

For the fifth consecutive year, government sponsored revenues surpassed both budget and prior year results and the Institution completed 2004 in strong financial condition. This strength is due in large measure to both the Institution's scientific and engineering achievements and its commitment to administrative efficiency and fiscal discipline.

Financial highlights:

- The Institution's total assets grew by more than \$60 million, or 15%, to \$455 million. This increase is attributable to the performance of the Endowment and to construction of new laboratories on both campuses.
- During 2004 the Institution issued \$54,850,000 of Massachusetts Health and Educational Facilities Authority (MHEFA) variable rate bonds to construct new laboratories and to repay previous MHEFA loans. The Institution negotiated an interest rate swap agreement that effectively locks in a fixed rate on the bonds of 3.79% for 30 years.
- The Institution's accrued pension liability increased from \$6.9 million in 2003 to \$24.7 million in 2004. To allow time to evaluate the retirement plan and control the cost, the plan was amended effective December 31, 2004, by freezing compensation. A task force will propose a new plan that will be in place by the end of 2005.
- The Institution ended the year with a slight decrease in total net assets of \$2.5 million due in large part to pension fund accruals.
- The Endowment Fund grew to \$291 million in 2004 from \$269 million in 2003 with a total return of 12%.
- The Institution ended the year with a total increase in net assets from operating activities of \$8.3 million.

Total sponsored research released to operations was \$108.5 million in 2004 compared with \$100.8 million in 2003, an increase of 8 percent. Government sponsored research, excluding ship and submersible operations, was \$67.5 million in 2004 compared with \$63.4 million in 2003, a 6 percent increase. The Institution's labor bases,

against which fringe benefits and overhead are recovered, finished the year slightly over budget, while overhead costs were reduced by almost \$2.7 million, resulting in a substantial over-recovery of overhead expenses. Our total overhead recovery was \$55.2 million compared with \$47.7 million in 2003.

Our primary federal sponsor, the National Science Foundation (NSF), did not receive a large increase in its 2004 appropriation. However, the Institution benefited from a 22% funding increase from NSF, which more than offset a decrease in funding from the United States Navy.

Through the generosity of friends of the Institution, gifts, grants, and pledges reached \$15.3 million in 2004. Outstanding net pledges at the end of 2004 were \$6.9 million.

Investment returns distributed to operations totaled \$13.7 million in 2004. Sponsored research received \$4.7 million, education received \$5.6 million and current operations received \$3.4 million. Distributions from investment returns have become an important source of revenue for the Institution and make up 10 percent of total operating revenues.

The Institution spent \$56.3 million on compensation during 2004. Included in this amount was \$8.9 million for vacation, holidays and sick time. Other fringe benefits cost \$10.8 million for a total compensation package of \$67.1 million, 52 percent of our total 2004 operating expenses of \$128.2 million.

The Institution invested \$19.4 million on the construction and renovation of facilities during 2004. In addition, \$895,000 was invested in maintaining existing facilities compared with \$884,000 in 2003.

During 2004, to relieve overcrowding and create state of the art laboratories, the Institution has made significant progress in developing the Quissett Campus and renovating laboratories in the Village, while maintaining its financial stability. However, we face significant short and long-term economic challenges: reductions in federal funding agency budgets and a shift in focus from basic to applied



Tom Kleindinst, WHOI Graphic Services

Carolyn Bunker with Dave Stephens, controller.

research will probably require that WHOI change as well.

In the short term we are taking steps to control spiraling health plan and retirement plan costs. We are undertaking a comprehensive assessment of the Institution's central administrative functions to improve effectiveness and competitiveness and direct resources to high priorities.

To prepare for long-term challenges, we are exploring additional and new funding sources with an emphasis on intellectual property development and applied research. These changes will be challenging, but with the support of the staff, students, trustees and corporation members, the Institution will continue to prosper and grow in reputation.

A handwritten signature in black ink that reads "Carolyn A. Bunker". The signature is written in a cursive style.

Statement of Financial Position

December 31, 2004 (with comparative information as of December 31, 2003)

	2004	2003
Assets		
Cash, unrestricted	\$12,669,547	\$18,097,572
Cash, restricted	382,421	1,507,755
Reimbursable costs and fees:		
Billed (net of allowance for doubtful accounts of \$226,658 for 2004 and \$234,033 for 2003)	3,335,365	1,728,635
Unbilled	6,458,930	4,670,629
Receivable for investments sold (Note 3)	-	22,044,791
Interest and dividends receivable	276,130	497,941
Other receivables (Note 12)	2,970,530	8,034,611
Pledges receivable, net	6,879,190	4,846,696
Inventory	1,233,746	1,084,124
Deferred charges and prepaid expenses	1,402,357	775,518
Deferred fixed rate variance	-	3,197,693
Investments, pooled	287,277,109	242,720,582
Investments, nonpooled	5,237,388	5,326,668
Deposits with trustees for construction	24,278,081	-
Deposits with trustees for debt service	3,154,350	-
Prepaid postretirement benefit cost	639,297	788,826
Supplemental retirement	6,537,921	6,257,039
Intangible pension asset	-	5,644,240
Other assets	17,384,437	11,983,651
Deferred financing costs	<u>1,268,753</u>	<u>-</u>
Subtotal	<u>381,385,552</u>	<u>339,206,971</u>
Property, plant and equipment		
Land, buildings and improvements	68,493,906	65,789,103
Vessels and dock facilities	6,442,869	4,365,175
Laboratory and other equipment	18,132,850	15,880,819
Construction in process	<u>24,195,589</u>	<u>7,523,530</u>
	117,265,214	93,558,627
Accumulated depreciation	<u>(53,404,419)</u>	<u>(49,070,058)</u>
Net property, plant and equipment	<u>63,860,795</u>	<u>44,488,569</u>
Remainder trusts	<u>10,043,233</u>	<u>10,532,306</u>
Total assets	<u>\$455,289,580</u>	<u>\$394,227,846</u>

	2004	2003
Liabilities		
Accounts payable and other liabilities (Note 12)	\$17,845,971	\$17,114,484
Accrued payroll and related liabilities	5,291,214	6,227,950
Payable for investments purchased	47,251	-
Deferred fixed rate variance	129,500	-
Accrued supplemental retirement benefits	6,537,921	6,257,039
Accrued pension liability	24,697,407	6,946,274
Deferred revenue and refundable advances	6,739,232	5,316,136
Bond and loans payable	<u>54,850,000</u>	<u>10,724,206</u>
Total liabilities	<u>116,138,496</u>	<u>52,586,089</u>

