CREATING FUTURES

UNIVERSITY OF WASHINGTON ANNUAL REPORT 2004

> FACTS

STUDENTS	2003–2004	1998–1999	1993–1994
Autumn Enrollment			
Undergraduate	30,888	27,537	26,043
Graduate	10,023	8,385	7,947
Professional	1,797	1,719	1,266
TOTAL	**42,708**	**37,641**	**35,256**
Extension[1]	39,263	32,334	34,755
Number of Degrees Awarded			
Bachelor's	8,427	6,936	6,433
Master's	2,780	2,072	2,019
Doctoral	506	520	455
Professional	488	470	365
TOTAL	**12,201**	**9,998**	**9,272**
INSTRUCTIONAL FACULTY	3,553	3,500	3,168
FACULTY AND STAFF[2]	26,750	21,781	20,488

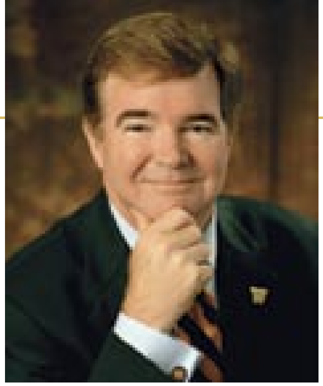
	2003–2004	1998–1999	1993–1994
RESEARCH FUNDING – ALL SOURCES *(in thousands of dollars)*	$ 954,000	$ 601,000	$ 459,000
SELECTED REVENUES *(in thousands of dollars)*			
Gifts, Grants, and Contracts	$ 957,863	$ 610,224	$ 427,214
Auxiliary Enterprises[3] and Other Revenues	1,189,453	719,766	487,045
State Appropriations (Operating)	309,618	301,812	261,500
Tuition and Fees[4]	304,189	228,754	154,835
SELECTED EXPENSES *(in thousands of dollars)*			
Instruction, Academic Support, and Student Services	$ 806,749	$ 567,873	$ 421,535
Research and Public Service	576,607	415,634	299,995
Auxiliary Enterprises[3]	729,003	574,518	361,434
Institutional Support and Physical Plant	248,986	157,256	124,372
CONSOLIDATED ENDOWMENT FUNDS[5] *(in thousands of dollars)*	$ 1,208,000	$ 673,000	$ 264,000
SQUARE FOOTAGE[6] *(in thousands of square feet)*	17,500	14,800	13,900

1 Course registrations
2 Full-time equivalents
3 Includes UWMC
4 Net of scholarship allowances of $46,519,000 in 2003-2004
5 Stated at fair value
6 Gross square footage, all campuses

FRONT COVER

A laboratory model of the North Pole depicting the circulation of Earth's atmosphere in a form called Rossby waves, which are also a key part of the ocean circulation. Understanding both atmospheric and ocean circulation is vital to predicting global climate change in the future.

– SOURCE, UW GEOPHYSICS FLUID DYNAMICS LABORATORY



First, a personal note: my thanks to all of you who have welcomed me back to Washington, and my greetings to those I have not yet had the opportunity to meet. Returning to lead one's alma mater—especially one as distinguished as the University of Washington—is a rare and fortunate experience. I am thrilled to be here.

When I arrived last July, the fiscal year covered in this report had just ended. But the stories you will read in these pages reach forward into the current year and beyond. Like the University itself, they are oriented toward the future. They illustrate ongoing goals, commitments, ways of working, and relationships:

- Together with the public schools, we are deeply involved in improving elementary and secondary education in Washington—and, by the power of example, around the country.
- This region has become a hub of global-health and international-relief activity. UW students and faculty are in the thick of those efforts, pursuing the promise of a better life for millions of people.
- Preserving the Northwest environment, so critical to our collective identity and well being, is the focus of UW research in fields from oceanography to forestry to biology.
- Our School of Nursing, which has ranked best in the nation ever since rankings began, has put issues like infant mental health on society's to-do list.
- And in this entrepreneurial corner of the world, our faculty, staff, and students—in business, medicine, science, technology, and even the arts and humanities—are boosting the state's economy by turning academic research and discoveries into companies, products, and benefits.

So the stories in this report are a glimpse into larger stories. They portray a university engaged with the world, tackling important problems, and marshalling energies and expertise across borders—of discipline, geography, age, whatever (as our students say). Note that these are characteristics not just of UW research and public service, but of our education as well. Every year, more UW undergraduates join faculty research projects, take service-learning courses, study abroad, apply for internships, and graduate with double or triple majors.

From my various higher-education posts around the country, I watched the University of Washington grow into the exceptional institution it is today. But one thing I did not see fully until I got here: the unusually strong culture of collaboration, collegiality, and cross-disciplinary work. It is that culture, firmly established in a faculty of extraordinary individual distinction, that makes the University a true powerhouse in addressing the kinds of enormous, complicated problems we face today.

In my view, this will increasingly be the UW's signature: a capacity, indeed an eagerness, for taking on big, complex questions. These questions abound, in realms such as climate change, global health, genomics, human learning and development, the relationship of science to humanistic values, and many more.

From this signature, other qualities follow. Our education must be open to all and second to none. We must build new partnerships with the world beyond the campus. We must complete the work of fully integrating the state's diversity in our students, faculty, and staff.

Of course, for a large state university in these times, a vision is not the same as a self-fulfilling prophecy. The UW faces challenges. Prime among them is the long-term decline in state funding, which is a national problem but has been more acute here. The state legislature, the general public, and the business community now understand what is at stake in the competitive erosion of higher education in Washington. It is not yet clear, however, where they will find the resources to fix the problem.

This is one of the reasons the UW has embarked on an ambitious, multi-year fundraising campaign. To be the kind of university this region needs, to do the good things we know we can and should do, is going to take more dollars than are likely to come to us from the state. The generosity of private individuals, corporations, and foundations can make an enormous difference in our ability to do our job—as it has in the past.

A first-rate University of Washington is crucial to the future of this state. I am confident that all of us together, acting on that conviction, will keep it a first-rate university.

Mark A. Emmert


25 KGS. NET

"THERE'S A PROCESS OF SYNCHRONY THAT'S EXTREMELY IMPORTANT—THE ABILITY OF PARENT AND BABY TO SHARE EMOTIONS, TO RESPOND TO ONE ANOTHER'S CUES."

THE RIGHT START

What does infancy feel like? That turns out to be a central question for those who probe the mysteries of human development.

UW nursing professor Kathryn Barnard has been in the forefront of such research for 30 years. Early in her career, she worked with mentally and emotionally damaged babies and their mothers. Those encounters gave her a mission—infant mental health—and a conviction: right from the beginning, infants register the signals of human relationships. The very earliest interactions between parent and child have profound and lasting effects—on the child's ability to learn, to make friends, and to find a positive place in society.

"The mother's capacity to be there for the baby is key," says Dr. Barnard. "How parents respond to distress is one of the most significant things. There's a process of synchrony that's extremely important—the ability of parent and baby to share emotions, to respond to one another's cues." All too often, she says, problems go back to a mother's own early life. "We know that some mothers don't even hear their babies crying, because their own crying was not attended to."

The first step in breaking this cycle, Dr. Barnard believed, was identifying babies at risk. So she developed a protocol for evaluating mother-child interaction. That protocol, the NCAST scale, is now used by thousands of nurses, public-health practitioners, psychologists, pediatricians, and social workers worldwide. A problematic NCAST score is a call for help. To provide that help, Dr. Barnard founded the UW's Center on Infant Mental Health and Development (CIMHD). It is the only such center at any American university to combine education, research, work on public policy, and clinical services to families.

The next step came in fall 2003: the opening of a new Birth-to-Three Research Lab at CIMHD. The lab provides facilities for both observing mother-child interactions and collecting physiological data, such as cortisol levels and heart rate. The lab's first project—based on research by nursing Ph.D. candidate Sandra Jolley—studied the effects of post-partum depression on mother-infant relationships. Future studies may look at fetal alcohol syndrome and babies in foster care.

"We're beginning to show," says Dr. Barnard, "that consistent therapeutic intervention—working on the relationship—can make a difference."

For the enormous difference she herself has made for infant mental health, Dr. Barnard received the 2003 Episteme Award from Sigma Theta Tau International—"the equivalent," says nursing dean Nancy Woods, "of the Nobel Prize for nursing."

Sandra Jolley, Ph.D. student in nursing, tests baby in new Birth-to-Three Research Lab.

Opposite: **Nursing professor Kathryn Barnard**

THE UW PROGRAM WILL GIVE ITS GRADUATES INTENSIVE MENTORING BY UW PROFESSORS AND BY MASTER TEACHERS ON SITE AT THEIR SCHOOLS.

LEARNING TO TEACH

Teachers change lives. “No one had ever suggested college to me,” says UW English professor Juan Guerra, “but in my senior year, Mr. Piper—my chemistry teacher—told me about scholarships for Mexican-Americans. He kept after me until I applied. That’s the kind of role a teacher can play—a crucial strategic intervention when the moment is right.”

With thanks to Mr. Piper, Professor Guerra will now help lead a new effort to rethink and reshape the teaching of teachers.

In July 2003, the Carnegie Corporation chose the UW as one of 11 American universities to join its ambitious Teachers for a New Era program, with a grant of $5 million over five years. “Recent research,” says Carnegie, “establishes beyond doubt that the quality of the teacher is the most important cause of pupil achievement.” With Teachers for a New Era, Carnegie aims to produce better teachers and to prove that good professional training makes a difference in P-12 classrooms.

At the heart of the UW program is close collaboration among the College of Education, the College of Arts and Sciences, and the public schools. Professor Guerra is the Arts and Sciences representative on the project’s leadership team, which also includes education professor Bill McDiarmid and veteran teacher and principal Wanda Brown. Together, the three are building a program that features team teaching, collaborative curriculum development, and sustained work by master P-12 teachers on the UW campus and UW professors in P-12 classrooms.

For UW undergraduates, the program will create a clear pathway toward a career in teaching. A new education minor will feature courses on brain and learning science, in which UW researchers play a leading role. New tracks in Arts and Sciences majors will ask students to consider, as they study (for example) history or mathematics, what it means to think like historians or mathematicians and how to teach the subject in that context.

Students will enter the UW Master’s in Teaching program better prepared. And they will leave it far better supported. In the daunting early years of teaching, when so many new teachers leave the field, the UW program will give its graduates intensive mentoring by UW professors and by master teachers on site at their schools.

For the public, the final piece—evaluation—may be the crucial one. “This program is a radical departure,” says Professor Guerra. “We’ll have to use statistical data to persuade people that we’re producing real change in the classroom. But we can’t stop there. We have to look beyond statistics to what really happens in people’s lives.”

Marcia Chow (UW ’76), master teacher at Lakeridge Elementary School in Renton, mentors colleague Laretha Oliver-Todd, completing her M.Ed. at UW Bothell. >

"I DON'T THINK THERE'S ANOTHER UNIVERSITY THAT'S DOING THIS WORK. STEVE AND CHRISTINA WERE REALLY ON THE CUTTING EDGE."

REDESIGNING RELIEF

In August 2004, the UN issued an international relief appeal for Kenya. Drought and related ills had put 2.3 million people in urgent need of emergency food supplies.

When the appeal went out, two UW graduate students were already on the front lines of relief work in Kenya. Christina Maiers, from the Evans School of Public Affairs, and Steve Kotleba, from industrial engineering, were there as interns with the UW's new Interdisciplinary Program in Humanitarian Relief (IPHR). Their mission was research: finding out what actually happens when many different relief agencies scramble to get food and medicine to those in dire need.

"Unfortunately, relief is a growth industry," says technical communication professor Mark Haselkorn, who taught IPHR's first official course and then oversaw its first six interns in Africa. "The system by which we address the needs of people in disasters is incredibly complicated. We need to make it better, but the relief organizations themselves don't have the time or resources to look at the big picture. How can all these agencies coordinate their work better? How can they make better use of information technology and techniques for managing the supply chain? I don't think there's another university that's doing this work. Steve and Christina were really on the cutting edge."

"We talked to the people who were doing the daily work," says Christina, "the logistics people, mostly Kenyans. They received us wonderfully. Nobody had asked them these questions before—'How do you do your job? What might make it easier?'"

Says Steve, "It was extremely interesting to do this work together. I'm an engineer—I do models, systems, number crunching. Christina has a public-policy perspective—she's looking at the complex environment. We learned each other's analytical tools."

That was exactly the hope of the partners who started IPHR: the Marc Lindenberg Center for Humanitarian Action, International Development, and Global Citizenship (named for the late dean of the Evans School); several departments in the College of Engineering; and the Center for Internet Studies, with initial funding from the Fritz Institute and the UW Provost's Fund.

Steve and Christina are now analyzing their data, which will turn into a report and recommendations. They themselves foresee careers in this field. IPHR, they feel, can have a real impact on the relief of human suffering. In Kenya, says Steve, "the amount of enthusiasm for what the UW is trying to do is overwhelming."

