

Statement of Cash Flows

December 31, 2005 (with summarized information as of December 31, 2004)

	2005	2004		2005	2004
Cash flows from operating activities			Cash flows from investing activities		
Total change in net assets	\$ 26,036,122	\$ (2,490,673)	Capital expenditures		
Adjustments to reconcile increase (decrease) in net assets to net cash provided by (used in) operating activities			Additions to property and equipment	(26,175,431)	(20,007,169)
Depreciation and amortization	5,882,972	5,180,075	Endowment		
Change in split interest agreements	(378,137)	643,575	Receivable for investments sold	-	22,044,791
Allowance for uncollectible pledges	75,098	93,679	Payable for investments purchased	(14,816)	47,251
Discount on pledges	(127,932)	215,801	Proceeds from the sale of investments	95,045,755	130,132,661
Net realized and unrealized (gain) loss on investments	(24,591,314)	(27,688,898)	Purchase of investments	(91,006,910)	(146,911,010)
Additional minimum pension liability	(14,055,206)	14,055,206	Change in construction fund	21,239,529	-
Contributions to be used for long-term investment	(2,395,237)	(2,553,132)	Change in debt service funds	1,256,248	-
Gift of property	-	(5,034,355)	Net cash provided by (used in) investing activities	344,375	(14,693,476)
(Increase) decrease in assets			Cash flows from financing activities		
Restricted cash	(644,598)	1,125,334	Borrowings under debt agreement	-	54,850,000
Interest and dividends receivable	(52,502)	221,811	Loan payments	-	(10,724,206)
Reimbursable costs and fees			Deferred financing costs	-	(1,290,196)
Billed	1,279,187	(1,606,730)	Proceeds from bonds deposited into construction fund	-	(24,278,081)
Unbilled	(406,399)	(1,788,301)	Proceeds from bonds deposited into debt service funds	-	(3,154,350)
Other receivables	2,199,348	5,064,081	Contributions to be used for long-term investment	2,395,237	2,553,132
Pledges receivable	2,124,187	(2,341,974)	Net cash provided by financing activities	2,395,237	17,956,299
Inventory	61,868	(149,622)	Net increase (decrease) in cash and cash equivalents	8,690,640	(5,428,025)
Deferred charges and prepaid expenses	750,522	(626,839)	Cash and cash equivalents, beginning of year	12,669,547	18,097,572
Deferred fixed rate variance	-	3,197,693	Cash and cash equivalents, end of year	\$ 21,360,187	\$ 12,669,547
Other assets	8,228,770	(366,431)	Supplemental disclosures		
Remainder trusts	-	(43,044)	Cash paid for interest	\$ 663,969	\$ 761,500
Prepaid pension cost	(149,529)	149,529	Noncash activity		
Supplemental retirement	(47,286)	(280,882)	Gift of property	-	5,034,355
Increase (decrease) in liabilities			Construction in process additions remaining in accounts payable	2,240,377	4,523,689
Accrued pension liability	4,478,979	9,340,167	Change in intangible pension asset	13,674,720	5,644,240
Accounts payable and other liabilities	(5,609,826)	(3,903,660)			
Accrued payroll and related liabilities	(124,222)	(936,736)			
Deferred revenue and refundable advances	376,634	1,423,096			
Accrued supplemental retirement benefits	47,286	280,882			
Deferred fixed rate variance	2,992,243	129,500			
Net cash provided by (used in) operating activities	5,951,028	(8,690,848)			

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

Statement of Activities

December 31, 2005 (with summarized information as of December 31, 2004)

