at which the College

provides services.

Other Cooperating Patient Care Institutions

In addition to the affiliated teaching hospitals described above, the College's students, residents and physicians also provide health care services to other hospitals, private hospitals, and sub-acute facilities, including the following:

Community Health Centers
Cullen Bayou Place
DePelchin Children's Center
Houston Child Guidance Center
Jewish Family Service
Kelsey-Seybold Clinic

Park Plaza Hospital
Quentin Mease Hospital
Seven Acres Jewish Geriatric Center
Shriners Hospital for Children
Thomas Street AIDS Clinic
The Women's Hospital of Texas

HISTORICAL ACHIEVEMENTS AT THE COLLEGE

The following list summarizes what College Management believes are historical achievements in education, research and patient care at the College:

- 1949 • Dr. Michael E. DeBakey begins a program of innovative cardiovascular surgery.
- 1953 • Dr. DeBakey invents the Dacron graft.
- 1955 • The College's affiliated hospital residency program is created.
- 1961 • The World Health Organization Collaborating Center for Virus Reference and Research is established at the College.
- 1964 • Dr. DeBakey performs the first successful coronary artery bypass operation.
 - The Jesse H. Jones Hall, M.D. Anderson Hall, and the Jewish Institute for Medical Research are added to the College's East Campus.
- 1971 • The College begins a Physician Assistant Program to train students focused on a career in the allied health profession.
- 1972 • The College and the Houston ISD create the nation's first High School for Health Professions.
- 1974 • The College is designated the National Influenza Research Center and the National Heart and Blood Vessel Research and Demonstration Center.
- 1977 • The College begins the M.D./PhD. program for students interested in medicine and research.
 - Dr. Roger Guillemin receives the Nobel Prize in Medicine for research conducted during his tenure as a College faculty member.
- 1978 • The College researchers achieve a first in recombinant DNA research: extraction, purification and cloning of Escherichia coli bacteria.

- The nation's first Children's Nutrition Research Center is opened in collaboration with the U.S. Department of Agriculture and Texas Children's Hospital.
- 1982 • The Michael E. DeBakey Center for Biomedical Education and Research building opens.
- 1983 • BCM Technologies, Inc., is established to take faculty research developments to the marketplace.
- 1986 • The Ben Taub Research Center opens to provide additional research space for the College faculty.
- 1988 • The Vivian and Bob Smith Medical Research Building opens.
- A Federally funded Children's Nutrition Research Center building opens.
- 1990 • The College and Rice University establish a Medical Scholars Program to simultaneously accept students to both institutions for a seamless 8-year program for students interested in becoming physicians.
- 1991 • The College is designated as a national Human Genome Sequencing Center to complete the mapping of the human genome.
- The Center for Gene Therapy is created.
- The AIDS Research Center is established.
- 1992 • The Science Academy of South Texas is formed by the College, Rice University and the South Texas ISD.
- 1993 • The gene for Severe Combined Immune Deficiency disease, which resulted in the death of David, the Bubble Boy, is discovered by consortium of scientists at the College and NIH.
- 1994 • The College is designated as a site for the national Women's Health Initiative, the first large scale study of women's health issues.
- 1997 • The National Space Biomedical Research Institute is established with the College serving as the lead of the consortium of 12 institutions.
- 1998 • Surgeons in Germany implant the first MicroMed Ventricular Assist Device developed by Dr. DeBakey.
- The Center for Cell and Gene Therapy is established.
- 1999 • The gene that causes Rett Syndrome, a disease that robs healthy girls of language and mental function, is discovered at the College.
- 2001 • The Vannie Cook Children's Cancer Center, a joint project of the College and Texas Children's Hospital, opens in McAllen to provide care to children with cancer in South Texas.
- Baylor International Pediatric AIDS Initiative begins to provide care to children in third world countries.
- 2002 • The Menninger Clinic announces it will move to Houston and partner with the College and The Methodist Hospital to provide mental health services.
- The College physicians perform islet cell transplant to "cure" patient of diabetes.
- 2003 • Dr. Lawrence Chan develops the first successful gene therapy for diabetes in mice.

- Human Neuroimaging Lab opens to study brain function.
- 2004
- Alliance for NanoHealth is created with consortium of the College, Rice University, University of Houston, M.D. Anderson, University of Texas Medical Branch at Galveston, and The University of Texas Health Science Center.
 - The College and the University of Houston create a joint program to offer a combined M.D./J.D. degree.
- 2005
- Blood pressure drug that may prevent osteoporosis is identified at the College.
 - Research at the College shows for the first time when and where "trust" is formed in the brain.
- 2006
- Establishment of Baylor Pediatric AIDS Corps to care for the HIV-positive children in Africa.
 - Genetic cause of cardiomyopathy and sudden death in young adults identified at the College.
 - The College is awarded four-year \$114 million grant for gene sequencing.
 - The College is awarded first and only NIH quantum grant for stroke research.
- 2007
- Rhesus macaque genome is mapped at the College.
- 2008
- Dr. DeBakey is awarded the Congressional Gold Medal, the nation's highest civilian honor.

PHYSICAL PLANT

The College's campus began in 1947 with the construction of The Roy and Lillie Cullen Building (the "**Cullen Building**"). The Cullen Building served as the center for education, research and many outpatient clinics for almost 20 years. Today, the Cullen Building serves as the primary location for the College's administrative offices and also houses departmental offices and research facilities. Basic research laboratories and departmental offices are also housed in Anderson Hall, Jones Hall and the Jewish Institute. In 1982, a new Cullen Building main entry, including the Alkek Fountain and circular drive, was constructed.

The Jesse H. Jones Hall, M.D. Anderson Hall and the Jewish Institute for Medical Research were added to the Cullen Building in 1964. The adjoining Michael E. DeBakey Center for Biomedical Education and Research was occupied in 1980. The DeBakey Center is divided between basic science teaching facilities for medical students and research laboratories. Teaching facilities include modern anatomy laboratories, two 300-seat auditoriums, multi-disciplinary teaching labs, classrooms and a learning resources center.

The Ben Taub Research Center, completed in 1986, and the Vivian and Bob Smith Medical Research Building, dedicated in 1989, are twin nine-story research towers joined to the Cullen Building complex. The Ben Taub Research Center and the Vivian and Bob Smith Medical Research Building house facilities primarily dedicated to biomedical research. The Smith Building houses one of the nation's Human Genome Centers.

Apart from the main complex, the College has facilities located throughout the Texas Medical Center. More than 4 million gross square feet (GSF) is located on the Main campus (1.7 million GSF) and satellite facilities (2.3 million GSF). The Neurosensory Center and the Alkek Tower are joint projects of the College and The Methodist Hospital. Dedicated in 1977, the Neurosensory Center is an eleven-story research, teaching and patient-care facility that serves the Departments of Ophthalmology, Neurology, and Otolaryngology and Communicative Sciences. The Alkek Tower, completed in 1978, is a four-story addition to Methodist's Brown Cardiovascular Research and Training Center.

The nation's only Children's Nutrition Research Center ("**CNRC**"), established in 1979, is operated by the College in cooperation with Texas Children's Hospital for the United States Department of Agriculture. The CNRC

establishes the nutritional requirements of children from infancy through adolescence, as well as those of pregnant and nursing women. An 11-story facility at the corner of Fannin and Holcombe was completed in 1988 to house all CNRC research. The facility was funded by the United States Department of Agriculture.

Construction of the 16-story Albert B. Alkek Graduate School building was substantially completed in 1997 and includes the Graduate School of Biomedical Sciences, Office of Admissions, the Office of Scholarships & Student Financial Planning, numerous research laboratories, lecture rooms, and a 176-seat auditorium. Completion of such building was paid, in part, out of the proceeds of the Series 1999 Bonds. During the years 1997 through 2003 eleven floors of the building were built out for basic science laboratory use.

The Margaret M. Alkek Building for Biomedical Research was completed and occupied in January 2008. The research tower is eight stories high with 170,000 square feet for research and research support facilities.

College faculty members currently serve patients at the Baylor Clinic located at 6620 Main. The facilities at that location are leased from St. Luke's Episcopal Hospital.

College ophthalmology physicians serve patients at a building at the northeast corner of the McNair Campus. The new building opened in the fall of 2008.

FINANCIAL INFORMATION

Sources of Revenue

The mission of the College involves education, research, patient care and community services. The following table shows the approximate percentages, as derived from the audited financial statements, of unrestricted operating revenues from these activities for the three fiscal years ended June 30, 2010.

	Fiscal Years Ended June 30,		
	2008	2009	2010
Education	9%	8%	8%
Research	34%	32%	32%
Medical Services	28%	22%	19%
Affiliated Hospitals	18%	27%	31%
Other	11%	11%	10%
TOTAL	100%	100%	100%

Revenues derived from education represent, tuition, fees, and state appropriations through a contract with the Texas Higher Education Coordinating Board (see "**EDUCATION**"). Revenues derived from research are from unrestricted grants and awards from federal, state and private sources (see "**RESEARCH**"). Revenues derived from medical services are fees paid to the College by patients or third party payers for medical services provided by physician employees of the College to such patients. Revenues derived from affiliated hospitals are revenues received as contractual payments by affiliated institutions for the provision of doctors and residents in those institutions (see "**PATIENT CARE**"). Revenues derived from other sources include gifts and investment and endowment income (see "**INVESTMENT CONSIDERATIONS**") for a discussion of how these sources of revenue could change in the future.

Cash and Investments

The following table (dollars in thousands) sets forth the cash and investment holdings of the College, as of the ends of the fiscal years ended June 30, 2008, 2009 and 2010.

	June 30,		
	2008	2009	2010
Cash and Cash Equivalents	\$61,609	\$51,762	\$17,618
Investments (at fair market value)	1,132,799	757,229	824,581
TOTAL	\$1,194,408	\$808,991	\$842,199

The College's portfolio of investments is managed by professional portfolio managers under the guidance of the Investment Committee of the Board (the "***Investment Committee***"). The Investment Committee determines the asset allocation of the College's portfolio of investments based upon the current income needs of the College's various departments, overall domestic economic conditions, investment preferences, and risk tolerance. As of June 30, 2010 approximately 38.7% of the College's investment portfolio was allocated to U.S. Equity Securities, 15.3% to Fixed Income Securities, 12.2% to International Equities, 6.7% Emerging Markets, 21.4% to Private Equities and 5.7% to High Yield Securities. Currently, the investment policy of the College does not allow for investment in Derivative Securities.

