



**University of California
San Francisco Foundation**

Annual Financial Report
June 30, 2006 and 2005

University of California San Francisco Foundation

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Report of Independent Auditors

The Board of Directors
University of California San Francisco Foundation

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of the University of California San Francisco Foundation (the Foundation), a component unit of the University of California, at June 30, 2006 and 2005, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Management's Discussion and Analysis on pages 2-5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

September 8, 2006

University of California San Francisco Foundation Management's Discussion and Analysis (Unaudited)

University of California San Francisco Foundation

Management's Discussion and Analysis

The following discussion and analysis presents an overview of the financial performance of the University of California San Francisco Foundation (the "Foundation") for the years ended June 30, 2006 ("2006") and 2005 ("2005"). It should be read in conjunction with, and is qualified in its entirety by, the related financial statements and footnotes. The financial statements, footnotes and this discussion and analysis were prepared by management and are the responsibility of management.

Financial Highlights

The following occurred in 2006:

- The Foundation's net assets increased 1.7% or \$10.3 million to \$605.6 million at June 30, 2006 from \$595.3 million at June 30, 2005. This compares to an increase of \$34.9 or 6.2% for 2005.
- Gifts to the Foundation, both current and endowment, increased 13.7% or \$10.8 million to \$89.6 million for 2006 compared with \$78.8 million during 2005. The increase for 2006 compares to an increase of \$75.3 million or 48.9% for 2005.
- The allowance for uncollectible pledges was increased by \$0.2 million in 2006 to \$6.2 million at June 30, 2006 compared with \$6.0 million at June 30, 2005. This compares to a decrease of \$4.7 million for 2005.
- The fair value of Foundation investments increased \$30.6 million in 2006. This compares to an increase of \$20.6 million for 2005.

The Foundation, which invests primarily in equity and fixed income securities, recorded nonoperating income of \$42.4 million in 2006 which represents a return of 8.4% on total cash, cash equivalents and investments; this compares with nonoperating income of \$31.4 million in 2005 which represented a return of 6.7%.

Using This Report

This annual report consists of a series of financial statements prepared in accordance with the statements of the Governmental Accounting Standards Board. These statements focus on the financial condition of the Foundation, its changes in net assets and its cash flows, taken as a whole.

One of the most important questions asked about Foundation finances is whether the Foundation is better off or worse off as a result of the year's activities. The key to understanding this question is the Statements of Net Assets, Statements of Revenues, Expenses and Changes in Net Assets and the Statements of Cash Flows. These statements present financial information in a form similar to that used by private sector companies. The Foundation's net assets (the difference between assets and liabilities) are one indicator of the Foundation's financial health. Over time, increases or decreases in net assets is one indicator of the improvement or erosion of the Foundation's financial health when considered with other nonfinancial information.

University of California San Francisco Foundation Management's Discussion and Analysis (Unaudited)

The Statements of Net Assets includes all assets and liabilities. The Statements of Revenues, Expenses and Changes in Net Assets presents revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating, with gifts and disbursements to University of California San Francisco ("UCSF") reported as operating revenue and expense, respectively, and investment results reported as nonoperating revenue or expense. These statements are prepared using the accrual basis of accounting.

Another way to assess the financial health of the Foundation is to look at the Statements of Cash Flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The Statements of Cash Flows helps users assess an entity's ability to generate future net cash flows, its ability to meet its obligations as they come due and its needs for external financing.

Condensed Financial Information

Condensed Statements of Net Assets June 30, 2006 and 2005 In Millions

	2006	2005	Change	
			\$	%
Assets				
Current assets	\$ 88.2	\$ 95.6	\$ (7.4)	-7.7%
Noncurrent assets	538.2	522.1	16.1	3.1%
Total assets	626.4	617.7	8.7	1.4%
Liabilities				
Current liabilities	7.2	9.0	(1.8)	-20.0%
Noncurrent liabilities	13.6	13.4	0.2	1.5%
Total liabilities	20.8	22.4	(1.6)	-7.1%
Net assets				
Restricted				
Nonexpendable	237.6	218.3	19.3	8.8%
Expendable	367.7	376.7	(9.0)	-2.4%
Unrestricted	0.3	0.3	-	-
Total net assets	\$ 605.6	\$ 595.3	\$ 10.3	1.7%

Foundation total assets at June 30, 2006 increased 1.4% or \$8.7 million to \$626.4 million from \$617.7 million at June 30, 2005. Total assets include cash and cash equivalents, investments, pledges and investment income receivable, receivable for investments sold, externally managed trusts, and other assets. Cash and investments increased by \$35.0 million or 7.0% due, primarily, to the results of operations in 2006. Pledges receivable decreased by \$24.1 million — pledge payments exceeded new pledges by \$24.6 million; this net decrease further was offset by a net decrease in the discount on multi-year pledges and the allowance for uncollectible pledges of \$0.5 million.

University of California San Francisco Foundation Management's Discussion and Analysis (Unaudited)

Foundation liabilities at June 30, 2006 decreased 7.1% or \$1.6 million to \$20.8 million from \$22.4 million at June 30, 2005. At June 30, 2006, liabilities to annuitants and life beneficiaries at \$14.5 million and agency funds held in trust at \$3.9 million are the largest components of the Foundation's liabilities.