	Unrestricted				2005	2004
	Operating	Sponsored Research	Temporarily Restricted	Permanently Restricted		
Operating revenues						
Fees	\$ 232,291				\$ 232,291	\$ 576,649
Sponsored research						
Government		\$ 70,174,037			70,174,037	67,496,538
Nongovernment		16,251,346	\$ 4,910,827		21,162,173	21,012,293
Ships and subs operations		20,895,382			20,895,382	20,102,588
Sponsored research assets released to operations	112,409,418	(107,320,765)	(5,088,653)		-	-
Education						
Tuition	3,773,444				3,773,444	3,455,307
Investment return designated for education	3,867,255		1,761,590		5,628,845	5,585,654
Gifts			209,503		209,503	351,013
Education funds released from restriction	2,562,023		(2,562,023)		-	-
Investment return designated for current operations	3,464,870				3,464,870	3,381,128
Contributions and gifts, net of releases from restrictions of \$737,803 and \$884,486 in 2005 and 2004, respectively	12,385,611		(396,265)	\$822,997	12,812,343	12,805,394
Contributions in kind	622,183				622,183	267,687
Rental income	743,687				743,687	660,191
Communication and publications	252,830				252,830	294,620
Other	533,062				533,062	544,184
Total revenues	140,846,674	-	(1,165,021)	822,997	140,504,650	136,533,246
Expenses						
Sponsored research						
National Science Foundation	42,551,224				42,551,224	41,499,749
United States Navy	12,094,074				12,094,074	14,223,555
Subcontracts	10,174,343				10,174,343	12,127,174
National Oceanic & Atmospheric Administration	10,480,622				10,480,622	8,514,822
Department of Energy	521,065				521,065	690,864
United States Geological Survey	1,469,623				1,469,623	999,024
National Aeronautics & Space Administration	980,943				980,943	741,428
Ships Operations	15,307,124				15,307,124	14,809,301
Submersible and ROV operations	5,588,258				5,588,258	5,293,287
Privately funded grants	4,323,674				4,323,674	3,126,607
Other	8,918,468				8,918,468	6,447,780

Statement of Activities (continued)

	Unrestricted			2005	2004
	Operating	Sponsored Research	Temporarily Restricted		
Education					
Faculty expense	3,583,387			3,583,387	2,930,827
Student expense	4,175,946			4,175,946	3,963,605
Postdoctoral programs	413,616			413,616	369,900
Other	721,291			721,291	687,280
Rental expenses	538,897			538,897	498,164
Communication, publications and development	2,628,541			2,628,541	2,572,930
Fundraising expenses	2,620,896			2,620,896	2,507,237
Un-sponsored programs	6,182,535			6,182,535	5,279,055
Other expenses	1,284,272			1,284,272	920,888
Total expenses	<u>134,558,799</u>	<u>-</u>	<u>-</u>	<u>134,558,799</u>	<u>128,203,477</u>
Change in net assets from operating activities	<u>6,287,875</u>	<u>-</u>	<u>(1,165,021)</u>	<u>822,997</u>	<u>8,329,769</u>
Nonoperating income					
Investment return in excess of amounts designated for sponsored research, education and current operations	3,153,328		9,121,972	12,275,300	19,535,160
Net realized/unrealized gains (losses) on interest swap	(640,157)			(640,157)	(4,020,690)
Change in value of split interest agreements	52,687		6,353	319,097	378,137
Contributions and gifts			5,000	5,000	15,502
Net assets released from restriction	5,000		(5,000)	-	-
Nonoperating expenses					
Other nonoperating expenses	(99,976)			(99,976)	(99,976)
Net periodic pension cost (Note 8)	(4,389,971)			(4,389,971)	(9,004,045)
Redesignation of gifts and transfers to operating	(1,090,000)		(404,458)	1,190	(2,036,589)
Write-off of fixed assets				-	(511,023)
Change in net assets from nonoperating activities	<u>(3,009,089)</u>	<u>-</u>	<u>8,723,867</u>	<u>320,287</u>	<u>3,234,764</u>
Change in net assets from operating and nonoperating activities	<u>3,278,786</u>	<u>-</u>	<u>7,558,846</u>	<u>1,143,284</u>	<u>11,564,533</u>
Change in additional pension minimum liability (Note 8)	14,055,206			14,055,206	(14,055,206)
Total change in net assets	17,333,992	-	7,558,846	1,143,284	(2,490,673)
Net assets at beginning of year	86,613,405	-	183,317,021	69,220,658	341,641,757
Net assets at end of year	<u>\$ 103,947,397</u>	<u>\$ -</u>	<u>\$ 190,875,867</u>	<u>\$ 70,363,942</u>	<u>\$ 365,187,206</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, 2005, 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 2004 financial statements, and in our report dated March

17, 2005, 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

April 24, 2006

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, 2004, 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 and in accordance with Massachusetts law, 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 decreases 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. Certain releases from temporarily restricted amounting to \$737,803 and \$884,486 for the years ended December 31, 2005 and 2004, respectively, are netted against contributions and are included in unrestricted sponsored research. 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 on the

noncontributory defined benefit pension plan that is not reimbursed by the employee benefit fixed rate. 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 and approximates market value.