Endowment

The following table (dollars in thousands) sets forth the endowment of the College as of the end of the fiscal years ended June 30, 2008, 2009 and 2010, including the historical cost and market value of the endowment as of such dates. See "**FINANCIAL INFORMATION – Cash and Investments.**"

	June 30,		
	2008	2009	2010
Market	\$1,132,799	\$757,229	\$824,581
Cost	845,906	706,942	772,971

Contributions to the College

The following table (dollars in thousands) sets forth the restricted and unrestricted contributions received by the College for the fiscal years ended June 30, 2008, 2009 and 2010.

2008	2009	2010
\$83,173	\$77,642	\$21,182

Since its formation, the College has sponsored a series of fundraising campaigns to raise money for the College's various departments, programs, and services. On May 23, 2007, the College formally announced its \$1 billion Best Minds Best Medicine Campaign. The campaign started with a silent phase in July 2003, and has now raised more than \$767 million in pledges.

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Summary of Revenue and Expenses (Fiscal Year)

The following table (dollars in thousands) sets forth a comparative summary of revenues and expenses for the two fiscal years ended June 30, 2009 through 2010, derived from the audited consolidated financial statements of the College, followed by Management's Discussion and Analysis. These summaries should be considered in conjunction with the complete audited consolidated financial statements for the fiscal years ended June 30, 2009 and 2010, set Forth in **APPENDIX B**.

	Fiscal Year Ended June 30,	
	2009	2010
Operating Revenues		
Tuition and fees	\$20,482	\$22,652
Less: Institutional scholarships	<u>(12,044)</u>	<u>(12,064)</u>
Net tuition and fees	8,438	10,588
State appropriations	41,727	49,574
Government and private grants and contracts:		
Direct recoveries	308,807	315,624
Indirect recoveries	65,043	68,372
Medical services	247,878	224,257
Affiliated hospital contracts	306,496	367,157
Investment income distribution and other	58,430	52,269
Equipment acquired through grants, contracts, and gifts	8,568	11,876
Contributions	28,524	18,299
Net assets released from restrictions	37,358	34,953
Other sources	<u>43,481</u>	<u>39,262</u>
Total Operating Revenues	1,154,750	1,192,231
Operating Expenses		
Salaries, wages and benefits	797,609	830,610
Services, supplies and other	345,385	316,005
Depreciation	65,806	64,220
Interest	<u>18,675</u>	<u>21,137</u>
Total Operating Expenses	1,227,475	1,231,972
Revenues Under Expenses	<u>(72,725)</u>	<u>(39,741)</u>
Non-Operating Activities		
Contributions	2,927	2,747
Investment (loss) income, net of distribution	(154,521)	43,480
Unrealized loss on bond swaps	(52,878)	(33,536)
Non-equipment assets acquired through grants, contracts and gifts	(254)	(79)
Losses on disposals and write-downs of property and equipment	(1,989)	(1,962)
Net assets released from restrictions	1,562	790
Retirement of bond original issue costs	(3,579)	(6,586)
Impairment losses on capital projects	(57,000)	(23,000)
Net asset reclassification based on change in law		
(Decrease)Increase in Unrestricted Net Assets from Non-Operating Activities	<u>(265,732)</u>	<u>(18,146)</u>
Increase (Decrease) in Unrestricted Net Assets	<u>(338,457)</u>	<u>(57,887)</u>
Temporarily Restricted Net Assets		
Contributions	30,185	(6,283)
Net assets released from restrictions	(38,920)	(35,742)
Investment Income (Loss)	<u>(129,412)</u>	<u>17,734</u>
Net asset reclassification based on change in law		
Increase (Decrease) in Temporarily Restricted Net Assets	<u>(138,147)</u>	<u>(24,291)</u>
Permanently Restricted in Net Assets		
Contributions (Loss)	16,006	6,419
Investment Income Net of distributions	<u>(5,537)</u>	<u>1,379</u>
Increase in Permanently Restricted Net Assets	<u>10,469</u>	<u>7,798</u>
Increase (Decrease) in Net Assets	(466,135)	(74,380)
Net Assets, beginning of year	1,430,995	964,860
Net Assets, end of year	\$964,860	\$890,480

Management's Discussion and Analysis

Fiscal Years ended June 30, 2009 and 2010. The College's revenues under expenses for the year ended June 30, 2010 were \$39.7 million compared to revenues under expenses in fiscal year 2009 of \$72.7 million. For the year ended June 30, 2010 to the year ended June 30, 2009 operating revenues increased \$37.5 million or 3.3%, while operating expenses increased \$4.5 million or .4%.

Direct recoveries increased \$6.8 million or 2.2% for fiscal year 2010 compared to the same period for fiscal year 2009, while indirect recoveries increased \$3.3 million or 5.1%. Medical Services Revenue decreased \$23.6 million or 9.5%. Affiliated hospital contracts increased \$60.7 million or 19.8%. Investment Income distributed from endowment decreased \$6.2 million or 11%. Net assets released from restrictions decreased \$2.4 million or 6.4%. Operating contributions for fiscal year 2010 decreased \$10.2 million or 36% compared to fiscal year 2009. Temporarily restricted contributions were down \$36.5 million or 121% for the comparable periods; permanently restricted contributions decreased \$9.6 million or 60%.

Operating expenses increased \$4.5 million in fiscal year 2010 compared to fiscal year 2009 and consisted principally of increases of \$33 million in salary and benefits and, decreased \$29 million in services, supplies and other. These increases are the result of normal growth at the College. The remaining operating expense increases for fiscal year 2010 compared to fiscal year 2009 were the result of increased interest expenses related to increasing interest rates on the College's variable rate debt.

The decrease in unrestricted net assets for the year ended June 30, 2010 was \$58 million compared to a \$347.2 million decrease for fiscal year 2009.

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INTEREST RATE SWAPS

General

The College follows a board-approved policy for its use of interest rate swaps, caps, options, basis swaps, rate locks, total return swaps, and other similar derivative products. The policy authorizes such derivative products to be used only with board authority and only to achieve a specific objective consistent with the College's overall debt and investment management policy and not for speculation. Under the policy, the College's total variable rate exposure, net of derivatives transactions which have the economic effect of reducing (or increasing) variable rate exposure, may not exceed an amount to be determined by the Board from time to time (currently 40-70%). The policy requires that the College enter into derivatives transactions only with counterparties that are rated in the "A" category or above or that provide collateral or additional guarantees. In addition, the policy provides that the College is to include terms in derivatives transactions to mitigate and offset its exposure to counterparty risk, including ratings-based termination events. The chief financial officer prepares periodic reports on the status of the College's derivatives transactions, including a summary of transaction terms, the credit ratings of the counterparties, the value of posted collateral, the market value of the transactions, and cumulative and periodic cash flows.

Interest Rate Swap Transactions

The College entered into a 30-year interest rate swap transaction (the "**2005 Swap Transaction**") with Citibank, N.A., New York (the "**Swap Provider**"), on May 13, 2005, to substantially hedge the College's interest expense associated with the subsequently issued Series 2005A Bonds. Under the 2005 Swap Transaction, the College pays amounts computed at a fixed rate of 3.395% per annum, and the Swap Provider pays amounts computed at a floating rate equal to 67% of one-month LIBOR, in each case times the notional amount of the transaction, and the two parties' payments are netted. The initial notional amount of the swap was \$125,000,000 and was to be reduced proportionately each year, beginning in November of 2009, at the rate at which the Series 2005A Bonds were to be retired through mandatory sinking fund redemption. The College's scheduled net payment obligations under the 2005 Swap Transaction were insured by a financial guaranty insurance policy issued by Ambac Assurance Corporation ("**Ambac**").

In anticipation of the issuance of the Series 2007A Bonds, the College entered into interest rate swap transactions (the "**2007 Swap Transactions**") with the Swap Provider in order to substantially fix the College's expected net interest expenses associated with the Series 2007A Bonds. After redeeming a portion of the Series 2007A Bonds, the College maintained the 2007A Swap Transactions as a hedge of its interest expense for the Series 2007A Bonds that were not being redeemed and the variable rate demand bonds issued to partially refund the Series 2007A Bonds. The aggregate notional amount of the 2007 Swap Transactions is equal to the aggregate amount of the unredeemed Series 2007A Bonds and such refunding bonds scheduled to remain outstanding in each period (currently \$400,000,000). The College's net payment obligations under the 2007 Swap Transactions were insured by Ambac but Citibank N.A. released that policy in 2008.

With respect to a notional amount of \$300,000,000, the 2007 Swap Transactions provide that, subject to the terms thereof, the College is obligated to make payments to the Swap Provider at a fixed rate of 4.125% per annum, and the Swap Provider is obligated to make reciprocal floating rate payments calculated on the same notional amount at a rate equal to 70% of a taxable short-term interest rate index - the U S dollar one-month LIBOR rate reset weekly. With respect to a notional amount of \$100,000,000, the 2007 Swap Transactions provide that, subject to the terms thereof, the College is obligated to make payments to the Swap Provider at a fixed rate of 3.833% per annum, and the Swap Provider is obligated to make reciprocal floating rate payments calculated on the same notional amount at a rate equal to 70% of 'a taxable short-term interest rate index -- the U.S. dollar one-month LIBOR rate reset weekly.

Under both the 2005 Swap Transaction and the 2007 Swap Transaction (the "**Swap Transactions**") net payments by the College or the Swap Provider as applicable, are payable monthly. The floating rate which the College receives pursuant to the Swap Transactions may be greater or less than the interest rate on the bonds that they are intended to hedge.

The Swap Transactions may be terminated prior to the maturity of the hedged bonds under certain circumstances. If a Swap Transaction is terminated under certain market conditions, the College may owe a termination payment to the Swap Provider or the Swap Provider may owe a termination payment to the College. Such a termination payment would be based upon the market value of the applicable Swap Transaction on the date of termination, and could be substantial. In addition, each party is obligated to post cash or securities with the other party equal to all or a portion of its settlement obligation on a daily basis.

The College's obligations under the Swap Transactions are evidenced by Notes issued by the College to the Swap Provider. The Notes are secured under the Master Indenture (i) on a parity with all outstanding Notes secured under the Master Indenture and any future Notes that may be secured by the Master Indenture to the extent that the College's obligations under the Swap Transactions are insured and (ii) on a subordinate basis, to the extent that such obligations are not insured.

LITIGATION, MEDICAL MALPRACTICE AND OTHER INSURANCE

The College is a defendant in various lawsuits and has identified certain events that can be expected to result in claims for damages. Based upon the claims history of the College, actuarial computations, the current status of pending claims and other information known to College Management, the College Management is of the opinion that no medical malpractice or other claim of which the College is now aware, whether or not filed as of the date hereof, will have a material adverse effect on the financial condition or operations of the College. College Management also believes that the self-insurance fund and commercial insurance coverage can reasonably be expected to pay for any insured liability of the College, although no assurance can be made that this will be the case.