Net Assets

	Unrestricted	Temporarily restricted	Permanently restricted		
Undesignated	\$10,306,900	\$ -	\$ -	10,306,900	10,961,721
Pension	(23,705,136)	-	-	(23,705,136)	(645,885)
Designated	2,148,390	8,243,578	-	10,391,968	10,977,926
Pledges and other	-	4,693,522	13,327,331	18,020,853	16,277,347
Plant and facilities	29,968,854	-	-	29,968,854	31,420,297
Education	-	3,437,863	-	3,437,863	3,361,005
Endowment and similar funds	<u>67,894,397</u>	<u>166,942,058</u>	<u>55,893,327</u>	<u>290,729,782</u>	<u>269,289,346</u>
Total net assets	<u>\$86,613,405</u>	<u>\$183,317,021</u>	<u>\$69,220,658</u>	<u>339,151,084</u>	<u>341,641,757</u>
Total liabilities and net assets				<u>\$455,289,580</u>	<u>\$394,227,846</u>

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

Statement of Activities

Year Ended December 31, 2004 (with summarized financial information for the year ended December 31, 2003)

	Unrestricted		Temporarily Restricted	Permanently Restricted	2004	2003
	Operating	Sponsored Research				
Operating Revenues						
Fees	\$576,649				\$576,649	\$483,754
Sponsored research						
Government		\$67,496,538			67,496,538	63,389,385
Nongovernment		16,287,190	\$4,725,103		21,012,293	20,711,972
Ships and subs operations		20,102,588			20,102,588	17,558,382
Sponsored research assets released to operations	108,473,591	(103,886,316)	(4,587,275)		-	-
Education						
Tuition	3,455,307				3,455,307	2,977,535
Endowment income	3,683,100		1,902,554		5,585,654	5,671,555
Gifts			351,013		351,013	170,620
Education funds released from restriction	2,176,709		(2,176,709)		-	-
Investment return designated for current operations	3,381,128				3,381,128	3,453,967
Contributions and gifts, net of releases from restrictions of \$884,486 and \$2,023,298 in 2004 and 2003, respectively	7,912,467		(158,970)	\$5,051,897	12,805,394	18,866,945
Contributions in kind	267,687				267,687	309,153
Rental income	660,191				660,191	718,440
Communication and publications	294,620				294,620	262,004
Other	544,184				544,184	195,644
Total revenues	131,425,633	-	55,716	5,051,897	136,533,246	134,769,356
Expenses						
Sponsored research						
National Science Foundation	41,499,749				41,499,749	34,097,378
United States Navy	14,223,555				14,223,555	18,379,000
Subcontracts	12,127,174				12,127,174	9,324,911
National Oceanic & Atmospheric Administration	8,514,822				8,514,822	7,412,224
Department of Energy	690,864				690,864	878,280
United States Geological Survey	999,024				999,024	822,196
National Aeronautics & Space Administration	741,428				741,428	753,186
Ships Operations	14,809,301				14,809,301	13,001,577
Submersible and ROV operations	5,293,287				5,293,287	4,556,805
Privately funded grants	3,126,607				3,126,607	3,742,846
Other	6,447,780				6,447,780	7,780,861

Statement of Activities (continued)

	Unrestricted		Temporarily Restricted	Permanently Restricted	2004	2003
	Operating	Sponsored Research				
Education						
Faculty expense	2,930,827				2,930,827	2,968,490
Student expense	3,963,605				3,963,605	3,840,130
Postdoctoral programs	369,900				369,900	472,037
Other	687,280				687,280	647,797
Rental expenses	498,164				498,164	535,178
Communication, publications and development	2,572,930				2,572,930	2,284,343
Fundraising expenses	2,507,237				2,507,237	2,201,452
Un-sponsored programs	5,279,055				5,279,055	3,821,259
Other expenses	920,888				920,888	980,073
Total expenses	128,203,477	-	-	-	128,203,477	118,500,023
Change in net assets from operating activities	3,222,156	-	55,716	5,051,897	8,329,769	16,269,333
Nonoperating income						
Investment return in excess of amounts designated for sponsored research, education and current operations	5,379,780		14,155,380		19,535,160	31,182,420
Net realized/unrealized gains (losses) on interest swap	(4,020,690)				(4,020,690)	-
Change in split interest agreements	(14,038)		(35,851)	(593,686)	(643,575)	1,149,391
Net periodic pension cost	(9,004,045)				(9,004,045)	(5,819,299)
Contributions and gifts			15,502		15,502	2,163,286
Net assets released from restriction	1,151,030		(1,151,030)		-	-
Nonoperating expenses						
Other nonoperating expenses	(99,976)				(99,976)	(99,972)
Redesignation of gifts	(847,746)		(1,249,343)	60,500	(2,036,589)	57,558
Write-off of fixed assets	(511,023)				(511,023)	-
Change in net assets from nonoperating activities	(7,966,708)	-	11,734,658	(533,186)	3,234,764	28,633,384
Change in net assets from operating and nonoperating activities	(4,744,552)	-	11,790,374	4,518,711	11,564,533	44,902,717
Change in additional pension minimum liability (Note 8)	(14,055,206)				(14,055,206)	5,975,263
Total change in net assets	(18,799,758)	-	11,790,374	4,518,711	(2,490,673)	50,877,980
Net assets at beginning of year	105,413,163		171,526,647	64,701,947	341,641,757	290,763,777
Net assets at end of year	\$86,613,405	\$ -	\$183,317,021	\$69,220,658	\$339,151,084	\$341,641,757

The accompanying notes are an integral part of these financial statements

Statement of Cash Flows

Year Ended December 31, 2004 (with comparative information for the year ended December 31, 2003)