Condensed Statements of Revenues, Expenses and Changes In Net Assets June 30, 2006 and 2005 In Millions

	2006	2005
Operating revenues & expenses		
Contributions	\$ 71.4	\$ 64.3
Disbursements to UCSF	(121.2)	(80.0)
Other operating income (loss), net	(0.5)	4.7
Net operating (loss) income	(50.3)	(11.0)
Nonoperating income		
Net investment income	11.8	10.8
Net increase in fair value of investments	30.6	20.6
Nonoperating income	42.4	31.4
Additions to permanent endowments	18.2	14.5
Increase in net assets	10.3	34.9
Net assets		
Net assets, beginning of year	595.3	560.4
Net assets, end of year	\$ 605.6	\$ 595.3

The Statements of Revenues, Expenses and Changes in Net Assets presents operating and nonoperating revenues and expenses for 2006 and reports an increase in the Foundation's net assets of \$10.3 million in 2006 compared to an increase of \$34.9 million in 2005. The increase in net assets is primarily attributable to additions to permanent endowments and an increase in the fair value of investments and net investment income.

For 2006, the Foundation reported an operating loss of \$50.3 million, compared to an operating loss of \$11.0 million for 2005. This resulted from contributions in 2006 of \$71.4 million compared to contributions of \$64.3 million in 2005. Operating revenue is offset by disbursements to UCSF of \$121.2 million in 2006 compared to \$80.0 million in 2005. Other operating expenses included an increase in the provision for uncollectible pledges receivable of \$0.2 million compared to a decrease of \$4.7 million in 2005. The allowance for uncollectible pledges receivable is generally a minimum of 1% of discounted outstanding pledge amounts. A higher allowance may be used for specifically identified pledges as deemed necessary by management.

Nonoperating revenues include the results of investment activities. A net increase in the fair value of investments of \$30.6 was recognized in 2006 compared with an increase of \$20.6 million in 2005. These amounts are before investment income of \$11.8 million in 2006 compared with \$10.8 in 2005.

University of California San Francisco Foundation Management's Discussion and Analysis (Unaudited)

Gifts to permanent endowments were \$18.2 million in 2006, an increase of \$4.7 million or 25.5% from 2005.

As a result of market volatility, the market value of some permanent endowments is less than the historic gift value of such endowments. Endowments with such market value deficiency are referred to as "underwater". While endowment payout typically is derived from both investment income and, to the extent needed, accumulated gains, the portion of payout derived from accumulated gains for these underwater endowments legally cannot be spent and accordingly, is reinvested into the endowment principal. The underwater amount of these endowments was \$0.5 million and \$0.2 million for 2006 and 2005, respectively. The amount of the reinvested payout was \$0.2 million and \$0.1 million for 2006 and 2005, respectively.

Factors Impacting Future Periods

Management is not aware of any factors that would have a significant impact on future periods.

University of California San Francisco Foundation
Statements of Net Assets
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 35,341,766	\$ 21,206,952
Short-term investments	21,141,540	33,522,377
Receivable for investments sold	147,982	485,863
Accrued investment income	736,282	943,669
Pledges receivable, net	28,992,623	38,947,563
Other assets	1,848,080	470,232
Current assets	<u>88,208,273</u>	<u>95,576,656</u>
Noncurrent assets		
Investments, excluding endowments and trusts	65,241,625	75,157,572
Cash and cash equivalents, endowments and trusts	58,461,375	33,560,399
Investments, endowments and trusts	358,428,419	339,955,270
Funds held in trust by others	4,172,001	7,408,656
Accrued investment income, endowments	711,187	658,028
Pledges receivable, net	51,038,272	65,239,710
Other assets	174,876	114,300
Noncurrent assets	<u>538,227,755</u>	<u>522,093,935</u>
Total assets	<u>626,436,028</u>	<u>617,670,591</u>
LIABILITIES		
Current liabilities		
Payable for investments purchased	380,409	3,846,702
Agency funds held in trust	3,932,337	3,226,692
Annuities payable	521,268	481,843
Liabilities to life beneficiaries	1,177,757	1,157,843
Other liabilities	1,181,911	319,360
Current liabilities	<u>7,193,682</u>	<u>9,032,440</u>
Noncurrent liabilities		
Annuities payable	3,343,721	3,574,499
Liabilities to life beneficiaries	9,419,609	8,978,106
Other liabilities	854,757	849,759
Noncurrent liabilities	<u>13,618,087</u>	<u>13,402,364</u>
Total liabilities	<u>20,811,769</u>	<u>22,434,804</u>

(continued)

The accompanying notes are an integral part of these financial statements.

University of California San Francisco Foundation
Statements of Net Assets
June 30, 2006 and 2005

(continued)	<u>2006</u>	<u>2005</u>
NET ASSETS		
Restricted		
Nonexpendable		
Endowment corpus	235,992,895	216,411,314
Trusts-annuity and life income funds	1,654,609	1,845,488
Total nonexpendable	<u>237,647,504</u>	<u>218,256,802</u>
Expendable		
Endowment income and net appreciation	100,039,458	80,602,357
Quasi-endowments	44,870,146	41,461,357
Trusts-annuity and life income funds	20,903,894	17,954,084
Contributions	201,892,379	236,686,256
Total expendable	<u>367,705,877</u>	<u>376,704,054</u>
Total restricted	605,353,381	594,960,856
Unrestricted	<u>270,878</u>	<u>274,931</u>
Total net assets	<u>\$ 605,624,259</u>	<u>\$ 595,235,787</u>

The accompanying notes are an integral part of these financial statements.

