MEHARRY MEDICAL COLLEGE

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2006 AND 2005

CROSSLIN VADEN
CERTIFIED PUBLIC ACCOUNTANTS
& ASSOCIATES

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CERTIFIED PUBLIC ACCOUNTANTS & ASSOCIATES

Independent Auditors' Report

The Board of Trustees
Meharry Medical College
Nashville, Tennessee

We have audited the accompanying consolidated statements of financial position of Meharry Medical College as of June 30, 2006 and 2005, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Meharry Medical College as of June 30, 2006 and 2005, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Crosslin, Vaden + Associates, P.C.

Nashville, Tennessee
September 8, 2006

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MEHARRY MEDICAL COLLEGE
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

ASSETS

	June 30, 2006	June 30, 2005
Cash and cash equivalents	$ 5,562,275	$ 5,886,852
Accounts receivable, net	11,537,104	10,947,349
Contributions receivable	3,482,584	5,603,355
Inventories and other assets	68,017	212,877
Student loans receivables, net	12,566,377	11,587,724
Investments	66,148,944	55,731,782
Investment in real estate	36,677,768	38,594,476
Plant facilities, net of accumulated depreciation	60,747,167	54,440,281
Funds held by trustees	1,230,405	1,197,631
Deferred charges	1,185,533	1,263,280
Total assets	$199,206,174	$185,465,607

LIABILITIES AND NET ASSETS

	2006	2005
Notes payable to banks	$ 4,100,000	$ 4,600,000
Accounts payable	6,991,137	5,001,579
Accrued liabilities	7,778,389	10,187,784
Advances under grants and contracts	2,144,810	1,733,585
Deferred revenue	2,491,791	2,654,556
Bonds payable	64,997,514	69,101,590
Funds held in trust for others	157,714	141,250
Government advances for student loans	11,860,438	11,717,759
Total liabilities	100,521,793	105,138,103
Unrestricted		
Undesignated	14,043,801	5,066,535
Net minimum pension liability	(855,596)	(1,665,905)
Unrealized loss on interest rate swap agreement	(392,214)	(1,438,929)
Refunding loss on debt service of bonds refinanced	(7,098,576)	(7,350,729)
Total unrestricted net assets (accumulated deficit)	5,697,415	(5,389,028)
Temporarily restricted	19,163,199	19,407,598
Permanently restricted	73,823,767	66,308,934
Total net assets	98,684,381	80,327,504
Total liabilities and net assets	$ 199,206,174	$ 185,465,607

See accompanying notes to consolidated financial statements.

MEHARRY MEDICAL COLLEGE
CONSOLIDATED STATEMENTS OF ACTIVITIES

	Year Ended June 30,	
	2006	2005
Changes in unrestricted net assets:		
Operating revenues:		
Tuition and fees	$ 16,232,587	$ 15,347,932
Less College funded scholarships	3,276,023	3,295,449
Net tuition and fees	12,956,564	12,052,483
Government grants and contracts	65,517,226	59,773,554
Private gifts, grants, and contracts	3,836,709	3,681,992
Income on long-term investments, net	228,558	335,968
Net gain on investments	365,749	247,469
Sales and services of educational departments	896,967	862,348
Other sources	2,607,043	2,847,416
Health services division	25,463,022	25,526,247
Net assets released from restrictions	9,963,850	4,283,481
Total operating revenues	121,835,688	109,610,958
Operating expenses:		
Instruction	24,487,980	22,045,896
Research	19,159,886	15,817,689
Public service	7,349,305	8,660,968
Academic support	10,965,556	9,662,926
Student services	3,314,540	3,370,897
Institutional support	24,501,412	22,532,911
Health services division	22,827,590	23,739,245
Total operating expenses	112,606,269	105,830,532
Increase in unrestricted net assets from operating activities	9,229,419	3,780,426
Nonoperating items:		
Change in net minimum pension liability	810,309	(753,751)
Change in market value of interest rate swap agreement	1,046,715	195,693
Increase in unrestricted net assets	11,086,443	3,222,368

See accompanying notes to consolidated financial statements.

MEHARRY MEDICAL COLLEGE
CONSOLIDATED STATEMENTS OF ACTIVITIES - Continued

	Year Ended June 30, 2006	Year Ended June 30, 2005
Changes in temporarily restricted net assets:		
Gifts, grants, and contracts	5,822,288	3,255,861
Income on long-term investments, net	1,449,456	2,142,373
Net gain on investments	2,447,707	1,656,138
Net assets released from restrictions	(9,963,850)	(4,283,481)
Change in temporarily restricted net assets	(244,399)	2,770,891
Increase in permanently restricted net assets:		
Gifts and grants	7,514,833	4,841,938
Income on long-term investments, net	-	3,919
Increase in permanently restricted net assets	7,514,833	4,845,857
Increase in net assets	18,356,877	10,839,116
Net assets at beginning of year	80,327,504	69,488,388
Net assets at end of year	$ 98,684,381	$ 80,327,504

See accompanying notes to consolidated financial statements.