	2004	2003		2004	2003
Cash flows from operating activities			Cash flows from investing activities		
Total change in net assets	\$(2,490,673)	\$50,877,980	Capital expenditures		
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities			Additions to property and equipment	(20,007,169)	(9,972,134)
Depreciation and amortization	5,180,075	4,585,752	Short-term investments		
Change in split interest agreements	643,575	(1,149,391)	Purchase of investments	-	1,000,000
Allowance for uncollectible pledges	93,679	4,708	Endowment		
Discount on pledges	215,801	(56,202)	Receivable for investments sold	22,044,791	(22,044,791)
Net realized and unrealized (gain) loss on investments	(27,688,898)	(41,731,926)	Payable for investments purchased	47,251	(10,193)
Intangible pension asset	5,644,240	5,854,284	Proceeds from the sale of investments	130,132,661	90,451,740
Additional minimum pension liability	14,055,206	(5,975,263)	Purchase of investments	<u>(146,911,010)</u>	<u>(60,187,013)</u>
Contributions to be used for long-term investment	(2,553,132)	(4,926,199)	Net cash used in investing activities	<u>(14,693,476)</u>	<u>(762,391)</u>
Gift of property	(5,034,355)	(7,620,000)	Cash flows from financing activities		
(Increase) decrease in assets			Borrowings under debt agreement	54,850,000	2,679,044
Restricted cash	1,125,334	534,400	Loan payments	(10,724,206)	-
Interest and dividends receivable	221,811	34,285	Deferred financing costs	(1,290,196)	-
Reimbursable costs and fees			Use of bond proceeds deposited with trustee		
Billed	(1,606,730)	2,194,443	Construction fund	(24,278,081)	-
Unbilled	(1,788,301)	140,509	Change in debt service funds	(3,154,350)	-
Other receivables	5,064,081	6,890,372	Contributions to be used for long-term investment	<u>2,553,132</u>	<u>4,926,199</u>
Pledges receivable	(2,341,974)	(332,147)	Net cash provided by financing activities	<u>17,956,299</u>	<u>7,605,243</u>
Inventory	(149,622)	405,897	Net increase (decrease) in cash and cash equivalents	(5,428,025)	4,123,806
Deferred charges and prepaid expenses	(626,839)	223,686	Cash and cash equivalents, beginning of year	<u>18,097,572</u>	<u>13,973,766</u>
Deferred fixed rate variance	3,197,693	(2,770,823)	Cash and cash equivalents, end of year	<u>\$12,669,547</u>	<u>\$18,097,572</u>
Other assets	(366,431)	(186,464)	Supplemental disclosures		
Remainder trusts	(43,044)	-	Cash paid for interest	\$761,500	\$117,284
Prepaid pension cost	149,529	-	Noncash activity - gift of property	5,034,355	7,620,000
Supplemental retirement	(280,882)	(762,713)	Construction in process additions remaining in accounts payable	4,523,689	-
Increase (decrease) in liabilities					
Accrued pension liability	3,695,927	308,900			
Accounts payable and other liabilities	(3,903,660)	(7,555,154)			
Accrued payroll and related liabilities	(936,736)	(467,491)			
Deferred revenue and refundable advances	1,423,096	(2,003,202)			
Accrued supplemental retirement benefits	280,882	762,713			
Deferred fixed rate variance	<u>129,500</u>	<u>-</u>			
Net cash used in operating activities	<u>(8,690,848)</u>	<u>(2,719,046)</u>			

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

Report of Independent Auditors

To the Board of Trustees of
Woods Hole Oceanographic Institution

In our opinion, the accompanying statement of financial position and the related statements of activities and cash flows present fairly, in all material respects, the financial position of Woods Hole Oceanographic Institution (the "Institution") at December 31, 2004, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Institution's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Institution's 2003 financial statements, and in our report dated March 19, 2004, we expressed an unqualified opinion on those financial statements. We conducted our audit of these statements

in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 17, 2005

Notes to financial Statements

1. Background

Woods Hole Oceanographic Institution (the "Institution") is a private, independent not-for-profit research and educational institution located in Woods Hole, Massachusetts. Founded in 1930, the Institution is dedicated to working and learning at the frontier of ocean science and attaining maximum return on intellectual and material investments in oceanographic research.

The Institution is a qualified tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code as it is organized and operated for education and scientific purposes.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis and in accordance with the reporting principles of not-for-profit accounting.

The financial statements include certain prior-year summarized comparative information, but do not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Institution's audited financial statements for the year ended December 31, 2003, from which the summarized information was derived.

Net assets, revenues, and realized and unrealized gains and losses are classified based on

the existence or absence of donor-imposed restrictions and legal restrictions imposed under Massachusetts State law. Accordingly, net assets and changes therein are classified as follows:

Permanently Restricted Net Assets

Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained permanently by the Institution. Generally the donors of these assets permit the Institution to use all or part of the income earned and capital appreciation, if any, on related investments for general or specific purposes.

Temporarily Restricted Net Assets

Temporarily restricted net assets are subject to donor-imposed stipulations that may or will be met by actions of the Institution and/or the passage of time. Unspent gains on permanent endowment are classified as temporarily restricted until the Institution appropriates and spends such sums in accordance with the terms of the underlying endowment funds at which time they will be released to unrestricted revenues.

Unrestricted Net Assets

Unrestricted net assets are not subject to donor-imposed stipulations. Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or de-

creases in unrestricted net assets unless their use is restricted by explicit donor stipulations or law. Expirations of temporary restrictions on net assets, that is, the donor-imposed stipulated purpose has been accomplished and/or the stipulated time period has elapsed, are reported as reclassifications between the applicable classes of net assets. Amounts received for sponsored research (under exchange transactions) are reflected in unrestricted sponsored research and released to operations when spent for the appropriate purpose, or as deferred revenue if expenditures have yet to be incurred.

Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Contributions subject to donor-imposed stipulations that are met in the same reporting period are reported as unrestricted support. Promises to give that are scheduled to be received after the balance sheet date are shown as increases in temporarily restricted net assets and are reclassified to unrestricted net assets when the purpose or items' restrictions are met. Promises to give, subject to donor-imposed stipulations that the corpus be maintained permanently, are recognized as increases in permanently restricted net assets. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions other than cash are generally recorded at market value on the date of the gift (or an estimate of fair value), although certain noncash gifts, for which a readily determinable market value cannot be established, are recorded at a nominal value until such time as the value becomes known. Contributions to be received after one year are discounted at the appropriate rate commensurate with risk. Amortization of such discount is recorded as additional contribution revenue in accordance with restrictions imposed by the donor on the original contribution, as applicable. Amounts receivable for contributions are reflected net of an applicable reserve for collectibility.

The Institution reports contributions in the form of land, buildings, or equipment as unrestricted operating support at fair market value when received.

Dividends, interest and net gains on investments of endowment and similar funds are reported as follows:

- as increases in permanently restricted net assets if the terms of the gift require that they be added to the principal of a permanent endowment fund;
- as increases in temporarily restricted net assets if the terms of the gift or relevant state law impose restrictions on the current use of the income or net realized and unrealized gains; and
- as increases in unrestricted net assets in all other cases.