University of California San Francisco Foundation
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues		
Contributions	\$ 71,462,895	\$ 64,297,381
Total operating income	<u>71,462,895</u>	<u>64,297,381</u>
Operating expenses		
Disbursements to UCSF	121,244,126	79,959,106
Foundation operating expenses	215,779	145,283
Change in allowance for uncollectible pledges	254,946	(4,653,444)
Total operating expenses	<u>121,714,851</u>	<u>75,450,945</u>
Net operating loss	<u>(50,251,956)</u>	<u>(11,153,564)</u>
Nonoperating income		
Investment income, net of investment expense	11,813,021	10,815,347
Net increase in fair value of investments	30,630,193	20,635,472
Total nonoperating income	<u>42,443,214</u>	<u>31,450,819</u>
(Loss) income before other changes in net assets	(7,808,742)	20,297,255
Other changes in net assets		
Additions to permanent endowments	<u>18,197,214</u>	<u>14,591,144</u>
Increase in net assets	10,388,472	34,888,399
Net assets at beginning of the year	<u>595,235,787</u>	<u>560,347,388</u>
Net assets at end of the year	<u>\$ 605,624,259</u>	<u>\$ 595,235,787</u>

The accompanying notes are an integral part of these financial statements.

University of California San Francisco Foundation
Statements of Cash Flows
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities		
Contributions	\$ 88,995,680	\$ 68,893,668
Disbursements to UCSF	(121,244,126)	(79,959,106)
Payments to beneficiaries	(1,705,668)	(1,732,715)
Payments for administrative or operating expenses	(221,079)	(150,597)
Agency funds receipts	705,644	6,953
Other receipts	1,705,668	1,732,715
Net cash used in operating activities	<u>(31,763,881)</u>	<u>(11,209,082)</u>
Cash flows from noncapital financing activities		
Contributions for permanent endowment purposes	18,197,214	14,591,144
Other payments	(610,869)	(53,874)
Net cash provided by noncapital financing activities	<u>17,586,345</u>	<u>14,537,270</u>
Cash flows from investing activities		
Proceeds from sales and maturities of investments	279,813,358	213,982,229
Purchases of investments	(238,719,697)	(231,330,451)
Investment income, net of investment expense	12,119,665	11,817,729
Net cash provided by (used in) investing activities	<u>53,213,326</u>	<u>(5,530,493)</u>
Net increase (decrease) in cash and cash equivalents	39,035,790	(2,202,305)
Cash and cash equivalents at beginning of the year	54,767,351	56,969,656
Cash and cash equivalents at end of the year	<u>\$ 93,803,141</u>	<u>\$ 54,767,351</u>
Reconciliation of net operating income to net cash provided by operating activities		
Net operating loss	\$ (50,251,956)	\$ (11,153,564)
Adjustments to reconcile net operating income to net cash provided by operating activities		
Change in allowance for uncollectible pledges	254,946	(4,653,444)
Change in unamortized discount on pledges	(725,209)	(3,223,814)
Changes in assets and liabilities		
Pledges receivable	24,626,641	8,376,236
Funds held in trust by others	(72,078)	(3,810)
Real estate	(6,058,000)	-
Other assets and liabilities, net	461,775	(550,686)
Net cash used in operating activities	<u>\$ (31,763,881)</u>	<u>\$ (11,209,082)</u>

The accompanying notes are an integral part of these financial statements.

University of California San Francisco Foundation

Notes to Financial Statements

June 30, 2006 and 2005

1. Organization

The University of California San Francisco Foundation (the "Foundation") was incorporated on May 25, 1982 for the purpose of encouraging private giving to the University of California San Francisco (UCSF). The Foundation is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and qualifies for exemption from income taxes under Section 501(a) of the Code. Expenditures of the Foundation are generally limited to disbursements in support of the Regents of the University of California (the University) and normal administrative costs. The Foundation's financial statements are discretely presented in the University of California's financial statements as a component unit.

2. Summary of Significant Accounting Policies

The financial statements of the Foundation have been prepared in accordance with accounting principles generally accepted in the United States of America, including all applicable effective statements of the Governmental Accounting Standards Board (GASB) and all statements of the Financial Accounting Standards Board through November 30, 1989 that do not conflict with, or contradict GASB standards. The statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements is presented below:

Cash and Cash Equivalents

Cash and cash equivalents consist of bank deposits and money market funds, including those amounts held for long-term investment purposes that are classified as noncurrent cash and cash equivalents.

Investments

Investment securities are reported at fair value. Marketable securities' fair values are based on quoted market prices obtained from independent sources. Investments in alternative investments, including limited partnerships, private equity funds, hedge funds and absolute return funds, are reported at a fair value by the general partner after considering factors such as the nature of the underlying portfolios, liquidity and market conditions. Because they are not readily marketable, the fair values may differ from the values that would have been used had a ready market for these investments existed. Investments in real estate are stated at a fair value as established by independent appraisals.

Short-term investments consist of U.S. government and corporate obligations with a maturity date of less than one year. All endowment and trust investments are classified as noncurrent regardless of maturity due to restrictions limiting the Foundation's ability to use these investments.

Investment income consists of dividend and interest income and is shown net of investment management and foundation management fees.

The net change in the fair value of investments consists of both realized and unrealized gain and loss on investments. The calculation of realized gain and loss on the sale of investments is independent of the calculation of the net change in the fair value of investments.

