

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Consolidated Financial Statements

June 30, 2006

(With Independent Auditor's Report Thereon)

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Consolidated Financial Statements and Supplemental Schedules

June 30, 2006

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Independent Auditors' Report

The Board of Directors
University of Virginia Investment Management Company:

We have audited the accompanying consolidated statement of financial position of the University of Virginia Investment Management Company (the Company) as of June 30, 2006, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Investment Management Company as of June 30, 2006, 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.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary information included the Schedule of Investments Held for Others (at Fair Value), Shares Outstanding, and Net Asset Values Per Share and the Schedule of Changes in Net Investment Assets are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

October 16, 2006

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Consolidated Statement of Financial Position

June 30, 2006

(Dollars in thousands)

Assets

Cash and cash equivalents	\$	196
Accounts receivable		65
Prepaid expenses		92
Investment in long-term pool		1,584
Investments in securities, held for others at fair value		3,691,942
Investments in securities at fair value, collateral received under securities loan or repurchase agreements (see note 3)		184,545
Property and equipment, net		115
Total assets	\$	<u><u>3,878,539</u></u>

Liabilities and Net Assets

Amounts held for others	\$	3,691,942
Payable under securities loan or repurchase agreements (see note 3)		184,545
Accrued compensation and benefits		380
Accounts payable and accrued expenses		169
Total liabilities		<u>3,877,036</u>
Unrestricted net assets		<u>1,503</u>
Total liabilities and net assets	\$	<u><u>3,878,539</u></u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Consolidated Statement of Activities

Year ended June 30, 2006

(Dollars in thousands)

Unrestricted net assets, beginning of year	\$ 886
Revenues:	
Return on investments	418,173
Contributions and other income	317
Total revenues	<u>418,490</u>
Expenses:	
Allocation of net return on investments to depositors	411,775
Compensation and benefits	4,499
Other operating expenses	1,545
Depreciation and amortization	54
Total expenses	<u>417,873</u>
Increase in unrestricted net assets	<u>617</u>
Unrestricted net assets, end of year	<u><u>\$ 1,503</u></u>

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Consolidated Statement of Cash Flows

Year ended June 30, 2006

(Dollars in thousands)

Beginning of period cash and cash equivalents	\$	1,667
Cash flows from operating activities:		
Management fees		6,435
Contributions		334
Cash paid to employees		(5,039)
Other cash operating expenditures		(1,498)
Net cash flows from operating activities		<u>232</u>
Cash flows from investing activities:		
Investment in long term pool		(1,601)
Purchases of fixed assets		(102)
Net cash flows from investing activities		<u>(1,703)</u>
Net increase (decrease) in cash and cash equivalents		<u>(1,471)</u>
End of period cash and cash equivalents	\$	<u>196</u>

Cash and securities received from depositors and cash distributions to depositors are reported as changes in Investments in Securities, Held for Others at Fair Value. Cash and securities received from depositors and cash distributions to depositors during the year ended June 30, 2006 were \$1,239,714 and \$814,282, respectively.

See accompanying notes to consolidated financial statements.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Notes to Consolidated Financial Statements

June 30, 2006

(Dollars in thousands)

(1) Organization

The University of Virginia Investment Management Company (UVIMCO) is a not-for-profit corporation organized to invest funds on behalf of the Rector and Visitors of the University of Virginia (the University) and University-related Foundations (the Foundations). UVIMCO was incorporated as a nonstock corporation in the Commonwealth of Virginia on May 28, 2004, and commenced operations on July 1, 2004.

Assets deposited with UVIMCO are held in the custody and control of UVIMCO on behalf of the University and Foundations within unitized investment pools. The Long Term Pool commingles endowment and other long term funds of the University and Foundations. The Aggregate Cash Pool commingles short term investments of the University and the Long Term Pool. UVIMCO is also responsible for the investment management of certain charitable trust assets for which the University serves as trustee. For the fiscal year ended June 30, 2006, the consolidated financial statements of UVIMCO reflect both the results of investment management services provided by UVIMCO to the University and Foundations throughout the fiscal year and the results of investments held for others and managed by UVIMCO. Intercompany accounts and transactions including the Long Term Pool's investment in the Aggregate Cash Pool, UVIMCO's investment in the Long Term Pool and investment management fees charged by UVIMCO to the investment pools have been eliminated.

