Report from the Vice President for Finance and Administration

Substantial progress was made this year in achieving the vision articulated by President and Director Bob Gagosian (see page 2). We increased research support to the Ocean Institutes, completed the first phase of improving our shore facilities, and began construction of a new coastal research vessel. Despite persistent weakness in the financial markets, the Institution's overall 2002 financial position is healthy. We continue to show positive operating results.

Sponsored research revenue released to operations increased 10 percent to $97.5 million in 2002 compared to an increase of 14 percent to $88.8 million in 2001. Federally sponsored research, excluding ship and submersible operations, was $59.1 million compared to $58 million in 2001. This growth demonstrates the Institution's ability to compete successfully for research grants and contracts. The Institution had a planned, modest under-recovery of overhead expenses.

Gifts, grants, and pledges from private sources totaled $13.8 million in 2002, a remarkable achievement considering global economic problems. Outstanding pledges at the end of 2002 were $4.5 million, compared to $1.8 million in 2001. Friends of the Institution continue to be generous during this difficult financial period.

Although our endowment declined from $268.2 million in 2001 to $234.6 million in 2002, the results were in line with our benchmarks. Our 2002 endowment total return of -11.4 percent outperformed the S & P 500 index of -22.1 percent. Our endowment spending policy seeks to preserve the fund's real purchasing power while providing a predictable stream of income to support annual budgetary needs. During 2002, we distributed $5.4 million of endowment income to education and $4.1 million to research.

The Institution had $8 million in long-term debt on its statement of financial position at year-end, and the use of low-cost, 1 percent at year-end, tax-exempt debt has a substantial financial benefit. We anticipate that tax-exempt borrowings will finance a substantial portion of planned new laboratory space on the Quissett Campus as well as renovations to existing laboratories in the Village Campus. State-of-the-art laboratory space is essential if we are to remain competitive in the conduct of research, graduate education, and recruitment and retention of the best scientists.

In October 2002, a fire occurred in the Clark Laboratory on the Quissett Campus. There were no injuries and minimal fire damage but extensive smoke damage, compounded by the sensitive nature of many instruments and facilities in the laboratory. We immediately resettled the two dozen affected investigators in temporary workspaces, and began the cleanup, which includes replacement or repair of equipment. We expect this work to be completed by summer 2003. The Institution recorded a receivable of $13.3 million to reflect the estimated insurance proceeds that will cover the cost of restoring the building to a pre-fire condition. Following the fire, we have undertaken a comprehensive review of all our facilities and emergency procedures to further minimize the risk of such an event.

The Institution will safeguard the assets created over 72 years to ensure that our research and education continue to thrive. We are indebted to the scientists, staff, students, trustees, and friends whose contributions and talents enable us to pursue our vision of furthering understanding of the oceans.

—**Carolyn A. Bunker,** Vice President for Finance and Administration

Statements of Financial Position

As of December 31, 2002 (with comparative information as of December 31, 2001)

	2002	2001
Assets		
Cash, unrestricted	$13,973,766	$25,279,708
Cash, restricted	2,042,155	2,127,319
Reimbursable costs and fees:		
Billed	3,923,078	2,270,064
Unbilled	4,507,921	3,792,387
Interest and dividends receivable	532,226	747,738
Other receivables (Note 12)	14,924,983	489,022
Pledges receivable, net	4,463,055	1,837,433
Inventory	1,490,021	1,338,200
Deferred charges and prepaid expenses	999,204	632,799
Deferred fixed rate variance	426,870	-
Investments, pooled	231,262,026	255,533,434
Investments, nonpooled	6,318,027	16,914,043
Prepaid pension and postretirement benefit cost	788,826	7,196,027
Supplemental retirement	5,494,326	6,464,586
Intangible pension asset	11,498,524	-
Other assets	4,177,187	4,255,459
	306,822,195	328,878,219
Property, plant and equipment:		
Land, buildings and improvements	62,363,781	58,416,408
Vessels and dock facilities	3,474,118	3,186,277
Laboratory and other equipment	14,485,199	12,687,970
Construction in process	3,788,855	1,714,908
	84,111,953	76,005,563
Accumulated depreciation	(45,009,763)	(41,311,575)
Net property, plant and equipment	39,102,190	34,693,988
Remainder trusts	9,395,272	10,819,303
Total assets	$355,319,657	$374,391,510