University of California San Francisco Foundation

Notes to Financial Statements

June 30, 2006 and 2005

Endowments

Endowments are invested in a unitized pool. Transactions within each individual endowment in the pool are based on the unit market value at the beginning or end of the month during which the transaction takes place for withdrawals and additions, respectively. It is the goal of the Foundation that the total return from endowment investments should be adequate to meet the following objectives:

- Preserve investment capital and its purchasing power.
- Generate sufficient resources to meet spending needs (payout).
- Attain reasonable capital appreciation through prudent acceptance of risk to enhance the future purchasing power of the investment capital.

The Foundation adopted the Uniform Management of Institutional Funds Act (UMIFA) in 1992. Under UMIFA, annual spending (endowment payout) may be taken from investment income, and accumulated realized and unrealized investment gain. The annual payout rate is 5% of the average market value of the endowment investment pool for the previous 36 months less foundation management fees. Payout is distributed to individual funds annually based on average units outstanding during the year.

As a result of market volatility, the market value of some permanent endowments is less than the historic gift value of such endowments. Endowments with such market value deficiency are referred to as “underwater”. While endowment payout typically is derived from both investment income and, to the extent needed, accumulated gains, the portion of payout derived from accumulated gains for these underwater endowments legally cannot be spent and accordingly, is reinvested into the endowment principal. Reinvestment on underwater endowments occurs only as long as the market value of such endowments remains less than the historic gift value of the endowment.

Trusts

Trusts include irrevocable gift annuity, annuity trust and unitrust gifts made to the Foundation in which a designated beneficiary retains an interest in the gift as specified in the trust agreement. The Foundation is trustee and a remainderman for these trusts. For these funds, a liability for beneficiary payments is established representing the present value of estimated future beneficiary payments over the expected life of the life beneficiaries. The liability is calculated using standard gift annuity tables and applicable IRS guidelines. The remaining amount is recognized as revenue in the period in which the Foundation is notified that it is a remainderman or beneficiary.

Funds held in trust by others include assets for which the Foundation is a remainderman or has a life interest as beneficiary and for which there is an external trustee. In the period the Foundation is notified that it is a party to such a trust, the discounted present value of funds held in trust by others is recorded as revenue.

Pledges Receivable

Pledges are written unconditional promises to make future payments. Pledges receivable, other than endowment pledges, are recognized as contribution revenue in accordance with donor imposed restrictions, if any, in the period pledged as they meet the time requirements specified by GASB

University of California San Francisco Foundation
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Statement No. 33. Endowment pledges are recognized as additions to endowments at the time payments are received. Pledge payments extending beyond one year are discounted to recognize the present value of the future cash flows. In subsequent years, this discount is accreted and recorded as additional contribution revenue. In addition, an allowance for uncollectible pledges has been established based on past experience as deemed necessary by management.

Conditional promises, which depend on the occurrence of a specified future or uncertain event, such as matching gifts from other donors, are recognized as revenue when the conditions are substantially met.

Agency Funds Held in Trust

Agency funds held in trust represent funds held by the Foundation under an agency relationship with various support groups of UCSF. Such amounts are not assets owned or contributed to the Foundation and, accordingly, are recorded as liabilities, and not as revenue, when received. The corresponding assets are included in investments.

Net Assets

To ensure observance of limitations and restrictions placed on the use of resources available to the Foundation, net assets and revenues, expenses and gains and losses are classified and reported as follows, based on the existence or absence of donor-imposed restrictions.

Restricted Nonexpendable Net Assets

Restricted nonexpendable net assets include permanent endowments. Such funds are generally subject to donor restrictions requiring that the principal be invested in perpetuity for the purpose of producing investment income and appreciation that may be expended or added to principal in accordance with donors' wishes. The Foundation classifies the original endowment gift and any amounts added to principal per the donor's wishes, as restricted nonexpendable net assets. In addition, depreciation on underwater endowments is classified as a reduction in restricted nonexpendable net assets. Trust resources that are not expendable upon maturity are also classified as restricted nonexpendable net assets.

Restricted-Expendable Net Assets

Restricted-expendable net assets relate to contributions designated by donors for use by particular entities or programs or for specific purposes or functions of UCSF. They also include quasi-endowments, which are internally restricted net assets that can be expended. Investment income and appreciation of endowment investments are classified as restricted expendable net assets unless otherwise specified by the donor. Trust resources that are expendable upon maturity are classified as restricted expendable net assets.

Unrestricted Net Assets

Unrestricted net assets are net assets of the Foundation that are not subject to donor-imposed restrictions.

Revenues and Expenses

Since they are fundamental to the core mission of the Foundation, contributions and pledges meeting the requirements of GASB Statement No. 33 are recognized as operating revenues in the period received or pledged. Disbursements in support of UCSF and certain administrative expenses incurred in conducting the business of the Foundation are presented in the financial statements as operating activities.

University of California San Francisco Foundation
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June 30, 2006 and 2005

Nonoperating income and expenses include investment income and net realized gain (loss) on the sale of investments and change in unrealized appreciation (depreciation) on the value of investments held at the end of the period.

Gifts for permanent endowment purposes are classified as other changes in net assets.

Use of Estimates

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

3. University of California

The Foundation is subject to the policies and procedures of the University and was established for the benefit of UCSF. The University establishes administrative guidelines for the Foundation, with regard to the Foundation's ability to conduct operations, through its policy on campus foundations. The University policy limits the ability of the Foundation to make certain expenditures and provides a general framework over its operations. The Foundation was established solely to support the mission of the University and UCSF and, accordingly, is considered a governmental not-for-profit organization subject to reporting under the GASB.