In Kenya, UW graduate students study relief work. >

Opposite: **Steve Kotleba, graduate student in industrial engineering**

"A LOT OF UW SCIENTISTS ARE WORKING ON THIS. BY GETTING MORE AND BETTER DATA, WE CAN DO THE LARGE-SCALE MODELING THAT WILL GIVE US SOME PREDICTIVE CAPABILITY AND PROVIDE CLUES TO LONG-TERM SOLUTIONS."

RESTORING HOOD CANAL

On a sunny March day, from the deck of the UW research vessel Clifford A. Barnes, Hood Canal looked beautiful. Steve Kassakian was using state-of-the-art equipment to sample and analyze the waters of the canal—research for his senior project in oceanography. "Those were great days," he says. "I was really surprised that this was considered work."

But Steve's results from the southern Hood Canal became the latest data in a disturbing trend: "The dissolved oxygen levels measured in early March 2004 were the lowest values ever reported for this time of year." Marine creatures need oxygen in the water to sustain life. Steve's findings reinforced the state's decision, a month earlier, to close the canal to fishing (except for salmon, trout, clams, and oysters) until water conditions improved—a ban still in effect as of fall 2004.

"It's the dead fish that got everybody's attention," says Andrea Copping, associate director of the Washington Sea Grant Program at the UW. When those fish washed up on Hood Canal beaches in fall 2003, alarmed residents and public officials began looking hard for solutions.

The problem, says Dr. Copping, is that "we don't understand enough about how the whole system works."

Some things are clear. Increased human population means more nutrients in canal waters, with sources ranging from septic tanks to fertilizer runoff. When too many nutrients accumulate in the water, they cause "blooms" of algae, which then die, sink to the bottom, and consume oxygen as they decompose. Since there is poor water circulation in Hood Canal, oxygen is replenished very slowly, especially near the bottom.

But are the current low levels of oxygen really new, caused mainly by human activity, or are they simply a natural, recurring effect of the canal's unusual geography? Scientists aren't sure, because they don't have enough historical data.

"We need more pieces of the puzzle," says Steve, who graduated in August 2004 and is now on the oceanography research staff. "We need more time to really understand what's going on, so we can begin to tease out what the natural state of things might be and how much is being affected by human activity."

Dr. Copping agrees. "A lot of UW scientists are working on this. By getting more and better data, we can do the large-scale modeling that will give us some predictive capability and provide clues to long-term solutions. It won't help right away, but it's going to be incredibly important down the road."

Steve Kassakian, oceanography graduate, researches water quality in Hood Canal. >

"HELPING OUR AGING POPULATION HAS BECOME A PERSONAL CHARTER FOR ME. BUT I NEVER EXPECTED TO FIND A SCIENTIFIC PARTNER IN MY OWN CLASSROOM!"

THE BUSINESS OF HOPE

In spring 2004, the jubilant faces of five young men beamed forth from several UW publications. Students at the Business School's Center for Technology Entrepreneurship (CTE), they had just won first place in the national Venture Capital Investment Competition. The CTE team had bested those from the Wharton School, MIT, and more than 30 other business schools—a remarkable feat. Four of the UW teammates were MBA students; the fifth was Joy Ghosh, a Ph.D. candidate in the medical school's Program in Biomolecular Structure and Design.

Joy was there because his research on cataracts had taken an unexpected turn. He had discovered a set of molecules that keeps proteins from forming the toxic clumps associated with diseases like Alzheimer's and Parkinson's. He saw right away the possibilities for both a cure and a business. So he enrolled in CTE, which brings together students from business, medicine, law, and engineering to learn how to commercialize new ideas. "CTE was the right opportunity," he says, "and I took it."

At CTE, Joy soon connected with MBA student Aaron Coe, who was drawn to Joy's entrepreneurial goals on both business and personal grounds. The potential market for an Alzheimer's cure—aging baby-boomers—was huge. But Aaron, who had come back to school after working with several high-tech start-up companies, was also looking for "some sort of moral dimension" in his future work. "I seem to have a real affinity for older people—my own grandparents, and a group I got to know when I was living in San Diego," he says. "Helping our aging population has become a personal charter for me. But I never expected to find a scientific partner in my own classroom!"

Joy and Aaron set to work designing a company—Promentix—to commercialize Joy's discovery. They used the skills they were learning at CTE, and they tapped into invaluable help and advice from CTE's partners in the local business and venture-capital community. Then they entered yet another CTE contest, the 2004 business-plan competition. With almost 200 student competitors from around the region, Promentix placed among the 16 finalists.

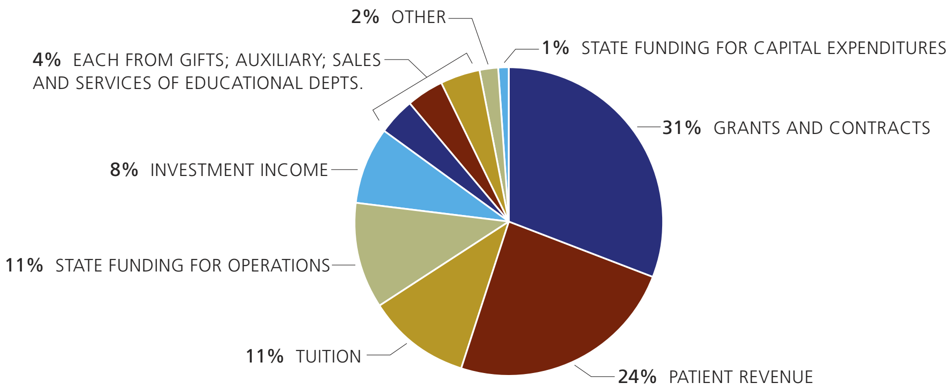
Promentix is now a fledgling biotech, with Aaron as CEO and Joy as Chief Scientific Officer. "CTE has given us many gratifying moments," says Joy, "like winning competitions. But I think the long-term moments are yet to come—hopefully in the future of Promentix."

Joy Ghosh (Ph.D. student in medical science) and Aaron Coe (MBA '04) met in the classroom and founded a business. >

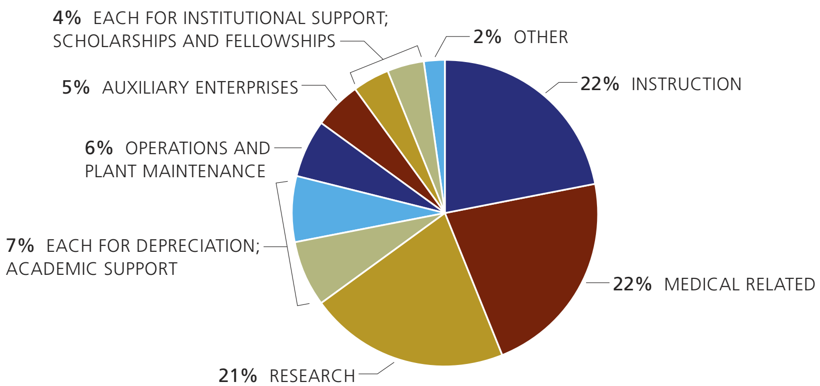
Opposite: **Joy Ghosh (middle) with teammates Shaun Westfall (MBA'04), Balu Chenicheri (MBA '05), Uday Keshavadas (MBA '04), and Andy Baldridge (MBA '04)**

FINANCIAL HIGHLIGHTS

Sources of Funds



Uses of Funds



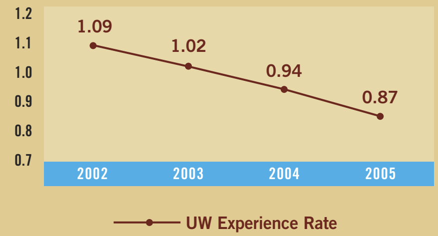
- The University has a diversified revenue base. No single source generated more than 31 percent of the total fiscal year 2004 revenues of $2.9 billion.
- State operating appropriations were $310 million, or 11 percent of total revenues. The University relies heavily on state funding for instructional activities.
- Grants and contracts (31 percent) generated $896 million of current year revenue, a 6 percent increase over fiscal year 2003. These funds provided the opportunity for graduate and undergraduate students to work with nationally recognized faculty in research as part of their educational experience.
- Income from gifts totaled $122 million (4 percent of the total). This is a decrease of $48 million from the prior year; however, the previous year's amount included an individual gift of over $70 million.
- Two primary functions of the University, instruction and research, comprised 43 percent of total operating expenses. These dollars provided instruction to more than 42,000 students and funded 5,300 research awards.
- The University provided students with scholarships and fellowships totaling $102 million (4 percent of operating expenditures), which included scholarship allowances of $48 million.

Workers Compensation Program Reduces Insurance Costs

In the face of rapidly growing insurance costs, the Office of Risk Management is focusing serious attention on strategies to reduce workers' compensation costs throughout the University. This focus derives from the basic mission of the Office of Risk Management: to protect the resources of the University of Washington from the financial impact of accidental loss.

Despite steady increases in the base rate for colleges and universities, the UW workers' compensation program remains strong and highly effective. It has achieved premium savings of $600-$700 thousand in each of the past three years thanks to the declining UW "experience rate." The experience rate measures claim costs relative to those of similar institutions; a rate lower than 1.0 is below the average and results in lower-than-average premiums.

- The UW paid $11.6 million in 2003 for coverage through the Department of Labor & Industries. L&I manages all claims and pays benefits out of an insurance pool called the Washington State Fund.
- Even though the base rate for all colleges and universities will increase by 4 percent in 2005, a lowered experience rate will minimize the impact to the UW and staff.

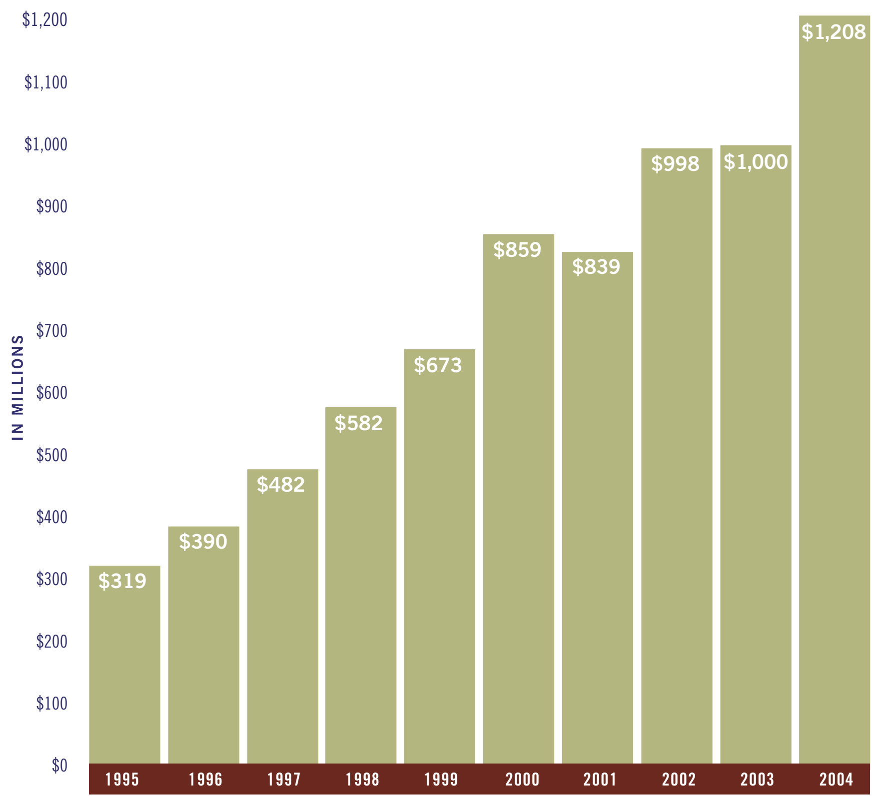


- Employees' share of workers' compensation insurance, which is about one-third of the total premium, will increase in January 2005 by less than 1 percent.
- The 0.87 experience rate for 2005 will be the lowest assigned to the UW in the past eight years and will reduce the premium by $692,000.

To lower the University's experience rate, the workers' compensation program developed new performance measures and objectives, using an approach called the "balanced scorecard." The scorecard is used to continuously develop return-to-work programs and strategically manage claims.

In the Facilities Services Custodial Division, for example, the frequency and severity of claims were analyzed before (2000-2001) and after (2002-2003) improvements were made to the unit's return-to-work program. The number of claims dropped 23 percent and the number of lost workdays decreased 48 percent. A key factor to this success was a team approach that involved input from managers and supervisors throughout the Custodial Division.

Growth of Consolidated Endowment Fund: 1995-2004



- Investment returns provide an important source of revenue for the University's programs. Among the funds invested by the University are endowments, life income trusts and annuities, outright gifts, reserve balances, and excess cash.
- Endowed gifts for current use provide permanent capital and an ongoing stream of current earnings to the University. Programs supported by the endowment include undergraduate scholarships, graduate fellowships, professorships and chairs, and research activities.
- Most endowments are commingled in the Consolidated Endowment Fund (CEF), a balanced investment fund. As in a mutual fund, each individual endowment maintains a separate identity and owns units in the fund. On June 30, 2004, the fair market value of the CEF was $1.2 billion, representing the investments of 1,906 individual endowments.
- During fiscal year 2002, the Board of Regents approved the investment of a portion of the University's operating funds to establish an endowment. These funds currently comprise $290 million of the CEF market value.
- Endowed program support over the last five years totaled $233 million. During that period, the average annual total return on the CEF was 5.7 percent.
- Non-endowed gifts, reserve balances, and cash are commingled for investment purposes although accounted for separately. The fair market value of these investments at the end of the fiscal year was $681 million. The total return has averaged 6.2 percent annually over the last five years.