Included in restricted cash at December 31, 2005 and 2004 is \$782,927 and \$142,991, 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, 2005 and 2004 is \$244,092 and \$239,430, 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, such as private equity funds, for which no such quotations or valuations are readily available, are carried at fair value as estimated by management using values provided by external investment managers. The Institution believes that these valuations are a reasonable estimate of fair value as of December 31, 2005 and 2004 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% and 5.5% of a 36-month average market value of qualifying endowment investments is appropriated. This amounted to \$13,562,503 and \$13,316,806 for the years ending December 31, 2005 and 2004, 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, 2005 and 2004, respectively, the amounts consist of \$1,898,102 and \$3,154,350 for debt service and \$3,038,552 and \$24,278,081 for construction purposes. Interest income on debt service amounted to \$61,265 in 2005 and \$20,766 in 2004 and is reflected in the statement of activities within other income. Interest income on construction funds amounted to \$248,171 and \$310,933 in 2005 and 2004, respectively, 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 90% and 92% of its sponsored research revenues from government agencies including 55% and 57% of its operating revenues from the National Science Foundation and 11% and 14% from the United States Navy in fiscal years 2005 and 2004, 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 \$5,740,108 and \$5,058,656 in 2005 and 2004, respectively, has been charged to operating activities. Depreciation on certain government-funded facilities (the Laboratory for Marine Science and the dock facility) amounting to \$99,976 in 2005 and in 2004 has been charged to nonoperating expenses as these assets were gifted by the Government.

Construction commitments totaled \$2,264,844 at December 31, 2005.

During fiscal 2005 and 2004, the Institution capitalized interest of \$716,427 and \$65,500, respectively.

Included in construction in process is \$669,180 and \$18,799,066 at December 31, 2005 and 2004, respectively, relating to campus development.

Conditional Asset Retirement Obligations

The Institution implemented Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* during 2005. The effects of implementing this interpretation in 2005 were immaterial.

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:

	2005		2004	
	Cost	Market	Cost	Market
US treasury bonds	\$ 27,200,000	\$ 27,650,867	\$ 27,200,000	\$ 27,254,862
Corporate bonds	17,330,371	17,194,079	17,411,829	17,620,896
International bond funds	9,619,483	9,070,163	9,613,758	10,219,035
Private equity funds	51,018,353	69,197,823	40,003,133	52,910,222
Hedge funds	36,295,000	40,176,098	31,295,000	33,005,771
Domestic equities	46,578,718	55,288,876	48,425,676	59,816,051
International equities	48,693,352	62,668,897	50,282,579	63,791,628
Venture capital	28,375,188	26,702,972	28,027,323	22,611,951
Other	46,693	46,693	46,693	46,693
Total investments	\$ 265,157,158	\$ 307,996,468	\$ 252,305,991	\$ 287,277,109

The nonpooled investments with a cost of \$5,200,020 and a market value of \$5,070,498 at December 31, 2005 are invested in a private bond fund.

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

	Unrestricted	Temporarily restricted	2005 Total	2004 Total
Dividend and interest income	\$ 1,996,691	\$ 1,761,590	\$ 3,758,281	\$ 6,813,948
Investment management costs	(2,069,753)	-	(2,069,753)	(1,275,801)
Net realized gains	3,893,821	12,996,199	16,890,020	17,142,121
Change in unrealized appreciation	6,664,694	1,036,600	7,701,294	10,546,777
Total return on investments	<u>10,485,453</u>	<u>15,794,389</u>	<u>26,279,842</u>	<u>33,227,045</u>
Investment return designated for				
Sponsored research	-	(4,910,827)	(4,910,827)	(4,725,103)
Education	(3,867,255)	(1,761,590)	(5,628,845)	(5,585,654)
Current operations	<u>(3,464,870)</u>	<u>-</u>	<u>(3,464,870)</u>	<u>(3,381,128)</u>
Total distributions to operations	<u>(7,332,125)</u>	<u>(6,672,417)</u>	<u>(14,004,542)</u>	<u>(13,691,885)</u>
Investment return in excess of amounts designated for sponsored research, education and current operations	<u>\$ 3,153,328</u>	<u>\$ 9,121,972</u>	<u>\$ 12,275,300</u>	<u>\$ 19,535,160</u>