From FY 1978 to FY 2003, the College was partially self-insured for Medical malpractice claims and purchased commercial excess insurance policies. Thereafter, the College became completely self-insured for this exposure. The College's self-insured retention is funded based upon actuarial reports that determine the amount needed for payment of medical malpractice losses, related legal expenses and the cost of administering the fund. The assets of the fund, as well as the actuarially determined liabilities, are reported in the combined balance sheets as of June 30, 2010 and 2009, which are included in **APPENDIX B**. Income from the fund assets, professional liability losses and administrative costs are reported in the combined statements of activities for the years ended June 30, 2010 and 2009, which are included in **APPENDIX B**.

The College maintains coverage with respect to general liability and other insurance that is similar to other medical schools.

EMPLOYEES

As of June 30, 2010 the College had approximately 5,506 full-time faculty and staff, 983 part-time employees and 919 residents. The College provides a competitive compensation and benefits program that includes a 401(a) savings plan, group life, medical, disability and dental insurance plans as well as paid vacation, holidays, and sick leave programs.

The College currently has no labor unions or collective bargaining agreements. There have been no stoppages of work due to strikes or labor problems. Employee problem resolution is provided by the Department of Human Resources through workplace mediation, an open-door policy with management and a formal grievance procedure. College Management considers its relationship with College employees to be excellent.

BAYLOR COLLEGE OF MEDICINE

**FINANCIAL
STATEMENTS**

2010

Together with Auditor's Report



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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Baylor College of Medicine
Houston, Texas

We have audited the accompanying balance sheets of Baylor College of Medicine (the "College") as of June 30, 2010 and 2009, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the College at June 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 6 to the financial statements, the College adopted the provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification 820, *Fair Value Measurements and Disclosures* (formerly FASB Statement No. 157, *Fair Value Measurements*).

Deloitte & Touche LLP

October 28, 2010

Baylor College of Medicine

Balance Sheets

As of June 30, 2010 and 2009 (in thousands)

	2010	2009
Assets		
Cash and cash equivalents	\$ 17,618	\$ 51,762
Cash held by bond trustee	270,792	348,411
Accounts receivable, net	85,092	98,644
Patient receivables, net	29,360	35,180
Contributions receivable, net	122,648	164,667
Notes receivable	17,773	18,593
Investments	814,557	754,397
Investments loaned under security lending agreements	10,024	2,832
Security lending collateral	10,480	2,952
Property and equipment, net	721,946	712,917
Other assets	21,166	27,756
Total Assets	\$ 2,121,456	\$ 2,218,111
Liabilities		
Accounts payable and other liabilities	\$ 179,182	\$ 197,458
Short term line of credit	49,000	25,000
Bond swap liability, net	1,738	14,099
Self-insurance reserves	33,512	42,845
Unexpended current awards	68,853	73,466
Bonds payable	888,211	897,431
Payable under security lending agreements	10,480	2,952
Total Liabilities	1,230,976	1,253,251
Net Assets		
Unrestricted	253,005	310,892
Temporarily restricted	303,085	327,376
Permanently restricted	334,390	326,592
Total Net Assets	890,480	964,860
Total Liabilities and Net Assets	\$ 2,121,456	\$ 2,218,111

See accompanying notes to financial statements.

Baylor College of Medicine

Statements of Activities

For the Years Ended June 30, 2010 and 2009 (in thousands)

	<u>2010</u>	<u>2009</u>
Operating Revenues		
Tuition and fees	\$ 22,652	\$ 20,482
Less: Institutional scholarships	<u>(12,064)</u>	<u>(12,044)</u>
Net tuition and fees	10,588	8,438
State appropriations	49,574	41,727
Government and private grants and contracts:		
Direct recoveries	315,624	308,807
Indirect recoveries	68,372	65,043
Medical services	224,257	247,878
Affiliated hospital contracts	367,157	306,496
Investment income distribution and other	52,269	58,430
Equipment acquired through grants and contracts	11,876	8,568
Contributions	18,299	28,524
Net assets released from restrictions	34,953	37,358
Other sources	<u>39,262</u>	<u>43,481</u>
Total Operating Revenues	<u>1,192,231</u>	<u>1,154,750</u>
Operating Expenses		
Salaries, wages and benefits	830,610	797,609
Services, supplies and other	316,005	345,385
Depreciation	64,220	65,806
Interest	<u>21,137</u>	<u>18,675</u>
Total Operating Expenses	<u>1,231,972</u>	<u>1,227,475</u>
Expenses in Excess of Revenues	<u>(39,741)</u>	<u>(72,725)</u>
Non-Operating Activities		
Contributions	2,747	2,927
Investment gain (loss), net of distribution	43,480	(154,521)
Unrealized loss on bond swaps	(33,536)	(52,878)
Non-equipment assets acquired through grants, contracts and gifts and other	(79)	(254)
Losses on disposals and write-downs of property and equipment	(1,962)	(1,989)
Net assets released from restrictions	790	1,562
Write-off of original bond issue costs	(6,586)	(3,579)
Impairment losses on capital projects	<u>(23,000)</u>	<u>(57,000)</u>
Increase (Decrease) in Unrestricted Net Assets from Non-Operating Activities	<u>(18,146)</u>	<u>(265,732)</u>
Decrease in Unrestricted Net Assets	<u>\$ (57,887)</u>	<u>\$ (338,457)</u>

(Continued)

See accompanying notes to financial statements.

Baylor College of Medicine

Statements of Activities

For the Years Ended June 30, 2010 and 2009 (in thousands)

	2010	2009
Decrease in Unrestricted Net Assets	<u>\$ (57,887)</u>	<u>\$ (338,457)</u>
Temporarily Restricted Net Assets		
Contributions, net	(6,283)	30,185
Net assets released from restrictions	(35,742)	(38,920)
Investment loss	<u>17,734</u>	<u>(129,412)</u>
Decrease in Temporarily Restricted Net Assets	<u>(24,291)</u>	<u>(138,147)</u>
Permanently Restricted Net Assets		
Contributions	6,419	16,006
Investment income (loss)	<u>1,379</u>	<u>(5,537)</u>
Increase in Permanently Restricted Net Assets	<u>7,798</u>	<u>10,469</u>
Decrease in Net Assets	(74,380)	(466,135)
Net Assets, beginning of year	<u>964,860</u>	<u>1,430,995</u>
Net Assets, end of year	<u><u>\$ 890,480</u></u>	<u><u>\$ 964,860</u></u>

(Concluded)

See accompanying notes to financial statements.

Baylor College of Medicine

Statements of Cash Flows

For the Years Ended June 30, 2010 and 2009 (in thousands)

	2010	2009
Cash Flows from Operating Activities		
Decrease in Net Assets	\$ (74,380)	\$ (466,135)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation and loss on disposals and write-downs of property and equipment and other	70,260	70,904
Impairment losses on capital projects	23,000	57,000
Equipment acquired through grants and contracts	(11,433)	(8,376)
Investment income	(12,464)	(5,469)
Change in net unrealized (gains) losses on investments	(50,315)	236,904
Net realized (gains) losses on sale of investments	(44,748)	13,165
Decrease (increase) in accounts receivable	13,552	(6,051)
Decrease in patient receivables	5,821	1,607
Decrease in contributions receivable	42,019	1,859
Permanently restricted contributions and investment income	(7,798)	(10,469)
Decrease in other assets	6,591	4,644
Decrease (increase) in accounts payable and other liabilities	(22,554)	11,644
Increase in bond swap liability	34,092	52,878
Decrease in deferred insurance proceeds	-	(6,202)
Net Cash Used In Operating Activities	(28,357)	(52,097)
Cash Flows from Investing Activities		
Purchases of investments	(181,339)	(172,732)
Proceeds from sales of investments	209,049	298,232
Purchases of property and equipment	(100,425)	(198,572)
Decrease in restricted cash held by bond trustee	77,619	154,772
Investment income	12,464	5,469
Issuances of notes receivable	(1,772)	(2,157)
Repayments of notes receivable	2,592	2,272
Net Cash Provided by Investing Activities	18,188	87,284
Cash Flows from Financing Activities		
Proceeds of line of credit	78,380	-
Repayment of line of credit	(54,380)	(25,000)
Proceeds from bonds payable	-	251,893
Payments to bond swap collateral	(46,453)	(75,671)
Repayment of bonds payable	(9,320)	(243,150)
Purchases of bonds payable	-	36,425
Permanently restricted contributions and investment income	7,798	10,469
Net Cash Used In Financing Activities	(23,975)	(45,034)
Net Increase/(Decrease) in Cash and Cash Equivalents	(34,144)	(9,847)
Cash and Cash Equivalents, beginning of year	51,762	61,609
Cash and Cash Equivalents, end of year	\$ 17,618	\$ 51,762
Supplemental disclosures		
Net interest paid on bonds (excluding capitalized interest)	\$ 17,983	\$ 17,644
Non-cash investing activities:		
Property and equipment acquisitions in accounts payable and other liabilities	\$ (9,568)	\$ (7,263)
Increase (decrease) in security lending collateral	\$ 7,527	\$ (30,010)

See accompanying notes to financial statements.

Baylor College of Medicine

Notes to Financial Statements

For the Years Ended June 30, 2010 and 2009

(1) DESCRIPTION OF ORGANIZATION

Baylor College of Medicine (the College) is a Texas not-for-profit corporation and is exempt from Federal income taxes under Section 501(a) of the Internal Revenue Code (IRC) of 1986, as amended, by reason of being an organization described in Section 501(c)(3) of the Code. The College is located in the Texas Medical Center in Houston, Texas and is the only private medical school in the southwestern United States.

In addition to physician education, the College offers programs and postgraduate degrees in biomedical sciences, the allied health fields and graduate medical education. Further, the College is one of the nation's leading biomedical research institutions and provides extensive patient care services.

Baylor College of Medicine International Pediatric AIDS Initiative (BIPAI) is a Texas not-for-profit corporation organized to foster international HIV/AIDS prevention, care and treatment, health professional education, and clinical research. BIPAI's activities, which are primarily located in the Sub-Saharan region of Africa, are included in the College's financial statements.