	2002	2001
Liabilities		
Accounts payable and other liabilities (Note 12)	$25,212,044	$10,099,366
Accrued payroll and related liabilities	6,695,441	5,835,734
Payable for investments purchased	10,193	281,912
Accrued supplemental retirement benefits	5,494,326	6,464,586
Accrued pension liability	12,082,593	-
Deferred revenue and refundable advances	7,016,121	7,483,854
Deferred fixed rate variance	-	2,196,646
Loan payable	8,045,162	5,067,952
Total liabilities	64,555,880	37,430,050

Net Assets	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	2002	2001
Undesignated	$(3,303,895)	$ -	$ -	(3,303,895)	7,595,488
Designated	2,311,223	7,229,346	-	9,540,569	13,517,728
Pledges and other	-	4,691,922	11,201,785	15,893,707	13,840,577
Plant and facilities	30,168,807	300,001	-	30,468,808	30,418,781
Education	-	3,524,553	-	3,524,553	3,389,196
Endowment and similar funds	53,878,577	130,687,993	50,073,465	234,640,035	268,199,690
Total net assets	$83,054,712	$146,433,815	$61,275,250	290,763,777	336,961,460
Total liabilities and net assets				$355,319,657	$374,391,510

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

Statement of Activities

For the Year Ended December 31, 2002 (with summarized financial information for the year ended December 31, 2001)

	Unrestricted					
	Operating	Sponsored research	Temporarily restricted	Permanently restricted	2002	2001
Operating:						
Revenues:						
Fees	$607,986				$607,986	$480,048
Sponsored research:						
Government		$59,124,026			59,124,026	57,999,323
Nongovernment		17,224,926	$4,159,299		21,384,225	15,045,925
Ships and subs operations		17,774,506			17,774,506	16,318,230
Sponsored research assets released to operations	97,467,531	(94,123,458)	(3,344,073)		-	-
Education:						
Tuition	2,963,417				2,963,417	2,422,919
Endowment income	3,683,100		1,671,359		5,354,459	5,087,302
Gifts	-		239,556		239,556	441,327
Education funds released from restriction	1,775,560		(1,775,560)		-	-
Investment return designated for current operations	3,682,563				3,682,563	3,324,643
Contributions and gifts	4,868,541		925,861	$4,824,584	10,618,986	29,555,236
Contributions in kind	237,791				237,791	569,524
Rental income	683,358				683,358	681,800
Communication and publications	283,189				283,189	230,953
Other	210,809				210,809	17,407
Total revenues	116,463,845		1,876,442	4,824,584	123,164,871	132,174,637
Expenses:						
Sponsored research:						
National Science Foundation	32,456,976				32,456,976	32,319,177
United States Navy	16,903,854				16,903,854	16,294,420
Subcontracts	6,921,702				6,921,702	5,602,882
National Oceanic & Atmospheric Administration	5,513,645				5,513,645	5,091,049
Department of Energy	671,558				671,558	760,432
United States Geological Survey	1,150,464				1,150,464	913,216
National Aeronautics & Space Administration	598,067				598,067	752,414
Ships Operations	13,920,251				13,920,251	12,050,433
Submersible and ROV operations	3,854,255				3,854,255	4,267,797
Privately funded grants	3,898,586				3,898,586	2,976,296
Other	11,578,173				11,578,173	7,756,424

Statement of Activities (continued on next page)

Statement of Activities (continued)