Certain investments are made by UVIMCO and held indirectly through special purpose vehicles wholly owned or affiliated with UVIMCO. UVIMCO's consolidated financial statements have been prepared as if such investments were held directly by UVIMCO.

The consolidated financial statements of UVIMCO have been prepared on the accrual basis of accounting. The significant accounting policies are described in note 2.

(2) Significant Accounting Policies

(a) Investments in Securities

UVIMCO values direct investments at independent market prices where readily available. Exchange traded securities are stated at the last reported sales price on the day of valuation. Securities traded in the over-the-counter market are valued using the mean of the last quoted bid and ask prices. Independent third party sources are used to value all publicly traded securities. Fixed income securities are valued based upon bid quotations obtained from major market makers or security exchanges.

Investments in limited partnership hedge funds, private equity and venture capital partnerships or similar private investment vehicles that do not actively trade through established exchange mechanisms are valued at estimated fair market value, based upon UVIMCO's interest in the investee as determined and reported by the external manager of the investment vehicle. Such investments represent \$557,270 (15% of investments held for others) at June 30, 2006. Changes in the value of such investments are reflected on the statement of activities as a component of return on investments. Because of the inherent uncertainty of such valuations, these estimated values may

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Notes to Consolidated Financial Statements

June 30, 2006

(Dollars in thousands)

differ from the values that would have been used had a ready market for the investments existed, and such differences could be material.

At June 30, 2006, UVIMCO's investments in securities included interests in hedge funds that engage in speculative trading of equities, futures and other financial instruments. However, the risk to UVIMCO is limited to the value of UVIMCO's investment in each of the respective funds. All investments in hedge funds are subject to lock-up periods which range from one month to five years, in accordance with the provisions of the respective fund agreements. As of June 30, 2006, UVIMCO has unfunded commitments of approximately \$27,012 for additional investment in hedge funds.

At June 30, 2006, UVIMCO's investments also included interests in private equity funds. UVIMCO has unfunded commitments of approximately \$997,878 for additional investment in such funds. The liquidity of UVIMCO's private equity fund investments is principally dependent on the timing of the liquidation of the underlying investments in such funds.

Investment transactions are accounted for on a trade date basis. Interest income is recognized on an accrual basis and dividends from equity securities are recognized as income on the ex-dividend date. Interest and dividend income is included as a component of the return on investments.

(b) Revenue Recognition

Fees for investment advisory services and related administrative services provided by UVIMCO are recognized in the period that the services are provided.

(c) Foreign Currency

The accounting records of UVIMCO are maintained in U.S. dollars. Investment securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollar amounts at the date of valuation. Transactions with investment funds denominated in foreign currencies are translated into U.S. dollar amounts on the respective dates of such transactions.

UVIMCO does not isolate that portion of return on investments resulting from changes in foreign exchange rates on investments from the fluctuations arising from change in market prices of securities held by investment funds. Such fluctuations are included as a component of the return on investments.

(d) Income Taxes

UVIMCO has received a letter from the Internal Revenue Service dated March 4, 2005, exempting UVIMCO from income taxes on related income under section 501(c)(3) of the Internal Revenue Service Code, and therefore UVIMCO is not subject to income taxes on normal operations. In addition, UVIMCO is considered a public charity under section 509(a)(3) of the Internal Revenue Code. UVIMCO may, however, incur federal income taxes on unrelated business income.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Notes to Consolidated Financial Statements

June 30, 2006

(Dollars in thousands)

(e) Cash and Cash Equivalents

For purposes of the consolidated statements of financial condition and cash flows, cash represents the amount of operating cash on hand held by UVIMCO and does not include any short term investments held for others in the investment pools managed by UVIMCO. Cash and cash equivalents held for others within the investment pools managed by UVIMCO are reported as Investments in Securities, Held for Others at Fair Value.

(f) Prepaid Expenses

Prepaid expenses consist of expenses paid in advance for rent, insurance and various services. Prepaid expenses are ratably expensed over the period to which they relate.