UW Matching Initiative Aims for $120 Million in New Endowments

Building a strong and robust endowment is crucial to advancing the University of Washington's mission of education, research, and service to the community. Endowments are among the University's most precious resources as they enable the University to attract and retain the best and brightest students and faculty by providing permanent support for student scholarships and fellowships, faculty professorships and chairs, and University programs. Endowed professorships and chairs provide the University with the resources to recruit and reward outstanding faculty, and in turn, provide faculty with demonstrated success the crucial support to pursue innovative research and teaching. Fellowships and scholarships provide motivated students with financial need the chance to pursue their education, and join with faculty in discovery and innovation.

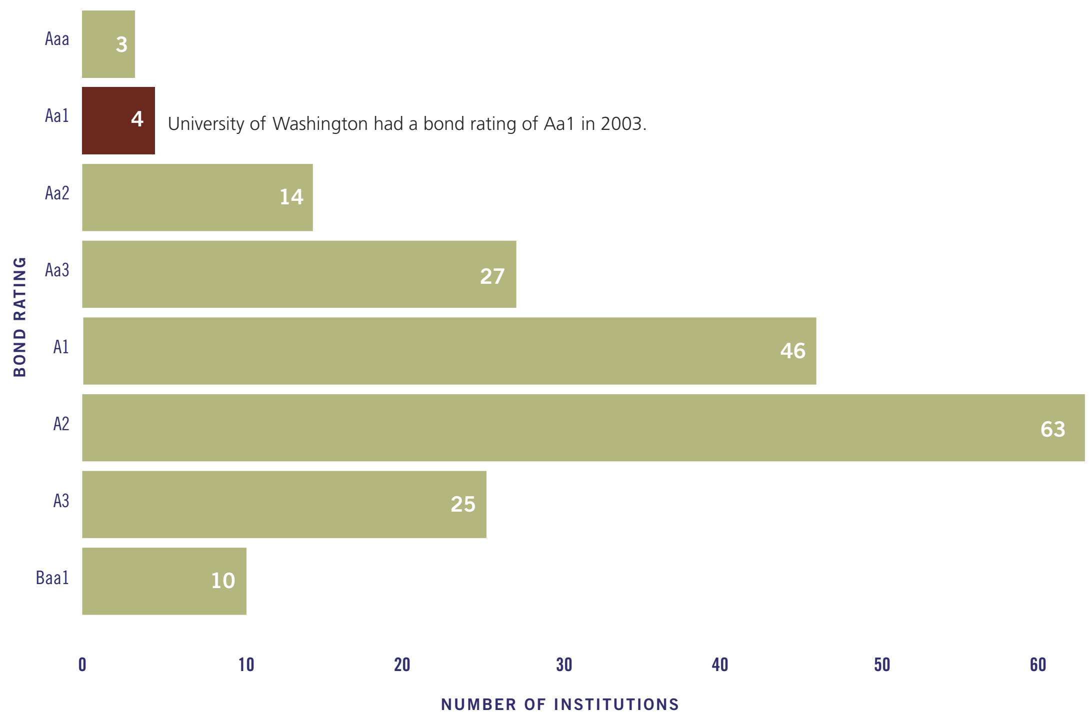
Increasing the University's endowment is one component of Campaign UW: Creating Futures, the University's $2 billion comprehensive campaign. That's why in January 2004 the University launched the Matching Initiative — an effort through which the UW seeks to add $120 million to the University's endowment to support students and faculty.

To stimulate donor investment in permanent endowments, the University has created a $40 million matching pool comprising $20 million in University funds and $20 million in private contributions received from a visionary and generous group of donors known as The Founders. They are: David Bonderman; William H. and Mimi Gates; Sally B. and William H. Neukom; Bruce A. and Jeannie Nordstrom; Lucille Schimel; Starbucks Corporation; Conrad J. and Charlotte R. Tobin; and the Washington Research Foundation. The matching pool is intended to provide an additional incentive to donors to establish endowments in support of faculty and students.

Contributors who commit to supporting students and faculty through endowed gifts may qualify for matching funds on a 1-to-2 basis. To qualify for a match, gifts must be designated to fund endowments for undergraduate scholarships, graduate fellowships, or faculty professorships or chairs. The minimum gift to qualify for matching funds is $100,000 for endowed scholarships and fellowships, $250,000 for endowed professorships, and $1 million for endowed chairs.

As of November 4, 2004, gifts and pledges received through the Matching Initiative are funding endowments for nine faculty chairs, 29 professorships, 36 fellowships, and 17 scholarships. A total of 91 gifts and pledges qualified for matching funds, and 21 schools, colleges, and units have secured qualifying gifts and pledges.

Moody's 2003 Public College and University Ratings



- In November 2003, the University's new borrowing platform for research facilities was rated by the major rating agencies, Standard & Poor's and Moody's. Both rating agencies have recognized the UW's financial strength and effective management with their second highest bond rating, Aa1 from Moody's and AA+ from Standard & Poor's. These ratings put the UW in elite company; only three other public universities have a higher rating and just three others have the same rating.

- Strong ratings carry substantial advantages for the UW: continued and better access to capital markets when the University issues debt, lower interest rates on bonds, and the ability to negotiate favorable bond terms.

- The University takes seriously its role of financial stewardship and works hard to manage its financial resources effectively. Continued high debt ratings are important indicators of the University's success in this area.

Securing Space for Tomorrow's Research Today

What happens when research growth exceeds available laboratory space? With space on the Seattle campus dwindling, UW Medicine looked to South Lake Union as the place to create a research hub that would enhance collaboration with nearby biotech companies and research partners. The area is home to the Fred Hutchinson Cancer Research Center, Seattle Cancer Care Alliance, Merck, Zymogenetics, Seattle Biomedical Research Institute, Children's Hospital and Regional Medical Center research programs, and the Rosen Building, already occupied by UW Medicine researchers.

Using financing authority received in 2003, the UW signed a long-term lease with Washington Biomedical Research Properties I, a local non-profit, to occupy the renovated 105,000-square-foot "Blue Flame" building, the former headquarters of Washington Natural Gas. Occupancy is scheduled for the end of 2004. The UW also secured options for adjacent parcels that could increase the current space for UW Medicine research by nearly 40 percent. Among the research projects scheduled to occupy this initial phase are programs to find a breast cancer vaccine and to combat heart attacks by regenerating heart tissue.

Developed as a public-private partnership, the Blue Flame renovation project was financed by nearly $40 million of bonds issued by the non-profit in August 2004. This tax-exempt financing structure means that UW lease payments are significantly below market rent for comparable lab space. The result is cost-effective space that allows the continued growth of UW Medicine research and helps the region solidify its position as one of the leading biotechnology centers in the nation.

The University's capital projects are staged according to an overall strategy: balancing the need to restore and renew aging facilities with the need to grow. Major projects under construction in 2003-04 reflect that strategy. They include:

William H. Foege BioEngineering/Genome Sciences Building

Construction of approximately 265,000 square feet will provide state-of-the-art facilities for multi-disciplinary research and teaching. The project cost of approximately $150 million is funded by private sources, borrowing (to be repaid from the grant and contract indirect-cost recovery), and $12 million of federal funds.

Johnson Hall Renovation

Renovation of 121,500 square feet includes upgrading all major building systems, correcting accessibility, seismic, and life and safety code conditions; and providing updated facilities for earth and space sciences, biology, and general-assignment classrooms. This renovation of approximately $55 million was state funded and is the first of a series of renovation projects to restore critical facilities at the Seattle campus.

Conibear Shellhouse Renovation and Addition

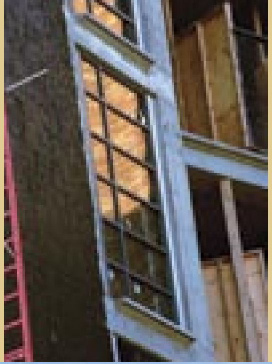
The home to the nationally renowned Husky men's and women's crew programs will also house the Student Athlete Life Center, including academic and dining facilities. Construction started in January 2004 and is expected to be completed in May 2005. The project of $16,925,000 will be funded from donor and Intercollegiate Athletics sources.

South Lake Union Blue Flame Building

The renovation of approximately 105,000 square feet of leased facilities at Lake Union will be completed at the end of 2004. Medical research programs that will move into the renovated building include a cancer research project specifically studying women's cancers, cardiovascular regenerative research, a new proteomics center, and research on inflammation.

UW Tacoma Phase 2B

The state-funded renovation of five 19th-century historic buildings to provide increased instructional space (classrooms, computer laboratories, and offices) was completed this year. Three warehouses on Pacific Avenue were interconnected into one building named Cherry Parkes of 82,000 square feet, and two connected buildings on Commerce Street of 61,000 square feet were also renovated. This renovation received a LEED (Leadership in Energy and Environmental Design) silver certificate from the U.S. Green Building Council —a first for both the UW and the City of Tacoma.



Merrill Hall Reborn with Sustainable Building and Landscaping

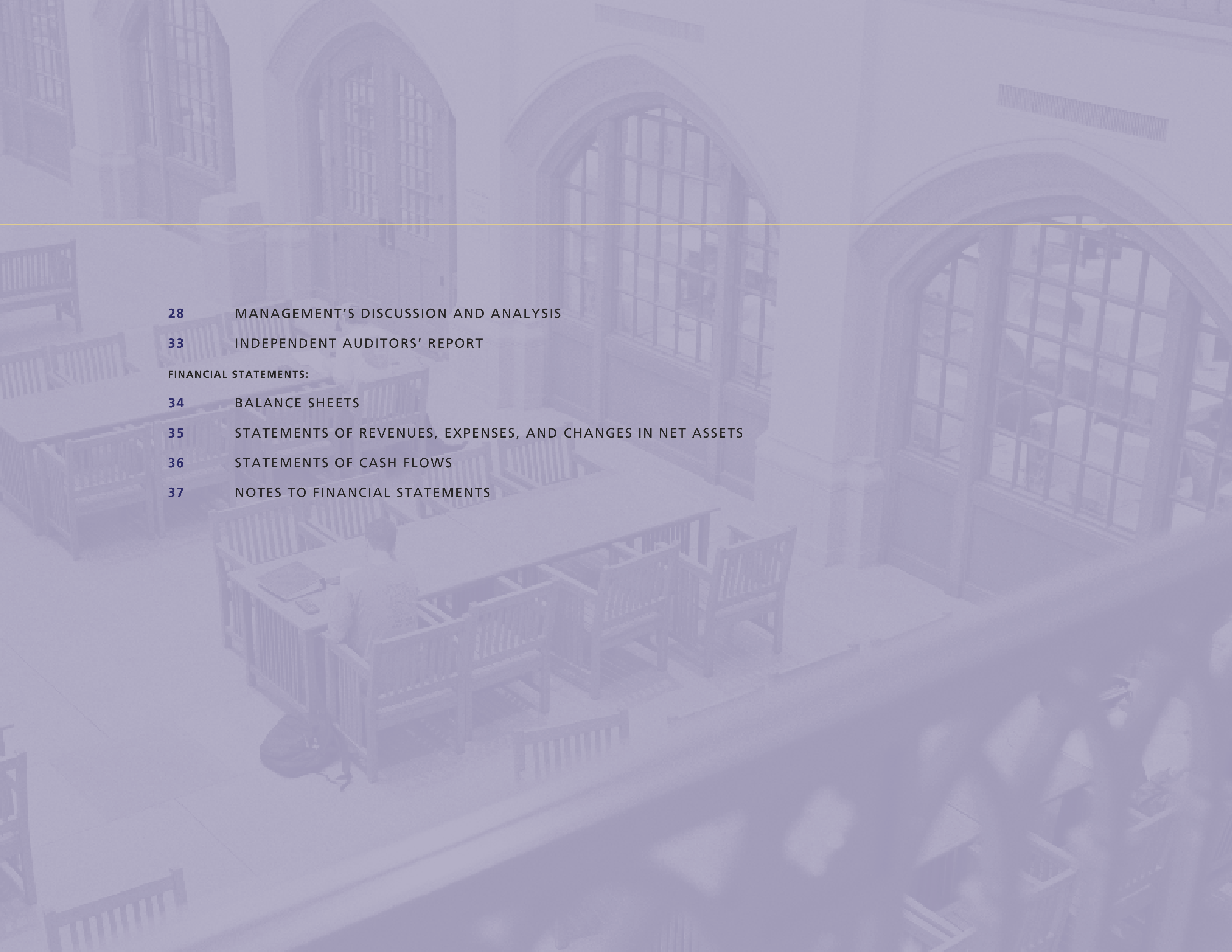
On October 1, 2003, the University broke ground for a new Merrill Hall, at the Center for Urban Horticulture, part of the College of Forest Resources. An arson fire destroyed the original Merrill Hall in May, 2001. The new building will provide facilities for teaching and ecological research, public outreach programs, and the Elizabeth C. Miller Horticultural Library.