	Unrestricted					
	Operating	Sponsored research	Temporarily restricted	Permanently restricted	2002	2001
Education:						
Faculty expense	2,633,267				2,633,267	2,396,656
Student expense	3,591,195				3,591,195	3,134,580
Postdoctoral programs	502,313				502,313	478,479
Other	653,290				653,290	630,559
Rental expenses	527,772				527,772	523,835
Communication, publications and development	1,706,855				1,706,855	1,731,513
Fundraising expenses	1,980,070				1,980,070	1,783,952
Unsponsored programs	4,119,677				4,119,677	3,174,119
Other expenses (Note 12)	2,747,399				2,747,399	2,291,793
Write off of fixed assets	-				-	531,614
Total expenses	115,929,369				115,929,369	105,461,640
Change in net assets from operating activities	534,476		1,876,442	4,824,584	7,235,502	26,712,997
Nonoperating income:						
Investment return (less than) in excess of amounts designated for sponsored research, education and current operations	(13,827,426)		(30,475,544)		(44,302,970)	(31,194,277)
Change in split interest agreements	(23,495)		174,011	(1,403,114)	(1,252,598)	299,554
Change in prepaid pension cost	(1,233,787)				(1,233,787)	2,566,404
Nonoperating expenses:						
Other nonoperating expenses	(302,267)		(366,300)		(668,567)	(204,956)
Net asset transfers - donor redesignation	-		(5,000,000)	5,000,000	-	-
Change in net assets from nonoperating activities	(15,386,975)		(35,667,833)	3,596,886	(47,457,922)	(28,533,275)
Change in net assets from operating and nonoperating activities	(14,852,499)	-	(33,791,391)	8,421,470	(40,222,420)	(1,820,278)
Change in additional pension minimum liability (Note 8)	(5,975,263)	-	-	-	(5,975,263)	-
Total change in net assets	(20,827,762)		(33,791,391)	8,421,470	(46,197,683)	(1,820,278)
Net assets at beginning of year	103,882,474		180,225,206	52,853,780	336,961,460	338,781,738
Net assets at end of year	$83,054,712		$146,433,815	$61,275,250	$290,763,777	$336,961,460

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

Statements of Cash Flows

For the year ended December 31, 2002 (with comparative information for the year ended December 31, 2001)

	2002	2001
Cash flows from operating activities:		
Total change in net assets	$(46,197,683)	$(1,820,278)
Adjustments to reconcile (decrease) increase in net assets to net cash (used in) provided by operating activities:		
Depreciation	3,698,188	3,683,710
Contributions and change in value of remainder trusts	1,252,598	(10,608,626)
Allowance for uncollectible pledges	-	200,000
Discount on pledges	64,446	58,064
Net realized and unrealized (gain)/loss on investments	36,276,953	24,307,603
Accrued pension liability	12,082,593	-
Contributions to be used for long-term investment	(3,094,823)	(1,080,551)
(Increase) decrease in assets:		
Restricted cash	85,164	246,356
Interest and dividends receivable	215,512	88,097
Reimbursable costs and fees:		
Billed	(1,653,014)	(191,914)
Unbilled	(715,534)	(689,393)
Other receivables	(14,435,961)	(73,658)
Pledges receivable	(2,690,068)	779,647
Inventory	(151,821)	(267,897)
Deferred charges and prepaid expenses	(366,405)	(317,893)
Prepaid pension and postretirement benefit cost	(5,091,323)	(2,566,404)
Deferred fixed rate variance	(426,870)	-
Other assets	78,272	478,672
Supplemental retirement	970,260	694,028
Increase (decrease) in liabilities:		
Accounts payable and other liabilities	15,284,111	2,040,160
Accrued payroll and related liabilities	859,707	298,685
Payable for investments purchased	(271,719)	(120,645)
Deferred revenue and refundable advances	(467,733)	(61,427)
Accrued supplemental retirement benefits	(970,260)	(694,028)
Deferred fixed rate variance	(2,196,646)	(1,398,779)
Net cash (used in) provided by operating activities	(7,862,056)	12,983,529

	2002	2001
Cash flows from investing activities:		
Capital expenditures:		
Additions to property and equipment	(8,743,124)	(5,045,978)
Disposals of property and equipment	636,734	200,697
Short-term investments:		
Purchase of investments	10,811,667	(5,573,145)
Endowment:		
Proceeds from the sale of investments	252,731,559	197,143,639
Purchase of investments	(264,952,755)	(198,293,388)
Net cash used in investing activities	(9,515,919)	(11,568,175)
Cash flows from financing activities:		
Borrowings under debt agreement	2,977,210	1,146,435
Contributions to be used for long-term investment	3,094,823	1,080,551
Net cash provided by financing activities	6,072,033	2,226,986
Net (decrease) increase in cash and cash equivalents	(11,305,942)	3,642,340
Cash and cash equivalents, beginning of year	25,279,708	21,637,368
Cash and cash equivalents, end of year	$13,973,766	$25,279,708
Supplemental disclosures:		
Interest paid	$109,293	$154,472

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

Report of Independent Accountants

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, 2002 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 2001 financial statements, and in our report dated March 8, 2002, 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, which 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 14, 2003

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, 2001, 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 endowment gains 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 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. 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.