(g) Distributions

Distributions to depositors are controlled by various spending policies approved by the University, Foundations or charitable trust donors and communicated to UVIMCO. Distributions requests are processed and recorded as they are received by UVIMCO.

(h) Functional Expenses

UVIMCO is a single program company organized to provide investment management for the University and Foundations. Natural expenses for the year ended June 30, 2006 are composed of the following functional expenses:

	<u>Program services</u>	<u>Supporting services</u>	<u>Total expenses</u>
Compensation and benefits	\$ 3,525	974	4,499
General operating	840	595	1,435
Rent	66	44	110
	<hr/>	<hr/>	<hr/>
Total before depreciation	4,431	1,613	6,044
Depreciation and amortization	32	22	54
	<hr/>	<hr/>	<hr/>
Total expenses	\$ 4,463	1,635	6,098
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

(i) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Notes to Consolidated Financial Statements

June 30, 2006

(Dollars in thousands)

(3) Investments in Securities, Held for Others at Fair Value

The Long Term Pool commingles endowment and other long term funds of the University and Foundations in a unitized investment vehicle. Assets of the Long Term Pool are pooled on a fair value basis and unitized monthly. Deposits and withdrawals are processed monthly. Each depositor subscribes to or disposes of units on the basis of the value per share at fair value as calculated on the last calendar day of the month in which a deposit or redemption request is received by UVIMCO.

The Aggregate Cash Pool commingles short term investments of the University and the Long Term Pool. Investments held within the Aggregate Cash Pool are held at estimated fair value. Investments are valued on a daily basis by UVIMCO's custodian bank. All units within the Pool are valued at \$1.00. Deposits and withdrawals are processed daily. An income factor comprised of interest and dividends earned, realized gain/loss, change in unrealized gain/loss, and fees is calculated daily. Income factors are totaled for each depositor on a monthly basis, and income is reinvested on the first business day of the following month.

The fair value of investment assets for the assets managed by UVIMCO as of June 30, 2006 is summarized as follows:

	Investments in securities, held for others			Collateral received
	Unpledged	Pledged	Total	
Public equity	\$ 872,912	9,601	882,513	—
Hedge funds	1,704,518	—	1,704,518	—
Private equity	450,140	—	450,140	—
Real assets	145,063	—	145,063	—
Fixed income	19,037	173,645	192,682	—
Cash and accruals	317,026	—	317,026	184,545
Total investments	<u>\$ 3,508,696</u>	<u>183,246</u>	<u>3,691,942</u>	<u>184,545</u>

(4) Related Party Transactions

UVIMCO provides investment management and advisory services solely to the University and related Foundations under various Deposit and Management agreements. UVIMCO receives a monthly management fee equal to 1/12 of 20 basis points (20 basis points per annum) of the Long Term Pool's adjusted net asset value as of the end of each calendar month. For purposes of calculating this fee, net assets are determined before accrual of the current month management fees. The revenue for these services for the year ended June 30, 2006 was \$6,081. UVIMCO also collects investment management fees from the University related to the Aggregate Cash Pool and management of charitable trust assets. The revenue for these services for the year ended June 30, 2006 was \$232 and \$85, respectively.

UVIMCO contracts for computer support, Internet and mainframe connection services with the University. The expense for these services for the year ended June 30, 2006 was \$26.

UVIMCO leases three full time employees from the University. The total compensation and benefits expense related to these leased employees for the year ended June 30, 2006 was \$789.

UNIVERSITY OF VIRGINIA
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Notes to Consolidated Financial Statements

June 30, 2006

(Dollars in thousands)

The University provides UVIMCO with investment asset and shareholder accounting services. The contractual services expense related to these accounting services for the year ended June 30, 2006 was \$250.

UVIMCO subleases office space from the University under a lease renewable for one-year terms. The future minimum lease payment as of June 30, 2006, for fiscal year ending June 30, 2007, is \$113.

All transactions with the University and Foundations are conducted at prevailing market rates.