The Washington State Legislature and University provided funding to replace the building space, and donors provided funding for additional space and other enhancements.

This facility showcases sustainable building and landscaping features and was designed with the goal of earning LEED (Leadership in Energy and Environmental Design) certification. The building's construction methods, materials and sustainability concepts are unique. They include exposing wood structural elements and building systems, demonstrating sustainable and engineered wood products and advancing sustainable concepts in energy efficiency, daylighting, natural ventilation, and stormwater management.

FINANCIAL STATEMENTS

AND REQUIRED SUPPLEMENTARY INFORMATION



The following discussion and analysis provides an overview of the financial position and activities of the University of Washington ("University") for the years ended June 30, 2004 and 2003. This discussion has been prepared by management and should be read in conjunction with the financial statements and accompanying notes which follow this section.

Using the Financial Statements

The University's financial statements include the Balance Sheets, the Statements of Revenues, Expenses, and Changes in Net Assets, the Statements of Cash Flows, and the Notes to the Financial Statements. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for public colleges and universities. GASB standards require that financial statements be presented on a consolidated basis in order to focus on the University as a whole.

Financial Health

BALANCE SHEETS

The Statements of Net Assets (Balance Sheets) present the financial condition of the University at the end of the last two fiscal years and reports all assets and liabilities of the University. A summarized comparison of the University's assets, liabilities and net assets as of June 30, 2004, 2003 and 2002, follows:

	2004	2003 (in millions)	2002
Current assets	$ 958	$ 1,091	$ 891
Noncurrent assets:			
Capital assets, net	2,182	2,110	1,908
Other	2,150	1,962	1,964
Total assets	**5,290**	**5,163**	**4,763**
Current liabilities	787	889	724
Noncurrent liabilities	759	734	733
Total liabilities	**1,546**	**1,623**	**1,457**
Net assets	**$ 3,744**	**$ 3,540**	**$ 3,306**

Current assets consist primarily of cash, short-term investments, securities lending collateral and accounts receivable. Total current assets decreased by $133 million, to $958 million at June 30, 2004. The June 30, 2003 balance of $1,091 million was an increase of $200 million from 2002. The excess of current assets over current liabilities of $171 million in 2004 demonstrates the University's ability to meet its short-term obligations.

The difference between total assets and total liabilities—net assets, or "equity"—is one indicator of the current financial condition of the University. The change in net assets measures whether the overall financial condition has improved or deteriorated during the year.

The University reports its "equity" in four categories:

- **Invested in Capital Assets** (net of related debt) — This is the University's total investment in property, plant, equipment and infrastructure, net of accumulated depreciation and outstanding debt obligations related to those capital assets;
- **Restricted Net Assets:**
  Expendable net assets are resources which the University is legally or contractually obligated to spend in accordance with time or purpose restrictions on the use of the asset placed by donors and/or other external parties;

  Non Expendable net assets consist of funds on which the donor or external party has imposed the restriction that the corpus is not available for expenditures but for investment purposes only;
- **Unrestricted Net Assets —** These are all other funds available to the institution for the general and educational obligations to meet current expenses for any purpose. Unrestricted assets are often internally designated for specific purposes.

The University's net assets at June 30, 2004, 2003 and 2002 are summarized as follows:

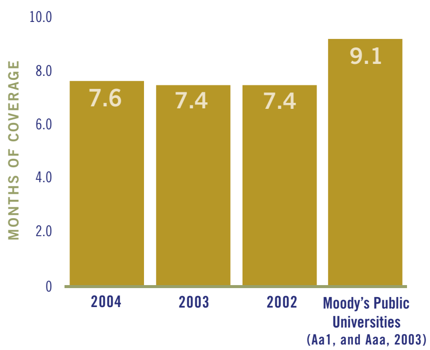
	2004	2003 (in millions)	2002
Invested in capital assets, net of related debt	$ 1,539	$ 1,512	$ 1,404
Restricted:			
Nonexpendable	544	498	477
Expendable	933	833	809
Unrestricted	728	697	616
Total net assets	**$ 3,744**	**$ 3,540**	**$ 3,306**

The $27 million, or 2% and $108 million, or 8% increase in the net investment in capital assets in 2004 and 2003, respectively, shows that the University continues to invest in its buildings and plant. Restricted net assets grew $146 million, or 11%, and $45 million, or 3% in 2004 and 2003, respectively, as a result of gifts and earnings on endowments.

Unrestricted Net Assets increased a modest 4% in 2004. Additional tuition revenue, indirect cost recoveries, and stronger unrestricted investment returns were offset by capital reinvestment and by the net impact of a significant settlement payment of $26 million. The Unrestricted Net Asset growth in 2003 of $81 million, or 13%, was due to increases in tuition, unrestricted investment income, patient revenues, indirect cost recoveries as well as the result of conservative spending for operating activities.

The ratio of expendable financial resources to operations (as defined by Moody's) measures the strength of Net Assets. This ratio, illustrated in the chart below, shows that as of June 30, 2004, 2003 and 2002, the University had enough expendable resources from various sources to fund operations for over seven months.

Expendable Financial Resources to Operations (months)[1]



Endowment and Other Investments

The Consolidated Endowment Fund (CEF) returned 17.8%, ending the year at $1.2 billion, compared to a return of 1.6% in the prior year. In fiscal year 2002, the Board of Regents approved the investment of a portion of the University's operating funds into the endowment. These funds comprise $290 million of the CEF market value. Over the past ten years, the CEF averaged a 12% return and stands in the top quartile of the Cambridge Associates College and University peer group.

The Invested Funds (IF), or operating monies of the University, returned 0.1% for fiscal year 2004 and 7.5% in 2003, ending the 2004 fiscal year with a market value of $681 million.

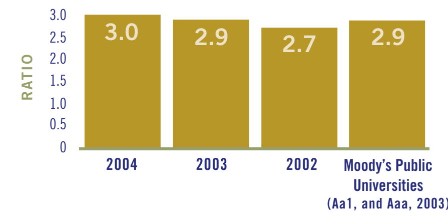
Capital Improvements and Related Debt

Total long-term debt associated with capital assets increased in 2004 to $655 million, a $34 million increase over 2003. Additions for the year included funding for constructing the new William H. Foege BioEngineering/Genome Sciences Building and renovations to student residence halls. Capital construction expenditures amounted to almost $150 million, including costs associated with the previously mentioned projects as well as the second phase of the Tacoma campus ($14 million), UWMC Surgery Pavilion ($10 million), William Gates Hall (Law School) ($11 million), and IMA expansion ($8 million).

Total long-term debt associated with capital assets decreased slightly during 2003, as there were no significant issuances during the year. The largest new debt issue was $10 million in bonds at 4.6% to complete construction of the William H. Gates Hall and the University of Washington Medical Center's (UWMC) Surgery Pavilion.

The expendable financial resources to debt ratio (as defined by Moody's) shows that the University has sufficient expendable resources to cover its long-term debt obligations. The University's ratio of 3.0 for 2004 is a slight increase from the prior year.

Expendable Financial Resources to Direct Debt[2]



STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statements of Revenues, Expenses and Changes in Net Assets present the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as either operating or nonoperating. A condensed comparison of the University's revenues, expenses and changes in net assets for the years ended June 30, 2004, 2003 and 2002 follows:

	2004	2003	2002
		(in millions)	
Total operating revenues	$ 2,169	$ 2,036	$ 1,791
Operating expenses	2,587	2,429	2,263
Operating loss	**(418)**	**(393)**	**(472)**
Nonoperating revenues, net of expense	529	521	442
Other revenues	93	106	83
Increase in net assets	**204**	**234**	**53**
Net assets, beginning of year	3,540	3,306	3,253
Net assets, end of year	**$ 3,744**	**$ 3,540**	**$ 3,306**

[1] The sum of Unrestricted Net Assets and Restricted Expendable Net Assets, divided by Total Operating Ex cit and total operating expenses of $2 million and $15.4 million, respectively, have been omitted for five new component units required by GASB 39, in order for the University's ratios to be comparable to Moody's peer averages. Prior year amounts for these entities have also been excluded.)

[2] The sum of Unrestricted Net cit and total debt of $2 million and $130.3, respectively, have been omitted for five new component units required by GASB 39, in order for the University's ratios to be comparable to Moody's peer averages. Prior year amounts for these entities have also been excluded.)

The University has a diversified revenue base. No single source generated more than 31% of the total fiscal 2004 revenues of $2.9 billion. The following table summarizes revenues from all sources for the years ended June 30, 2004, 2003 and 2002:

	2004	2003 (in millions)	2002
Tuition	$ 304	$ 282	$ 250
Patient Services	689	636	562
Grants and Contracts	896	843	722
Sales and Services of Educational Departments	103	96	91
Auxiliary	126	119	113
State Funding for Operations	310	333	344
Gifts	122	170	145
Investment income	220	88	9
State Funding for Capital Projects	33	61	42
Other	52	59	63
Total revenue – all sources	**$ 2,855**	**$ 2,687**	**$ 2,341**

Grant Revenue

The largest source of revenues has been from grants and contracts. This revenue has increased 6% in 2004, compared to a 17% increase in 2003. The University receives more dollar awards of federal grants and contracts than any other public institution in the country. This revenue is recorded only when direct expenditures (such as researchers' compensation or purchases of goods and services) are made; therefore, there is little effect to the University's operating margin as a result of this direct expense reimbursement process.

Facility and administrative expenses necessary to support grants and contracts are reimbursed by an indirect cost recovery. The current indirect cost recovery for research awards is approximately 29 cents on every direct expenditure dollar on these grants and contracts.

Primary Non-Grant Funding Sources

The University relies primarily on student tuition and fees and state appropriations as revenue sources to back its non-grant funded core operating expenses. Tuition revenue, net of scholarship allowances, has continued to grow, increasing from $282 million in fiscal year 2003 to $304 million in the 2004 fiscal year, an increase of 8%. The increase in the current year was due primarily to overall increases in tuition rates. However, the University continued its pledge to counter the effect of rising tuition rates by increasing its scholarship by $11 million in 2004. The University has flexibility in its ability to set non-undergraduate resident tuition rates, which helps to compensate for shortfalls in state funding.

State appropriations are considered nonoperating revenue under GASB 35 standards and are reflected in the nonoperating section of the income statement; however, they are used solely for operating purposes. State appropriations for operating purposes have decreased $23 million, or 7% from fiscal year 2003, compared to a decrease of $11 million or 3% in the prior year.

Patient Services

Revenues from patient services increased $53 million, or 8%, from $636 million in 2003 to $689 million in 2004. In 2003, patient revenues increased 13% over the previous year. Revenues increased due to both patient volume and price increases during both years. Volume increases were primarily in transplant, oncology and other tertiary care service areas.

Gifts and Endowments and Other Investments

Investment income and gifts continue to provide the University with an added margin of excellence and the flexibility to respond to special opportunities. Income from these two sources was the difference between growth and loss in net assets.

Net investment returns for the years ended June 30, 2004, 2003 and 2002 consisted of the following components:

	2004	2003 (in millions)	2002
Interest and dividends	$ 56	$ 65	$ 66
Metropolitan Tract operating income	9	12	11
Net appreciation (depreciation) of fair value of investments	162	18	(60)
Investment expenses	(7)	(7)	(8)
Net investment income	**$ 220**	**$ 88**	**$ 9**

Net investment income increased from $88 million in 2003 to $220 million in 2004, or 150%. The increase was due primarily to the $162 million net appreciation in the fair value of the investments. Net appreciation includes both realized and unrealized gains and losses. In 2003, net investment income increased $79 million over 2002, due to an increase in net appreciation of investments.

The University continues to receive strong support from its donors. Gifts in the current year amounted to $122 million. This is a decrease of $48 million from the prior year; however, last year's balance included an individual gift of over $70 million. Gifts are used to support a variety of purposes, including capital improvements, scholarships, research and endowments for various academic and research chairs.

Expenses

A comparative summary of the University's expenses by functional classification for the years ended June 30, 2004, 2003 and 2002 is as follows:

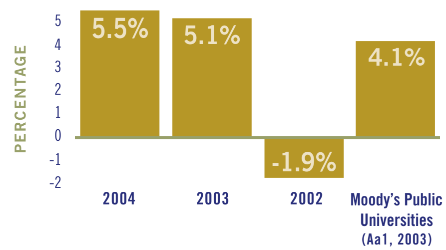
	2004	2003 (in millions)	2002
Operating expenses:			
Instruction	$ 595	$ 594	$ 558
Research	553	501	420
Public service	23	21	20
Academic support	186	166	189
Student services	26	25	24
Institutional support	103	97	90
Operations and maintenance of plant	145	155	141
Scholarships and fellowships	54	51	45
Auxiliary enterprises	124	128	131
Medical related	605	538	490
Depreciation	173	153	155
Total operating expense	**2,587**	**2,429**	**2,263**

The University's operating expenses continue to increase. However, budget reductions imposed by state appropriation decreases, as well as prudent management, held down operating expenses, excluding depreciation, to a 6% increase as opposed to an 8% increase in the prior year. Consistent with the growth in the research and medical related areas, operating expenses for research grew $52 million or 10%, and for medical related activities, $67 million or 12%. This compares to prior year increases of $81 million or 19% in research operating expenses, and $48 million or 10% in medical related operating expenses.