Investment return distributed to operations includes \$442,039 and \$375,079 earned on non-endowment investments for the years ended December 31, 2005 and 2004, 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 \$232,279 at December 31, 2005 and \$434,022 at December 31, 2004. 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 for pooled investments is allocated to each individual fund based on a per unit valuation. The value of an investment unit at December 31 is as follows:

	2005	2004
Unit value, beginning of year	\$ 4.1517	\$ 3.9177
Unit value, end of year	4.3755	4.1517
Net change for the year	.2238	.2340
Investment income per unit for the year	.0173	.0361
Total return per unit	<u>\$.2411</u>	<u>\$.2701</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:

	2005	2004
Unconditional promises expected to be collected in:		
Less than one year	\$ 2,127,027	\$ 2,372,251
One year to five years	3,208,472	5,087,435
Reserve for uncollectible pledges receivable	(373,485)	(298,387)
Unamortized discount	<u>(154,177)</u>	<u>(282,109)</u>
	<u>\$ 4,807,837</u>	<u>\$ 6,879,190</u>

5. Contribution Receivable from Remainder Trusts

The Institution recorded \$10,390,619 and \$10,043,233 at December 31, 2005 and 2004, 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, 2003	\$ 3,197,693
2004 indirect costs	51,834,850
2003 adjustment	1,081
Amounts recovered	<u>(55,163,124)</u>
2004 change	<u>(3,327,193)</u>
Deferred Fixed Rate Variance liability, December 31, 2004	<u>(129,500)</u>
2005 indirect costs	53,394,255
2004 adjustment	(5,572)
Amounts recovered	<u>(56,380,926)</u>
2004 change	<u>(2,992,243)</u>
Deferred Fixed Rate Variance liability, December 31, 2005	<u>\$ (3,121,743)</u>

As of December 31, 2005 the Institution has received a cumulative recovery in excess of expended amounts of \$3,121,743 which will be reflected as a deduction to future year recoveries. This amount has been reported as liability of the Institution.

7. Bonds 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 \$1,898,102 and \$3,154,350 at December 31, 2005 and 2004, respectively. The Series 2004 Bonds are collateralized by the Institution's unrestricted revenues. The interest rate for the Series 2004 Bonds is variable and set weekly, and at December 31, 2005, the rate was 3.46%.

The aggregate maturities due on long-term debt at December 31, 2005 are as follows:

Fiscal Year	Principal Amount
2008	\$ 1,150,000
2009	1,200,000
2010	1,250,000
Thereafter	<u>51,250,000</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, 2005 and 2004, respectively, the market value of the swap agreement amounted to a liability of \$3,070,826 and \$3,298,128 which is included in accounts payable and other liabilities. 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 paid interest expense in association with the swap agreement of \$867,459 and \$722,562 which is reflected as part of the net realized/unrealized gains (losses) on interest swap at December 31, 2005 and 2004, respectively. 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.

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	
	2005	2004
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 1,319,056	\$ 1,200,690
Service cost	20,615	25,699
Interest cost	66,098	86,005
Plan amendments	510,796	(190,939)
Actuarial (gain) loss	<u>(275,626)</u>	<u>197,601</u>
Benefit obligation at end of year	<u>\$ 1,640,939</u>	<u>\$ 1,319,056</u>
Funded status	\$ (1,640,939)	\$ (1,319,056)
Unrecognized net actuarial loss	33,773	355,726
Unrecognized prior service cost	<u>525,887</u>	<u>(28,941)</u>
Net amount recognized	<u>\$ (1,081,279)</u>	<u>\$ (992,271)</u>
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	\$ (1,405,839)	\$ (1,090,718)
Cumulative reduction in net assets	-	98,447
Intangible asset	<u>324,560</u>	<u>-</u>
Net amount recognized	<u>\$ (1,081,279)</u>	<u>\$ (992,271)</u>