UCSF provides facilities and equipment for the Foundation and pays all salaries, benefits, and related expenses for employees, as well as some other operating expenses of the Foundation. The costs of such items are not included in the accompanying financial statements. Expenses related to investment management, insurance, legal, and other professional services are paid for by the Foundation.

UCSF charges the Foundation a management fee (foundation management fee), which is an administrative charge based on the average market value of the Foundation's cash, cash equivalents and investments, excluding trust investments. For 2005, the fee was 0.25% and charged against both current and endowment assets. For 2006, the fee is 0.35% and charged only against endowment assets. This fee is reduced by certain operating expenses of the Foundation. The foundation management fee was \$1,159,846 and \$1,029,019 for the years ended June 30, 2006 and 2005, respectively.

All contributions to the Foundation ultimately benefit UCSF. For the years ended June 30, 2006 and 2005, disbursements to the University were \$121,244,126 and \$79,959,106, respectively, from restricted expendable net assets. The accompanying financial statements reflect only contributions made to the Foundation; contributions made to UCSF are reflected in the financial statements of the University.

4. Cash and Cash Equivalents

The Foundation manages a substantial amount of its cash through its master custodian; other cash intended to meet operating needs is maintained in demand deposit accounts. All cash balances are minimized by sweeping available balances into investment accounts on a daily basis.

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Notes to Financial Statements
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At June 30, 2006 and 2005, the carrying amount of the Foundation's cash and cash equivalents held in nationally recognized banking institutions was \$84,203,141 and \$54,767,351, respectively, compared to bank balances of \$84,165,856 and \$54,532,458, respectively. Deposits in transit are the primary difference. Bank balances are collateralized by U.S. government and corporate money market securities held in the name of the bank. The Federal Deposit Insurance Corporation (FDIC) insures the remaining uncollateralized bank balances.

The Foundation does not have exposure to foreign currency risk in its demand deposit accounts.

5. Investments

Pursuant to UCSF's policies on campus foundations, the Foundation's Board of Directors has elected to oversee the management of its investments rather than delegating that function to the Treasurer of the University. The Board of Directors of the Foundation, as the governing Board, is responsible for oversight of the Foundation's investments. Establishment and implementation of investment policy, including the establishment of investment guidelines and the selection of investment managers, has been delegated by the Board of Directors of the Foundation to its Investment Committee.

The unendowed investment portfolio is managed so as to maximize returns consistent with safety of principal and liquidity considerations necessary to meet UCSF's cash flow requirements. Investments authorized by the Investment Committee include readily marketable money market and fixed income securities; other types of investments may be made with the prior approval of the Investment Committee.

The endowed portfolio is an investment pool in which a large number of individual endowments participate in order to benefit from diversification and economies of scale. The primary investment objective of the endowed investment portfolio is growth of principal sufficient to preserve purchasing power and to provide income to support current and future UCSF activities. Long term, the total return on the portfolio should equal the rate of inflation, plus the payout rate which is used to support current activities, plus an amount reinvested to support future activities. Investments authorized by the Investment Committee include high quality, readily marketable equity and fixed income securities; other types of investments may be made with the prior approval of the Investment Committee.

The equity portion of the endowed portfolio may include both domestic and foreign equities, including foreign currency denominated, common and preferred stocks, actively managed and passive (index) strategies, along with a modest exposure to private equities, including venture capital partnerships, buy-out and international funds. Overall, the equity portfolio is measured against the Russell 3000 Index. Additional benchmarks have been established based on specific characteristics of groups of equities. For large, medium and small capitalization equities, the portfolio is measured against the Standard & Poor's 500 Index, the Russell Midcap Index, and the Russell 2500 Index, respectively. For foreign equities, the portfolio is measured against the EAFE Index.

The fixed income portion of the endowed portfolio may include both domestic and foreign securities, along with certain securitized investments, including mortgage-backed and asset-backed securities. The effective duration of the fixed income portfolio is to be maintained in a range of 75%-125% of the effective duration of the benchmark Lehman Aggregate Bond Index.

University of California San Francisco Foundation
Notes to Financial Statements
June 30, 2006 and 2005

The composition of the Foundation's investments at June 30, 2006 and 2005 is as follows:

Investment Type	2006		2005	
	Market	Cost	Market	Cost
Equity securities				
Domestic	\$ 85,358,550	\$ 69,600,970	\$ 110,903,586	\$ 87,974,495
Foreign	26,569,324	19,305,733	26,729,503	21,253,090
Equity securities	111,927,874	88,906,703	137,633,089	109,227,585
Fixed income securities				
U.S. Treasury bills, notes & bonds	28,321,074	28,339,370	65,362,249	66,309,626
U.S. government- backed securities	3,777,435	3,757,935	4,437,955	4,234,850
U.S. government guaranteed	32,098,509	32,097,305	69,800,204	70,544,476
Other U.S. dollar denominated				
Corporate bonds	46,652,152	47,357,409	43,694,120	41,614,372
U.S. agencies	70,643,390	72,689,650	57,321,303	57,700,967
Corporate - asset-backed securities	2,408,603	2,503,080	2,964,800	2,993,478
Other U.S. dollar denominated	119,704,145	122,550,139	103,980,223	102,308,817
Commingled funds				
Absolute return funds	33,319,160	22,500,000	15,972,143	15,000,000
Balanced funds	24,354,641	26,167,750	24,141,990	25,741,521
U.S. equity funds	41,047,749	31,231,248	46,257,691	39,153,386
Non-U.S. equity funds	52,413,202	47,215,444	33,132,920	30,975,688
Non-U.S. bond funds	2,889,127	2,939,660	2,634,701	2,524,536
Commingled funds	154,023,879	130,054,102	122,139,445	113,395,131
Private equity	15,489,084	25,920,340	9,572,165	13,766,905
Real estate	11,568,093	8,853,806	5,510,093	2,795,806
Externally held irrevocable trusts	4,172,001	4,641,089	7,408,656	6,156,215
Total investments	448,983,585	413,023,484	456,043,875	418,194,935
Less: current portion	21,141,540	21,093,329	33,522,377	34,359,714
Noncurrent portion	\$ 427,842,045	\$ 391,930,155	\$ 422,521,498	\$ 383,835,221