Depreciation increased $20 million, or 13%, because buildings costing more than $450 million were placed into service during the year. In addition, changes in the following expenses impacted most categories above: Salaries and benefits expense increased approximately 7% this year compared to 6% in the prior year. Supplies, materials, and services increased a total of $22 million, or 4%, in 2004 versus $71 million, or 15%, in 2003.

The net result of revenue and expense activity is measured by the operating margin, (as defined by Moody's). The current year margin is a positive 5.5%, a slight improvement over the prior year's margin of 5.1%.

Operating Margin Percentage[3]



Economic Factors that Will Affect the Future

The University's funding comes primarily from four general sources: research grants and contracts, revenues from patient services, state appropriations and tuition and fees.

The ability to fund the instructional function of the University continues to be under pressure due to decreasing state funding. However, the ability to increase certain tuition rates, along with continued strong demand for services offsets much of that pressure.

The University is experiencing slower growth in research awards after several years of double-digit growth. Given the awards in the pipeline, research revenues are expected to remain somewhat constant in the upcoming year. Also, revenue from medical related activities currently remains strong.

[3] Operating loss, (inclu
(2004 Operating loss and total revenues of $2.1 million and $13.3 million, respectively, have been omitted for five new component units required by GASB 39, in order for the University's ratios to be comparable to Moody's peer averages.)

KPMG

INDEPENDENT AUDITORS' REPORT

The Board of Regents
University of Washington:

We have audited the accompanying financial statements of the University of Washington, an agency of the State of Washington, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We

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. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Washington as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 28 through 31 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain

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the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in Note 1 to the financial statements, on July 1, 2003 the University adopted Statement No. 39 of the Governmental Accounting Standards Board Statement (GASB 39), "Determining Whether Certain Organizations are Component Units," and retroactively restated June 30, 2003 financial statements for the effect of this standard.

KPMG LLP

Seattle, Washington
November 5, 2004

UNIVERSITY OF WASHINGTON

Balance Sheets

ASSETS	June 30, 2004	2003
CURRENT ASSETS:		
CASH AND CASH EQUIVALENTS (NOTE 2)	$ 35,880	$ 30,799
COLLATERAL FROM SECURITIES LENDING (NOTE 6)	318,277	357,087
SHORT-TERM INVESTMENTS (NOTE 6)	211,026	252,186
ACCOUNTS RECEIVABLE (NET OF $74,516 AND $59,996 ALLOWANCE) (NOTE 5)	324,907	390,016
INVENTORIES	22,014	21,282
OTHER ASSETS	46,132	39,335
TOTAL CURRENT ASSETS	958,236	1,090,705
NONCURRENT ASSETS:		
DEPOSIT WITH STATE OF WASHINGTON (NOTE 3)	58,500	44,741
LONG-TERM INVESTMENTS (NOTE 6)	1,914,293	1,742,095
METROPOLITAN TRACT (NOTE 7)	117,454	115,435
STUDENT LOANS RECEIVABLE (NET OF $7,935 AND $7,988 ALLOWANCE) (NOTE 4)	59,668	59,886
CAPITAL ASSETS (NET OF $1,620,094 AND $1,491,037 ACCUMULATED DEPRECIATION) (NOTE 8)	2,182,077	2,109,787
TOTAL NONCURRENT ASSETS	4,331,992	4,071,944
TOTAL ASSETS	**$ 5,290,228**	**$ 5,162,649**

LIABILITIES	June 30, 2004	2003
CURRENT LIABILITIES:		
ACCOUNTS PAYABLE	$ 92,600	$ 89,203
ACCRUED LIABILITIES	184,551	284,946
PAYABLES: SECURITIES LENDING TRANSACTIONS (NOTE 6)	318,277	357,087
DEFERRED REVENUE	102,109	115,186
FUNDS HELD FOR OTHERS	11,295	9,426
SHORT-TERM NOTES PAYABLE	27,488	–
LONG-TERM LIABILITIES, CURRENT PORTION (NOTES 9, 10, AND 11)	50,828	32,984
TOTAL CURRENT LIABILITIES	787,148	888,832
NONCURRENT LIABILITIES:		
DEFERRED REVENUE	4,685	5,131
U.S. GOVERNMENT GRANTS REFUNDABLE (NOTE 4)	49,720	48,759
LONG-TERM LIABILITIES, NET OF CURRENT PORTION (NOTES 9, 10, AND 11)	704,348	679,742
TOTAL NONCURRENT LIABILITIES	758,753	733,632
TOTAL LIABILITIES	1,545,901	1,622,464
NET ASSETS		
INVESTED IN CAPITAL ASSETS, NET OF RELATED DEBT	1,538,941	1,512,384
RESTRICTED:		
NONEXPENDABLE – SCHOLARSHIPS, RESEARCH AND DEPARTMENT USES	543,679	497,964
EXPENDABLE – SCHOLARSHIPS, RESEARCH AND DEPARTMENT USES	933,198	832,937
UNRESTRICTED	728,509	696,900
TOTAL NET ASSETS	3,744,327	3,540,185
TOTAL LIABILITIES AND NET ASSETS	**$ 5,290,228**	**$ 5,162,649**

Dollars in thousands

See accompanying Notes to the Financial Statements

Statements of Revenues, Expenses, and Changes in Net Assets

REVENUES	For the Year Ended June 30, 2004	2003
OPERATING REVENUES:		
STUDENT TUITION AND FEES (NET OF SCHOLARSHIP ALLOWANCES OF $46,519 AND $38,848)	$ 304,189	$ 282,132
PATIENT SERVICES (NET OF CHARITY CARE AND UNCOLLECTIBLE ACCOUNTS OF $18,089 AND $20,940)	688,521	636,290
FEDERAL GRANTS AND CONTRACTS	758,427	702,226
STATE AND LOCAL GRANTS AND CONTRACTS	49,139	46,089
NONGOVERNMENTAL GRANTS AND CONTRACTS	87,986	94,580
SALES AND SERVICES OF EDUCATIONAL DEPARTMENTS	103,187	96,115
AUXILIARY ENTERPRISES:		
HOUSING AND FOOD SERVICES	40,921	42,338
PARKING SERVICES	7,282	7,282
SPORTS PROGRAMS (NET OF SCHOLARSHIP ALLOWANCES OF $1,905 AND $1,633)	34,574	37,126
OTHER AUXILIARY ENTERPRISES	43,088	32,253
OTHER MEDICAL CENTER REVENUES	32,171	31,568
OTHER OPERATING REVENUES	19,876	27,793
TOTAL OPERATING REVENUES	2,169,361	2,035,792
EXPENSES		
OPERATING EXPENSES:		
SALARIES	1,311,585	1,241,464
BENEFITS	333,908	301,676
SCHOLARSHIPS AND FELLOWSHIPS	53,566	50,654
UTILITIES	41,354	40,241
SUPPLIES AND MATERIALS	266,699	272,042
PURCHASED SERVICES	313,656	286,368
DEPRECIATION	172,567	152,698
OTHER	94,143	83,887
TOTAL OPERATING EXPENSES	2,587,478	2,429,030
OPERATING LOSS	(418,117)	(393,238)

NONOPERATING REVENUES (EXPENSES)	For the Year Ended June 30, 2004	2003
STATE APPROPRIATIONS	309,618	332,518
GIFTS	62,311	125,401
INVESTMENT INCOME (NET OF INVESTMENT EXPENSE OF $6,873 AND $6,937)	219,831	88,485
INTEREST ON CAPITAL ASSET-RELATED DEBT	(27,624)	(24,821)
OTHER NONOPERATING REVENUES (EXPENSES)	(35,370)	(328)
NET NONOPERATING REVENUES	528,766	521,255
INCOME BEFORE OTHER REVENUES, EXPENSES, GAINS, OR LOSSES	110,649	128,017
CAPITAL APPROPRIATIONS	33,395	61,389
CAPITAL GRANTS AND GIFTS	26,986	12,418
GIFTS TO PERMANENT ENDOWMENTS	33,112	32,183
TOTAL OTHER REVENUE	93,493	105,990
INCREASE IN NET ASSETS	204,142	234,007
NET ASSETS		
NET ASSETS – BEGINNING OF YEAR, AS RESTATED	3,540,185	3,306,178
NET ASSETS – END OF YEAR	**$ 3,744,327**	**$ 3,540,185**

Dollars in thousands

See accompanying Notes to the Financial Statements

UNIVERSITY OF WASHINGTON

Statements of Cash Flows

CASH FLOWS FROM OPERATING ACTIVITIES	For the Year Ended June 30, 2004	2003
STUDENT TUITION AND FEES	$ 292,071	$ 269,292
PATIENT SERVICES	696,934	638,031
GRANTS AND CONTRACTS	894,242	825,347
PAYMENTS TO SUPPLIERS	(288,373)	(257,193)
PAYMENTS FOR UTILITIES	(40,582)	(39,975)
PURCHASED SERVICES	(327,617)	(291,446)
OTHER OPERATING DISBURSEMENTS	(91,874)	(82,912)
PAYMENTS TO EMPLOYEES	(1,308,502)	(1,236,984)
PAYMENTS FOR BENEFITS	(313,074)	(285,788)
PAYMENTS FOR SCHOLARSHIPS AND FELLOWSHIPS	(53,566)	(50,655)
LOANS ISSUED TO STUDENTS	(29,356)	(29,278)
COLLECTION OF LOANS TO STUDENTS	28,613	25,980
SALES AND SERVICES OF THE MEDICAL CENTER	32,171	31,569
AUXILIARY ENTERPRISE RECEIPTS	122,228	115,298
SALES AND SERVICES OF EDUCATIONAL DEPARTMENTS	101,860	102,319
OTHER RECEIPTS	13,797	25,693
NET CASH USED BY OPERATING ACTIVITIES	(271,028)	(240,702)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
STATE APPROPRIATIONS	308,920	337,231
GIFTS, EXCLUDING PERMANENT ENDOWMENT AND CAPITAL	62,311	125,401
ADDITIONS TO PERMANENT ENDOWMENTS	33,112	32,183
DIRECT LENDING RECEIPTS	123,558	121,645
DIRECT LENDING DISBURSEMENTS	(137,482)	(121,202)
RECEIPTS FROM OUTSIDE AFFILIATED AGENCIES	377,737	347,623
DISBURSEMENTS TO OUTSIDE AFFILIATED AGENCIES	(364,914)	(342,050)
OTHER	(23,304)	572
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	379,938	501,403

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	For the Year Ended June 30, 2004	2003
PROCEEDS FROM CAPITAL DEBT	75,170	65,005
CAPITAL APPROPRIATIONS	31,101	62,759
CAPITAL GRANTS AND GIFTS RECEIVED	26,986	12,418
PURCHASES OF CAPITAL ASSETS	(265,056)	(337,735)
PRINCIPAL PAID ON CAPITAL DEBT AND LEASES	(28,716)	(42,515)
INTEREST PAID ON CAPITAL DEBT AND LEASES	(32,094)	(32,321)
OTHER	(11,398)	3,475
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(204,007)	(268,914)

CASH FLOWS FROM INVESTING ACTIVITIES		
PROCEEDS FROM SALES OF INVESTMENTS	2,486,309	2,824,312
PURCHASES OF INVESTMENTS	(2,444,302)	(2,904,580)
INVESTMENT INCOME	58,171	70,913
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	100,178	(9,355)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	5,081	(17,568)
CASH AND CASH EQUIVALENTS – BEGINNING OF THE YEAR	30,799	48,367
CASH AND CASH EQUIVALENTS – END OF THE YEAR	$ 35,880	$ 30,799

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
OPERATING LOSS	$ (418,117)	$ (393,238)
ADJUSTMENTS TO RECONCILE OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES:		
DEPRECIATION EXPENSE	172,567	152,698
CHANGES IN ASSETS AND LIABILITIES:		
RECEIVABLES	16,454	(37,094)
INVENTORIES	(732)	130
OTHER ASSETS	(6,797)	4,882
ACCOUNTS PAYABLE AND ACCRUED LIABILITIES	(11,509)	28,484
DEFERRED REVENUE	(13,523)	8,644
OTHER LONG-TERM LIABILITIES	(8,628)	(1,911)
U.S. GOVERNMENT GRANTS REFUNDABLE	218	(2,303)
LOANS TO STUDENTS	(961)	(994)
NET CASH USED BY OPERATING ACTIVITIES	$ (271,028)	$ (240,702)

Dollars in thousands

See accompanying Notes to the Financial Statements

NOTE 1:

Summary of Significant Accounting Policies

FINANCIAL REPORTING ENTITY

The University of Washington (University), an agency of the State of Washington, is governed by a ten-member Board of Regents, appointed by the Governor and confirmed by the state Senate.

The financial statements include the individual schools, colleges, and departments of the University, the University of Washington Medical Center, Portage Bay Insurance (a wholly owned subsidiary of the University) and certain affiliated operations determined to be a part of the University's financial reporting entity. Affiliated organizations are evaluated for inclusion in the reporting entity as component units based on the significance of their relationship with the University.