Baylor Medical Foundation (the Foundation) is a Texas not-for-profit corporation organized exclusively to aid, support and maintain the College. The Foundation is governed by a separate Board. In the event of dissolution of the Foundation, any funds or property then owned by the Foundation are to be transferred to the College. In accordance with Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities* (formerly Statement of Financial Accounting Standards (SFAS) No. 136, *Transfer of Assets to a Not-for-Profit Organization or Charitable Trust that Raises or Holds Contributions for Others*), the College's interest in the net assets of the Foundation is included in the accompanying balance sheets (see Note 5).

In January, 2007, the Board of Trustees of the College passed a resolution to develop an integrated Baylor Clinic and Hospital (BCH Project). The BCH Project is located on 33 acres of College-owned land in the Texas Medical Center area. Construction commenced in May, 2007, and is being financed in part with the proceeds of the bonds issued in November, 2007. The remainder of the costs will be funded by the College from a combination of College resources, community support, philanthropy or a potential joint venture partner. In February 2009, the College decided, based on changes in the U.S. economy and higher than expected costs to complete the BCH Project, to pause the construction of the BCH Project once the building's core and shell is completed, which is expected to occur mid fiscal year 2011. The College is using the remaining bond proceeds, after the shell and core are completed, to repurchase some of the College's outstanding bonds (see Note 8). See Note 2 for the College's consideration and recognition of impairment on these long-lived assets. See Note 3 for management's plan.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The accompanying financial statements of the College have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Preparation of the financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including contingencies, at the date of the financial statements and the reported revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash Equivalents

The College considers all unrestricted demand deposits and short-term managed pooled investments, with original maturities of 90 days or less, to be cash equivalents.

Accounts Receivable, net

Accounts receivable, net consists primarily of unreimbursed grant and contract expenditures and amounts owed by various affiliated hospitals to which the College provides residents and faculty. These amounts are reduced by approximately \$2.4 and \$1.2 million at June 30, 2010 and 2009, respectively, related to allowances for uncollectible accounts. Unreimbursed grant and contract expenditures consist of receivables from the Federal Government, principally the National Institutes of Health, and other non-federal sources for payment for research provided by the College.

Patient Receivables, net

Patient receivables are recorded net of an allowance for contractual adjustments and doubtful accounts to report the receivables at their estimated net realizable value. At both June 30, 2010 and 2009, the patient receivables were reduced by approximately \$1.6 million related to the allowance for doubtful accounts.

Contributions Receivable, net

Unconditional promises to give, that are expected to be collected within one year, are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at fair value, which is measured as the present value of their future cash flows. The discounts on those amounts are computed using risk-adjusted interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in contribution revenue. Conditional promises to give are not included as support until the conditions are substantially met.

Investments

The College's investments in marketable equity and fixed income securities are recorded at fair value. Non-marketable securities are securities for which no public market exists; substantially all of these securities are accounted for under the equity method, which

approximates fair value. These non-marketable securities include investments in private equity limited liability corporations or partnerships.

Other investments are stated at cost or fair value at the date of the acquisition or donation. Realized gains and losses arising from the sale or other disposition of investments have been accounted for as changes in unrestricted net assets unless restrictions have been imposed by the donor. Certain investments are pooled with each fund subscribing to or disposing of units on the basis of the market value per unit, which is computed monthly. Realized gains and losses arising from the sale of securities are determined on an average cost basis.

The U.S. and international financial markets have experienced significant volatility that has resulted in substantial fluctuations in equity markets, in which the College invests. Market volatility can affect the value the College receives for its investments in future periods.

Securities Lending

The College participates in securities lending transactions whereby a portion of its investments are loaned, through its agent, to various parties in return for cash and securities from the parties as collateral for the securities loaned, usually on a short-term basis. Collateral provided by parties is maintained at levels of at least 100% of the fair value of the securities on loan and is adjusted for market fluctuations (see Note 6). The fees received for these transactions are recorded as investment income.

Property and Equipment

Property and equipment acquisitions are recorded at cost on the date of acquisition. Contributed property and equipment is recorded at fair value at the date of donation. If donors stipulate how long the assets must be used, the contributions are recorded as restricted support. In the absence of such stipulations, contributions of property and equipment are recorded as unrestricted support. Depreciation is calculated on the straight-line method based on the estimated useful lives of the assets, which range from 17 to 50 years for buildings, the shorter of the lease term or 5 to 15 years for leasehold improvements, and 3 to 10 years for furniture, equipment and computer software.

Impairment of Long-Lived Assets

In accordance with ASC 360 *Property, Plant and Equipment*, (formerly SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*), when events or changes in circumstances indicate the carrying amount of property and equipment, and intangible or other long-lived assets, related to specifically acquired assets may not be recoverable, an evaluation of the recoverability of currently recorded costs is performed. When an evaluation is performed, the estimated value of undiscounted future net cash flows associated with the asset is compared to the asset's carrying value to determine if a write down to fair value is required. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The College added \$58.8 million of cost and capitalized interest during the year ended June 30, 2010 to bring the BCH Project carrying amount to \$205.2 million, which was then written down to its fair value of \$182.2 million, resulting in \$23 million impairment charge. As of June 30, 2009, the BCH

Project with carrying amount of \$203.5 million was written down to its fair value of \$146.5 million resulting in an impairment charge of \$57 million. The fair value estimate for the BCH Project was derived from internal estimates of future net cash flows expected to be received from the ultimate disposition of the assets. The estimates of future cash flows are based on assumptions the College believes to be reasonable and supportable. Fair value estimates can change by material amounts in subsequent periods as many factors and assumptions can impact an estimate. The impairment charge was included in non-operating "Impairment losses on capital projects" in the June 30, 2010 and 2009 statement of activities.

Other Assets

Other assets primarily include inventory, prepaid expenses and deferred bond issue costs. Inventories are stated at lower of first-in, first-out cost or market. The deferred issuance costs are being amortized over the respective lives of the bonds. During fiscal year 2010, the College released Ambac Financial Group, Inc., from its obligation to provide bond insurance for the Series 2007A Bonds, resulting in a write off of prepaid bond insurance premiums of \$6.6 million.

Unexpended Current Awards

Unexpended current awards represent amounts received from sponsors for which the College has not yet fulfilled its obligations. These amounts will be recognized in future periods once the obligations are satisfied.

Unrestricted, Temporarily Restricted and Permanently Restricted Net Assets

Unrestricted net assets generally result from operating and non-operating revenues and gains generated by the College in fulfilling its mission that are neither temporarily nor permanently restricted by donor-imposed stipulations. Revenues and gains with explicit donor stipulations are reported as either temporarily restricted or permanently restricted net assets as determined by the nature of the stipulations. Unrestricted net assets also reflect all expenditures of the College.

Temporarily restricted net assets include contributions, investment income, and gains for which donor-imposed purpose and/or time restrictions have not been satisfied. Donor restricted contributions, for which the restrictions are satisfied in the same reporting period as the contribution was received, are reported as unrestricted revenue. The amount of temporarily restricted net assets for which the College has satisfied the restrictions or the donor has released the College from the restrictions during the current reporting period are reported as net assets released from restrictions in the statements of activities. Income and appreciation on permanently restricted net assets that exceed appropriations for expenditures (therefore the restrictions have not been satisfied) are included in temporarily restricted net assets.

Permanently restricted net assets result from donor-imposed stipulations on contributions and other assets, which neither expire by the passage of time, nor can be fulfilled or otherwise removed by actions of the College. Permanently restricted net assets at June 30, 2010 and 2009, include amounts that are required by donor restrictions to be invested in perpetuity. The income and appreciation on permanently restricted net assets for

which restrictions have not been satisfied are included in temporarily or permanently restricted net assets, depending on the nature of the donor-imposed restriction.

Temporarily and permanently restricted net assets at June 30, 2010 and 2009 are principally restricted for research and education.

Operating and Non-Operating Activities

Operating activities include revenues provided by and expenses and equipment associated with the College's medical education, research and patient care programs. Non-operating activities include endowment investment gains or losses in excess of the College's spending policy, changes in unrealized gains and losses related to investments, unrealized losses on bond interest rate swaps, losses on disposals and write-downs of property and equipment, net assets released from restrictions for capital, restricted contributions and transfers, and other. Additionally, any unusual or non-recurring gains and retirement of bond original issue costs are included in non-operating activities.

State Appropriations

The College receives funding in the form of appropriations from the state of Texas. State appropriations received during fiscal years 2010 and 2009 were \$49.6 million and \$41.7 million, respectively.

Included in appropriations are amounts received from the state of Texas Higher Education Coordinating Board for the purpose of training or educating undergraduate medical students and graduate medical residents. The College expended \$167.2 million and \$174.0 million, respectively, for fiscal years 2010 and 2009 to train and educate undergraduate medical students and graduate medical residents. Expenditures used to satisfy these appropriations are reflected as instruction expenditures and certain amounts related to the instruction of graduate medical residents are included in affiliated hospital programs expenditures in the schedule of Functional Expense (see Note 10).

Medical Services Revenue

Medical services revenue is reported at the anticipated realizable amounts from patients, third-party payors, and others for services rendered before any allowance for bad debt. Bad debt expense related to medical services in fiscal years 2010 and 2009 was \$24.7 million and \$19.5 million, respectively.

The College has entered into payment agreements with certain commercial insurance carriers, health care maintenance organizations, and preferred provider organizations. The basis for payment to the College under these agreements is primarily prospectively determined rates. In addition, the College provides services to Medicare and Medicaid program beneficiaries in which the College is paid based on prospectively determined rates. At June 30, 2010 and 2009, revenue from the Medicare and Medicaid programs accounted for approximately 27% and 32%, respectively, of the College's medical service revenue. Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The College believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory

inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs could have an adverse or positive impact on prospective medical services revenues.

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, governmental health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

Endowment Investments and Income Distribution

The College recognizes the goals of endowment management are preserving the purchasing power of the assets and providing stable support for current programs. The primary focus of the College's endowment investment policy is structuring both the endowment's investment portfolio and its annual spending in order to balance the needs of current and future generations of scholars, scientists, patients and teachers. Current annual spending from the endowment, plus inflation, combines to create a minimum target total return for the portfolio. The College employs strategies of investing in equity assets and some illiquid assets, broadly diversifying and investing in assets that are out of favor. The College believes these strategies will help achieve the total return target over the long-term.

The College's board approved endowment earnings distribution policy, as permitted by the Texas Uniform Prudent Management of Institutional Funds Act of 2006, is based on a 5% distribution applied to a trailing 12-quarter average market value of the endowment assets. In February 2010, the College approved a modification to its distribution policy whereby the College will utilize a trailing 28-quarter average for the coming fiscal year. Funds for the earnings distribution are provided from endowment investment income and realized capital gains and are reflected as investment income distribution in the accompanying financial statements. Amounts distributed under this policy are considered appropriated for purposes of ASC 958-205, *Not-for-Profit Entities* (formerly FASB Staff Position 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*), (see Note 5).