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 attributable to the Institution's current annual research or educational programs, including a component of endowment income appropriated for operations (see 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 (less than) in excess of amounts designated for sponsored research, education and current operations. Nonoperating revenue also includes the change in value of split interest agreements and the net periodic benefit cost/(income) on the noncontributory defined benefit pension plan.

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. At times the Institution maintains amounts at a single financial institution in excess of federally insured limits.

Included in restricted cash at December 31, 2002 and 2001 is $1,803,162 and $1,890,053, respectively, representing advances received from the United States Navy and other US 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, 2002 and 2001 is $238,993 and $237,266, 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. For investments in venture capital and investment partnerships, the Institution relies on valuations reported to the Institution by the managers of these investments except where the Institution may reasonably determine that additional factors should be considered.

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.

Options and Futures

An option is a contract in which the writer of the option grants the buyer the right to purchase from (call option) or sell to (put option) the writer a designated instrument at a specified price within a period of time. Premiums received on written options are recorded as negative cost basis until the contract is closed. The liability representing the Institution's obligation under a written option or the Institution's investment in a purchase option is valued at the last sale price or, in the absence of a sale, the mean between the closing bid and asked price or at the most recent asked price (bid for purchase option) if no bid and asked price are available. Over-the-counter written or purchased options are valued using dealer-supplied quotations. Over-the-counter options have the risk of the potential inability of counterparts to meet the terms of their contracts. The Institution's maximum exposure for purchased options is limited to the premium initially paid.

A futures contract is an agreement between a buyer or seller and an established futures exchange or clearinghouse in which the buyer or seller agrees to take (or make) delivery of an amount of an item at a specific price on a specific date (settlement date). Upon entering into a futures contract, the Institution deposits with a financial intermediary an amount ("initial margin") equal to a percentage of the face value of the futures contract. Subsequent payments are made or received by the Institution each day, dependent on the daily fluctuations in the value of the underlying security, and are recorded as unrealized gains or losses. The Institution will realize a gain or loss equal to the difference between the value of the futures contract to sell and the futures contract to buy at settlement date or by closing the contract. Futures contracts are valued at the most recent settlement price.

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 $12,577,096 and $11,106,742 for the years ending December 31, 2002 and 2001, respectively, and is classified in operating revenues (research, education, and operations). The Institution has interpreted relevant state law as generally permitting the spending of gains on endowment funds over a stipulated period of time.

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 72% and 76% of its operating revenues from government agencies including 41% and 44% of its operating revenues from the National Science Foundation and 17% and 17% from the United States Navy in fiscal years 2002 and 2001, respectively. Although applications for research funding to federal agencies historically have been funded, authorizations are subject to annual Congressional appropriations and payment.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is provided on a straight-line basis at annual rates of 8 to 50 years on buildings and improvements, 28 years on vessels and dock facilities, and 3 to 5 years on laboratory and other equipment. Depreciation expense on property, plant, and equipment purchased by the Institution in the amounts of $3,598,212 and $3,583,734 in 2002 and 2001, respectively, has been charged to operating activities. Construction commitments totaled $1,851,000 at December 31, 2002.

Depreciation on certain government-funded facilities (the Laboratory for Marine Science and the dock facility) amounting to $99,976 in 2002 and 2001 has been charged to nonoperating expenses as these assets were gifted by the Government.

Included in construction in process is $1,735,010 and $526,059 at December 31, 2002 and 2001, respectively, relating to campus planning.

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.

Reclassification of Amounts

Certain prior year amounts have been reclassified to conform to the December 31, 2002 presentation.

3. Investments

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

	2002		2001	
	Cost	Market	Cost	Market
U.S. Government and government agencies	$ -	$ -	$10,884,250	$10,706,678
Corporate bonds	52,633,479	53,238,160	39,449,169	39,747,540
International bonds	13,286,797	12,726,162	11,463,914	11,719,036
Equity securities and mutual funds	93,437,150	89,751,465	90,717,251	108,384,925
International equities	43,002,089	36,751,352	42,946,376	38,653,939
Hedge fund limited partnerships	23,920,000	23,523,925	23,920,000	31,516,655
Venture Capital and private equity	21,928,173	15,171,834	15,974,232	14,590,510
Other	99,128	99,128	192,773	192,773
Subtotal investments	248,306,816	231,262,026	235,547,965	255,512,056
Purchased call options	-	-	59,618	21,903
Written call options	-	-	(1,358)	(40)
Written put options	-	-	(20,394)	(485)
Total investments	$248,306,816	$231,262,026	$235,585,831	$255,533,434

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 $5,372,617 and $7,773,970 for the years ended December 31, 2002 and 2001, respectively, including dividends, distributions and changes in the estimated value of such investments.