The University of Washington Alumni Association, University of Washington Physicians, University of Washington Physicians Network, Community Development Properties C-D, Educational Research Properties, Radford Court Properties, Twenty-Fifth Avenue Properties and Washington Biomedical Research Properties I are included in the reporting entity as blended component units. These legally separate entities are included in the University's financial reporting entity because of the nature of their relationship to the University. Financial information for these affiliated organizations may be obtained from their respective administrative offices.

BASIS OF ACCOUNTING

The financial statements of the University have been prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No, 34. Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, as amended by GASB Statement No. 35, Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities; No. 37, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus (an amendment of GASB Statements No. 21 and No. 34); and No. 38, Certain Financial Statement Note Disclosures. The University is reporting as a special purpose government engaged in business type activities (BTA). In accordance with BTA reporting, the University presents a management's discussion and analysis, balance sheets, statements of revenues, expenses, and changes in net assets, statements of cash flows, and notes to the financial statements. The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All intra-agency transactions have been eliminated. The University has elected not to apply any FASB pronouncements after November 30, 1989. The University reports capital assets net of accumulated depreciation, and reports depreciation expense in the Statement of Revenues, Expenses, and Changes in Net Assets.

On July 1, 2003, the University adopted GASB Statement No. 39, "Determining Whether Certain Organizations are Component Units," and retroactively restated the June 30, 2003 financial statements to reflect this standard. This statement amends GASB Statement No. 14 by establishing specific criteria for determining when the financial information of independent organizations, such as fund-raising foundations and other not-for-profit entities supporting public institutions, should be, based on the nature and significance of their relationship with the institution, reported as component units by the institution being supported. In addition to the three component units previously blended in the University's financial statements (University of Washington Alumni Association, University of Washington Physicians, and University of Washington Physicians Network), an additional five organizations (Community Development Properties C-D, Educational Research Properties, Radford Court Properties, Twenty-Fifth Avenue Properties and Washington Biomedical Research Properties I) meet the criteria set forth for component units under GASB Statement No. 39 and were added in the current year as a result of the adoption of this new accounting standard.

The following table shows the effect of this change on Net Assets:

(Dollars in thousands)

	June 30, 2003	June 30, 2002
NET ASSETS PREVIOUSLY REPORTED	$ 3,543,100	$ 3,307,363
CHANGES FOR GASB 39	(2,915)	(1,185)
AS RESTATED	$ 3,540,185	$ 3,306,178

On July 1, 2003, the University also adopted GASB Statement No. 40, "Deposit and Investment Risk Disclosures." This statement establishes and modifies disclosure requirements related to investment risks. Disclosures of the University's interest rate risk (associated with fixed income securities), credit risk, and foreign currency risk are included in Note 6.

OTHER ACCOUNTING POLICIES

Investments. Investments other than real estate or miscellaneous investments are stated at fair value. Real estate and miscellaneous investments are stated at cost or, in the case of gifts, at fair values at the date of donation. Limited partnership investments are valued based upon the valuations provided by the respective general partners. Securities are valued at the last sale price on the last business day of the fiscal year, as quoted on a recognized exchange or an industry standard pricing service. Securities for which no sale was reported as of the close of the last day of business of the fiscal year are valued at the quoted market price of a dealer who regularly trades in the security being valued.

Investments under long-term strategies are considered non-current. Short-term investments consist primarily of cash equivalents and fixed income vehicles with maturities of less than one year.

Securities Lending Transactions. Cash collateral received from borrowers through securities lending transactions is recorded as an asset with an offsetting liability.

Inventories. Inventories are carried at the lower of cost or market value. Consumable inventories, consisting of expendable materials and supplies held for consumption, are generally valued using the weighted average method. Merchandise inventories are generally valued using the first-in, first-out method.

Capital Assets. Land, buildings, equipment, and library books are stated at cost or, if acquired by gift, at fair market value at the date of the gift. Additions, replacements, major repairs, and renovations are capitalized.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 50 years for building components, 20 to 50 years for infrastructure and land improvements, 15 years for library books, and five to seven years for equipment.

Capitalized construction-related interest was $4,950,000 and $7,354,000 during 2004 and 2003, respectively.

Deferred Revenues. Deferred revenues occur when funds have been collected in advance of an event, such as advance ticket sales, summer quarter tuition, and unspent cash advances on certain grants.

Deferred Giving – Split Interest Agreements. Under these agreements, donors make initial gifts to trusts or directly to the University. The University has beneficial interests but is not the sole beneficiary. The University records an asset related to these agreements at fair market value at year end. The University also records a liability related to the split-interest agreements equal to the present value of expected future distributions; the discount rates applied range from 5.4% to 8.0%.

Compensated Absences. University employees accrue annual leave at rates based on length of service, and for sick leave at the rate of one day per month. Annual leave accrued as of June 30, 2004 and 2003 of $49,214,000 and $40,675,000, respectively, was included in accrued liabilities. Sick leave accrued as of June 30, 2004 and 2003 of $20,751,000 and $14,324,000, respectively, was included in long-term liabilities.

In fiscal year 2004, the University changed its method of estimating annual leave and sick leave, resulting in approximately $7,134,000 and $5,461,000, respectively, of additional employee benefits expense. These amounts are included in the fiscal year 2004 statement of revenues, expenses and changes in net assets.

Tuition and Fees. Tuition and Fees are reported net of scholarship allowances applied to students' accounts, while student aid paid directly to students is reported as scholarship and fellowship expenses.

State Appropriations. The State of Washington appropriates funds to the University on both annual and biennial bases. These revenues are reported as nonoperating revenues in the Statements of Revenues, Expenses, and Changes in Net Assets. The University of Washington Medical Center received $8,306,000 and $8,308,000 in operating state appropriations in 2004 and 2003, respectively. These amounts are included in other medical center revenue in the Statements of Revenues, Expenses, and Changes in Net Assets.

Operating Activities. The University's policy for reporting operating activities in the Statements of Revenues, Expenses, and Changes in Net Assets is to include activities that generally result from exchange transactions. Examples of exchange transactions are payments received or made for an exchange of goods or services. Certain other significant revenue streams used for operations, such as state appropriations, gifts and investment income are recorded as nonoperating revenues, as prescribed by GASB 35.

Net Assets. The University's net assets are classified as follows:

Invested in capital assets, net of related debt: The University's investments in capital assets, less accumulated depreciation, net of outstanding debt obligations related to capital assets

Restricted net assets – nonexpendable: Net assets subject to externally-imposed requirements that they be maintained permanently by the University, including permanent endowment funds

Restricted net assets – expendable: Net assets which the University is obligated to spend in accordance with restrictions imposed by external parties

Unrestricted net assets: Net assets not subject to externally imposed restrictions, but which may be designated for specific purposes by management, or the Board of Regents.

Tax Exemption. The University is a tax-exempt organization under the provisions of Section 115 of the Internal Revenue Code and is exempt from federal income taxes on income related to the University's mission.

Related Party. During the year ended June 30, 2003, the University received $70,000,000 as a gift from a foundation related to a member of the Board of Regents.

Reclassifications. Certain amounts in the 2003 financial statements have been reclassified for comparative purposes to conform to the presentation in the 2004 financial statements.

NOTE 2:

Cash and Cash Equivalents

Cash includes bank demand deposits, cash held by fiscal agents, $10,530,000 and $11,292,000 of cash held with escrow agents in 2004 and 2003, respectively, and petty cash. Most cash, except for cash held at the University, is covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). At June 30, 2004 and 2003, bank balances of $764,000 and $1,040,000, respectively, were insured by the FDIC and balances of $22,037,000 and $20,255,000, respectively, were collateralized under the PDPC.

NOTE 3:

Deposit with State of Washington

State law requires the University to deposit certain funds with the state treasurer, who holds and invests the funds. The deposits include: amounts held for the University's permanent land grant funds, the University of Washington building fee, and certain general obligation bonds reserve funds. The fair value of these funds approximates the carrying value.

NOTE 4:

Student Loans Receivable

Net student loans of $59,668,000 and $59,886,000 at June 30, 2004 and 2003, respectively, consist of $49,720,000 and $48,759,000 from federal programs and $9,948,000 and $11,127,000 from University programs. Interest income from student loans for the years ended June 30, 2004 and 2003, was $1,244,000 and $1,302,000, respectively. Loans are made primarily to students who reside in the state of Washington. The loans are unsecured and are expected to be repaid from earnings of the borrowers.

NOTE 5:

Accounts Receivable

The major components of accounts receivable as of June 30, 2004 and 2003, were:

(Dollars in thousands)

	2004	2003
PATIENT SERVICES	$ 189,519	$ 181,996
GRANTS AND CONTRACTS	118,038	124,721
PENDING INVESTMENT SALES	15,341	68,381
SALES AND SERVICES	9,064	7,772
TUITION	16,427	18,677
STATE APPROPRIATIONS	4,279	1,288
OTHER	46,755	47,177
TOTAL	399,423	450,012
LESS ALLOWANCE FOR DOUBTFUL ACCOUNTS	(74,516)	(59,996)
ACCOUNTS RECEIVABLE, NET	$ 324,907	$ 390,016

NOTE 6:

Investments

INVESTMENTS – GENERAL

The Board of Regents of the University of Washington is responsible for the management of the University's investments. The Board establishes investment policy which is carried out by the Investment Officer, who is also the Treasurer of the Board of Regents. The University of Washington Investment Committee (UWINCO), comprised of Board members and investment professionals, advises on matters relating to the management of the University's investment portfolios.

The majority of the University's investments are insured, registered, and held by the University's custodial bank as an agent for the University. Investments not held by the custodian include lent securities, mutual funds, venture capital, private equity, opportunistic, marketable alternatives, mortgages, real estate, and miscellaneous investments.

TABLE 1 – UNIVERSITY INVESTMENTS AND COLLATERAL FROM SECURITIES LENDING

Investment Type	*(Dollars in thousands)* Carrying Value June 30, 2004	June 30, 2003
CASH EQUIVALENTS	$ 25,701	$ 93,065
DOMESTIC FIXED INCOME	593,275	491,722
DOMESTIC FIXED INCOME – LOANED	307,024	417,816
FOREIGN FIXED INCOME	31,890	37,365
FOREIGN FIXED INCOME – LOANED	–	726
DOMESTIC EQUITY	503,512	382,306
DOMESTIC EQUITY – LOANED	36,443	40,322
FOREIGN EQUITY	241,804	186,628
FOREIGN EQUITY – LOANED	22,112	18,216
VENTURE CAPITAL	63,269	55,077
BUYOUT	45,741	47,133
OPPORTUNISTIC	52,675	46,033
MARKETABLE ALTERNATIVES	194,173	170,520
REAL ESTATE	7,679	3,024
MISCELLANEOUS	21	4,328
TOTAL INVESTMENTS	2,125,319	1,994,281
COLLATERAL FROM SECURITIES LENDING – CASH	318,277	357,087
TOTAL INVESTMENTS AND COLLATERAL	$ 2,443,596	$ 2,351,368

INVESTMENT POOLS

The University combines most short-term cash balances into the Invested Funds Pool. At June 30, 2004, the Invested Funds Pool totaled $681,015,000 compared to $762,391,000 at June 30, 2003. The fund also owns units in the Consolidated Endowment Fund valued at $289,859,000 on June 30, 2004 and $206,448,000 on June 30, 2003. By University policy, departments with qualifying funds in the Invested Funds Pool receive one of four rates of return based on the realized yield of the portfolio. Long-term deposits received 3.1% and 6.3% for fiscal years 2004 and 2003. Operating and plant fund balances of self-sustaining units received 2.8% and 5.7%. Royalty accounts received 1.0% in 2004 and 3.0% in 2003, and gift accounts received 3.0% in both fiscal years. The difference between the actual earnings of the Invested Funds Pool and the calculated distributions is used to support activities benefiting all University departments.

The composition of the carrying amounts of investments by type at June 30, 2004 and 2003 are listed in Table 1.

The majority of the endowed funds are invested in a pooled fund called the Consolidated Endowment Fund (CEF). Individual endowments subscribe to or dispose of units in the pool on the basis of a per unit valuation of the CEF at fair value on the last business day of the calendar quarter. Income is distributed based on the number of units held. The CEF income distribution is 5% of the average fair value of the CEF for the previous three years. RCW 24.44.050 of the Washington State Code allows for the spending of appreciation in the CEF.

The University records its permanent endowments at the lower of original value or current market value in the Restricted Nonexpendable Net Assets category. Of the total of approximately $700,000,000 and $603,000,000 permanent endowment funds (at market value) as of June 30, 2004 and 2003, the aggregate amount of the deficiencies for all funds for which the fair value of the assets is less than the original gifts is $6,167,000 and $14,993,000 at June 30, 2004 and 2003, respectively.

Funds in irrevocable trusts managed by trustees other than the University are not reported in the financial statements. The fair value of these funds was approximately $50,000,000 at June 30, 2004 compared to $48,000,000 at June 30, 2003. Income received from these trusts was $2,075,000 for the year ended June 30, 2004 and $2,194,000 for the year ended June 30, 2003.