Affiliated Hospital Contracts

The College has affiliation agreements with area hospitals, including, but not limited to, St. Luke's Episcopal Hospital, The Methodist Hospital, Texas Children's Hospital, The Institute for Rehabilitation and Research, Menninger Clinic, Michael E. DeBakey Veterans Affairs Medical Center, and the Harris County Hospital District. Under the terms of these agreements, the College conducts administrative, research and educational activities on behalf of these hospitals. In addition, the College provides residents to the affiliated institutions who in turn provide patient care services as part of their medical training. Mutual commitments include sharing of operational and research costs, including physicians' salaries. Amounts due to the College from affiliated

hospitals included in accounts receivable, net in the accompanying balance sheets as of June 30, 2010 and 2009 were \$36.0 million and \$39.3 million, respectively.

Charity Care

The College is committed to providing assistance to financially indigent patients in the community who require care and services at reduced or no cost. Additionally, the College provides care to a number of Medicaid and Medicare eligible patients that require continued care after benefits are exhausted.

Records are maintained to identify and monitor the level of charity care the College provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The level of charity care provided during fiscal years 2010 and 2009, based on established charges, was \$206.7 million and \$192.0 million, respectively.

Uncertainty in Income Taxes

ASC 740, *Income Taxes*, (formerly FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*) creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of ASC 740, tax-exempt organizations could now be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. Prior to ASC 740, tax liabilities were recorded as incurred. There are no material unrecorded tax liabilities as of June 30, 2010 and 2009.

New Accounting Standards

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (SFAS 168) and codified in FASB Accounting Standards Codification - 105. SFAS 168 establishes the FASB Accounting Standards Codification TM (the "Codification" or "ASC") as the single source of authoritative, nongovernmental generally accepted accounting principles ("GAAP"), other than guidance issued by the SEC. ASC does not change GAAP; it introduces a new structure for organizing GAAP and limits the hierarchy to two levels-authoritative and nonauthoritative. Subsequent issuances of new standards will be in the form of Accounting Standards Updates (ASU) that will be included in the ASC. ASC 105 is effective for annual financial periods ending after September 15, 2009. The College adopted ASC beginning on July 1, 2009 and the principal impact on its financial statements is limited to disclosures, as all future references to authoritative accounting literature will be referenced in accordance with the Codification.

In February 2008, the FASB issued FASB Staff Positions (FSP) SFAS 157-2, *Effective Date for FASB Statement 157-(ASC 820-10-50)*. This FSP permits the delayed application of SFAS 157 for all non-recurring fair value measurements of non-financial assets and non-financial liabilities until fiscal years beginning after November 15, 2008. The College adopted this statement for its non-financial assets and liabilities on July 1, 2009.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133* (ASC 815-10-50). This statement requires enhanced disclosures regarding the location and amounts of derivative instruments in the College's financial statements, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect its financial position, financial performance, and cash flows. This guidance is effective for financial statements issued for fiscal years beginning after November 15, 2008. The College adopted this guidance beginning July 1, 2009. See Note 9 for disclosures required by this guidance.

In January 2010, the FASB issued ASU No. 2010-06, which amends ASC Topic 820, *Fair Values* to add new disclosure requirements about recurring and non-recurring fair value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for reporting periods beginning after December 15, 2009, except for the Level 3 reconciliation disclosures which are effective for reporting periods beginning after December 15, 2010. The College does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In August 2010, the FASB issued ASU 2010-23, which requires that costs be used as the measurement basis of charity care disclosures and that cost be identified as the direct and indirect cost of providing the charity care. The ASU also requires disclosure of the method used to identify the costs. The ASU is effective for fiscal years beginning after December 15, 2010. Retrospective application and early adoption are permitted. The College has not yet determined the impact, if any, on the financial statements from the adoption of this ASU.

(3) MANAGEMENT PLAN

The accompanying consolidated financial statements have been prepared assuming the College will continue as a going concern. The College has experienced deficits (i.e., expenses in excess of revenue) from operations for fiscal years 2004 to 2009, ranging from \$17 million to \$72 million, and a deficit from operations for the year ended June 30, 2010 of approximately \$40 million. The College is also in technical default on one of its bond covenants as of June 30, 2010. Factors that contributed to these operating deficits included increased investment in faculty, bond reissuance costs incurred when the College converted auction rate debt to variable-rate bonds during fiscal years 2007 and 2008, BCH Project start-up and shut down costs and increased fees incurred related to waivers due to debt covenant defaults during 2009.

To address these operating deficits, the College has taken certain actions, including instituting a salary freeze, reducing benefits and identifying other cost savings to reduce the operating deficits. The College is completing its final construction activities to weatherproof the BCH Project facility (see Notes 1 and 2) and has delayed other capital projects. Management is projecting a breakeven budget from operations for fiscal year 2011, and the College is committed to implementing additional cost reductions, if needed, to achieve these budgeted results. In accordance with the non-financial

covenants established in November 2009 by its waiver agreements, the College hired a Chief Implementation Officer in March 2010 to help implement a proposed reorganization plan that was based on recommendations related to operational improvements received by the College from certain consultants. The College has implemented enhanced controls around its budgeting and monitoring process.

The technical default as of June 30, 2010 was related to the maintenance of minimum unrestricted net assets of at least \$350 million (as defined). Investment losses in recent fiscal years, which losses primarily occurred as a result of significant declines in the U.S. and international financial markets, as well as reclassifications from unrestricted net assets to temporarily restricted net assets required by ASC 958-205 (formerly FSP FAS 117-1), had a significant impact on the College's inability to meet this debt covenant. On June 30, 2010, the College received a second amendment to its waiver agreement which extended the original terms of the waiver agreement to August 3, 2010. On August 3, 2010, the College received a third amendment to its waiver agreement from its creditors which extended the terms of the waiver period, through July 1, 2013. The College is required to meet the following revised covenants: 1) to maintain days cash on hand of at least 60 days measured as of December 31 and June 30 of each year; 2) to maintain a maximum capitalization ratio of no more than 0.80 measured as of each fiscal quarter, through and including the fiscal quarter ending June 30, 2012 and 0.75 for the remaining fiscal quarters through June 30, 2013; and 3) to maintain a minimum debt service coverage (as defined) of not less than 1.20 measured as of each fiscal quarter through June 30, 2011, 1.25 for each fiscal quarter through September 30, 2012 and 1.40 for fiscal quarter through June 30, 2013. Without these waivers, the bonds could have been called by any or all of its creditors, and the College would have been required to repurchase the bonds. The College believes it can meet these revised covenants through July 1, 2013 and beyond, absent another significant decline in the U.S. and international financial markets, by executing on its plan to reduce cost and pay down the debt.

By the end of fiscal year 2011, the College plans to have redeemed \$300 million of its \$850 million variable rate debt outstanding as of June 30, 2010, using unspent bond proceeds and unrestricted College funds to fund the redemption. This redemption will reduce the ultimate debt service requirement and enable the College to hold the BCH Project asset. As of October 28, 2010, the College has redeemed approximately \$270 million.

The College is currently in discussions with several not-for-profits and for profit organizations to provide these organizations with a controlling interest in the BCH Project for an undetermined consideration. No agreement has been finalized with any of these institutions, and the ultimate outcome of these discussions is uncertain at this time.

(4) CONTRIBUTIONS

Contributions receivable as of June 30, 2010 and 2009 are expected to be realized as follows (in thousands):

	2010	2009
In one year or less	\$ 20,450	\$ 33,155
Between one year and five years	67,274	90,039
More than five years	62,979	74,789
Less: present value discount (1.875% to 5.09%)	(28,055)	(33,316)
Total	<u>\$ 122,648</u>	<u>\$ 164,667</u>

Included in contributions receivable at June 30, 2010 and 2009 is \$28.2 million and \$60.3 million, respectively, for the BCH Project. As of June 30, 2010 and 2009, the College had received conditional promises to give and indications of intentions to give, of approximately \$196.7 million and \$209.9 million, respectively, in addition to the amounts recorded as contributions receivable. These conditional promises to give are not reflected in the accompanying financial statements until such time as the conditions are substantially met.

(5) INVESTMENTS

Investments (including amounts for self-insurance) held by the College at June 30, 2010 and 2009, are as follows (in thousands):

	2010	2009
Pooled investments:		
Stocks (cost of \$232,755 and \$286,382)	\$ 303,366	\$ 347,834
Bonds (cost of \$93,559 and \$93,356)	94,501	87,747
Other short-term investments	75,759	8,958
International equities (cost of \$170,760 and \$169,618)	149,907	136,451
Private equity securities (cost of \$143,085 and \$139,233)	171,524	146,881
Assets held for state of Texas (cost of \$31,779 and \$31,385)	(25,085)	(23,013)
Total pooled investments	769,972	704,858
Net equity interest in Baylor Medical Foundation	24,053	21,951
Other stocks (cost of \$7,018 and \$8,532)	15,991	16,546
Real estate, at cost	2,152	2,152
Assets held in trust (cost of \$8,250 and \$8,681) and other	12,413	11,722
Total	<u>\$ 824,581</u>	<u>\$ 757,229</u>

The College's commitments outstanding for private equity investments are described in Commitments and Contingencies (see Note 12).

In fiscal year 2000, the College received \$25.0 million to establish a fund for investing a portion of receipts paid to the state of Texas under a judgment rendered in the tobacco settlement (the "tobacco funds"). The College is responsible for the administration of the

tobacco funds, which are invested along with the College's pooled investments; however, the College does not have title to the assets, and the tobacco funds are not recorded in the financial statements. As of June 30, 2010 and 2009, the value of the distributed funds is included in pooled investments and a corresponding reduction to the College's investments has been recorded to reflect that the College does not currently have an ownership interest.

The earnings of the tobacco funds are required to be remitted to the state of Texas which, in turn, appropriates the earnings to the College to benefit programs in medical research, health education and treatment. This distribution is included in state appropriations in the statement of activities.