Operations

The statement of activities report the Institution's operating and nonoperating activities. Operating revenues and expenses consist of those activities attributable to the Institution's current annual research or educational programs, all gifts received except those received for property, plant and equipment purposes and a component of endowment income appropriated for operations (Note 3). Unrestricted endowment investment income and gains over the amount appropriated under the Institution's spending plan are reported as nonoperating revenue as investment return in excess of amounts designated for sponsored research, education and current operations. Nonoperating revenue also includes the change in value of split interest agreements, contributions restricted for property, plant and equipment purposes, gains or losses on disposals of fixed assets, net realized/unrealized gains (losses) on interest swaps and the net periodic pension cost (income) on the noncontributory defined benefit pension plan. Additionally, nonoperating activities includes redesignation of donor gifts and depreciation on certain government-funded facilities.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash, money market accounts, certificates of deposit and overnight repurchase agreements with initial maturities of three months or less when purchased which are stated at cost, which approximates market value.

Included in restricted cash at December 31, 2004 and 2003 is \$142,991 and \$1,268,574, respectively, representing advances received from the United States Navy and other U.S. Government and state agencies. Such amounts are restricted as to use for research programs. Interest earned on unspent funds is remitted to the federal government.

Also included in restricted cash at December 31, 2004 and 2003 is \$239,430 and \$239,181, respectively, representing cash restricted by the Massachusetts Department of Public Health. Interest earned on unspent funds is reinvested within the restricted cash account.

In addition, cash and cash equivalents include uninvested amounts from each classification of net assets (e.g., endowment).

Investments

Investment securities are carried at market value determined as follows: securities traded on a national securities exchange are valued at the last reported sales price on the last business day of the year; securities traded in the over-the-counter market and listed securities for which no sales prices were reported on that day are valued at closing bid prices. The value of publicly traded securities is based upon quoted market prices and net asset values. Other securities, for which no such quotations or valuations are readily available, are carried at estimated fair value as provided by external investment managers. The Institution believes that these valuations are a reasonable estimate of fair value as of December 31, 2004 and 2003 but are subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market

for the investments existed and such differences could be material.

Purchases and sales of investment securities are recorded on a trade date basis. Realized gains and losses are computed on a specific identification method. Investment income, net of investment expenses, is distributed on the unit method.

Investment Income Unitization

The Institution's investments are pooled in an endowment fund and the investments and allocation of income are tracked on a unitized basis. The Institution distributes to operations for each individual fund an amount of investment income earned by each of the fund's proportionate share of investments based on a total return policy.

The Board of Trustees has appropriated all of the income and a specified percentage of the net appreciation (depreciation) to operations as prudent considering the Institution's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Under the Institution's current endowment spending policy, which is within the guidelines specified under state law, between 4 percent and 5.5 percent of the average of the market value of qualifying endowment investments at September 30 of each of the previous three years is appropriated. This amounted to \$13,316,806 and \$13,509,442 for the years ending December 31, 2004 and 2003, respectively, and is classified in operating revenues (research, education, and operations).

Deposits with Trustees

Deposits with trustees consists principally of investments in United States Government obligations and have been deposited with trustees as required under certain loan agreements. At December 31, 2004, the amounts consist of \$3,154,350 for debt service and \$24,278,081 for construction purposes. Interest income on debt service amounted to \$20,766 in 2004 and is reflected in the statement of activities within other income. Interest income on construction funds amounted of \$310,933 in 2004 and is reflected in the statement of activities within other income.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Contracts and Grants

Revenues earned on contracts and grants for research are recognized as related costs are incurred.

The Institution received approximately 92% and 90% of its operating revenues from government agencies including 57% and 50% of its operating revenues from the National Science Foundation and 14% and 21% from the United States Navy in fiscal years 2004 and 2003, respectively. Although applications for research funding to federal agencies historically have been funded, authorizations are subject to annual Congressional appropriations and payment.

Deferred Financing Costs

Costs incurred in connection with the placement of the Massachusetts Health and Educational Facilities Authority, Variable Rate Revenue Bonds, Woods Hole Oceanographic Institution Issue, Series 2004, have been deferred and are being amortized over the term of the obligation on a straight line basis.

Interest Rate Swap

The Institution has entered into an interest rate swap agreement on the Massachusetts Health and Educational Facilities Authority, Variable Rate Revenue Bonds, Woods Hole Oceanographic Institution Issue, Series 2004 Bonds in order to convert a portion of the variable rate debt to fixed rate, thereby economically hedging against changes in the cash flow requirements of the Institution's variable rate debt obligations.

Net payments or receipts (difference between variable and fixed rate) under the swap agreement along with the change in fair value of the swap are recorded in nonoperating activities as net realized/unrealized gains (losses) on interest swap.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is provided on a straight-line basis at annual rates of 12 to 39 years on buildings and improvements, 10 to 15 years on vessels and dock facilities and 5 to 10 years on laboratory and other equipment. Depreciation expense on property, plant, and equipment purchased by the Institution in the amounts of \$5,058,656 and \$4,485,780 in 2004 and 2003, respectively, has been charged to operating activities. Construction commitments totaled \$24,339,591 at December 31, 2004.

Depreciation on certain government-funded facilities (the Laboratory for Marine Science and the dock facility) amounting to \$99,976 in 2004 and \$99,972 in 2003 has been charged to nonoperating expenses as these assets were gifted by the Government.

During fiscal 2004, the Institution capitalized interest of \$65,500.

Included in construction in process is \$18,799,066 and \$4,829,373 at December 31, 2004 and 2003, respectively, relating to campus development.

Use of Estimates

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

3. Investments

The cost and market value of pooled investments held at December 31 are as follows:

	2004		2003	
	Cost	Market	Cost	Market
US treasury bonds	\$ 27,200,000	\$ 27,254,862	\$ -	\$ -
Corporate bonds	17,411,829	17,620,896	52,788,223	53,788,201
International bonds	9,613,758	10,219,035	6,993,216	7,124,933
Equity securities and mutual funds	119,723,809	145,732,044	88,645,967	110,400,060
International equities	50,282,579	63,791,628	43,002,089	50,950,411
Hedge fund limited partnerships	442,829	1,179,948	2,741,760	3,116,672
Venture capital and private equity	27,584,494	21,432,003	24,147,061	17,261,882
Other	46,693	46,693	78,423	78,423
Total investments	<u>\$252,305,991</u>	<u>\$287,277,109</u>	<u>\$218,396,739</u>	<u>\$242,720,582</u>

Amounts held in venture capital and investment partnerships and other investments are invested in securities or other assets for which there is not necessarily a publicly traded market value or which are restricted as to disposition. The return on such investments was \$732,688 and (\$128,840) for the years ended December 31, 2004 and 2003, respectively, including dividends, distributions and changes in the estimated value of such investments.