Net appreciation (depreciation) in the fair value of investments includes both realized and unrealized gains and losses on investments. During the years ended June 30, 2004 and 2003, the University realized net gains (losses) of $68,162,000 and $(20,055,000), respectively, from the sale of investments. The calculation of realized gains and losses is independent of the net appreciation of the fair value of investments. Realized gains and losses on investments that have been held in more than one fiscal year and are sold in the current year, include the net appreciation of these investments reported in the prior year(s). The net appreciation in the fair value of investments during the years ended June 30, 2004 and 2003, was $161,660,000 and $17,572,000, respectively.

SECURITIES LENDING

The University's investment policies permit it to lend its securities to broker dealers and other entities. The University's custodian lends securities for collateral in the form of cash or other securities, with the simultaneous agreement to return the collateral for the same securities in the future. U.S. securities are loaned and secured by collateral valued at 102% of the fair value of the securities plus any accrued interest. Non-U.S. securities are loaned and secured by collateral valued at 105% of the fair value of the securities plus any accrued interest. At year-end, the University had no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University.

The contract with the custodian requires it to indemnify the University if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the University for income distributions by the securities' issuers while the securities are on loan.

Either the University or the borrower can terminate all securities loans on demand, although the average term of overall loans is 104 days. Cash collateral is invested in a short-term investment pool which had an average weighted maturity of 24 days as of June 30, 2004.The relationship between the maturities of the investment pool and the University's loans is affected by the maturities of the securities loaned by other entities that use the custodian's pool. The University cannot determine the maturities of these loaned securities. The University cannot sell or pledge non-cash collateral unless the borrower defaults. Non-cash collateral at June 30, 2004 and 2003 was $54,524,000 and $82,902,000, respectively.

Securities on loan at June 30, 2004 and 2003, totaled $365,579,000 and $477,080,000, respectively, and are listed by investment type in Table 1. The securities lending program resulted in net revenues of $615,000 for the year ended June 30, 2004 and $676,000 for the year ended June 30, 2003.

INTEREST RATE RISK

Through its investment policies, the University manages its exposure to fair value losses arising from increasing interest rates by limiting the modified duration of the fixed income securities in its investment portfolios to less than 3.5 years in the Consolidated Endowment Fund (CEF) and less than 2.25 years in the Invested Funds Pool. Modified duration, which estimates the sensitivity of a bond's price to interest rate changes, is based on Macaulay duration. Macaulay duration is the basic calculation developed for a portfolio of bonds assembled to fund a fixed liability. Macaulay duration is calculated as follows: sum of discounted time-weighted cash flows / bond price. Modified duration is calculated using the following formula: Macaulay duration / (1 + yield-to-maturity / number of coupon payments per year).

As of June 30, 2004, modified duration of the University's investments for which duration is measured is as follows:

TABLE 2 – INVESTMENTS MANAGED BY THE UNIVERSITY

(Dollars in thousands, modified duration in years)

Investment	CEF Market Value	CEF Modified Duration	Invested Funds Market Value	Invested Funds Modified Duration	Insurance Funds Market Value	Insurance Funds Modified Duration
DOMESTIC FIXED INCOME (INCLUDING LOANED)						
ASSET BACKED	$ 11,586	0.58	$ 120,478	1.68	$ 3,533	2.14
CASH EQUIVALENTS (SHORT TERM MONEY MARKET)	4,880	0.08	47,199	0.08	576	0.03
CORPORATE BONDS	16,886	4.49	22,404	2.88	13,881	5.51
GOVERNMENT AND AGENCIES	37,014	5.58	335,829	2.99	6,183	4.08
MORTGAGE RELATED	46,546	1.04	145,238	1.37	3,264	3.55
SUBTOTAL	116,912		671,148		27,437	
FOREIGN FIXED INCOME						
INTERNATIONAL FIXED	25,366	5.88	–	–	3,838	6.02
TOTAL	$ 142,278	3.43	$ 671,148	2.22	$ 31,275	4.60

Approximately $84,802,000 of additional domestic fixed income securities (including Loaned) and $2,686,000 of additional foreign fixed income securities, which in total make up 3.6% of the University's investments, are not included in the duration figures above. These investments, some of which are managed by the University and others by the University's affiliates, are not invested under the same investment strategy or with the same custodian as those detailed in Table 2.

CREDIT RISK

The University investment policies limit investments to investment grade assets. The Investment Policy for the University's operating funds reflects a higher level of credit risk/loss sensitivity and requires each manager to maintain an average AA rating as issued by a nationally recognized rating organization. Additionally, the investment policy requires the operating funds to have 50% of the assets invested in government and government agencies issues. The Investment Policy for the CEF reflects its long-term nature by specifying average quality rating levels by individual manager, but still restricting investment to investment grade credits.

FOREIGN CURRENCY RISK

The University's investment policies permit investments in international equity and other asset classes which can include foreign currency exposure.

The University's investment strategy within the Invested Funds Pool is to hedge exposure to foreign currency. Within this pool, the University enters into foreign currency forward contracts, futures contracts, and options to hedge the foreign currency exposure.

At June 30, 2004 and 2003, the University had net outstanding forward commitments to sell foreign currency with a total fair value of $25,060,000 and $28,249,000, respectively, which equals 1.2% and 1.4% of the total portfolio.

As part of the investment strategy, the University does not hedge foreign currency exposure within the equity portion of the Consolidated Endowment Fund.

The following table details the market value of foreign denominated securities by currency type in the Consolidated Endowment Fund.

(Dollars in thousands)

Foreign Currency	June 30, 2004 Market Value	Percentage
EURO	$ 105,944	31%
SWISS FRANC	23,336	7%
UK – STERLING	61,232	18%
JAPAN – YEN	47,203	14%
SOUTH KOREAN – WON	11,556	3%
OTHER (LESS THAN 3%)	92,951	27%
TOTAL	$ 342,222	100%

NOTE 7

Metropolitan Tract

The Metropolitan Tract, located in downtown Seattle, is comprised of approximately 11 acres of developed property, including office space, retail space, parking, and a luxury hotel. This land was the original site of the University from 1861 until 1895 when the University moved to its present location. Since the early 1900s, the Metropolitan Tract has been leased by the University to entities responsible for developing and operating the property. On July 18, 1953, the Board of Regents of the University and the entity now known as Unico Properties, Inc. entered into a lease agreement for office, retail, and parking facilities, which will expire in 2014. On January 19, 1980, the Board of Regents of the University entered into a lease with the Urban/Four Seasons Hotel Venture for the Olympic Hotel property, which will expire in 2040.The hotel was operated as the Four Seasons Olympic Hotel until July 31, 2003. On August 1, 2003, the remaining lease term was assigned to LHCS Hotel Holding (2002) LLC. The hotel was renamed the Fairmont Olympic Hotel and is now managed by Fairmont Hotels & Resorts.

The balances as of June 30, 2004 and 2003, represent operating assets, net of liabilities, and land, buildings, and improvements stated at appraised value as of November 1, 1954, plus all subsequent capital additions and improvements at cost, less buildings retired or demolished and accumulated depreciation of $82,269,000 and $77,129,000, respectively.

NOTE 8:

Capital Assets:

Capital asset activity for the two year period ended June 30, 2004 is summarized as follows:

CAPITAL ASSETS *(Dollars in thousands)*

	Balance at June 30, 2002	Additions/ Transfers	Retirements	Balance at June 30, 2003	Additions/ Transfers	Retirements	Balance at June 30, 2004
LAND	$ 59,129	$ –	$ –	$ 59,129	$ –	$ –	$ 59,129
INFRASTRUCTURE	158,918	1,066	–	159,984	–	–	159,984
BUILDINGS	1,818,066	193,445	5,566	2,005,945	457,680	319	2,463,306
FURNITURE, FIXTURES, AND EQUIPMENT	734,956	87,987	63,036	759,907	87,344	46,558	800,693
LIBRARY MATERIALS	183,705	11,531	976	194,260	13,354	1,033	206,581
CAPITALIZED COLLECTIONS	4,409	–	–	4,409	–	–	4,409
CONSTRUCTION IN PROGRESS	351,815	65,375	–	417,190	(309,121)	–	108,069
TOTAL	3,310,998	359,404	69,578	3,600,824	249,257	47,910	3,802,171
LESS ACCUMULATED DEPRECIATION							
INFRASTRUCTURE	46,672	3,731	–	50,403	4,243	–	54,646
BUILDINGS	706,040	57,468	4,315	759,193	74,359	145	833,407
FURNITURE, FIXTURES, AND EQUIPMENT	538,911	82,187	59,606	561,492	84,213	42,711	602,994
LIBRARY MATERIALS	111,243	9,312	606	119,949	9,752	654	129,047
TOTAL ACCUMULATED DEPRECIATION	1,402,866	152,698	64,527	1,491,037	172,567	43,510	1,620,094
CAPITAL ASSETS, NET	**$1,908,132**	**$ 206,706**	**$ 5,051**	**$2,109,787**	**$ 76,690**	**$ 4,400**	**$2,182,077**

NOTE 9:

Long-Term Liabilities:

Long-term liability activity for the two year period ended June 30, 2004 is summarized as follows:

LONG-TERM LIABILITIES *(Dollars in thousands)*

	Balance as of June 30, 2002	Additions	Reductions	Balance as of June 30, 2003	Additions	Reductions	Balance as of June 30, 2004	Current Portion 2003	Current Portion 2004
LEASES AND BONDS PAYABLE:									
CAPITAL LEASE OBLIGATIONS	$ 23,547	$ 3,272	$ 5,639	$ 21,180	$ 17,651	$ 4,485	$ 34,346	$ 3,918	$ 7,651
GENERAL OBLIGATION BONDS PAYABLE	294,169	27,805	27,933	294,041	27,070	11,466	309,645	11,466	12,478
REVENUE BONDS PAYABLE	269,450	–	5,340	264,110	16,985	10,175	270,920	6,015	6,490
TOTAL LEASES AND BONDS PAYABLE	587,166	31,077	38,912	579,331	61,706	26,126	614,911	21,399	26,619
OTHER LIABILITIES:									
NOTES PAYABLE & OTHER – CAPITAL ASSET RELATED	37,059	7,040	2,414	41,685	767	2,590	39,862	2,498	2,894
NOTES PAYABLE & OTHER – NON-CAPITAL ASSET RELATED	13,057	–	5	13,052	120	55	13,117	–	10,002
CHARITABLE AND DEFERRED GIFT ANNUITY LIABILITY	30,266	3,486	4,490	29,262	7,586	4,173	32,675	–	–
SICK LEAVE	13,636	1,445	757	14,324	10,002	3,575	20,751	787	900
SELF-INSURANCE	32,440	7,080	4,448	35,072	6,563	10,526	31,109	8,300	9,413
NET PENSION OBLIGATION	–	–	–	–	3,775	1,024	2,751	–	1,000
TOTAL OTHER LIABILITIES	126,458	19,051	12,114	133,395	28,813	21,943	140,265	11,585	24,209
TOTAL LONG-TERM	**$ 713,624**	**$ 50,128**	**$ 51,026**	**$ 712,726**	**$ 90,519**	**$ 48,069**	**$ 755,176**	**$ 32,984**	**$ 50,828**

NOTE 10:

Leases

CAPITAL LEASES

The University has certain lease agreements in effect that are considered capital leases. As of June 30, 2004 and 2003, the University had buildings in the amounts of $9,987,000 and $9,987,000 and equipment in the amounts of $36,693,000 and $19,043,000, respectively, related to capital leases. These assets were recorded net of accumulated depreciation of $14,271,000 and $7,077,000, respectively, for buildings, and $3,995,000 and $2,996,000, respectively, for equipment. The University recorded depreciation expense of $999,000 and $999,000 for buildings, and $7,194,000 and $3,593,000 for equipment in the respective years. Future minimum lease payments under capital leases, and the present value of the net minimum lease payments, as of June 30, 2004, are as follows:

Year	*(Dollars in thousands)*
2005	$ 8,786
2006	8,476
2007	6,493
2008	4,254
2009	4,232
2010-2014	5,779
TOTAL MINIMUM LEASE PAYMENTS	38,020
LESS: AMOUNT REPRESENTING INTEREST COSTS	(3,674)
PRESENT VALUE OF MINIMUM LEASE PAYMENTS	$ 34,346

OPERATING LEASES

The University has certain lease agreements in effect that are considered operating leases, primarily for leased building space. During the years ended June 30, 2004 and 2003, the University recorded expenses of $34,300,000 and $29,066,000, respectively, for these leases.

Future lease payments under these leases as of June 30, 2004, are as follows:

Year	*(Dollars in thousands)*
2005	$ 32,945
2006	28,193
2007	19,678
2008	16,647
2009	14,941
2010-2014	55,642
2015-2019	9,743
2020-2024	2,212
2025-2051	1,792
TOTAL MINIMUM LEASE PAYMENTS	$ 181,793

NOTE 11:

Bonds and Notes Payable

The bonds and notes payable at June 30, 2004, consist of State of Washington General Obligation and Refunding Bonds, University Revenue and Facilities Bonds, and Notes Payable. These obligations have fixed interest rates ranging from 2.00% to 6.40%, except for debt totaling $1,225,000, which has variable rates.