(5) 401(k) Plan

Effective July 1, 2004, UVIMCO established a tax-sheltered annuity arrangement that provides retirement benefits for its employees by contributing to a custodial account invested in publicly traded mutual funds. UVIMCO contributes 10.4% of annual gross compensation to the plan on behalf of eligible employees, subject to applicable federal limits. Employer contributions for the year ended June 30, 2006 were \$135.

(6) Securities Lending

UVIMCO participates in a securities lending program through its agent, Mellon Trust of New England, N.A. All security loan agreements are collateralized by readily available marketable and liquid securities, loans, or other obligations secured by a lien or similar interest on an asset totaling at least 102% of the fair value of the loaned securities. The average term of the security loans as well as collateral held is less than one week. At June 30, 2006, UVIMCO loaned securities having a fair value of \$9,601 collateralized by cash in the amount of \$10,138. Included in the consolidated statement of activities are expense offsets of \$17 arising from securities lending proceeds.

(7) Repurchase Agreements

UVIMCO enters into repurchase agreements with certain banks and broker/dealers through its agent, Standish Mellon Asset Management Company LLC, whereby UVIMCO sells portfolio assets concurrent with an agreement by UVIMCO to repurchase the same assets at a later date at a fixed price. In connection with these agreements, UVIMCO establishes segregated accounts with its custodian in which UVIMCO maintains cash equal in value to its obligations in respect of repurchase agreements. Repurchase agreements involve the risk that the market value of the securities UVIMCO has sold may decline below the price at which it is obligated to repurchase them under the agreement. At June 30, 2006, the fair value of securities under repurchase agreements including accrued interest is \$173,645, collateralized by cash of \$174,407. All repurchase agreements are renegotiated daily with interest rates ranging from 10 basis points above or below the daily effective federal funds rate of interest.

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June 30, 2006

(Dollars in thousands)

(8) Indemnifications

In the normal course of business, UVIMCO enters into contracts that contain a variety of representations and warranties that provide general indemnifications. UVIMCO's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against UVIMCO that have not occurred. However, based on experience, UVIMCO expects the risk of loss to be remote.

(9) Subsequent Events

On June 26, 2006, UVIMCO established a single member limited liability corporation, UVIMCO II LLC, to facilitate structured investments. UVIMCO funded UVIMCO II LLC with \$50,000 on July 31, 2006.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Schedule of Investments Held for Others (at Fair Value), Shares Outstanding, and
Net Asset Values Per Share

June 30, 2006

(Dollars in thousands, except per share amounts)

	Long term pool	Charitable trusts	Aggregate cash	Eliminations	Total assets managed
Public equity	\$ 875,189	7,726	—	(402)	882,513
Hedge funds	1,682,575	22,714	—	(771)	1,704,518
Private equity	450,346	—	—	(206)	450,140
Real assets	145,129	—	—	(66)	145,063
Fixed income	184,021	8,745	—	(84)	192,682
Cash and accruals	119,649	389	318,020	(121,032)	317,026
Total assets	\$ 3,456,909	39,574	318,020	(122,561)	3,691,942
Shares outstanding	903,299		318,020		
Net asset value per share	\$ 3,826.98		1.00		

See accompanying independent auditors' report.

**UNIVERSITY OF VIRGINIA
INVESTMENT MANAGEMENT COMPANY**

Schedule of Changes in Net Investment Assets

Year ended June 30, 2006

(Dollars in thousands)

	<u>Long term pool</u>	<u>Charitable trusts</u>	<u>Aggregate cash</u>	<u>Eliminations</u>	<u>Total assets managed</u>
Beginning of period	\$ 2,593,961	36,007	302,371	(77,604)	2,854,735
Deposits by investors	570,854	2,563	1,883,689	(1,217,392)	1,239,714
Return on investments	407,364	3,597	13,556	(6,344)	418,173
Management fees	(6,081)	(85)	(232)	—	(6,398)
Distributions to investors	(109,189)	(2,508)	(1,881,364)	1,178,779	(814,282)
End of period	<u>\$ 3,456,909</u>	<u>39,574</u>	<u>318,020</u>	<u>(122,561)</u>	<u>3,691,942</u>

See accompanying independent auditors' report.