During 2003, the Institution terminated certain investment managers. Several of these managers were terminated on December 31, 2003 resulting in a receivable for investments sold of \$22,044,791.

The following schedule summarizes the investment return on pooled and nonpooled investments and its classification in the statement of activities:

	Unrestricted	Temporarily restricted	2004 Total	2003 Total
Dividend and interest income	\$4,911,394	\$ 1,902,554	\$ 6,813,948	\$ 4,554,734
Investment management costs	(1,275,801)		(1,275,801)	(1,282,538)
Net realized gains	4,043,938	13,098,183	17,142,121	354,669
Change in unrealized appreciation	4,764,477	5,782,300	10,546,777	41,377,257
Total return on investments	<u>12,444,008</u>	<u>20,783,037</u>	<u>33,227,045</u>	<u>45,004,122</u>
Investment return designated for				
Sponsored research		(4,725,103)	(4,725,103)	(4,696,180)
Education	(3,683,100)	(1,902,554)	(5,585,654)	(5,671,555)
Current operations	(3,381,128)		(3,381,128)	(3,453,967)
Total distributions to operations	<u>(7,064,228)</u>	<u>(6,627,657)</u>	<u>(13,691,885)</u>	<u>(13,821,702)</u>
Investment return in excess of amounts designated for sponsored research, education and current operations	<u>\$5,379,780</u>	<u>\$14,155,380</u>	<u>\$19,535,160</u>	<u>\$31,182,420</u>

Investment return distributed to operations includes \$375,079 and \$312,260 earned on non-endowment investments for the years ended December 31, 2004 and 2003, respectively.

As a result of market declines, the fair value of certain donor restricted endowments is less than the historical cost value of such funds by \$434,022 at December 31, 2004 and \$1,014,212 at December 31, 2003. These unrealized losses have been recorded as reductions in unrestricted net assets. Future market gains will be used to restore this deficiency in unrestricted net assets before any net appreciation above the historical cost value of such fund increases temporarily restricted net assets.

Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the value of investment securities will occur in the near term and that such changes could materially affect the market values and the amounts reported in the statement of financial position.

Endowment income is allocated to each individual fund based on a per unit valuation. The value of an investment unit at December 31 is as follows:

	2004	2003
Unit value, beginning of year	\$ 3.9177	\$ 3.4719
Unit value, end of year	4.1517	3.9177
Net change for the year	.2340	.4458
Investment income per unit for the year	.0361	.0419
Total return per unit	<u>\$.2701</u>	<u>\$.4877</u>

4. Pledges Receivable

Pledges that are expected to be collected within one year are recorded at their net realizable value. Pledges that are expected to be collected in future years are recorded at the present value

of estimated future cash flows. The present value of estimated future cash flows has been measured utilizing a discount rate equivalent to U.S. Treasury yields of similar maturity (ranging from 2.36– 3.63, depending upon the anticipated pledge fulfillment date).

Pledges receivable consist of the following at December 31:

	2004	2003
Unconditional promises expected to be collected in:		
Less than one year	\$2,372,251	\$1,688,779
One year to five years	5,087,435	3,428,933
Reserve for uncollectible pledges receivable	(298,387)	(204,708)
Unamortized discount	<u>(282,109)</u>	<u>(66,308)</u>
	<u>\$6,879,190</u>	<u>\$4,846,696</u>

5. Contribution Receivable from Remainder Trusts

The Institution recorded \$10,043,233 and \$10,532,306 at December 31, 2004 and 2003, respectively, relating to various charitable remainder trusts in its statement of financial position. The receivable and related revenue is measured at the present value of estimated future cash flows to be received and recorded in the appropriate net asset category based on donor stipulation. During the term of these agreements, changes in the value are recognized based on amortization of discounts and changes in actuarial assumptions.

6. Deferred Fixed Rate Variance

The Institution receives funding or reimbursement from federal government agencies for sponsored research under government grants and contracts. Revenue is recognized as related costs are incurred. The Institution has negotiated fixed rates with the federal government for the recovery of certain fringe benefits and indirect costs on these grants and contracts. Such recoveries are subject to carryforward provisions that provide for adjustments to be included in the negotiation of future fixed rates. The deferred fixed rate variance accounts represent the cumulative amount owed to or due from the federal government. The Institution's rates are negotiated with the Office of Naval Research (ONR), the Institution's cognizant agency.

The composition of the deferred fixed rate variance is as follows:

Deferred Fixed Rate Variance asset, December 31, 2002	\$ 426,870
2003 indirect costs	50,441,014
2002 adjustment	(7,930)
Amounts recovered	<u>(47,662,261)</u>
2003 change in receivable	<u>2,770,823</u>
Deferred Fixed Rate Variance asset, December 31, 2003	<u>3,197,693</u>
2004 indirect costs	51,834,850
2003 adjustment	1,081
Amounts recovered	<u>(55,163,124)</u>
2004 change in receivable	<u>(3,327,193)</u>
Deferred Fixed Rate Variance liability, December 31, 2004	<u>\$ (129,500)</u>

As of December 31, 2004, the Institution has received a cumulative recovery in excess of expended amounts of \$129,500 which will be reflected as a deduction to future year recoveries. This amount has been reported as liability of the Institution.

7. Bond and Loans Payable

In fiscal 2004, proceeds were received from the offering of the \$54,850,000 Massachusetts Health and Educational Facilities Authority (MHEFA) Variable Rate Revenue Bonds, Woods Hole Oceanographic Institution Issue, Series 2004, which were used to repay the MHEFA B Pool loans and are being used for campus construction. The bonds contain certain restrictive covenants including limitations on obtaining additional debt, filings of annual financial statements and limitations on the creation of liens. In addition, the Institution agrees that, subject to any governmental restrictions, its fiduciary obligations and limitations imposed by law, it will maintain unrestricted resources at a market value equal to at least 75% of all outstanding indebtedness. The bonds also require a debt service fund to be established. Included in deposits with trustees on the statement of financial position is the market value of the debt service fund of \$3,154,350 at December 31, 2004. The Series 2004 Bonds are collateralized by the Institution's unrestricted revenues and bond insurance. The interest rate for the Series 2004 Bonds is variable and set weekly, and at December 31, 2004, the rate was 2.28%.