Debt service requirements at June 30, 2004 were as follows:

BONDS AND NOTES PAYABLE *(Dollars in thousands)*

Year	STATE OF WASHINGTON GENERAL OBLIGATION Principal	STATE OF WASHINGTON GENERAL OBLIGATION Interest	REVENUE BONDS Principal	REVENUE BONDS Interest	NOTES PAYABLE AND OTHER Principal	NOTES PAYABLE AND OTHER Interest
2005	$ 12,478	$ 15,640	$ 6,490	$ 14,260	$ 12,896	$ 1,830
2006	12,618	15,120	6,770	13,871	2,902	1,708
2007	12,929	14,533	7,200	13,555	4,245	1,584
2008	13,720	13,876	7,775	13,213	4,234	1,461
2009	14,373	13,153	8,240	12,834	2,552	1,339
2010-2014	68,312	55,524	51,600	57,175	11,423	5,037
2015-2019	84,700	34,886	58,635	43,067	8,365	2,792
2020-2024	62,995	16,039	68,430	29,756	6,362	636
2025-2029	27,520	2,505	41,515	16,010	–	–
2030-2034	–	–	14,265	2,769	–	–
TOTAL	$ 309,645	$181,276	$ 270,920	$216,510	$ 52,979	$ 16,387

State law requires that the University reimburse the state for debt service payments relating to its portion of the State of Washington General Obligation and Refunding Bonds from Medical Center patient revenues, tuition, timber sales, and other revenues. The University has pledged the net revenues from the Housing and Dining System, the Intercollegiate Athletics Department, the Parking System, and a portion of special student fees to retire the related revenue and facilities bonds.

REFUNDING ACTIVITY

On April 6, 2004, $4,160,000 of Housing and Dining System Revenue Bonds with an average interest rate of 5.912% were refunded through the issuance of a $4,375,000 portion of $16,985,000 Housing and Dining System Revenue and Refunding Bonds, series 2004 with an average interest rate of 2.789% on the refunding portion. The refunding of the bonds decreased the University's total debt service payments to be made over the next 9 years by $457,000. The refunding resulted in an economic gain (difference between the present values of debt service payments on the old and new debt) of $413,000.

On May 27, 2003, $8,990,000 of Education Bonds, Series R95A (1994-A-UW) with an average interest rate of 5.696% were partially refunded. The refunding bonds have a maturity of $9,170,000, Series R2003C (R95A (1994-A-UW)) with an average interest rate of 3.684%.The refunding of the bonds decreased the University's total debt service payments to be made over the next 9 years by $809,000.The refunding resulted in an economic gain of $758,000.

On May 7, 2003, $7,995,000 of Education Bonds, Series R95A (1994-HE-UW) with an average interest rate of 5.065% were partially refunded. The refunding bonds have a maturity of $8,155,000, Series R2003C (R95A (1994-HE-UW)) with an average interest rate of 3.276%.The refunding of the bonds decreased the University's total debt service payments to be made over the next 9 years by $719,000.The refunding resulted in an economic gain of $674,000.

SUBSEQUENT DEBT OFFERINGS

On August 19, 2004, Washington Biomedical Research Properties issued $38,225,000 of debt at 4.831% that matures based on a schedule through June 1, 2034. On September 29, 2004, the University issued $20,410,000 of revenue bonds at 4.616% that matures based on a schedule through November 1, 2029, related to parking operations. On October 21, 2004, the University issued $60,720,000 of variable rate General Revenue Bonds that matures based on a schedule through December 1, 2036, related to research construction projects. Also related to the October issuance, the University entered into a swap arrangement whereby the interest rate is fixed at 3.268%.

NOTE 12:

Operating Expenses by Function

Operating expenses by functional classification for the year ended June 30, 2004 and 2003 are summarized as follows:

Operating Expenses	2004	2003
	(Dollars in thousands)	
EDUCATION AND GENERAL:		
INSTRUCTION	$ 594,837	$ 593,997
RESEARCH	553,240	501,338
PUBLIC SERVICE	23,367	21,196
ACADEMIC SUPPORT	186,316	165,624
STUDENT SERVICES	25,596	24,546
INSTITUTIONAL SUPPORT	103,059	97,419
OPERATION AND MAINTENANCE OF PLANT	145,927	155,257
SCHOLARSHIPS AND FELLOWSHIPS	53,566	50,654
AUXILIARY ENTERPRISES	124,020	127,891
MEDICAL RELATED	604,983	538,410
DEPRECIATION	172,567	152,698
TOTAL OPERATING EXPENSES	$ 2,587,478	$ 2,429,030

NOTE 13:

Pension Plans

The University offers two contributory plans: the Washington State Public Employees Retirement System (PERS) plan, a defined benefit retirement plan; and the University of Washington Retirement Plan (UWRP), a defined contribution plan with supplemental payment, when required.

PUBLIC EMPLOYEES RETIREMENT SYSTEM

Plan Description. The University of Washington contributes to PERS, a cost-sharing multiple-employer defined benefit pension plan administered by the State of Washington Department of Retirement Systems. PERS Plan 1 provides retirement and disability benefits, and minimum benefit increases beginning at age 66, to eligible non-academic plan members hired prior to October 1, 1977. PERS Plans 2 and 3 provide retirement and disability benefits, and a cost-of-living allowance, to eligible non-academic plan members hired on or after October 1, 1977. In addition, PERS Plan 3 has a defined contribution component, which is fully funded by employee contributions. The authority to establish and amend benefit provisions resides with the legislature. The Washington State Public Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for PERS. The report may be obtained by writing to the Department of Retirement Systems, P.O. Box 48380, Olympia, Washington 98504-8380, or visiting http://www.drs.wa.gov/agency/annualreport/index.htm.

Funding Policy. The Office of the State Actuary, using funding methods prescribed by statute, determines actuarially required contribution rates for PERS. Plan 1 members are required to contribute 6% of their annual covered salary. Contributions for Plan 2 members are determined by the aggregate method and may vary over time. The contribution rate for Plan 2 employees at June 30, 2004 and 2003 was 1.18% and 0.65%, respectively. PERS 3 members can choose contributions ranging from 5% to 15% of salary, based on the age of the member. The defined contribution benefit for PERS 3 will depend on the member's contributions, the investment earnings on those contributions, and if an annuity is taken, the age at which the member receives payment. The contribution rate for the University at June 30, 2004 and 2003, for each of PERS Plans 1, 2 and 3 was 1.40% and 1.32%, respectively.

The University's contributions to PERS for the years ended June 30, 2004, 2003, and 2002 were $8,120,000, $7,969,000 and $11,441,000 respectively, which were equal to the required contributions for each year.

UNIVERSITY OF WASHINGTON RETIREMENT PLAN

Plan Description. Faculty, librarians, professional staff and certain other salaried employees are eligible to participate in the University of Washington Retirement Plan, a defined contribution plan administered by the University. Contributions to the Plan are invested in annuity contracts or mutual fund accounts offered by one or more fund sponsors. Employees have at all times a 100% vested interest in their accumulations. Benefits from fund sponsors are available upon separation or retirement at the member's option. RCW 28.B.10.400 et. seq. assigns the authority to the University of Washington Board of Regents to establish and amend benefit provisions.

The Plan has a supplemental payment component which guarantees a minimum retirement benefit based upon a one-time calculation at each employee's retirement date. The University makes direct payments to qualifying retirees when the retirement benefits provided by the fund sponsors do not meet the benefit goals.

Funding Policy. Employee contribution rates, based on age, are 5%, 7.5%, or 10% of salary. The University matches the contributions of employees. Within parameters established by the legislature, contribution requirements may be established or amended by the University of Washington Board of Regents. Employee and employer contributions for the year ended June 30, 2004 were each $50,294,000 compared to $48,640,000 for the year ended June 30, 2003. The supplemental component of the UWRP is financed on a pay-as-you-go basis.

Supplemental Component (Unaudited). The University received an actuarial evaluation of the supplemental component of the UWRP during fiscal year 2004. The previous evaluation was performed in 1999. The Unfunded Actuarial accrued Liability (UAL) calculated as of June 30, 2004 and 1999 was $36,142,000 and $13,786,000, respectively, and is amortized over a 19.5 year period. The Annual Required Contribution (ARC) of $3,775,000 consists of amortization of the UAL ($2,129,000) and normal cost (or current cost) ($1,555,000). The UAL and ARC were established using the entry age normal cost method. The actuarial assumptions included an investment rate of return of 7% and projected salary increases ranging from 2% to 4%. Approximately $640,000,000 and $302,000,000 of the UW's payroll was covered under this plan during 2004 and 1999, respectively. The following table reflects the activity in the Net Pension Obligation for the year ended June 30, 2004:

BALANCE AS OF JULY 1, 2003	$ –
ANNUAL REQUIRED CONTRIBUTION	3,775,000
PAYMENTS TO BENEFICIARIES	1,024,000
BALANCE AS OF JUNE 30, 2004	$ 2,751,000

Annual payments for the fiscal years 2003 and 2002 were $1,109,000 and $1,170,000, respectively, and approximated the ARC.

NOTE 14:

Commitments and Contingencies

Authorized expenditures for construction projects unexpended as of June 30, 2004, were $162,902,000. These expenditures will be funded from local funds and state appropriations.

Substantial amounts are received and expended by the University under federal and state grants and contracts. This funding is used for research, student aid, Medical Center operations, and other programs, and is subject to audit by governmental granting agencies. Certain grant and contract costs billed to the federal government are subject to audit under OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. The University is also involved in various other claims and legal actions arising in the ordinary course of business. University management believes that any liabilities arising from these matters will not have a material effect on the University's financial statements.

The United States Departments of Justice and Health and Human Services completed their civil investigation of the University of Washington Physicians (UWP), an affiliated organization, and Children's University Medical Group (CUMG) under the laws and regulations relating to physician billing for services provided to beneficiaries of federally-funded health care programs. A settlement agreement was reached between the parties on April 30, 2004. In the settlement agreement and release, UWP and CUMG, collectively agreed to pay $35,000,000 as settlement offset by $600,000 in restitution previously paid. The settlement covers the period from January 1, 1995 through December 31, 2003. The settlement did not specify any allocation of the amount between UWP and CUMG. UWP and CUMG agreed to an allocation for accounting purposes and UWP's allocated share was $26,500,000, which is reflected in other nonoperating expense in 2004.

The University is exposed to risk of loss related to tort liability, injuries to employees, and loss of property. The University purchases insurance protection for workers' compensation as well as marine, aviation, and certain other risks. The University also purchases insurance protection for loss of property at self-sustaining units, bond-financed buildings, and where otherwise required by contract; otherwise, the risk of property loss is retained, unfunded. For professional, general, employment, and automobile liability, the University maintains a program of self-insurance reserves and excess insurance coverage.

The self-insurance reserve represents the estimated ultimate cost of settling claims resulting from events that have occurred on or before the balance sheet date. The reserve includes the amount that will be required for future payments of claims that have been reported and claims related to events that have occurred but not been reported. The self-insurance reserve is estimated through an actuarial calculation using individual case-basis valuations and statistical analyses. Although considerable variability is inherent in such estimates, management believes that the self-insurance reserve is adequate. Changes in the self-insurance reserve for the years ended June 30, 2004, 2003, and 2002 are noted below.

(Dollars in thousands)

	2004	2003	2002
RESERVE AT BEGINNING OF FISCAL YEAR	$ 35,072	$ 32,440	$ 36,653
INCURRED CLAIMS AND CHANGES IN ESTIMATES	6,563	7,080	8,806
CLAIM PAYMENTS	(10,526)	(4,448)	(13,019)
RESERVE AT END OF FISCAL YEAR	**$ 31,109**	**$ 35,072**	**$ 32,440**

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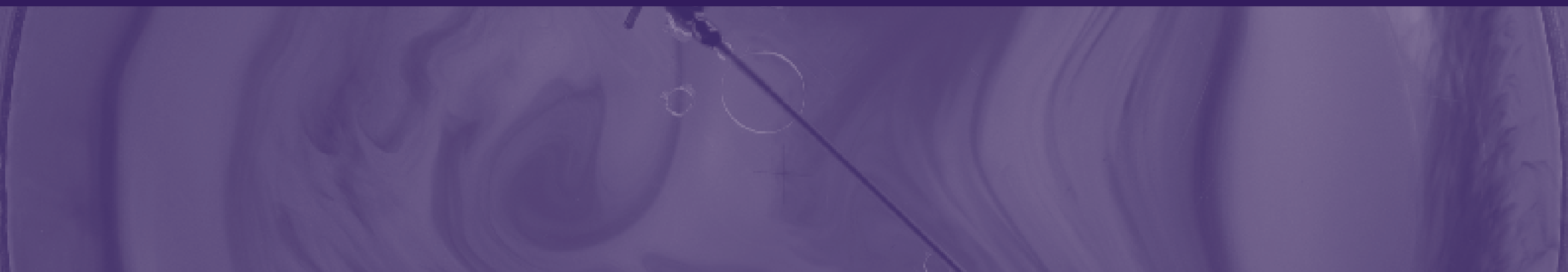

UNIVERSITY OF WASHINGTON