The following schedule summarizes the investment return and its classification in the statement of activities:

	Unrestricted	Temporarily restricted	2002 Total	2001 Total
Dividend and interest income	$4,684,625	$1,671,359	$6,355,984	$6,106,116
Investment management costs	(1,209,557)		(1,209,557)	(1,233,720)
Net realized gains	61,156	193,252	254,408	1,234,905
Change in unrealized appreciation	(5,862,565)	(30,668,796)	(36,531,361)	(25,542,508)
Total return on investments	(2,326,341)	(28,804,185)	(31,130,526)	(19,435,207)
Investment return designated for:				
Sponsored research	(4,135,422)		(4,135,422)	(3,347,125)
Education	(3,683,100)	(1,671,359)	(5,354,459)	(5,087,302)
Current operations	(3,682,563)		(3,682,563)	(3,324,643)
Total distributions to operations	(11,501,085)	(1,671,359)	(13,172,444)	(11,759,070)
Investment return (less than) in excess of amounts designated for sponsored research, education and current operations	$(13,827,426)	$(30,475,544)	$(44,302,970)	$(31,194,277)

Investment return distributed to operations includes $595,348 and $652,328 earned on non-endowment investments for the years ended December 31, 2002 and 2001, respectively.

Certain losses which would cause individual endowment funds to be reduced below the historical dollar amount contributed by the donor have been allocated to unrestricted net assets. This amounted to $2,537,533 in 2002.

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:

	2002	2001
Unit value, beginning of year	$4.0787	$4.5650
Unit value, end of year	3.4719	4.0787
Net change for the year	(0.6068)	(0.4863)
Investment income per unit for the year	0.0647	0.0655
Total return per unit	$(0.5421)	$(0.4208)

4. Pledges Receivable

Pledges receivable consist of the following at December 31:

	2002	2001
Unconditional promises expected to be collected in:		
Less than one year	$2,101,126	$982,658
One year to five years	2,684,439	1,112,839
Reserve for uncollectible pledges receivable	(200,000)	(200,000)
Unamortized discount	(122,510)	(58,064)
	$4,463,055	$1,837,433

5. Contribution Receivable from Remainder Trusts

The Institution recorded $9,395,272 and $10,819,303 at December 31, 2002 and 2001, 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. 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 (liability), December 31, 2000	$(3,595,425)
2000 indirect costs	39,546,829
2000 adjustment	(63,312)
Amounts recovered	(38,084,738)
2000 change in liability	1,398,779
Deferred Fixed Rate Variance (liability), December 31, 2001	(2,196,646)
2001 indirect costs	44,079,157
2001 adjustment	(8,664)
Amounts recovered	(41,446,977)
2001 change in liability	2,623,516
Deferred Fixed Rate Variance asset, December 31, 2002	$426,870

As of December 31, 2002, the Institution has expended a cumulative amount in excess of recovered amounts of $426,870 which will be reflected as an addition to future year recoveries. This amount has been reported as an asset of the Institution.

7. Loan Payable

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, 2002, $5,485,951 had been drawn down on the loan and was outstanding at year-end. The Institution is required to pay interest on the drawdowns at a variable rate established by the Authority, which was 1.000% at December 31, 2002. The final drawdown has not yet occurred. Once a final drawdown has occurred, a schedule of principal payments will be established by the Authority. The final payment is due on July 1, 2010.

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, 2002, $2,559,211 had been drawn down on the loan and was outstanding at year-end. Drawdowns are expected to occur during an eighteen-month period. During this period, no principal payments are due on the loan, but the Institution is required to pay interest on the drawdowns at a variable rate established by the Authority, which was 1.000% at December 31, 2002. Once the final drawdown has occurred or the eighteen-month period has lapsed, a schedule of principal payments will be established by the Authority until the final payment due on July 1, 2010.

The loan agreements have covenants, the most restrictive of which requires the Institution to maintain unrestricted net assets at a market value equal to at least 1.0x outstanding indebtedness.