The components of the net change in fair value of investments for the years ended June 30, 2006 and 2005 are as follows:

	2006	2005
(Decrease) increase in net unrealized appreciation on investments	\$ (1,888,830)	\$ 176,516
Net realized gain on sale of investments	32,519,023	20,458,956
Net increase in fair value of investments	\$ 30,630,193	\$ 20,635,472

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Net investment income for the years ended June 30, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Total investment income	\$ 14,275,039	\$ 13,002,824
Less: investment management fees	(1,302,172)	(1,158,458)
Less: foundation management fees	(1,159,846)	(1,029,019)
Net investment income	<u>\$ 11,813,021</u>	<u>\$ 10,815,347</u>

6. Investment Risk Factors

There are many factors that can affect the value of investments. Some, such as custodial credit risk, concentration of credit risk, and foreign currency risk may affect both equity and fixed income securities. Equity securities respond to such investment behavioral factors as economic conditions, individual company earnings performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates.

Credit Risk

Fixed income securities are subject to credit risk, which is the chance that a bond issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the security price to decline. The circumstances may arise due to a variety of factors, such as liquidity, financial weakness or bankruptcy. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are considered to have little or no credit risk.

A bond's credit quality is an assessment of the issuer's ability to pay interest on the bond, and ultimately, to pay the principal. Credit quality is evaluated by one of the independent bond-rating agencies, such as Moody's Investors Service (Moody's) or Standard and Poor's (S&P). The lower the rating, the greater the chance, in the rating agency's opinion, that the bond issuer will default, or fail to meet its payment obligations. Generally, the lower a bond's credit rating, the higher its yield should be to compensate for the additional risk.

The investment guidelines for the unendowed portfolio recognize that a limited amount of credit risk, properly managed and monitored, is prudent and provides incremental risk adjusted return over its benchmark. The benchmark for the unendowed portfolio, the Shearson Lehman Brothers 1-3 Year U.S. Treasury Index reflects a return with little or no credit risk. Commercial paper, banker's acceptances and certificates of deposit issuers must be rated P-1 (Moody's)/A-1 (S&P) or better at the time of purchase, with the long term securities of the issuer rated A3 (Moody's)/A- (S&P) or better; fixed income securities must be rated investment grade Baa3 (Moody's)/BBB- (S&P) or better at the time of purchase; asset-backed securities must be rated Aa3 (Moody's)/AA- (S&P) or better at the time of purchase. No more than 20% of the portfolio at the time of purchase may be invested in securities rated below Aa3 (Moody's)/AA- (S&P).

Credit risk is appropriate in the endowed portfolio, as evidenced by the benchmark chosen for the fixed income portion of the portfolio, the Lehman Aggregate Bond Index. Portfolio guidelines for this portfolio mandate that no more than 20% of the market value of the fixed income portfolio may be invested in issues that are unrated or that have credit ratings below investment grade by Moody's

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or S&P. Further, the weighted average credit rating must be maintained at a minimum investment grade quality of Baa3 (Moody's)/BBB- (S&P) or higher at all times.

The credit risk profile for fixed income securities at June 30, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
U.S. government guaranteed	\$ 32,098,509	\$ 69,800,204
Other U.S. dollar denominated		
AAA	75,258,732	62,544,797
AA	2,263,632	1,262,159
A	9,717,484	11,129,565
BBB	18,368,719	14,587,126
BB	7,963,474	14,088,360
B	3,835,697	-
Not rated	2,296,407	368,216
Total other U.S. dollar denominated	<u>119,704,145</u>	<u>103,980,223</u>
Commingled bond funds (not rated)		
Non-U.S. bond funds	<u>2,889,127</u>	<u>2,634,701</u>
Total commingled bond funds	<u>2,889,127</u>	<u>2,634,701</u>
 Total fixed income securities	 <u>\$ 154,691,781</u>	 <u>\$ 176,415,128</u>

Custodial Credit Risk

Custodial credit risk is the risk that in the event of the failure of the custodian, the Foundation's investments may not be returned.

Substantially all of the Foundation's investments are issued, registered or held in the name of the Foundation by its master custodian bank, as agent for the Foundation. Other types of investments represent ownership interests that do not exist in physical or book-entry form. As a result, custodial risk is considered to be remote.

Concentration of Credit Risk

Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic or credit developments.

Financial instruments that potentially subject the Foundation to concentrations of credit risk consist principally of cash equivalents, U.S. government and federal agency obligations, common stocks and corporate debt securities. Federal agency obligations consist primarily of collateralized mortgage obligations, which are collateralized by diversified home mortgages. The remainder of the portfolio is diversified and issuers are dispersed throughout many industries and geographies.

The equity portion of the Foundation's portfolios may be managed passively or actively. For the portion managed passively, the concentration of individual securities is equal to their concentration in the relative benchmark. With respect to the actively managed portfolio, investment policy requires that the portfolio be adequately diversified to limit exposure to concentration of credit risk.