MEHARRY MEDICAL COLLEGE
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Increase in net assets	$ 18,356,877	$ 10,839,116
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation	6,532,609	6,504,954
Amortization of deferred charges and bond discount	78,672	78,672
Increase (decrease) in allowance for doubtful accounts	3,293,897	(2,174,333)
Contributions restricted for long-term investment	(6,154,348)	(6,329,261)
Net realized and unrealized gains on long-term investments	(2,813,456)	(3,070,708)
Changes in:		
Accounts receivable	(3,883,652)	813,762
Contributions receivable	2,120,771	3,564,611
Inventory and other assets	144,860	(64,835)
Accounts payable	1,989,558	1,829,809
Accrued liabilities	(2,409,395)	(1,177,052)
Advances under grants and contracts	411,225	(408,411)
Deferred revenue	(162,765)	753,091
Funds held in trust for others	16,464	41,617
Net cash provided by operating activities	17,521,317	11,201,032
Cash flows from investing activities:		
Acquisition of plant facilities	(10,922,787)	(3,584,771)
Purchases of investments, net	(7,603,706)	(6,062,437)
Change in funds held by trustees	(32,774)	(19,217)
Net cash used in investing activities	(18,559,267)	(9,666,425)
Cash flows from financing activities:		
Proceeds from contributions restricted for investment in endowment	6,154,348	6,329,261
Student loans receivable, net	(978,653)	(844,071)
Change in government advances for student loans	142,678	40,658
Repayments on lines of credit	(500,000)	(350,000)
Principal repayments on bonds	(4,105,000)	(3,935,001)
Net cash provided by financing activities	713,373	1,240,847
Net (decrease) increase in cash and cash equivalents	(324,577)	2,775,454
Cash and cash equivalents at beginning of year	5,886,852	3,111,398
Cash and cash equivalents at end of year	$ 5,562,275	$ 5,886,852
Supplemental cash flows information:		
Cash paid for interest	$ 3,941,377	$ 4,194,110

See accompanying notes to consolidated financial statements.

A. ORGANIZATION AND PURPOSE

Meharry Medical College (the "College") is a fully accredited, private college committed to training health care professionals and leaders in many medical and health related fields. The College exists to provide an excellent education in the health sciences, while maintaining a center of excellence for the practice and delivery of health care, and the conduct of both basic and clinical research.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting

The consolidated financial statements of the College have been prepared on the accrual basis of accounting and in accordance with the accounting principles generally accepted in the United States of America.

The consolidated financial statements of the College include the operations of the wholly owned subsidiaries of the College; Meharry Campus Housing Corporation and Meharry Housing Corporation. All significant intercompany activity has been eliminated in consolidation.

To ensure observance of limitations and restrictions placed on the use of resources available, the College maintains its accounts in accordance with the principles and practices of fund accounting. Fund accounting is the procedure by which resources for various purposes are classified for accounting purposes into funds that are maintained in accordance with activities or objectives of the College.

For external financial reporting purposes, however, Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*, requires that resources be classified into three net asset categories according to donor-imposed restrictions. Net assets of the college and changes therein are classified as follows:

Unrestricted - Unrestricted net assets (which are free of donor-imposed restrictions) generally result from revenues derived from providing services, receiving unrestricted contributions, recognizing unrealized and realized gains and losses, and receiving dividends and interest from investing in income-producing assets, less expenses incurred in providing services, raising contributions, and performing administrative functions.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Temporarily Restricted - Temporarily restricted net assets generally result from contributions and other inflows of assets whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the College pursuant to those stipulations.

Permanently Restricted - Permanently restricted net assets generally represent the historical cost (fair value at date of gift) of contributions and other inflows of assets whose use by the University is limited by donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by the College.

Use of Estimates in the Preparation of Financial Statements

Judgment and estimation is exercised by management in certain areas of the preparation of the financial statements. The more significant areas include the recovery period for plant facilitates, the allocation of certain operating and maintenance expenses to functional categories, the collection of contributions receivable and the valuation of receivables. Management believes that such estimates have been based on reasonable assumptions and that such estimates are adequate, however, actual results could differ from those estimates.