Investment performance, including equity earnings, for the years ended June 30, 2010 and 2009, is summarized as follows (in thousands):

2010					
	Operating	Non Operating	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
Distribution of endowment earnings and other	\$ 3,771	\$ -	\$ 105	\$ -	\$ 3,876
Other investment income	-	5	2	3	10
Net realized gains	-	54,949	2,274	289	57,512
Net unrealized losses	-	37,024	15,353	1,087	53,464
Total investment return	\$ 3,771	\$ 91,978	\$ 17,734	\$ 1,379	\$ 114,862
Investment return, designated for current operations	48,498	(48,498)	-	-	-
Total investment return, net of distributions to operations	<u>\$ 52,269</u>	<u>\$ 43,480</u>	<u>\$ 17,734</u>	<u>\$ 1,379</u>	<u>\$ 114,862</u>
2009					
	Operating	Non Operating	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
Distribution of endowment earnings and other	\$ 4,591	\$ -	\$ 114	\$ -	\$ 4,705
Other investment income	-	57	47	4	108
Net realized gains (losses)	-	25,395	(21,051)	(1,932)	2,412
Net unrealized losses	-	(126,134)	(108,522)	(3,609)	(238,265)
Total investment return (loss)	\$ 4,591	\$ (100,682)	\$ (129,412)	\$ (5,537)	\$ (231,040)
Investment return, designated for current operations	53,839	(53,839)	-	-	-
Total investment return (loss), net of distributions to operations	<u>\$ 58,430</u>	<u>\$ (154,521)</u>	<u>\$ (129,412)</u>	<u>\$ (5,537)</u>	<u>\$ (231,040)</u>

Included within net unrealized gains (losses) above are approximately \$28.2 million and \$(25.7) million of the College's equity in earnings (losses) on private equity securities for the years ended June 30, 2010 and 2009, respectively.

Endowment earnings are recorded net of investment management fees, which amounted to approximately \$4.9 million and \$5.0 million for the years ended June 30, 2010 and 2009, respectively.

The College's endowment consists of the following net asset types at June 30, 2010 and 2009 (in thousands):

2010				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (18,025)	\$ 114,471	\$ 273,874	\$370,320
Board designated endowment funds	412,643	10,341	-	422,984
Total endowments at June 30, 2010	<u>\$ 394,618</u>	<u>\$ 124,812</u>	<u>\$ 273,874</u>	<u>\$793,304</u>

2009				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (34,306)	\$ 99,756	\$ 262,773	\$328,223
Board designated endowment funds	379,762	11,364	-	391,126
Total endowments at June 30, 2009	<u>\$ 345,456</u>	<u>\$ 111,120</u>	<u>\$ 262,773</u>	<u>\$719,349</u>

The following endowment-related activities occurred during the years ended June 30, 2010 and 2009 (in thousands):

2010				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at June 30, 2009	\$ 345,456	\$ 111,120	\$ 262,773	\$ 719,349
Investment income	97,152	15,132	1,230	113,514
Contributions	4,774	(274)	9,871	14,371
Appropriation of endowment assets for expenditure	(48,696)	-	-	(48,696)
Other changes:				
Transfer from board designated endowments within unrestricted net assets	(4,068)	(1,166)	-	(5,234)
Endowment net assets at June 30, 2010	<u>\$ 394,618</u>	<u>\$ 124,812</u>	<u>\$ 273,874</u>	<u>\$ 793,304</u>

	2009			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at June 30, 2008	\$ 606,039	\$ 232,182	\$ 253,780	\$1,092,001
Investment income	(107,109)	(120,075)	(5,690)	(232,874)
Contributions	3,203	164	14,683	18,050
Appropriation of endowment assets for expenditure	(53,888)	-	-	(53,888)
Other changes:				
Transfer from board designated endowments within unrestricted net assets	(102,789)	(1,151)	-	(103,940)
Endowment net assets at June 30, 2009	<u>\$ 345,456</u>	<u>\$ 111,120</u>	<u>\$ 262,773</u>	<u>\$ 719,349</u>

(6) FAIR VALUE OF ASSETS AND LIABILITIES

On July 1, 2008, the College adopted ASC 820, *Fair Value Measurements and Disclosures* (formerly SFAS No. 157, *Fair Value Measurements*). ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The statement establishes consistency and comparability by providing a fair value hierarchy that prioritizes the inputs to valuation techniques into three broad levels, which are described below:

Level 1 inputs are quoted market prices in active markets for identical assets or liabilities (these are observable market inputs).

Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability (includes quoted market prices for similar assets or similar assets in markets in which there are few transactions and prices that are not current or vary substantially).

Level 3 inputs are unobservable market inputs that reflect the entity's own assumptions in pricing the asset or liability (used when little or no market data is available).

ASC 820 requires the use of observable market inputs (quoted market prices) when measuring fair value whenever possible and requires Level 1 quoted prices be used to measure fair value whenever possible.

Financial and non-financial assets and liabilities included in the College's financial statements and measured at fair value as of June 30, 2010 are classified based on the applicable valuation technique level in the following tables (in thousands):

	Total	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	June 30, 2010			
Assets:				
Cash and Cash Equivalents	\$ 74,582	\$ 74,582	\$ -	\$ -
U.S. & international equities	459,828	398,985	51,873	8,970
Fixed income	91,513	-	91,513	-
Private equity investments	164,343	-	-	164,343
Long-lived asset held for use	182,228	-	-	182,228
Security lending collateral	10,480	-	10,480	-
	<u>\$ 982,974</u>	<u>\$ 473,567</u>	<u>\$ 153,866</u>	<u>\$ 355,541</u>
Liabilities:				
Payable under security lending agreements	\$ 10,480	\$ -	\$ 10,480	\$ -
Bond interest rate swap liability	123,862	-	123,862	-
	<u>\$ 134,342</u>	<u>\$ -</u>	<u>\$ 134,342</u>	<u>\$ -</u>

Financial assets and liabilities included in the College's financial statements and measured at fair value as of June 30, 2009, are classified based on the applicable valuation technique level in the following tables (in thousands):

	Total	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	June 30, 2009			
Assets:				
U.S. & international equities	\$ 485,083	\$ 473,860	\$ -	11,223
Fixed income	84,930	84,930	-	-
Private equity investments	140,114	-	-	140,114
Security lending collateral	2,952	-	2,952	-
	<u>\$ 713,079</u>	<u>\$ 558,790</u>	<u>\$ 2,952</u>	<u>\$ 151,337</u>
Liabilities:				
Payable under security lending agreements	\$ 2,952	\$ -	\$ 2,952	\$ -
Bond interest rate swap liability	89,771	-	89,771	-
	<u>\$ 92,723</u>	<u>\$ -</u>	<u>\$ 92,723</u>	<u>\$ -</u>

Cash & cash equivalents and U.S. & international equities included in Level 1 are measured using quoted market prices in active markets for the identical equities. U.S. & international equities and fixed income investments, included in Level 2, are measured using other than quoted market prices for similar assets or similar assets in markets in which there are few transactions. Non-marketable U.S. & international equities included in Level 3 are biotechnology startup companies generally based on technology derived from the College's clinical and research activities; as such, observable market prices are not available. These are valued using a combination of last outside transaction price and internal information on the progress of the technology.

In September 2009, the FASB issued ASU 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), an amendment of Fair Value Measurements and Disclosure* (ASU 2009-12). This amendment to ASC 820 provides additional guidance on using the net asset value per share, provided by an investee, when estimating the fair value on an alternative investment that does not have a readily determinable fair value and enhances the disclosures concerning these investments. Examples of alternative investments, within the scope of this amendment, included investments in hedge funds, private equity funds, real estate funds, and venture capital partnerships.

Private equity investment valuation is determined by the private equity general partner using proprietary information that is unobservable to a market participant. Private equity investments in pooled investments that the College is able to fully redeem at the net asset value have been classified as Level 2 investments. Private equity investments in pooled investments that cannot be fully redeemed at the net asset value in the "near term" have been classified as level 3.

Long-lived assets held for use valuation is derived from internal estimates of future net cash flows expected to be received from the ultimate disposition of the assets. The estimates of future cash flows are based on reasonable and supportable assumptions. , Assumptions include revenue and expense projections, future capital outlay, EBITA multiples and weighted average cost of capital for each alternative. The alternatives have been probability weighted.

Bond interest rate swap liability (see Note 9) valuation is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flow of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses observable market-based inputs, including forward interest rate curves. These observable (Level 2) inputs are available to a market participant.

The following is a reconciliation of activity for the period ended June 30, 2010 and 2009 for assets measured at fair value based on using significant unobservable inputs (Level 3) (in thousands):

	U.S. & International Equities	Private Equity Investments	Long-lived Asset Held for Use	Total
Balance at June 30, 2009	\$ 11,223	\$ 140,114	\$ 146,458	\$ 297,795
Realized and unrealized gains/(losses) included in earnings (or changes in net assets), net	(667)	22,170	(23,000)	(1,497)
Purchases, issuances and settlements (capital calls, distributions), net	50	2,059	58,770	60,879
Transfers to level 1	(1,636)	-	-	(1,636)
Balance at June 30, 2010	<u>\$ 8,970</u>	<u>\$ 164,343</u>	<u>\$ 182,228</u>	<u>\$ 355,541</u>

Change in unrealized gains/(losses) included in other income/(expense) related to assets held as of June 30, 2010, net

\$ 21,334

	U.S. & International Equities	Private Equity Investments	Total
Balance at June 30, 2008	\$ 23,787	\$ 139,718	\$ 163,505
Realized and unrealized gains/(losses) included in earnings (or changes in net assets), net	(8,251)	(23,255)	(31,506)
Purchases, issuances and settlements (capital calls, distributions), net	(4,313)	23,651	19,338
Balance at June 30, 2009	<u>\$ 11,223</u>	<u>\$ 140,114</u>	<u>\$ 151,337</u>

Change in unrealized gains/(losses) included in other income/(expense) related to assets held as of June 30, 2009, net

\$ 29,914

(7) PROPERTY AND EQUIPMENT

Property and equipment consist of the following at June 30, 2010 and 2009 (in thousands):

	Useful Life (years)	2010	2009
Land	–	\$ 27,583	\$ 27,583
Buildings	17 – 50	548,344	536,959
Land improvements	15 – 20	17,310	15,078
Leasehold improvements	5 – 15	94,498	94,526
Furniture and equipment	5 – 10	249,624	251,118
Computer software	3 – 10	81,601	60,275
		1,018,960	985,539
Less: Accumulated depreciation		(500,173)	(457,093)
		518,787	528,446
Construction in progress		191,878	175,843
International operations, principally buildings, net	40	11,281	8,628
Property and equipment, net		<u>\$ 721,946</u>	<u>\$ 712,917</u>

Capitalized interest is inclusive of standby letter of credit and remarketing fees. Capitalized interest expense and income for the years ended June 30, 2010 and 2009 are as follows (in thousands):

	2010	2009
Interest cost:		
Capitalized		
Interest expense	\$ 15,806	\$ 22,588
Letter of credit fees	10,562	3,670
	<u>26,368</u>	<u>26,258</u>
Charged to operations		
Interest expense	17,798	16,995
Letter of credit fees	2,358	332
	<u>20,156</u>	<u>17,327</u>
Total	<u>\$ 46,524</u>	<u>\$ 43,585</u>
Interest income:		
Capitalized	\$ 12,281	\$ 17,783
Credited to operations	378	656
Total	<u>\$ 12,659</u>	<u>\$ 18,439</u>

The College has obligations involving various federal, state and local regulations to decontaminate certain portions of buildings at the College's principal location.