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Within the unendowed portfolio, Foundation investment policy requires that at the time of purchase no more than 5% of the total market value of the portfolio be invested in any single issuer, with the exception of securities issued or guaranteed by the U.S. government, its agencies, or government sponsored enterprises, or collateralized by such securities or loans. Endowed portfolio investment policy requires that equity securities be diversified among at least 20 issuers, with no more than 5% of the total market value of the portfolio, at the time of purchase, in any one issuer. In addition, up to 15% of the portfolio may be invested in equities issued by small cap companies defined as companies with capitalizations below \$600 million.

Investments in issuers that represent 5% or more of total Foundation investments at June 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Issuer		
Fannie Mae	\$ 53,686,442	\$ 40,627,272
Vanguard S&P 500 Index Fund	\$ 25,064,422	\$ 27,678,500

Interest Rate Risk

Interest rate risk is the risk that the value of fixed income securities will decline because of changing interest rates. The prices of fixed income securities with a longer time to maturity, measured by effective duration, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter durations. Effective duration is the approximate change in price of a security resulting from a 100 basis point (one percentage point) change in the level of interest rates. It is not a measure of time.

Portfolio guidelines limit the maximum weighted average effective duration of the unendowed portfolio to not greater than 125% of the benchmark Lehman Brothers 1-3 Year U.S. Treasury Index; seven years is the maximum stated maturity or average life for an individual security. The effective duration of the fixed income portion of the endowed portfolio is to be maintained in a range of 75% to 125% of the effective duration of the benchmark Lehman Aggregate Bond Index. This constrains the potential price movement due to interest rate changes of the portfolio to be similar to that of the benchmark. The unendowed portfolio benchmark was changed during fiscal year 2005 from one that allowed for a longer maximum weighted average effective duration for the portfolio. Portfolio durations for 2006 and 2005 are presented for the combined unendowed and endowed portfolios and reflect this change in benchmark.

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The effective duration of the Foundation's fixed income securities at June 30, 2006 and 2005 follows. Information presented does not take into account the relative weighting of the portfolio components to the total portfolio.

	<u>2006</u>	<u>2005</u>
U.S. government		
U.S. Treasury notes	0.81	0.97
U.S. government backed securities	3.61	3.24
Other U.S. dollar denominated		
Corporate bonds	4.77	4.99
U.S. agencies	2.66	1.42
Corporate - asset-backed securities	1.29	1.70
Commingled funds		
Non-U.S. bond funds	6.70	5.94

In accordance with investment policies, investments may include mortgage pass-through securities, collateralized mortgage obligations, callable bonds and corporate asset-backed securities that are considered to be highly sensitive to changes in interest rates.

Mortgage Pass-Through Securities

These securities are issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae) and Federal Home Loan Mortgage Association (Freddie Mac), and include short embedded prepayment options. Unanticipated prepayments by the obligees of the underlying asset reduce the total expected rate of return.

Collateralized Mortgage Obligations

Collateralized mortgage obligations (CMO's) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments make the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. For an interest-only CMO, the reduced cash flow associated with the prepayments reduces the expected rate of return and causes the fair value to decline. For a principal-only CMO, the increased cash flows associated with the prepayments increases the expected rate of return and causes the fair value to increase. In a rising interest rate environment, the opposite is true for both the interest-only and principal-only CMO's. The Foundation does not invest in principal-only or interest-only CMO's.

Callable Bonds

Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The Foundation must then replace the called bond with a bond that may have a lower yield than the original bond. The call feature causes the fair value to be highly sensitive to changes in interest rates.

Corporate Asset-Backed Securities

Corporate asset-backed securities also generate a return based upon either the payment of interest or principal on obligations in an underlying pool, generally associated with auto loans or credit cards. The relationship between interest rates and prepayments make the fair value highly sensitive to changes in interest rates.

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At June 30, 2006 and 2005, the fair value of investments that are considered to be highly sensitive to changes in interest rates is as follows:

	<u>2006</u>	<u>2005</u>
Investments Highly Sensitive to Changes in Interest Rates		
Mortgage pass-through securities	\$ 60,316,850	\$ 42,898,205
Collateralized mortgage obligations	11,253,355	14,423,098
Callable bonds	1,039,524	811,720
Corporate asset-backed securities	2,408,614	2,964,800
	<u>\$ 75,018,343</u>	<u>\$ 61,097,823</u>

At June 30, 2006 and 2005, the effective duration for fixed income securities that are considered to be highly sensitive to changes in interest rates is as follows:

	<u>2006</u>	<u>2005</u>
Effective Duration of Investments Highly Sensitive to Changes in Interest Rates		
Mortgage pass-through securities	2.75	1.43
Collateralized mortgage obligations	2.22	1.39
Callable bonds	3.76	1.46
Corporate asset-backed securities	1.29	1.70

Foreign Currency Risk

The Foundation's asset allocation policy includes an allocation to non-U.S. equities. These investments are not hedged, therefore foreign currency risk is an accepted risk of the investment strategy. Portfolio guidelines for fixed income securities also allow exposure to non-U.S. dollar denominated bonds. Exposure to foreign currency risk from these securities is permitted and it may be fully or partially hedged using forward foreign currency exchange contracts. Under the investment policies, such instruments are not permitted for speculative use or to create leverage.