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, as well as a supplemental benefit plan which covers certain 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.

	Qualified Plan Pension Benefits 2002	2001
Change in benefit obligation:		
Benefit obligation at beginning of year	$142,163,706	$127,889,230
Service cost	5,024,294	3,933,908
Interest cost	10,340,134	9,652,748
Plan amendments	2,628,426	-
Actuarial (gain)/loss	16,311,089	9,003,337
Benefits paid	(7,344,481)	(8,315,517)
Benefit obligation at end of year	$169,123,168	$142,163,706
Change in plan assets:		
Fair value of plan assets at beginning of year	160,254,856	182,595,594
Actual return on plan assets	(18,929,640)	(14,025,221)
Benefits paid	(7,344,481)	(8,315,517)
Fair value of plan assets at end of year	$133,980,735	$160,254,856
Funded status	$(35,142,433)	$18,091,150
Unrecognized actuarial (gain)/loss	29,035,103	(21,492,494)
Unrecognized prior service cost	11,280,744	9,808,545
Net amount recognized	$5,173,414	$6,407,201
Amounts recognized in the statement of financial position consist of:		
Prepaid benefit cost	$ -	$6,407,201
Accrued pension liability	(12,082,593)	-
Accumulated other minimum liability	5,975,263	-
Intangible asset	11,280,744	-
Total amounts recognized	$5,173,414	$6,407,201
Cumulative reduction in net assets attributable to change in additional minimum liability recognition	5,975,263	-
Weighted average assumptions:		
Discount rate as of December 31	6.75%	7.25%
Expected return on plan assets for the year	10.00%	10.00%
Rate of compensation increase as of December 31	3.50%	3.50%
Components of net periodic benefit cost:		
Service cost	$5,024,294	$3,933,908
Interest cost	10,340,134	9,652,748
Expected return on plan assets and reserves	(15,286,868)	(15,167,435)
Amortization of:		
Transition obligation/(asset)	-	(642,223)
Prior service cost	1,156,227	1,175,999
Actuarial loss/(gain)	-	(1,519,401)
Net periodic benefit cost/(income)	$1,233,787	$(2,566,404)

The Institution has reflected the net periodic benefit cost/(income) in non-operating income as the change in prepaid pension cost. In 2002, the Institution recorded the additional minimum pension liability of $5,975,263, which resulted from an unfunded accumulated benefit obligation as of December 31, 2002 due to investment losses on plan assets and the decrease in discount rates.

During the year, the Plan was amended to increase the federal limits on allowable salary as permitted by law. In addition, the determination of the lump sum amounts was updated to reflect the new mortality table. This increased the obligation by approximately $2,600,000.

The Institution also maintains a restoration plan which covers certain employees. Included in the statement of financial position is a payable of $530,044 and an intangible pension asset of $217,780 related to this plan.

	Supplemental Plan Pension Benefits 2002	2001
Change in benefit obligation:		
Benefit obligation at beginning of year	$3,243,021	$3,178,410
Service cost	79,154	84,148
Interest cost	216,030	227,879
Plan amendments	2,261	-
Actuarial (gain)/loss	(2,046)	2,918
Benefits paid	(255,871)	(250,334)
Benefit obligation at end of year	$3,282,549	$3,243,021
Change in plan assets:		
Fair value of plan assets at beginning of year	$ -	$ -
Employer contribution	255,871	250,334
Benefits paid	(255,871)	(250,334)
Fair value of plan assets at end of year	$ -	$ -
Funded status	$(3,282,549)	$(3,243,021)
Unrecognized actuarial (gain)/loss	(259,057)	(405,902)
Unrecognized prior service costs	1,946	-
Net amount recognized	(3,539,660)	(3,648,923)
True up to earmarked reserves	(1,954,666)	(2,815,663)
Total earmarked reserves	$(5,494,326)	$(6,464,586)
Amounts recognized in the statement of financial position consist of:		
Supplemental retirement/accrued supplemental retirement benefits	$(5,494,326)	$(6,464,586)

	2002	2001
Weighted average assumptions:		
Discount rate as of December 31	6.75%	7.25%
Expected return on plan assets for the year	10.00%	10.00%
Rate of compensation increase as of December 31	3.50%	3.50%
Components of net periodic benefit cost:		
Service cost	$79,154	$84,148
Interest cost	216,030	227,879
Expected return on plan assets	(263,588)	(270,575)
Amortization of:		
Prior year service costs	315	-
Transition obligation	-	127,993
Actuarial loss/(gain)	(26,091)	(39,384)
Net periodic benefit cost	5,820	130,061
Investment return on invested reserves	140,788	184,563
Total periodic cost	$146,608	$314,624

The earmarked reserves are matched by a "Rabbi" Trust with $5,494,326 and $6,464,586, respectively, as of December 31, 2002 and 2001. The true up amount represents the total amount Plan assets are (over)/underfunded compared to the actuarially determined benefit obligation.