Contributions

The College reports gifts of cash and other assets as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However, donor-restricted contributions whose restrictions are met in the same reporting period as received are reported in the statement of activities as unrestricted contributions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period in which the assets are acquired or placed in service.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Contributions, including unconditional promises to give, are recognized as revenue in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Contributions to be received after one year are discounted at a rate commensurate with the risk involved. Amortization of the discount is recorded as additional contribution revenue and used in accordance with donor-composed restrictions, if any, on the contributions. Allowance is made for uncollectible contributions based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience and other relevant factors.

Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments with original maturities of three months or less.

Inventories

Inventories consisting of supplies are stated at the lower of cost (first-in, first out) or market (net realizable value).

Accounts Receivable

The College records accounts receivable at their estimated net realizable value. An allowance for doubtful accounts is recorded based upon management's estimate of uncollectible accounts determined by analysis of specific balances and a general reserve based upon aging of outstanding balances. Past due balances are charged against the allowance when they are determined to be uncollectible.

Investments

Investments in equity securities with readily determinable fair value and all investments in debt securities are reported at fair value with gains and losses included in the statement of activities. Fair values for investments in debt and equity securities held by the College are based on quoted market prices and dealer quotes. Works of art, historical treasures, and similar assets held as part of collections are reported at the fair market or appraisal value at the date of acquisition or contribution, respectively.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investment in hospital facility is stated at cost of acquisition plus the cost of renovations incurred. The cost of acquisition was based upon the estimated fair market value of the facilities based on payments to be received from the lease of the facilities. The investment is being depreciated on a straight-line basis over the estimated useful life of the facility and equipment which range from ten to forty years.

Life Income and Gift Annuities

The College's split interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which the College serves as trustee. Assets held in these trusts are included in investments. Contribution revenues are recognized at the dates the trusts are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted annually for changes in the value of the assets, accretion of the discount and other changes in the estimate of future benefits.

Plant Facilities

Plant facilities are stated at cost or estimated fair value at dates of gifts, less accumulated depreciation, computed on the straight-line basis over the estimated useful lives of the various assets, which range from 5 years to 40 years. Depreciation and operation and maintenance charges are allocated to appropriate functional expense categories. Plant disposals are removed from the records at time of disposal. The College lifts restrictions on contributions for long-lived assets at the time the assets are acquired.

Deferred Charges

Deferred charges consist of bond issuance costs, which are amortized on the straight-line basis over the lives of the related bond issues. As of June 30, 2006 and 2005, accumulated amortization was $658,487 and $580,741, respectively. The estimated future amortization expense for each of the next five years is $77,747.

Deferred Revenue

Early fall registration revenue and expenditures are deferred and are reported within the fiscal year in which the activities are completed.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Other Financial Instruments

The College employs derivatives in a limited manner, primarily interest rate swap agreements to manage market risk associated with outstanding variable-rate debt. Derivative financial instruments are reported at fair value with any resulting gain or loss recognized as a nonoperating item in the statement of activities.

Government Advances for Student Loans

Funds provided by the United States government under the Federal Perkins and Health Professions Student Loan programs are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the government and are therefore recorded as liabilities.

Health Services Division Revenue

Included in health services division revenue are amounts from the Meharry Medical Group, the Lloyd C. Elam Mental Health Center and various clinics operated by the College. The College has agreements with third-party payors that provide for payments to the College at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, per diem payments and capitation. Such revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Contractual adjustments are accrued on an estimated basis in the period that the related services are rendered and adjusted in future periods as final settlements are determined.

Program Services

The College's primary program services are instruction, research, health services, and public service. Expenses reported as academic support, student services, and auxiliary enterprises are incurred in support of these primary program services. Institutional support includes fundraising expenses of $2,231,854 and $2,158,995 in 2006 and 2005, respectively. For purposes of reporting fundraising expenses, the College includes those fundraising costs incurred by its Development Office as well as an estimate of payroll-related expenditures incurred by members of management in fundraising activities.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Income Taxes

The College has received a determination letter from the Internal Revenue service indicating it is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code; accordingly, no provision for income taxes is made in the financial statements.