	Restoration Plan Pension Benefits	
	2005	2004
Change in net assets attributable to change in additional minimum liability recognition	\$ (98,447)	\$ 98,447
Information for pension plans with accumulated benefit obligations in excess of plan assets		
Projected benefit obligation	1,640,939	1,319,056
Accumulated benefit obligation	1,405,828	1,090,718
Fair value of plan assets	-	-
Components of net periodic benefit cost		
Service cost	20,615	25,699
Interest cost	66,098	86,005
Amortization of prior service cost	(44,032)	87,650
Recognized actuarial loss	46,326	136,768
Net periodic benefit cost	<u>\$ 89,007</u>	<u>\$ 336,122</u>
Weighted-average assumptions used to determine benefit obligations at December 31		
Discount rate	5.75%	5.75%
Rate of compensation increase	4.50%	6.00%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	5.75%	6.25%
Rate of compensation increase	6.00%	6.00%

As a result of plan amendments made to the Institution's noncontributory defined benefit pension plan, the Restoration Plan pension benefits had a corresponding change (see qualified plan for a summary of plan amendments).

Expected Contributions

The Institution anticipates contributing \$47,570 to the Restoration Plan in 2006.

Estimated Future Benefit Payments

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

Years	Benefit Payments
2006	\$ 45,570
2007	-
2008	1,816,663
2009	-
2010 and thereafter	-

	Qualified Plan Pension Benefits	
	2005	2004
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 177,927,242	\$ 176,914,377
Service cost	5,922,793	7,006,323
Interest cost	9,751,495	11,250,529
Plan amendments	34,734,251	(27,041,213)
Actuarial (gain) loss	(3,985,084)	18,666,776
Benefits paid	(9,579,933)	(8,869,550)
Benefit obligation at end of year	<u>\$ 214,770,764</u>	<u>\$ 177,927,242</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 150,616,331	\$ 143,751,387
Employer contributions	1,927,020	-
Actual return on plan assets	12,958,470	15,734,494
Benefits paid	(9,579,933)	(8,869,550)
Fair value of plan assets at end of year	<u>\$ 155,921,888</u>	<u>\$ 150,616,331</u>
Funded status	<u>\$ (58,848,876)</u>	<u>\$ (27,310,911)</u>
Unrecognized net actuarial loss	27,551,799	36,107,982
Unrecognized prior service cost	17,257,176	(18,447,001)
Net amount recognized	<u>\$ (14,039,901)</u>	<u>\$ (9,649,930)</u>
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	\$ (27,390,061)	\$ (23,606,689)
Cumulative reduction in net assets	-	13,956,759
Intangible asset	13,350,160	-
Net amount recognized	<u>\$ (14,039,901)</u>	<u>\$ (9,649,930)</u>
Change in net assets attributable to change in additional minimum liability recognition	\$ (13,956,759)	\$ 13,956,759
Information for pension plans with accumulated benefit obligations in excess of plan assets		
Projected benefit obligation	214,770,764	177,927,242
Accumulated benefit obligation	183,311,949	174,223,020
Fair value of plan assets	155,921,888	150,616,331
Components of net periodic benefit cost		
Service cost	5,922,793	7,006,323
Interest cost	9,751,495	11,250,529
Expected return on plan assets	(10,689,353)	(11,708,592)
Amortization of prior service cost	(969,926)	1,343,266
Recognized actuarial loss	2,301,982	1,112,519
Net periodic benefit cost	<u>\$ 6,316,991</u>	<u>\$ 9,004,045</u>

In 2005, the Institution has reflected \$1,927,020 of the net periodic benefit cost in the operating section of the statement of activities which represents the amount reimbursed through the employee benefit fixed rate as negotiated with the United States Government. The remaining \$4,389,971 of net periodic benefit cost is reflected in nonoperating expenses. In 2004, the entire net periodic benefit cost of \$9,004,045 was reflected in the nonoperating section of the statement of activities as no portion of the cost was reimbursed through the employee benefit fixed rate. 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 2005, the accumulated reduction in net assets was reversed because an intangible asset was permitted to be established to offset the additional minimum liability on the statement of financial position.

	Qualified Plan Pension Benefits	
	2005	2004
Weighted-average assumptions used to determine benefit obligations at December 31		
Discount rate	5.75%	5.75%
Rate of compensation increase	4.50%	(3.5% prior to plan amendment)
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	5.75%	6.25%
Expected long-term rate of return on plan assets	8.00%	8.50%
Rate of compensation increase	-	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 8.00% 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.