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At June 30, 2006 and 2005, the U.S. dollar balances organized by currency denominations and investment type are as follows:

	<u>2006</u>	<u>2005</u>
Equity Securities:		
Australian Dollar	\$ 719,462	\$ 3,046,492
British Pound	5,619,888	5,945,096
Canadian Dollar	1,216,295	648,877
Chinese Yuan	-	42,607
Danish Krone	126,093	104,544
European Monetary Unit	8,511,109	7,653,192
Hong Kong Dollar	1,176,172	807,623
Indian Rupee	167,918	63,365
Japanese Yen	6,388,405	5,606,941
Mexican Peso	691,595	583,682
Norwegian Kronar	-	142,136
Singapore Dollar	81,117	59,516
South African Rand	166,152	116,014
South Korean Won	480,268	392,398
Swedish Krona	198,220	192,856
Swiss Franc	1,026,630	1,324,164
Total equity securities	<u>26,569,324</u>	<u>26,729,503</u>
Commingled Funds:		
Various currency denominations:		
Balanced funds – Non-U.S. equity	61,013,202	33,132,920
Balanced funds – Non-U.S. bond	2,889,127	2,634,701
Total commingled funds	<u>63,902,329</u>	<u>35,767,621</u>
Total exposure to foreign currency risk	<u>\$ 90,471,653</u>	<u>\$ 62,497,124</u>

Alternative Investment Risks

Alternative investments include ownership interests in a wide variety of partnership and fund structures that may be domestic, off-shore or foreign. Generally, there is little or no regulation of these investments by the Securities and Exchange Commission or U.S. state attorneys general. These investments employ a wide variety of strategies including absolute return, hedge, venture capital, private equity and other strategies. Investments in this category may employ leverage to enhance the investment return. Underlying investments can include financial assets such as marketable securities, non-marketable securities, derivatives, and synthetic and structured instruments; real assets; tangible and intangible assets; and other funds and partnerships. Generally, these investments do not have a ready market or may not be traded without approval of the general partner or fund management.

Alternative investments are subject to all of the risks described previously related to equities and fixed income instruments. In addition, the underlying assets may not be held by a custodian either because they cannot be, or because the entity has chosen not to hold them in this form. Valuations are determined by the investment manager who has a conflict of interest in that he or she is compensated for performance. Real assets may be subject to physical damage from a variety of

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means, loss from natural causes, theft of assets, lawsuits involving rights and other loss and damage. These risks may not be insured or insurable. Tangible assets are subject to loss from theft and other criminal actions and from natural causes. Intangible assets are subject to legal challenge and other possible impairment. Broadly, alternative strategies and their underlying assets and rights are subject to an array of economic and market vagaries that can limit or erode value.

7. Endowment Payout

Endowment pool investment income for the years ended June 30, 2006 and 2005 consists of the following:

	<u>2006</u>	<u>2005</u>
Total endowment pool investment income	\$ 8,652,422	\$ 8,528,855
Less: investment and foundation management fees	(2,244,107)	(1,613,875)
Less: endowment payout allocation	<u>(6,375,000)</u>	<u>(6,875,000)</u>
Investment income reinvested in the endowment pool	<u>\$ 33,315</u>	<u>\$ 39,980</u>

Under UMIFA, investment income, as well as a portion of accumulated realized and unrealized gains may be expended in support of the operational requirements of UCSF programs. For the years ended June 30, 2006 and 2005 endowment payout was comprised of the following:

	<u>2006</u>	<u>2005</u>
Investment income, net	\$ 6,375,000	\$ 6,875,000
Net accumulated gains	<u>9,034,379</u>	<u>6,562,095</u>
Endowment payout	15,409,379	13,437,095
Less: reinvestment of payout related to underwater funds	<u>(177,010)</u>	<u>(64,174)</u>
Endowment payout available for disbursement	<u>\$ 15,232,369</u>	<u>\$ 13,372,921</u>

Endowment payout is shown net of endowment portfolio related foundation management fees of \$1,159,846 and \$1,029,019 for 2006 and 2005, respectively.

As a result of market volatility, the market value of some permanent endowments can be less than the historic gift value of such endowments. The underwater amount of such endowments was \$535,820 and \$151,157 at June 30, 2006 and 2005, respectively.

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8. Pledges Receivable

Pledges receivable at June 30, 2006 and 2005 consist of the following unconditional promises to give:

	<u>2006</u>	<u>2005</u>
Pledges due in one year or less	\$ 32,265,602	\$ 44,243,973
Less: allowance for uncollectible pledges	<u>(3,272,979)</u>	<u>(5,296,410)</u>
Pledges receivable, current	<u>28,992,623</u>	<u>38,947,563</u>
Pledges due between one and five years	50,325,006	61,432,095
Pledges due in more than five years	<u>10,765,385</u>	<u>12,306,566</u>
Pledges due in more than one year	61,090,391	73,738,661
Less: allowance for uncollectible pledges	(2,937,364)	(658,987)
Less: unamortized discount	<u>(7,114,755)</u>	<u>(7,839,964)</u>
Pledges receivable, non-current	<u>51,038,272</u>	<u>65,239,710</u>
Total pledges receivable	<u>\$ 80,030,895</u>	<u>\$ 104,187,273</u>

Pledges from three donors represent more than 10% individually and 62.2% in the aggregate of total pledges receivable at June 30, 2006. Pledges from four donors represent more than 10% individually and 62.6% in the aggregate of total pledges receivable at June 30, 2005.

9. Commitments

As of June 30, 2006, the Foundation has contractual commitments to invest an additional \$9,320,580 in various endowment pool limited partnership investments through December 31, 2017.