Related Parties

Two members of the Board of Trustees are officers at banks with which the College does business.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

C. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following at June 30, 2006 and 2005:

	2006	2005
Receivable from grantors	$ 1,743,228	$ 5,653,876
Professional services receivable	5,051,315	2,437,576
Patient receivables, net of contractual allowances and doubtful account allowances of $10,762,564 and $7,488,667 at June 30, 2006 and 2005, respectively	3,641,003	2,513,834
Student accounts receivable, net of allowance of $114,000 and $94,000 at June 30, 2006 and 2005, respectively	1,035,297	277,243
Other accounts receivable	66,261	64,820
Total accounts receivable, net	$11,537,104	$10,947,349

D. CONTRIBUTIONS RECEIVABLE

The College includes unconditional promise to give as contributions receivable in accordance with the provisions of SFAS No. 116, *Accounting for Contributions Received and Contributions Made.*

	2006	2005
Unconditional promises to give, net	$ 3,783,635	$ 5,964,815
Less unamortized discount at 5%	(301,051)	(361,460)
Unconditional promise to give, net	$ 3,482,584	$ 5,603,355
Amounts due in:		
Less than one year	$2,741,806	$4,528,058
One to five years	1,041,829	1,436,757
	$3,783,635	$5,964,815

At June 30, 2006 and 2005, the College had also received bequest intentions and certain other conditional promises to give. These intentions and conditional promises to give are not recognized as assets and, if they are received, they will generally be restricted for specific purposes stipulated by the donors, primarily for faculty support, scholarships, or general operating support of a particular department or division of the College.

The College receives contributed services from alumni and other volunteers who assist in fundraising efforts through their participation in various fundraising drives. The value of such services, which the College considers not practicable to estimate, has not been recognized in the statements of activities.

E. STUDENTS LOANS RECEIVABLE

Student loans receivable at June 30, 2006 and 2005, consisted of the following:

	2006	2005
Notes receivable - students	$ 12,967,271	$ 12,073,627
Less allowance for doubtful loans	(400,894)	(485,903)
	$ 12,566,377	$ 11,587,724

F. INVESTMENTS

Investments at June 30, 2006 and 2005, are summarized below:

	2006		2005	
	Fair Value	Cost	Fair Value	Cost
Marketable securities:				
Cash equivalents	$ 573,234	$ 573,234	$ 1,924,645	$ 1,924,645
Mutual funds	7,130,197	7,311,167	6,403,248	7,811,399
Common stocks	46,767,833	40,667,138	30,184,652	26,592,548
Real estate	2,184,567	2,093,720	2,907,637	2,680,630
Bonds	9,433,113	10,075,565	14,251,600	14,656,783
Other	60,000	-	60,000	-
Total investments	$66,148,944	$60,720,824	$55,731,782	$53,666,005
Investment in real estate, net of accumulated depreciation		$36,677,768		$38,594,476

Mutual funds for 2006 and 2005 are comprised of solely of fixed income securities.

The College's investments are substantially all permanently restricted endowment funds. The investment in real estate is comprised of the College's investment in hospital facilities which are leased to the Metropolitan Government of Nashville and Davidson County (the Metropolitan Government) to house the operations of the Metropolitan Government's Nashville General Hospital. The thirty year operating lease with the Metropolitan Government began in December 1994 and provides for rent payments of $4,000,000 per year. The College funds scholarship expenses with unrestricted resources until such time as the investment in real estate generates enough cash to support scholarships at a predetermined level.

G. PLANT FACILITIES

Plant facilities consist of the following at June 30, 2006 and 2005:

	2006	2005
Land and land improvements	$ 5,453,212	$ 5,453,212
Buildings and building improvements	91,565,591	83,296,235
Equipment	19,516,360	19,493,937
Art	433,194	433,194
Library and visual aids	5,016,336	5,016,336
	121,984,693	113,692,914
Less accumulated depreciation	(61,237,526)	(59,252,633)
Total plant facilities	$ 60,747,167	$ 54,440,281

Plant operations and maintenance expenditures of $6,223,887 and $6,690,708 for the fiscal years ended June 30, 2006 and 2005, respectively, are allocated among functional expenses based on square footage percentages.

Depreciation expense was $6,532,609 and $6,504,954 for 2006 and 2005, respectively (of which $1,916,708, was from depreciation on the College's investment in real estate), and is allocated among the various functional expense categories. No interest expense was capitalized in 2006 or 2005.

It is the College's policy to capitalize and depreciate renovations of plant facilities as costs are incurred, as the facilities are generally being used while the renovations are being completed. The College reports construction-in-progress for the construction of new plant facilities. As of June 30, 2006, all projects currently being completed on College grounds represent renovations. The estimated cost to complete outstanding renovations is approximately $2,900,000.

The College leases certain equipment under agreements that are classified as capital leases. The cost of equipment under capital leases is included in the statement of financial position as equipment and was approximately $1,430,000 and $1,022,000 at June 30, 2006 and 2005, respectively. Accumulated amortization of the leased equipment at June 30, 2006 and 2005, was approximately $395,000 and $257,000 respectively. Amortization of assets under capital leases is included in depreciation expense. The remaining capital lease obligation of approximately $538,294 and $416,000 at June 30, 2006 and 2005, respectively, has been included in the statement of financial position caption Accrued Liabilities.