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 2002	2001
Change in benefit obligation:		
Benefit obligation at beginning of year	$24,305,656	$20,694,387
Service cost	529,739	449,011
Interest cost	1,936,615	1,692,874
Actuarial (gain)/loss	4,803,608	2,409,584
Benefits paid	(1,256,870)	(1,046,819)
Plan participants' contributions	141,082	106,619
Benefit obligation at end of year	$30,459,830	$24,305,656
Change in plan assets:		
Fair value of plan assets at beginning of year	$14,532,884	$15,642,206
Actual return on plan assets	(2,419,754)	(1,069,644)
Employer contribution	1,621,939	900,520
Benefits paid	(1,256,870)	(1,046,819)
Plan participants' contributions	141,082	106,619
Fair value of plan assets at end of year	$12,619,281	$14,532,882
Funded status	$(17,840,549)	$(9,772,774)
Unrecognized actuarial (gain)/loss	12,726,764	4,332,017
Unrecognized portion of net obligation/(asset) at transition	8,535,496	9,389,045
Unrecognized prior service cost/(credit)	(2,632,885)	(3,159,462)
Net amount recognized	$788,826	$788,826
Amounts recognized in the statement of financial position consist of:		
Prepaid benefit cost	$788,826	$788,826
Weighted average assumptions:		
Discount rate as of December 31	6.75%	7.25%
Expected return on plan assets for the year	10.00%	10.00%

For measurement purposes, a 10.0% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2002 for both pre-65 and post-65 benefits.

These were assumed to decrease gradually to 5.0% in 2010 and remain at that level thereafter.

	2002	2001
Components of net periodic benefit cost:		
Service cost	$529,739	$449,011
Interest cost	1,936,615	1,692,874
Expected return on plan assets and reserves	(1,487,375)	(1,568,337)
Recognized actuarial (gain)/loss		-
Amortization of:		
Transition obligation	853,549	853,549
Prior service cost/(credit)	(526,577)	(526,577)
Recognized actuarial (gain) or loss	315,988	-
Net periodic benefit cost/(income)	$1,621,939	$900,520

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

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:

	December 31, 2002	
	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total of service cost and interest cost:	$ 469,396	$ (367,984)
Effect on the postretirement benefit obligation:	$4,791,050	$(3,856,888)

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 2001. The current indirect cost recovery rates, which are fixed, include the impact of prior year settlements. While the 2002 direct and indirect costs are subject to audit, the Institution does not believe settlement of this year will have a material impact on its change in net assets or its financial position.

The DCAA issued an audit report on the completed audit of direct and indirect costs for the year ended December 31, 2001 on September 3, 2002. The audit resulted in no questioned direct or indirect costs.

The Institution through its endowment fund is committed to invest $55,423,226 in certain venture capital and investment partnerships, of which $25,406,325 has been contributed as of December 31, 2002.

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 2002, the Institution passed through Federal Awards of approximately $708,000 to subgrantee organizations in which an individual at the subgrantee organization is also a member of the Institution's Board of Trustees or Corporation. Additionally, a member of the Board of Trustees is affiliated with a law firm which provides legal services to the Institution. The Institution has purchased insurance services from an insurance company in which an officer of the company is also a member of the Board of Trustees.

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 October, the Institution has been coordinating with its insurance carrier and other interested parties to identify and quantify the damage caused by the fire. At December 31, 2002, the Institution has 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 has established an accrual of approximately $14,859,000 to estimate the costs to be paid in fiscal year 2003 associated with the fire. Included in the accrual but not covered by insurance is 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 has been reflected as a loss on the fire and included in other expenses in the statement of activities. The estimated amounts relating to the fire are subject to revision as more information becomes available.