The aggregate maturities due on long-term debt at December 31, 2004 are as follows:

Fiscal Year	Principal Amount
2008	\$ 1,150,000
2009	1,200,000
Thereafter	<u>52,500,000</u>
	<u>\$54,850,000</u>

In June 2004, the Institution entered into an interest rate swap agreement, with a term through June 1, 2034. This swap effectively locks in a fixed rate of 3.79% per annum. The agreement has a notional amount of \$54,850,000. At December 31, 2004, the market value of the swap agreement amounted to a liability of \$3,298,000. The value of the interest rate swap is reflected within accounts payable and other liabilities and nonoperating income/expense in the financial statements. Additionally, the Institution incurred additional interest expense in association with the swap agreement of \$722,690 which is reflected as part of the net realized/unrealized gains (losses) on interest swap. For internal financial reporting purposes, the realized/unrealized loss on the interest rate swap is reflected in operating expenses, and interest income and interest expense related to the debt is reflected in operating income and operating expenses, respectively.

The following loans were outstanding in the prior year. These loans were repaid in 2004.

On May 27, 1999, the Institution entered into a \$3,000,000 loan agreement with the Massachusetts Health and Educational Facilities Authority (the "Authority") to finance various

capital projects. On January 31, 2000, the agreement was amended to increase the maximum loan commitment to \$6,000,000. As of December 31, 2003, \$5,485,951 had been drawn down on the loan and was outstanding at year-end. The Institution was required to pay interest on the drawdowns at a variable rate established by the Authority, which was 1% at December 31, 2003.

On March 1, 2001, the Institution entered into an \$11,000,000 loan agreement with the Authority to finance additional capital projects. As of December 31, 2003, \$5,238,255 had been drawn down on the loan and was outstanding at year-end. Drawdowns were expected to occur during an eighteen-month period. During this period, no principal payments were due on the loan, but the Institution was required to pay interest on the drawdowns at a variable rate established by the Authority, which was 1% at December 31, 2003.

The Institution's variable rate debt approximates fair value. Fair value is based on estimates using current interest rates available for debt with equivalent maturities.

8. Retirement Plans

The Institution maintains a noncontributory defined benefit pension plan covering substantially all employees of the Institution, a restoration plan for certain senior employees and a supplemental benefit plan for certain other employees. Pension benefits are earned based on years of service and compensation received. The Institution's policy is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974.

The Institution uses a December 31 measurement date for all of its plans.

	Restoration Plan Pension Benefits	
	2004	2003
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 1,200,690	\$ 790,023
Service cost	25,699	21,155
Interest cost	86,005	77,640
Plan amendments	(190,939)	-
Benefits paid	-	-
Actuarial loss	197,601	311,872
Benefit obligation at end of year	<u>\$ 1,319,056</u>	<u>\$ 1,200,690</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contributions	-	-
Benefits paid	-	-
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Funded status	\$(1,319,056)	\$(1,200,690)
Unrecognized net actuarial loss	355,726	294,893
Unrecognized prior service cost	(28,941)	249,648
Net amount recognized	<u>(992,271)</u>	<u>\$ (656,149)</u>
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	\$(1,090,718)	\$ (770,184)
Intangible asset	-	114,035
Cumulative reduction in net assets	98,447	-
Net amount recognized	<u>\$ (992,271)</u>	<u>\$ (656,149)</u>
Cumulative reduction in net assets attributable to change in additional minimum liability recognition	\$ 98,447	\$ -
Information for pension plans with accumulated benefit obligations in excess of plan assets		
Projected benefit obligation	\$ 1,319,056	\$ 1,200,690
Accumulated benefit obligation	1,090,718	770,184
Fair value of plan assets	\$ -	-

	Restoration Plan Pension Benefits	
	2004	2003
Components of net periodic benefit cost		
Service cost	\$ 25,699	\$ 21,155
Interest cost	86,005	77,640
Amortization of prior service cost	87,650	87,650
Recognized actuarial loss	136,768	157,440
Net periodic benefit cost	<u>\$336,122</u>	<u>\$343,885</u>
Weighted-average assumptions used to determine benefit obligations at December 31		
Discount rate	5.75%	6.25%
Rate of compensation increase	6.00%	6.00%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	6.25%	6.75%
Rate of compensation increase	6.00%	6.00%

Expected Contributions

The Institution does not anticipate contributing to the Restoration Plan in 2005.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service are expected to be paid as follows:

Years	Benefit Payments
2005	\$ -
2006	93,887
2007	1,427,185
2008 and thereafter	-

	Qualified Plan Pension Benefits	
	2004	2003
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 176,914,377	\$ 169,123,168
Service cost	7,006,323	6,118,111
Interest cost	11,250,529	11,068,835
Plan amendments	(27,041,213)	-
Actuarial loss	18,666,776	4,019,659
Benefits paid	<u>(8,869,550)</u>	<u>(13,415,396)</u>
Benefit obligation at end of year	<u>\$ 177,927,242</u>	<u>\$ 176,914,377</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 143,751,387	\$ 133,980,735
Employer contributions	-	-
Actual return on plan assets	15,734,494	23,186,048
Benefits paid	<u>(8,869,550)</u>	<u>(13,415,396)</u>
Fair value of plan assets at end of year	<u>\$ 150,616,331</u>	<u>\$ 143,751,387</u>
Funded status	<u>\$(27,310,911)</u>	<u>\$(33,162,990)</u>
Unrecognized net actuarial loss	36,107,982	22,579,627
Unrecognized prior service cost	<u>(18,447,001)</u>	<u>9,937,478</u>
Net amount recognized	<u>\$ (9,649,930)</u>	<u>\$ (645,885)</u>
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	\$(23,606,689)	\$ (6,176,090)
Cumulative reduction in net assets	13,956,759	-
Intangible asset	-	5,530,205
Net amount recognized	<u>\$ (9,649,930)</u>	<u>\$ (645,885)</u>
Cumulative (addition) reduction in net assets attributable to change in additional minimum liability recognition	\$ 13,956,759	\$ (5,975,263)
Information for pension plans with accumulated benefit obligations in excess of plan assets		
Projected benefit obligation	177,927,242	176,914,377
Accumulated benefit obligation	174,223,020	149,927,477
Fair value of plan assets	150,616,331	143,751,387
Components of net periodic benefit cost		
Service cost	7,006,323	6,118,111
Interest cost	11,250,529	11,068,835
Expected return on plan assets	(11,708,592)	(12,710,913)
Amortization of prior service cost	1,343,266	1,343,266
Recognized actuarial loss	1,112,519	-
Net periodic benefit cost	<u>\$ 9,004,045</u>	<u>\$ 5,819,299</u>

The Institution has reflected the net periodic benefit cost in nonoperating income. In 2004, the Institution was required to record an additional charge of \$13,956,759 to reflect a minimum balance sheet liability equal to the Plan's unfunded accumulated benefit obligation. In 2003, the additional minimum liability that was established in 2002 was reversed as the minimum balance sheet liability was no longer necessary.