Accordingly, the College's recorded asset retirement obligation is \$0.6 million as of both June 30, 2010 and 2009.

(8) BONDS PAYABLE

A summary of bonds payable at June 30, 2010 and 2009 is as follows (in thousands):

<u>Medical Facilities Revenue Bonds</u>	<u>2010</u>	<u>2009</u>
Series 1999A	\$ 41,890	\$ 43,195
Series 2007A-1 & A-2	245,000	245,000
Series 2007B	200,000	200,000
Series 2008A	85,000	85,000
Series 2008B	34,550	34,550
Series 2008C	38,180	38,180
Series 2008D	191,985	200,000
Series 2008E	55,000	55,000
Less: Original Issue discount 1999A	(423)	(446)
Less: Original Issue discount 2008D	(2,971)	(3,048)
	<u>\$ 888,211</u>	<u>\$ 897,431</u>

The aggregate annual maturities of long-term debt as of June 30, 2010, for the next five fiscal years and thereafter are as follows (in thousands):

2011	\$ 9,555
2012	9,855
2013	10,490
2014	10,915
2015	11,370
Thereafter	<u>839,420</u>
	<u>\$ 891,605</u>

Tax-exempt debt is subject to arbitrage rules under the IRC §103(c) and related regulations that, in general, prohibit the yield realized from the investment of the proceeds of the new debt from exceeding the yield on the debt itself. Compliance with those rules is necessary for the interest on the debt to be exempt from federal income tax, and the College believes that it is in compliance with those rules.

All bonds outstanding have been issued under terms of the Master Trust Indenture, dated March 1, 1999, between master trustee and the College, as amended by supplemental master trust indentures. The master trustee has a secured interest in all gross receipts and substantially all College land including all improvement, appurtenances, personal property and proceeds now or here after placed, acquired or arising from the land.

Series 1999A Bonds

On April 9, 1999, Medical Facilities Revenue Bonds in the amount of \$50 million were issued with an original discount of \$0.6 million by the Harris County Health Facilities Development Corporation (the Issuer) under a loan agreement with the College. The Medical Facilities Revenue Bonds Series 1999A (Series 1999A Bonds) consist of the following at June 30, 2010 (in thousands):

- (a) Serial bonds, in the amount of \$19,170, due in annual installments between November 15, 2003 and November 15, 2016, with interest ranging between 4.0% and 5.375%, payable semiannually.
- (b) Term bonds, in the amount of \$6,095, due November 15, 2019, with interest at 5.125% payable semi-annually. Mandatory annual redemption before maturity is required between 2017 and 2019.
- (c) Term bonds, in the amount of \$24,735, due November 15, 2028, with interest at 5.00% payable semi-annually. Mandatory annual redemption before maturity is required between 2020 and 2028.

The College may redeem the Series 1999A Bonds commencing November 15, 2009, through November 14, 2010, at a 1% premium, declining to face value in 2010, and thereafter. Bond proceeds of the Series 1999A Bonds, together with funds of the College, were used to refund the Series 1997 Bonds and to pay the cost of issuance of the Series 1999A Bonds.

Series 2007A-1, 2007A-2 and 2007B Bonds

On November 15, 2007, the Harris County Health Facilities Development Corporation issued for the College Series 2007A-1 and Series 2007A-2 Bonds (Series 2007A Bonds) in the amount of \$400 million, \$245 million of which are still outstanding at June 30, 2010 and 2009, and Series 2007B Bonds in the amount of \$200 million. Both series are due November 15, 2047. The proceeds of the Series 2007A and Series 2007B Bonds are being used for construction of a medical office building and the BCH Project. Subsequent to the year ended June 30, 2010, \$90 million of Series 2007A-1, \$52.1 million of Series 2007A-2 and \$70 million of Series 2007B have been retired (see Note 14).

The Series 2007A Bonds bear interest at a variable rate. In November 2008, the interest mode on these bonds was converted from auction rate to variable rate demand bonds with interest rate pricing changing from weekly to daily. Letters of credit were provided as credit enhancements by Bank of America Corporation and Wachovia Corporation and the existing bond insurance provided by Ambac Financial Group, Inc. was discontinued after Ambac was downgraded to junk status. The average interest rate on borrowed amounts for Series 2007A-1 Bonds for the years ended June 30, 2010 and 2009 were 0.21% and 0.48%, respectively. The interest rates for the Series A-1 at June 30, 2010 and 2009 were 0.15% and 0.32%, respectively.

The average interest rate on borrowed amounts for Series 2007A-2 Bonds for the years ended June 30, 2010 and 2009 were 0.21% and 0.39% respectively. The interest rates for the Series A-2 at June 30, 2010 and 2009 were 0.17% and 0.30%, respectively.

The Series 2007B Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the Series 2007B Bonds for the years ended June 30, 2010 and 2009 were 0.208% and 0.62%, respectively. The interest rates at June 30, 2010 and 2009 were 0.14% and 0.18%, respectively.

Series 2008A, 2008B and 2008C Bonds

On June 15, 2008, the Harris County Health Facilities Development Corporation issued for the College Series 2008A Bonds in the amount of \$85 million, Series 2008B Bonds in the amount of \$34.6 million and Series 2008C Bonds in the amount of \$38.2 million, which are due June 15, 2048. The proceeds were used to redeem \$155 million of Series 2007A Bonds and to pay the cost of issuance of the Series 2008A, 2008B and 2008C Bonds. Credit is enhanced for the Series 2008A, 2008B and 2008C bond series with letters of credit provided by Compass Bancshares, Inc., Northern Trust Corporation and Commerzbank AG, respectively. Subsequent to the year ended June 30, 2010, \$21.7 million of Series 2008A, \$17.2 million of Series 2008B and \$19 million of Series 2008C have been retired (see Note 14).

The Series 2008A Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the 2008A Bonds for the year ended June 30, 2010, and 2009, were 0.61% and 1.36%, respectively. Interest rates at June 30, 2010 and 2009 were 0.50% and 0.28%, respectively.

The Series 2008B Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the 2008B Bonds for the year ended June 30, 2010 and 2009, were 0.22% and 1.27%, respectively. Interest rates at June 30, 2010 and 2009 were 0.30% and 0.20%, respectively.

The Series 2008C Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the 2008C Bonds for the year ended June 30, 2010 and 2009, were 0.27% and 1.30%, respectively. Interest rates at June 30, 2010 and 2009 were 0.28% and 0.32%, respectively.

Series 2008D Bonds

On September 4, 2008, the Harris County Cultural Education Facilities Finance Corporation issued for the College Series 2008D Bonds (Series 2008D Bonds) in the amount of \$200 million with an original discount of \$3.1 million. The proceeds, together with funds of the College, were used to refund \$66.9 million of Series 1999B Bonds, \$125 million of Series 2005A Bonds and to pay the cost of issuance of the Series 2008D Bonds. The Series 2008D Bonds consist of the following (in thousands):

- (a) Serial bonds, in the amount of \$69,220, due in annual installments between November 15, 2009 and November 15, 2019, with interest ranging between 3.00% and 5.00%, payable semiannually.
- (b) Term bonds, in the amount of \$29,965, due November 15, 2023, with interest at 5.125% payable semi-annually. Mandatory annual redemption before maturity is required between 2019 and 2023.

- (c) Term bonds, in the amount of \$44,905, due November 15, 2028, with interest at 5.375% payable semi-annually. Mandatory annual redemption before maturity is required between 2024 and 2028.
- (d) Term bonds, in the amount of \$55,910 due November 15, 2032 with interest at 5.625% payable semi-annually. Mandatory annual redemption before maturity is required between 2029 and 2032.

The College may redeem the Series 2008D Bonds, commencing November 15, 2020 through November 14, 2032, at a redemption price equal to 100% of the principal amount thereof, without premium.

The Loan Agreement on the Series 2008D Bonds provides for the initial establishment and maintenance by the College with the Bond Trustee of a reserve fund, as a debt service reserve, with a balance equal to the lesser of the maximum or 125% of the average annual debt service requirements on the Series 2008D Bonds. The balance of the reserve fund at June 30, 2010 is \$18.0 million. The College is required to cure any deficiency in the balance of the reserve fund on any interest payment date for the Series 2008D Bonds in 12 monthly installments if caused by a transfer to cure a deficiency in the bond fund, and otherwise by four monthly installments. There were no deficiencies at June 30, 2010.

Series 2008E Bonds

On August 27, 2008 the Harris County Cultural Education Facilities Finance Corporation issued for the College Series 2008E Bonds in the amount of \$55 million. Series 2008E Bonds are due November 15, 2035. The proceeds were used to refund Series 2005B bonds totaling \$50 million and to pay the cost of issuance of the Series 2008E Bonds. Credit enhancement in the form of a letter of credit for the Series 2008E Bonds is provided by J.P. Morgan Chase & Co.

The Series 2008E Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the years ended June 30, 2010, and 2009 were 0.24% and 1.20%, respectively and the interest rate at June 30, 2010 and 2009 were 0.30% and 0.22%, respectively.

Bond Compliance

The College was in technical default with its requirement to maintain a minimum of at least \$350 million of unrestricted net asset (as defined). On August 3, 2010, the College and all banks that provide letters of credit for its variable rate debt signed an amendment extending its default waiver agreement until July 1, 2013 (see Note 3). By the end of fiscal year 2011, the College plans to have redeemed \$300 million of its variable rate debt, using unspent bond proceeds of \$200 million and unrestricted College funds of \$100 million. As of October 28, 2010, the College has redeemed approximately \$270 million in accordance with the following redemption schedule (in thousands).