G. PLANT FACILITIES - Continued

Future minimum lease payments as of June 30, 2006, under capital leases are as follows:

2007	$ 180,564
2008	137,815
2009	113,105
2010	113,105
2011	67,967
	612,556
Less amounts representing interest	(74,262)
Present value of net minimum lease payments	$ 538,294

H. NOTES PAYABLE TO BANKS

Notes payable to banks consist of the following at June 30, 2006 and 2005:

	2006	2005
Secured $3,500,000 line of credit, bearing interest of 7.35% at June 30, 2006	$3,000,000	$3,500,000
Secured $1,450,000 line of credit, bearing interest of 9.00% at June 30, 2006	1,100,000	1,100,000
Total notes payable to banks	$4,100,000	$4,600,000

The notes are secured by accounts receivable, inventory, and certain plant assets.

I. BONDS PAYABLE

Bonds payable consist of the following at June 30, 2006 and 2005:

	2006	2005
Revenue Bonds, Series 2001	$ 9,985,000	$ 10,615,000
Revenue Bonds, Series 1998	8,080,000	10,260,000
Revenue Bonds, Series 1996, net of unamortized discount of $17,486 and $18,410 at June 30, 2006 and 2005, respectively	45,402,514	46,676,590
Housing Revenue Bonds, Series 1992	1,530,000	1,550,000
Total Bonds payable	64,997,514	69,101,590
Less current portion	(5,315,000)	(4,105,000)
Bonds payable, net of current portion	$ 59,682,514	$ 64,996,590

I. BONDS PAYABLE - Continued

The aggregate scheduled principal maturities of bonds payable at June 30, 2006, are as follows:

Year Ending June 30,	Revenue Bonds Series 2001	Revenue Bonds Series 1998	Revenue Bonds Series 1996	Housing Revenue Bonds Series 1992	Total
2007	$ 670,000	$3,285,000	$ 1,340,000	$ 20,000	$ 5,315,000
2008	720,000	335,000	1,415,000	20,000	2,490,000
2009	775,000	345,000	1,505,000	25,000	2,650,000
2010	830,000	360,000	1,595,000	25,000	2,810,000
2011	880,000	380,000	1,695,000	25,000	2,980,000
2012 and thereafter	6,110,000	3,375,000	37,870,000	1,415,000	48,770,000
Principal maturities	9,985,000	8,080,000	45,420,000	1,530,000	65,015,000
Less unamortized discounts	-	-	(17,486)	-	(17,486)
Total bonds payable	$9,985,000	$8,080,000	$ 45,402,514	$1,530,000	$ 64,997,514

On June 29, 2001, the College issued Taxable Variable Rate Demand Bonds, Series 2001 (Series 2001 Bonds), in the amount of $12,500,000 through a consortium of commercial banks. These bonds are collaterized by a $10.615 million letter of credit. Under the terms of the bond indenture, the proceeds were used to provide operating funds and refinance certain existing indebtedness. The Series 2001 Bonds bear interest as determined weekly by the Remarketing Agent (5.36% at June 30, 2006). In the event that the remarketing agent is unable to remarket the bonds, the bonds become a demand note under an irrevocable letter of credit with a commercial bank.

On December 3, 1998, the College issued Revenue Bonds, Series 1998, in the amount of $21,770,000 through the Health and Educational Facilities Board of The Metropolitan Government. These bonds are secured by a $10.260 million letter of credit. Under the terms of the bond indentures, the proceeds were to be used to refinance the Revenue Bonds, Series 1995 in the amount of $17,085,000 of which $13,835,000 was outstanding as of June 30, 1998. The remaining proceeds were used as additional funding for the Meharry Towers renovation and to pay a portion of the cost of issuance incurred in connection with the issuance of the bonds. The Series 1998 bonds bear interest at a rate as determined weekly by the Remarketing Agent (4.00% at June 30, 2006). In the event that the remarketing agent is unable to remarket the bonds, the bonds become a demand note under an irrevocable letter of credit with a commercial bank.

I. BONDS PAYABLE - Continued

The 2001 and 1998 bond issues contain certain restrictive covenants, including a minimum debt service coverage ratio. As of June 30, 2006 and 2005, the College was in compliance with the restrictive covenants including the minimum debt service coverage ratio.