	Qualified Plan Pension Benefits	
	2004	2003
Weighted-average assumptions used to determine benefit obligations at December 31		
Discount rate	5.75%	6.25%
Rate of compensation increase	3.50%	3.50%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	6.25%	6.75%
Expected long-term rate of return on plan assets	8.50%	8.50%
Rate of compensation increase	3.50%	3.50%

To develop the expected long-term rate of return on assets assumption, the Institution considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio, net of expenses expected to be paid. This resulted in the selection of the 8.50% assumption.

Effective December 31, 2004, final average compensation for the Plan was frozen and equal to a participant's final average compensation determined as of December 31, 2004. A one-year index of 4.5% will be applied to the frozen December 31, 2004 final average compensation for service performed during 2005. In addition, effective December 31, 2004, the minimum lump-sum benefit was amended to eliminate the 8% pay credit for years after 2005. These changes have been reflected in the liabilities as of December 31, 2004.

Plan Assets

The Institution's pension plan weighted-average asset allocations at December 31, 2004 and 2003, by asset category are as follows:

Asset Category	2004	2003
Equity securities	80%	67%
Debt securities	18%	25%
Cash	2%	8%
	<u>100%</u>	<u>100%</u>

The following target asset allocation is used:

Asset Category	Target Allocation
U.S. equity	30%
Global excluding U.S. equity	12%
Emerging markets equity	3%
Hedge fund of funds	15%
Alternative investments	15%
Real assets	5%
Bonds	20%

The primary financial objectives of the assets of the Plan are to (1) provide a stream of relatively predictable, stable and constant earnings in support of the Qualified Plan's annual benefit payment obligations; and (2) preserve and enhance the real (inflation-adjusted) value of assets, over time, with the goal of meeting the anticipated future benefit obligations of the qualified plan.

The long-term investment objectives of the assets of the Plan are to (1) attain the average annual total return assumed in the Plan's most recent actuarial assumptions (net of investment management fees) over rolling five-year periods; and (2) outperform the custom benchmark.

Contributions

The Institution anticipates contributing \$1,900,000 to the Qualified Plan in 2005.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service are expected to be paid as follows:

Years	Benefit Payments
2005	\$12,282,106
2006	14,891,932
2007	14,810,058
2008	14,622,043
2009	15,776,625
Years 2010 - 2014	79,904,781

	Supplemental Plan Pension Benefits	
	2004	2003
Change in benefit obligation		
Benefit obligation at beginning of year	\$3,430,977	\$3,282,549
Service cost	89,087	78,650
Interest cost	227,880	209,638
Actuarial loss	393,799	53,532
Benefits paid	<u>(219,460)</u>	<u>(193,392)</u>
Benefit obligation at end of year	<u>\$ 3,922,283</u>	<u>\$ 3,430,977</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contributions	219,460	193,392
Benefits paid	<u>(219,460)</u>	<u>(193,392)</u>
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Funded status	\$(3,922,283)	\$(3,430,977)
Unrecognized actuarial loss (gain)	331,548	(115,013)
Unrecognized prior service cost	<u>1,316</u>	<u>1,631</u>
Net amount recognized	<u>\$(3,589,419)</u>	<u>\$(3,544,359)</u>
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	<u>\$(3,589,419)</u>	<u>\$(3,544,359)</u>
Information for pension plans with accumulated benefit obligations in excess of plan assets		
Projected benefit obligation	\$ 3,922,283	\$ 3,430,977
Accumulated benefit obligation	3,402,514	2,854,088
Fair value of plan assets	-	-
Components of net periodic benefit cost		
Service cost	\$ 89,087	\$ 78,650
Interest cost	227,880	209,638
Expected return on earmarked reserves	(213,372)	(215,441)
Amortization of prior year service cost	<u>315</u>	<u>315</u>
Net periodic benefit cost	<u>\$ 103,910</u>	<u>\$ 73,162</u>
Actual return on earmarked reserves	\$ 160,610	\$ 124,929
Weighted-average assumptions used to determine benefit obligations at December 31		
Discount rate	5.75%	6.25%
Rate of compensation increase	3.50%	3.50%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	6.25%	6.75%
Expected long-term rate of return on plan assets	8.50%	8.50%
Rate of compensation increase	3.50%	3.50%

The accrued supplemental retirement is matched by a "Rabbi" Trust with \$6,537,921 and \$6,257,039, respectively, as of December 31, 2004 and 2003. An additional accrual of \$2,948,502 and \$2,712,680 has been established for the excess of the "Rabbi" Trust assets over the accrued supplemental retirement benefits at December 31, 2004 and 2003, respectively.

Contributions

The Institution anticipates paying benefit payments to the Supplemental Plan of \$299,004 from earmarked reserves in 2005.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service are expected to be paid as follows:

Years	Benefit Payments
2005	\$299,004
2006	275,996
2007	268,327
2008	256,312
2009	229,250
Years 2010 - 2014	1,097,300

9. Other Postretirement Benefits

In addition to providing retirement plan benefits, the Institution provides certain health care benefits for retired employees and their spouses. Substantially all of the Institution's employees may become eligible for the benefits if they reach normal retirement age (as defined) or elect early retirement after having met certain time in service criteria.

	Other Postretirement Benefits	
	2004	2003
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 33,153,875	\$ 30,459,830
Service cost	1,055,495	669,237
Interest cost	2,216,096	1,746,394
Plan amendment	(18,015,085)	-
Benefits paid	(1,278,178)	(1,128,721)
Actuarial loss	9,462,299	1,407,135
Benefit obligation at end of year	<u>\$ 26,594,502</u>	<u>\$ 33,153,875</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 16,213,670	\$ 12,619,281
Actual return on plan assets	1,397,393	2,753,110
Employer contributions	2,823,000	2,063,679
Benefits paid	(1,278,178)	(1,128,721)
Administrative expenses	(113,484)	(93,679)
Fair value of plan assets at end of year	<u>\$ 19,042,401</u>	<u>\$ 16,213,670</u>
Funded status	<u>\$(7,552,101)</u>	<u>\$(16,940,205)</u>
Unrecognized actuarial loss	20,957,816	12,153,392
Unrecognized portion of net obligation (asset) at transition	-	7,681,947
Unrecognized prior service cost (credit)	<u>(12,766,418)</u>	<u>(2,106,308)</u>
Net amount recognized	<u>\$ 639,297</u>	<u>\$ 788,826</u>
Amounts recognized in the statement of financial position consist of		
Prepaid benefit cost	<u>\$ 639,297</u>	<u>\$ 788,826</u>
Weighted-average assumptions used to determine benefit obligations at December 31		
Discount rate	5.75%	6.25%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	6.25%	6.75%
Expected long-term rate of return on plan assets	8.50%	8.50%

For measurement purposes, annual rates of increase of 11.5% and 9% in the per capita cost of covered healthcare benefits was assumed for 2004 and 2003 for both pre-65 and post-65 benefits.