Bond Series	August 3, 2010	Sept 1, 2010	Sept 30, 2010	Dec 31, 2010	March 31, 2011	June 30, 2011	Total Redemption
2007B	\$43,095	\$16,905	\$10,000	\$10,000	\$10,000	\$10,000	\$100,000
2007A-1	19,785	70,215					90,000
2007A-2	14,835	37,265					52,100
2008A	12,010	9,690					21,700
2008B	4,880	12,270					17,150
2008C	5,395	13,585					18,980
	<u>\$100,000</u>	<u>\$159,930</u>	<u>\$10,000</u>	<u>\$10,000</u>	<u>\$10,000</u>	<u>\$10,000</u>	<u>\$299,930</u>

Revolving Credit Line

The College has a \$50 million revolving credit line with a local bank of which \$49 million and \$25 million were outstanding at June 30, 2010 and 2009, respectively. The funds were used for operating purposes. The College was not in compliance with the revolving credit line covenant to maintain a minimum of \$350 million in unrestricted net assets at June 30, 2010. Subsequent to year end, the College has an amended loan agreement, which no longer includes this covenant, through July 1, 2013, from the bank providing the revolving credit line (see Note 3).

(9) DERIVATIVE AND OTHER FINANCIAL INSTRUMENTS

The College has derivative financial instruments, as allowed by its Debt and Swap Policy's Guidelines, both of which specifically preclude their use for speculation. In the normal course of business during fiscal year 2005, the College entered into a long-term interest rate swap agreement having a notional amount of \$125 million, which essentially fixed the interest rate on the variable rate Series 2005A Bonds at 3.395% through November 15, 2035.

During fiscal year 2008, the College entered into two additional long-term interest rate swap agreements having notional amounts of \$300 million and \$100 million. These swap agreements essentially fixed the interest rate on the variable rate Series 2007A Bonds. The \$300 million swap fixed the interest rate at 4.125% through November 15, 2047. The \$100 million swap fixed the interest rate at 3.833% through November 15, 2047.

The fair value of the interest rate swaps is the estimated amount that the College would receive or pay to terminate the agreements at the reporting date, taking into account current interest rates and the current credit-worthiness of the swap counter party.

The fair values of the College's \$525 million of interest rate swaps at June 30, 2010 and 2009 were liabilities of \$123.9 million and \$89.8 million, respectively. The College has not elected hedge treatment of these swap agreements as such; the change in the fair value of interest rate swaps is recorded in non-operating unrealized loss on bond swaps in the statement of activities and as an adjustment to reconcile operating activity on the statement of cash flows. For the years ended June 30, 2010 and 2009, the College has recognized \$(34.1) million and \$(52.9) million of changes, respectively. The swap

liability, net of collateral posted (see below), is presented as a separate line in the accompanying balance sheets.

As of June 30, 2009 the College was required to post cash as collateral equal to the amount of the fair value of any swap liability that exceeded \$25 million. On November 23, 2009, the College was required to post cash as collateral daily, equal to the amount of the fair value of any swap liability. The College has posted at June 30, 2010 and 2009, \$122.1 million and \$75.7 million, respectively, in accordance with these agreements.

On August 5, 2010 the College and Citibank, N.A., its interest rate swap provider, signed an agreement extending the default forbearance agreement to July 1, 2013. A condition of the agreement is that the College must terminate \$300 million of its interest rate swaps on or before February 1, 2011 and will have terminated the remaining interest rate swaps on or before July 1, 2013.

On September 22, 2010 the College terminated one interest rate swap with a notional amount of \$122.7 million. The fair value at date of termination was \$21.7 million and cash paid to terminate was \$0.2.

On October 22, 2010 the College partially terminated three interest rate swaps with a notional amount of \$132.7 million. The fair value at date of termination was \$39.7 million and cash paid to terminate was \$0.3 million. The College is currently working with its swap advisors to determine the appropriate strategy for terminating the remaining amount of swaps as agreed.

(10) FUNCTIONAL EXPENSES

The College's expenses relate principally to providing education, research and clinical services. The functional expenses for these services are recorded directly or allocated. Operation and maintenance of plant expense, depreciation expense and interest expense are allocated to the various functional areas of the College based on the square footage of space occupied by each program and supporting service. For the years ended June 30, 2010 and 2009, expenses related to providing these services are as follows (in thousands):

2010				
	Expenses by Functional Area	Allocations		Allocated Expenses by Functional Area
		Operations and Maintenance of Plant	Depreciation and Interest	
Instruction	\$ 112,095	\$ 8,099	\$ 9,218	\$ 129,412
Research	350,907	34,375	53,687	438,969
Medical Services	240,110	417	9,694	250,221
Affiliated Hospital Programs	336,642	-	209	336,851
Institutional Support	63,971	-	12,548	76,519
Total	<u>\$ 1,103,725</u>	<u>\$ 42,890</u>	<u>\$ 85,357</u>	<u>\$ 1,231,973</u>

2009				
	Expenses by Functional Area	Allocations		Allocated Expenses by Functional Area
		Operations and Maintenance of Plant	Depreciation and Interest	
Instruction	\$ 117,901	\$ 8,978	\$ 8,829	\$ 135,708
Research	352,744	38,003	53,036	443,783
Medical Services	242,009	446	7,047	249,502
Affiliated Hospital Programs	301,333	-	174	301,507
Institutional Support	81,580	-	15,395	96,975
Total	<u>\$ 1,095,567</u>	<u>\$ 47,427</u>	<u>\$ 84,481</u>	<u>\$ 1,227,475</u>

(11) EMPLOYEE BENEFITS

Retirement Plan

Substantially all faculty and staff participate in the College's defined contribution retirement plan (the Plan). The Plan is a core benefit, and contributions are made by the College based on a formula using the employee's base annual salary. The College's contributions to the Plan in the years ended June 30, 2010 and 2009 were \$33.4 million and \$42.1 million, respectively. The assets of the Plan are administered by third parties.

Post Retirement Life Insurance

The College sponsored a life insurance plan (the Plan) covering substantially all employees until June 30, 2009. The Plan's eligibility requirements were changed during fiscal year 2009 to allow only employees who retired on or before June 30, 2009 with at least 10 years of service and are at least age 55 to be eligible to receive benefits. Benefits under the Plan are based upon the employee's final annual salary. This negative plan amendment resulted in an \$8.7 million reduction of the post retirement benefit obligation for the year ended June 30, 2009 and will be amortized over 15 years through net periodic post retirement costs.

The College's post retirement benefit obligation at June 30, 2010 and 2009 is \$5.8 million and \$5.4 million, respectively, and is recorded in accounts payable and other liabilities. The post retirement obligation is measured at year end and is funded by general assets of the College on a pay-as-you-go approach. The weighted average discount rate for net periodic benefit costs for June 30, 2010 and 2009 is 6.25% and 6.25%, respectively. The weighted average discount rate for the benefit obligation at June 30, 2010 and 2009 is 5.00% and 6.25% respectively. The net periodic post retirement costs for the years ended June 30, 2010 and 2009, including the following components is as follows (in thousands):

	2010	2009
Interest cost	\$ 324	\$ 781
Service cost	-	376
Amortization of prior service credits	(532)	-
Amortization of transition obligation	-	108
Net periodic post retirement costs	<u>\$ (208)</u>	<u>\$ 1,265</u>

Future benefit payments expected to be paid in each of the next five fiscal years and in the aggregate for the following five years as of June 30, 2010, are as follows (in thousands):

2011	\$ 432
2012	431
2013	430
2014	427
2015	423
2016 - 2020	2,038

(12) COMMITMENTS AND CONTINGENCIES

Operating Leases

The College leases various facilities under non-cancelable operating leases expiring at various dates through 2017. Total rental expense in fiscal years 2010 and 2009 for all operating leases was \$17.3 million and \$17.4 million, respectively.

Future minimum lease payments under operating leases as of June 30, 2010, which have initial or remaining lease terms in excess of one year, are as follows (in thousands):

2011	\$ 15,664
2012	11,520
2013	9,977
2014	7,287
2015	6,189
Thereafter	2,284
	<u>\$ 52,921</u>

Private Equity Investments

The College has committed to invest in certain private equity investments over a period of time. The remaining private equity commitment as of June 30, 2010 and 2009 is \$99.6 million and \$119.4 million, respectively.

Self-Insurance Program for Professional Liability

Medical malpractice and other actions alleging wrongful conduct and seeking punitive damages are sometimes filed against physicians and the College's affiliated institutions. Since 1977, the College has maintained a medical malpractice self-insurance program (the Program) that until July 1, 2003 had been supplemented by reinsurance or excess insurance agreements with private insurance companies. Due to sharply increased costs, the College's favorable loss experience, and the positive effects of tort reform legislation, the College, effective July 1, 2003, elected not to purchase excess insurance coverage. The insurance market pricing improved, therefore the College purchased reinsurance. Effective September 1, 2010, the College purchased \$65 million in reinsurance above a \$15 million self insured retention.

The Program's dedicated account is funded on an occurrence basis, meaning it is designed to cover the health care provider for an incident that happened while he or she was a participant no matter when the claim or lawsuit was filed. Participants have access to a pool of a self-insured retention and, if the claim was made before July 1, 2003, or if the patient care was rendered after July 1, 1977 but before July 1, 1986, several layers of excess coverage to respond to claims made against them. Funding for the Program has been actuarially determined to the level of \$35 million per occurrence, \$70 million aggregate for payment of medical malpractice losses and related expenses. For the period from July 1, 2003 through September 1, 2010 all risk of loss is borne by the College.

The College has been named as a defendant in various claims for damages resulting from alleged medical malpractice. The malpractice reserve, which includes reserves for incurred but not reported claims, is \$33.5 million and \$42.8 million as of June 30, 2010 and 2009, respectively. The discount rate used in calculating the actuarial present value was 5.00% for both years.

General Liabilities

The College also has been named in other actions filed by individuals alleging discrimination in the terms, conditions and privileges of employment. Based on information received to date, the College's administration believes that uninsured losses resulting from these matters, if any, will not be material to the College's financial statements.

Construction Contracts

At June 30, 2010 and 2009, the remaining commitments on existing construction and information technology contracts for the BCH Project and other information technology projects are approximately \$18.3 million and \$109.6 million, respectively.

(13) TRANSACTIONS WITH AFFILIATES

Included among the College's Board of Trustees are members from the banking, insurance and legal communities, who provide assistance in the development of policies and programs for the College. Also, certain trustees, faculty and staff of the College participate in the management of affiliated hospitals with which the College has contracts to provide services. During fiscal years 2010 and 2009, the College paid legal and related professional fees of approximately \$4.1 million and \$8.5 million, respectively, to law firms with which several board members are affiliated. Also, the College has received, from time to time, significant contributions from various board members and corporations with which board members are affiliated. These transactions have been entered into in the normal course of business.

(14) SUBSEQUENT EVENTS

The College has evaluated events occurring between the end of its most recent fiscal year, June 30, 2010, and the date the financial statements were issued, October 28, 2010.

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