On August 14, 1996, the College issued Revenue Bonds, Series 1996, in the amount of $55,050,000 through the Health and Educational Facilities Board of The Metropolitan Government. Under the terms of the bond indenture, the proceeds were used to refinance the Revenue Bonds, Series 1994 in the amount of $48,725,000. The Revenue Bonds, Series 1996 were also issued through the Health and Educational Facilities Board of The Metropolitan Government to provide additional funding for the hospital renovation, to improve and acquire equipment for other related facilities, and for working capital. The Series 1996 bonds bear interest semi-annually at 4.85% to 6.00%. These bonds are collateralized by (1) all right, title, and interest of the College to rental payments owed to the College pursuant to the lease of the Facility to the Metropolitan Government, (2) the lien on the Facility pursuant to a mortgage and a security agreement, and (3) all funds held under the indenture. The trustee handling the bond issue held funds aggregating $1,063,703 and $1,032,221 at June 30, 2006 and 2005, respectively.

The College issued Housing Revenue Bonds, Series 1992, in the amount of $1,715,000 through the Health and Educational Facilities Board of the Metropolitan Government. The bonds bear interest semiannually at 6.50% to 7.25%. These bonds are collaterized by a mortgage on the property and the mortgage is guaranteed by the U.S. Department of Housing and Urban Development. The bonds are subject to mandatory redemption prior to maturity for mandatory sinking fund installments which are required to be made in amounts sufficient to redeem or pay on June 1 of each year, the respective principal amount plus accrued interest through the date fixed for redemption. The trustee handling the bond issue held funds aggregating $163,482 and $162,288 at June 30, 2006 and 2005, respectively.

J. INTEREST RATE SWAP ARRANGEMENTS

To manage variable interest rate exposure for its debt portfolio, in December 1998 and September 2001, the College entered into interest rate swap arrangements with a major financial institution. The total notional amounts were $33,155,000 for these swap arrangements. The swap notional amounts of each contract will gradually decline, corresponding to the principal amortization of the College's Series 1998 and Series 2001 bonds.

One swap arrangement is scheduled to expire in February 2007 and contains an option to extend the agreement to August 2018. The College pays a fixed rate of 4.10% under this agreement. Under another swap arrangement that is scheduled to expire in August 2012, the College pays a fixed rate of 6.20%.

These agreements effectively create a synthetic fixed rate of interest on the Series 1998 and Series 2001 bond issues, resulting in $328,659 and $707,152 of additional interest expense for fiscal 2006 and 2005, respectively.

As of June 30, 2006 and 2005, the estimated fair value loss of these swap arrangements was $392,214 and $1,438,929, and is included in accrued liabilities and as a component of unrestricted net assets.

K. EMPLOYEE BENEFIT PLANS

The College has three benefit plans which cover substantially all employees of the College, as follows:

Teacher's Insurance and Annuity Association and College Retirement Equities Funds (TIAA-CREF Plan)

The TIAA-CREF Plan is a defined contribution plan which covers substantially all full-time academic and certain other salaried employees. The TIAA-CREF Plan is a multi-employer plan that is funded by employee contributions subject to Internal Revenue Service annual limitations to a maximum of 20% of the employee's compensation, of which the College will match up to 5%. The College has adopted the policy of funding pension costs accrued. Expense under this plan for the year ended June 30, 2006 and 2005, amounted to $832,989 and $785,521, respectively.

K. EMPLOYEE BENEFIT PLANS - Continued

Retirement Income Plan

This noncontributory defined benefit retirement plan covers certain employees not eligible for participation in the TIAA-CREF Plan. The following table sets forth the plan's funded status and amounts recognized in the College's financial statements; and the principal weighted averages used:

Reconciliation of Funded Status at June 30,

	2006	2005
Actuarial present value of benefit obligations		
Vested benefit obligation	$(3,493,527)	$(3,955,261)
Accumulated benefit obligation	(3,696,786)	(4,190,164)
Projected benefit obligation	(3,697,132)	(4,191,683)
Plan assets at fair value	2,841,536	2,525,778
Funded status of plan (unfunded)	(855,596)	(1,665,905)
Unrecognized net loss	1,672,246	2,096,065
Prepaid pension cost before recognition of minimum liability adjustment	816,650	430,160
Minimum liability adjustment	(1,672,246)	(2,096,065)
Net pension liability recognized in the Statement of Financial Position	$(855,596)	$(1,665,905)
Primary assumptions used:		
Discount rate	6.25%	5.25%
Salary increase rate	5.00%	5.00%