Effective January 1, 2006, the Qualified Plan was amended. The lump sum (introduced in 1999) will no longer be available on benefits earned after January 1, 2006. Benefits for service from 25 to 35 years introduced in 1999 will be removed. The lifetime benefit payable upon early retirement has changed from a 6% per year reduction to a 5% per year reduction. Minimum lump sum benefits equal to 5% of final average compensation times service replaces the minimum in-

roduced in 1999 of approximately 8%. The preretirement death benefit has been reduced from 100% of the accrued pension benefit to 50% of the accrued pension benefit but not less than the participant's accrued benefit as of December 31, 2005. The 3-year vesting period (introduced in 1999) will change to a 5-year vesting service for employees hired after December 31, 2005. These changes have been reflected in the intangible asset and in the liability as of December 31, 2005.

Plan Assets

The Institution's pension plan weighted-average asset allocations at December 31, 2005 and 2004, by asset category are as follows:

Asset Category	2005	2004
Equity securities	57%	80%
Debt securities	17%	18%
Cash	3%	2%
Nonmarketable alternative investments	23%	-
	100%	100%

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.

Expected Contributions

The Institution anticipates contributing \$6,000,000 to the Qualified Plan in 2006.

Estimated Future Benefit Payments

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

Years	Benefit Payments
2006	\$ 14,725,939
2007	13,771,821
2008	13,638,214
2009	14,568,931
2010	13,651,305
2011 - 2015	75,261,192

	Supplemental Plan Pension Benefits	
	2005	2004
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 3,922,283	\$ 3,430,977
Service cost	71,554	89,087
Interest cost	186,266	227,880
Actuarial loss	(428,816)	393,799
Benefits paid	(193,737)	(219,460)
Plan change	38,350	-
Benefit obligation at end of year	<u>\$ 3,595,900</u>	<u>\$ 3,922,283</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ -	\$ -
Employer contributions	193,737	219,460
Benefits paid	(193,737)	(219,460)
Fair value of plan assets at end of year	<u>\$ -</u>	<u>\$ -</u>
Funded status	\$ (3,595,900)	\$ (3,922,283)
Unrecognized actuarial (gain) loss	(59,160)	331,548
Unrecognized prior service cost	39,351	1,316
Net amount recognized	<u>\$ (3,615,709)</u>	<u>\$ (3,589,419)</u>
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	<u>\$ (3,615,709)</u>	<u>\$ (3,589,419)</u>

Information for pension plans with accumulated benefit

obligations in excess of plan assets		
Projected benefit obligation	\$ 3,595,900	\$ 3,922,283
Accumulated benefit obligation	3,277,938	3,402,514
Fair value of plan assets	-	-
Components of net periodic benefit cost		
Service cost	\$ 71,554	\$ 89,087
Interest cost	186,266	227,880
Expected return on earmarked reserves	(192,649)	(213,372)
Amortization of prior year service cost	315	315
Net periodic benefit cost	<u>\$ 65,486</u>	<u>\$ 103,910</u>
Actual return on earmarked reserves	\$ 154,541	\$ 160,610

Weighted-average assumptions used to determine benefit

obligations at December 31		
Discount rate	5.75%	5.75%
Rate of compensation increase	4.50%	3.50%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31		
Discount rate	5.75%	6.25%
Expected long-term rate of return on plan assets	8.00%	8.50%
Rate of compensation increase	4.50%	3.50%

The accrued supplemental retirement is matched by a "Rabbi" Trust with \$6,585,207 and \$6,537,921, respectively, as of December 31, 2005 and 2004. An additional accrual of \$2,969,498 and \$2,948,502 has been established for the excess of the "Rabbi" Trust assets over the accrued supplemental retirement benefits at December 31, 2005 and 2004, respectively.

Expected Contributions

The Institution does not anticipate contributing to the Supplemental Plan in 2006.