These were assumed to decrease gradually to 5.0% in 2013 and remain at that level thereafter.

	2004	2003
Components of net periodic benefit cost		
Service cost	\$ 1,055,495	\$ 669,237
Interest cost	2,216,096	1,746,394
Expected return on plan assets	(1,456,524)	(1,112,924)
Amortization of transition obligation	853,549	853,549
Amortization of prior service cost	(526,577)	(526,577)
Recognized actuarial loss	830,490	434,000
Net periodic benefit cost	<u>\$ 2,972,529</u>	<u>\$ 2,063,679</u>

The Institution has reflected the net periodic benefit cost in operating expenses, as the amount is reimbursed through federal awards.

On December 8, 2003, Medicare reform legislation was enacted, providing a Medicare prescription drug benefit beginning in 2006 and federal subsidies to employers who provide drug coverage to retirees. The Institution decided not to reflect the future government subsidy in the fiscal 2004 expense. However, in December 2004, the Institution amended the plan to eliminate prescription drug coverage for all post-65 retirees effective January 1, 2006, and to encourage enrollment in Medicare Part D by reimbursing Medicare Part D premiums beginning in 2006. These changes have been reflected in the obligations as of December 31, 2004.

	2004		2003
	Pre-65	Post-65	Pre-65 & Post-65
Assumed health care cost trend rates at December 31			
Health care cost trend rate assumed for next year	11.0%	11.0%	11.5%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	4.3%	5.0%
Year that the rate reaches the ultimate trend rate	2014	2013	2013

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	2004	2003
	One-Percentage-Point Increase in Trend	One-Percentage-Point Increase in Trend
Effect on total of service cost and interest cost components	\$ 803,127	\$ 578,023
Effect on year-end postretirement benefit obligation	3,682,332	5,633,557
	One-Percentage-Point Decrease in Trend	One-Percentage-Point Decrease in Trend
Effect on total of service cost and interest cost components	\$ (410,643)	\$ (446,376)
Effect on year-end postretirement benefit obligation	(3,002,534)	(4,483,697)

Plan Assets

The Institution's postretirement benefit plan weighted-average asset allocations at December 31, 2004 and 2003, by asset category are as follows:

Asset Category	2004	2003
Equity securities	82%	81%
Debt securities	18%	19%
	<u>100%</u>	<u>100%</u>

The asset allocation follows the broad allocation of 80% equities and 20% fixed income.

To develop the expected long-term rate of return on assets assumption, the Institution considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio, net of expenses expected to be paid. This resulted in the selection of the 8.50% assumption.

Contributions

The Institution anticipates contributing \$893,000 to its retiree medical plan in 2005.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service are expected to be paid as follows:

Years	Benefit Payments
2005	\$1,515,281
2006	1,243,486
2007	1,260,392
2008	1,270,574
2009	1,267,858
Years 2010 - 2014	6,058,206

10. Commitments and Contingencies

The Defense Contract Audit Agency (DCAA) is responsible for auditing both direct and indirect charges to grants and contracts on behalf of the ONR. The Institution and the ONR have settled the years through 2003. The current indirect cost recovery rates, which are fixed, include the impact of prior year settlements. The DCAA issued an audit report on the completed audit of direct and indirect costs for the year ended December 31, 2003 on September 21, 2004. The audit resulted in no questioned direct or indirect costs.

The Institution through its endowment fund is committed to invest approximately \$24,000,000 in certain venture capital and investment partnerships as of December 31, 2004.

The Institution is a defendant in legal proceedings incidental to the nature of its operations. The Institution believes that the outcome of these proceedings will not materially affect its financial position.

11. Related Party Transactions

In fiscal year 2004, the Institution passed through Federal Awards of approximately \$1,247,000 to subgrantee organizations in which an individual at the subgrantee organization is also a member of the Institution's Board of Trustees or Corporation. The Institution also has other transactions such as legal services and other items with organizations where members of the Board of Trustees or Corporation are affiliated with the organizations. Total expenditures for legal and other transactions were approximately \$496,000 for the year ended December 31, 2004.

The Institution has loans due from various employees for education advances and computer purchases. The amounts outstanding are approximately \$643,000 at December 31, 2004.

12. Clark Laboratory Fire

In October 2002, the Institution experienced a fire in the Clark Laboratory Building which resulted in contamination and damage to several laboratories, clean rooms and equipment. Since then, the Institution has coordinated with its insurance carrier and other interested parties to identify and quantify the damage caused by the fire. At December 31, 2002, the Institution had recorded a receivable due from the insurance company of approximately \$13,259,000 to reflect the estimated insurance proceeds to cover the cost of renting temporary clean laboratories, repairing the laboratories, and cleaning and repairing or replacing damaged or destroyed equipment. Additionally, the Institution established an accrual of approximately \$14,669,000 to estimate the costs to be paid going forward associated with the fire. Included in the accrual but not covered by insurance was approximately \$1,500,000 relating to displaced employees' salaries, fringe benefits and general and administrative costs as well as \$100,000 associated with renting temporary clean laboratories. The total amount not covered by insurance of \$1,600,000 was reflected in 2002 as a loss on the fire.

In 2003 and 2004, the Institution has continued to coordinate its fire loss recovery efforts with its insurance carrier and other interested parties. At December 31, 2004 and 2003, respectively, a receivable due from the insurance company of \$2,293,000 and \$7,435,000 and an accrual of \$1,889,000 and \$8,877,000 are included in the statement of financial position. During 2003, \$4,000,000 was received in cash from the insurance company and approximately \$4,150,000 was paid to various outside parties for fire-related damages. During 2004, \$1,000,000 was received in cash from the insurance company and approximately \$2,718,000 was paid to various outside parties for fire-related damages. The receivable and related accrual have been adjusted during 2004 and 2003 as more information has become available. The estimated amounts continue to be subject to revision. A gain on the fire of \$129,000 was recognized in 2004. Any additional resulting gain or loss related to accounting for the fire will be recognized when such amounts can be determined with certainty.