K. EMPLOYEE BENEFIT PLANS - Continued

Unrecognized Net (Gain)/Loss

	2006	2005
Unrecognized net loss at beginning of fiscal year	$ 2,096,065	$ 1,587,565
Loss recognized in Pension Expense	183,772	144,820
Asset loss:		
Assets beginning of fiscal year	2,525,778	2,742,048
Expected return on assets	212,235	241,211
Actual benefit payments	(338,459)	(810,774)
Employer contributions	849,000	540,000
Expected assets at end of fiscal year	3,248,554	2,712,485
Actual assets at end of fiscal year	2,841,536	2,525,778
Asset loss	407,018	186,707
Change in projected benefit obligation:		
Benefit obligation at beginning of year	4,191,683	3,654,202
Service cost	278,687	249,666
Interest cost	212,286	234,973
Annuity benefit payments	(23,483)	(16,853)
Lump sum benefit payments	(314,976)	(793,921)
Expected projected benefit obligation at end of fiscal year*	4,344,197	3,328,067
Projected benefit obligation at end of fiscal year**	3,697,132	4,191,683
Projected benefit obligation change	647,065	(863,616)
Unrecognized net loss, prior to settlement recognition	1,672,246	2,493,068
Settlement recognition	-	(397,003)
Unrecognized net loss at end of fiscal year	$ 1,672,246	$ 2,096,065

*Based on 5.25% and 6.25% discount rate for 2006 and 2005, respectively from the beginning of fiscal year

**Measured end of year using a 6.25% and 5.25% discount rate for 2006 and 2005, respectively

K. EMPLOYEE BENEFIT PLANS - Continued

Changes in Assets During the Plan Year

	2006	2005
Market value of assets at beginning of fiscal year	$ 2,525,778	$ 2,742,028
Employer contributions	849,000	540,000
Distributions	(338,459)	(810,774)
Expenses	(43,600)	(89,661)
Return on plan assets	(151,183)	144,165
Net increase (decrease) during fiscal year	315,758	(216,270)
Estimated market value of assets at end of fiscal year	$ 2,841,536	$ 2,525,778

The College's expected long term return on plan assets assumption is based on a periodic review and modeling of the plans' asset allocation and liability structure over a long term horizon. Expectations of returns for each asset class are the most important of the assumptions used in the review and modeling and are based on comprehensive reviews of historical data and economical/financial market theory. The expected long term rate of return on assets was selected from within the reasonable range of rates determined by (a) historical returns, net of inflation, for the asset classes covered by the investment policy, and (b) projections of inflation over the long term period during which benefits are payable to plan participants.

Pension Expense for Fiscal Years

	2006	2005
Service cost	$ 278,687	$ 249,666
Interest cost	212,286	234,973
Expected return on assets	(212,235)	(241,211)
Loss amortization	183,772	144,820
Net periodic pension cost	462,510	388,248
Settlement cost	-	397,003
Pension expense	$ 462,510	$ 785,251
Primary assumptions used:		
Discount rate	5.25%	6.25%
Expected long term rate of return on plan assets	8.00%	8.00%

K. EMPLOYEE BENEFIT PLANS - Continued

The College expects to contribute $680,000 to its pension plan in the year ended June 30, 2007.

The following pension benefit payments, which reflect expected future services and participants electing life annuities at retirement age 65, as appropriate, are expected to be paid for the years ended June 30:

2007	$ 59,751
2008	76,546
2009	88,245
2010	115,600
2011	144,853
2012 to 2016	1,183,961

If lump sum payouts are elected it can materially accelerate cash benefit payments estimated above.

The College's pension plan asset allocation at June 30, 2006 and 2005 by asset category are as follows:

	2006	2005
Cash and cash equivalents	2.0%	7.70%
U.S. Equities	39.80%	38.20%
U.S. Bonds	40.00%	36.80%
Real Estate	3.00%	3.00%
International Equities	15.20%	14.30%
Total	100.00%	100.00%

K. EMPLOYEE BENEFIT PLANS - Continued

The College's target asset allocation as of June 30, 2006, by asset category, is as follows:

	Target	Allocation Range		
Cash and Cash Equivalents	5.00%	0.00%	to	5.00%
U.S. Equities	40.00%	30.00%	to	50.00%
U.S. Bonds	45.00%	35.00%	to	55.00%
International Equities	10.00%	5.00%	to	15.00%

The College's investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investment guidelines consider a broad range of economic conditions. Central to the policy are target allocation ranges (shown above) by major asset categories.

The objectives of the target allocations are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the plans' actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies.

The investment policy is periodically reviewed by the College and a designated third-party fiduciary for investment matters. The policy is established and administered in a manner so as to comply at all times with applicable government regulations.

The provisions of Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions*, requires the recognition of a net minimum liability in the amount of the unfunded accumulated benefit obligation (the amount by which the accumulated benefit obligation exceeds the fair market value of plan assets) with an equal amount recognized as an intangible asset and/or a reduction of net assets. At June 30, 2006 and 2005, the actuarially determined minimum pension liability for the College was $1,672,246 and $2,096,065, respectively. The offset to this accrued liability at June 30, 2006 and 2005 is an actuarially determined intangible asset of $816,650 and $430,160, respectively. The net of these amounts is shown as a reduction of unrestricted net assets.