Estimated Future Benefit Payments

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

Years	Benefit Payments
2006	\$ 396,872
2007	502,076
2008	576,642
2009	510,776
2010	519,166
Years 2011 - 2015	1,904,514

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	
	2005	2004
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 26,594,502	\$ 33,153,875
Service cost	693,340	1,055,495
Interest cost	1,385,648	2,216,096
Plan amendment	-	(18,015,085)
Benefits paid	(1,440,682)	(1,278,178)
Actuarial loss	(1,626,986)	9,462,299
Benefit obligation at end of year	<u>\$ 25,605,822</u>	<u>\$ 26,594,502</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 19,042,401	\$ 16,213,670
Employer contributions	683,853	2,823,000
Actual return on plan assets	1,038,079	1,397,393
Benefits paid	(1,440,682)	(1,278,178)
Administrative expenses	-	(113,484)
Fair value of plan assets at end of year	<u>\$ 19,323,651</u>	<u>\$ 19,042,401</u>
Funded status	\$ (6,282,171)	\$ (7,552,101)
Unrecognized net actuarial loss	18,497,259	20,957,816
Unrecognized prior service cost (credit)	(11,426,262)	(12,766,418)
Net amount recognized	<u>\$ 788,826</u>	<u>\$ 639,297</u>
Amounts recognized in the statement of financial position consist of		
Prepaid benefit cost	\$ 788,826	\$ 639,297
Components of net periodic benefit cost		
Service cost	\$ 693,340	\$ 1,055,495
Interest cost	1,385,648	2,216,096
Expected return on plan assets	(1,475,831)	(1,456,524)
Amortization of transition obligation	-	853,549
Amortization of prior service cost	(1,340,156)	(526,577)
Recognized actuarial loss	1,271,325	830,490
Net periodic benefit cost	<u>\$ 534,326</u>	<u>\$ 2,972,529</u>

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

Weighted-average assumptions used to determine benefit obligations at December 31

Discount rate	5.75%	5.75%
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Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31

Discount rate	5.75%	6.25%
Expected long-term rate of return on plan assets	8.00%	8.50%

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.

	2005		2004	
	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	10.0%	7.3%	11.0%	11.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	4.3%	5.0%	4.3%
Year that the rate reaches the ultimate trend rate	2014	2013	2014	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:

	2005		2004	
	One-Percentage-Point Increase in Trend	One-Percentage-Point Increase in Trend	One-Percentage-Point Decrease in Trend	One-Percentage-Point Decrease in Trend
Effect on total of service cost and interest cost components	\$ 365,522	\$ 803,127		
Effect on year-end postretirement benefit obligation	3,709,195	3,682,332		
Effect on total of service cost and interest cost components	\$ (292,004)	\$ (410,643)		
Effect on year-end postretirement benefit obligation	(3,048,587)	(3,002,534)		

Plan Assets

The Institution's postretirement benefit plan weighted-average asset allocations at December 31, 2005 and 2004, by asset category are as follows:

Asset Category	2005	2004
Equity securities	100%	82%
Debt securities	-	18%
	<u>100%</u>	<u>100%</u>

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 8.00% assumption.

Expected Contributions

The Institution anticipates contributing \$600,000 to the Retiree Medical Plan in 2006.

Estimated Future Benefit Payments

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

Years	Benefit Payments
2006	\$ 1,189,099
2007	1,253,294
2008	1,342,660
2009	1,406,349
2010	1,474,308
Years 2011 - 2015	8,735,830

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, 2004 on October 13, 2005. The audit resulted in no questioned direct or indirect costs. The 2005 costs remain subject to audit. Any adjustments will be recorded in the years they become known.

The Institution through its pooled investments is committed to invest \$19,465,355 in certain venture capital and investment partnerships as of December 31, 2005.

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 2005, the Institution passed through Federal Awards of approximately \$794,000 to subgrantee organizations in which an individual associated with 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 these legal and other transactions were approximately \$353,000 and \$496,000 for the years ended December 31, 2005 and 2004, respectively.

The Institution has loans due from various employees for education advances and computer purchases. The amounts outstanding are approximately \$693,000 and \$643,000 at December 31, 2005 and 2004, respectively.

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. The Institution has received a total of \$6,473,000 in cash from the insurance company of which \$1,473,000 was received in 2005 and \$1,000,000 was received in 2004. Approximately \$8,661,000 in total was paid to various parties for fire related damages. Of this amount, approximately \$1,798,000 was paid in 2005 and approximately \$2,118,000 was paid in 2004. The total loss related to the fire was \$2,188,000, of which \$729,000 was recognized in 2005.