K. EMPLOYEE BENEFIT PLANS - Continued

Employees' Tax Sheltered Annuity Plan

All participants in the College's Retirement Income Plan whose annual compensation is in excess of $15,000 are eligible to participate in this contributory defined contribution retirement plan. The College has pension expense to this plan of $489,408 and $288,515 as of and for the plan years June 30, 2006 and 2005, respectively.

L. NET ASSETS

Under provisions of SFAS No. 117, unrestricted net assets are these which are not subjected to donor-imposed restrictions. Substantially all of the net assets classified as unrestricted in the balance sheet as of June 30, 2006 and 2005 have been invested in property and equipment.

The refunding of debt service amounts shown as a reduction of unrestricted net assets resulted from refinancing transactions in 1997 and 1999, and represents the loss recognized under accounting principles generally accepted in the United States of America to enact the refinancing. This component of unrestricted net assets is being amortized into unrestricted net assets available for operations over the lives of the related bond issues.

Temporarily restricted net assets are primarily available for scholarships and instruction and research.

Permanently restricted net assets consist primarily of perpetual endowment funds, scholarships, and instruction and research.

M. ESTIMATED FAIR VALUES

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, requires the College to disclose the estimated fair value of its financial instruments. Estimates of the fair value of investments are presented in Note F to the consolidated financial statements.

The carrying values of cash, funds held by trustee, temporary investments, accounts and notes receivable, and accounts, bonds, and notes payable approximate the estimated fair value of these assets and liabilities.

N. COMMITMENTS AND CONTINGENT LIABILITIES

The College leases certain buildings and equipment under non-cancelable operating leases which expire at various dates through September 2013. Rent expense under these lease arrangements amounted to $459,445 and $476,891 for the years ended June 30, 2006 and 2005, respectively.

Future minimum rental payments required under operating leases that have initial or remaining lease terms in excess of one year as of June 30, 2006, are as follows:

Year Ending May 31,	Amount
2007	$ 415,869
2008	398,187
2009	397,466
2010	401,086
2011	402,028
Thereafter	929,339
	$2,943,975

The College has an agreement with Xerox to fully outsource all of the College's document management needs. Under the terms of the agreement Xerox will provide the College's document management services through June 30, 2007 for minimum annual fees of approximately $627,000 plus additional charges for usage above the contractual minimum. Total fees paid to Xerox under this agreement were $667,719 and $787,771 for the years ended June 30, 2006 and 2005, respectively.

Certain revenues, particularly Federal and state grants and contracts, are subject to adjustments based upon review by the granting agencies. Management does not anticipate that adjustments, if any, arising from such reviews would have a material effect on the consolidated financial statements.

The College is a defendant in several lawsuits arising in the normal course of business. Management and legal counsel are of the opinion that insurance coverage is sufficient to satisfy any judgment or settlement liability.

N. COMMITMENTS AND CONTINGENT LIABILITIES - Continued

In June 2001, the U.S. Department of Health and Human Services (HHS) asserted a claim against the College for approximately $2.9 million related to the final Medicare cost report submissions for Hubbard Hospital, which was closed in 1994. The HHS claim relates to cost submissions for the years 1986 to 1995 and includes accrued interest and penalties. Management of the College has completed discussions with HHS to settle this claim, and the College's officials have been informed that the Centers for Medicare and Medicaid have recommended informally to the Secretary of HHS that the $2.9 million obligation be abated in its entirety and that HHS has accepted that recommendation. The College has also been informed that HHS has requested the Department of Justice to approve the abatement in full or part. The College is waiting on the Department of Justice's final decision regarding the matter, but active collection efforts have ceased for more than three years pending the Department of Justice's decision. As of June 30, 2006, the College has not accrued any liability for this contingency.

O. CONCENTRATIONS OF CREDIT RISK

The College, in connection with its activities, grants credit that involves, to varying degrees, elements of credit risk. The maximum accounting loss from credit risk is limited to the amounts that are recognized in the accompanying statement of financial position as accounts receivable at June 30, 2006 and 2005.

Financial instruments which potentially subject the College to concentrations of credit risk consist principally of cash and investments held by the College and certain investment institutions. Cash at June 30, 2006 includes demand deposits at high quality financial institutions. The deposits possess credit risk to the extent they exceed federally inured limits. The exposure to concentrations of credit risk relative to securities is dependent on the College's investment objectives and policies.