Howard Hughes Medical Institute

Consolidated Financial Statements
for the years ended August 31, 2013 and 2012
and Report of Independent Auditors Thereon

Independent Auditor's Report

To Trustees of the
Howard Hughes Medical Institute:

We have audited the accompanying consolidated financial statements of the Howard Hughes Medical Institute and its subsidiaries (Institute), which comprise the consolidated statements of financial position as of August 31, 2013 and 2012, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Institute's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Institute's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Howard Hughes Medical Institute and its subsidiaries at August 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

October 25, 2013

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HOWARD HUGHES MEDICAL INSTITUTE

Consolidated Statements of Financial Position
August 31, 2013 and 2012

(In thousands)

Assets	2013	2012
Cash and Cash Equivalents	$ 606,675	$ 991,699
Escrowed Bond Proceeds	30,552	-
Investment Receivables	132,892	113,721
Investments	18,056,658	16,052,279
Securities Pledged as Collateral	-	103,294
Laboratory Space, Equipment, Buildings and Other Property, net	814,432	833,695
Other Assets	36,513	23,878
Total Assets	$ 19,677,722	$ 18,118,566
Liabilities		
Accounts Payable and Accrued Liabilities	$ 90,803	$ 91,183
Investment Payables	77,189	87,658
Investment and Derivative Liabilities	218,251	297,614
Repurchase Obligations	-	103,199
Grant Commitments	106,250	127,238
Postretirement/Postemployment Obligations	311,157	287,287
Capital Financing		
Note Payable	40,376	40,376
Capital Lease Obligation	19,023	19,902
Bonds Payable	1,913,667	1,283,000
Total Liabilities	2,776,716	2,337,457
Net Assets	16,901,006	15,781,109
Total Liabilities and Net Assets	$ 19,677,722	$ 18,118,566

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

HOWARD HUGHES MEDICAL INSTITUTE

Consolidated Statements of Operations and Changes in Net Assets
For the Years Ended August 31, 2013 and 2012

(In thousands)

Revenue	2013	2012
Investment Earnings		
Interest, Dividends, and Other Income from Investments	$ 237,825	$ 235,092
Realized Gain on Investment Sales, net	1,094,850	987,511
Change in Unrealized Gains of Investments	820,937	(110,881)
Less - Expenses Incurred in the Production of Income:		
Investment management expenses	(96,851)	(92,407)
Interest expense	(141)	(227)
Net Investment Earnings	2,056,620	1,019,088
Intellectual Property and Other Income	20,271	13,689
Total Revenue	2,076,891	1,032,777
Expenses		
Program Activities		
Medical Research	747,740	750,118
Science Education	77,870	123,573
General Administration	63,138	72,296
Interest Expense	47,518	45,548
Loss on Extinguishment of Debt	20,728	-
Total Expenses	956,994	991,535
Increase in Net Assets	1,119,897	41,242
Net Assets, beginning of year	15,781,109	15,739,867
Net Assets, end of year	$ 16,901,006	$ 15,781,109

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

HOWARD HUGHES MEDICAL INSTITUTE

Consolidated Statements of Cash Flows
For the Years Ended August 31, 2013 and 2012

(In thousands)	2013	2012
Increase in Net Assets	$ 1,119,897	$ 41,242
To Reconcile Change in Net Assets to Net Cash Used in Operating Activities		
Depreciation and Amortization	101,874	101,390
Loss on Disposal of Assets	5,802	6,118
(Increase)/Decrease in Receivables	(8,469)	8,450
Decrease in Securities Pledged as Collateral	103,294	-
Increase/(Decrease) in Accounts Payable, Accrued Liabilities, Commitments and Obligations	3,856	(10,295)
Realized Gains on Investment Sales	(1,094,850)	(987,511)
Change in Unrealized Gains of Investments	(820,937)	110,881
Net Cash Used in Operating Activities	(589,533)	(729,725)
Cash Flows From Investing Activities		
Use of Escrowed Bond Proceeds	(30,552)	501
Purchases of Facilities, Leasehold Improvements, and Equipment	(98,661)	(84,163)
Proceeds from Sale of Equipment	8,867	21,705
Proceeds from Sale of Investments	7,019,137	6,376,789
Purchases of Investments	(7,207,411)	(5,586,949)
Net Cash (Used in)/Provided by Investing Activities	(308,620)	727,883
Cash Flows from Financing Activities		
Issuance of Bonds Payable	1,230,646	-
Debt Issue Costs	(4,572)	-
Redemption of Bonds Payable	(600,000)	-
Repayment on Capital Lease Obligations	(9,746)	(5,283)
Repayment of Repurchase Obligations	(103,199)	-
Net Cash Provided by/(Used in) Financing Activities	513,129	(5,283)
Net Decrease in Cash	(385,024)	(7,125)
Cash and Cash Equivalents, beginning of year	991,699	998,824
Cash and Cash Equivalents, end of year	$ 606,675	$ 991,699

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General - Howard Hughes Medical Institute ("HHMI" or the "Institute") was established for the purpose of promoting knowledge within the basic sciences, principally medical research and education, and the effective application of this knowledge for the benefit of humanity. The Institute conducts medical research at its Janelia Farm Research Campus located in Loudoun County, Virginia, and in conjunction with hospitals and academic research institutions ("host institutions") under the terms of various agreements. The agreements generally require the Institute to pay occupancy charges for research space the Institute occupies within the host institution, and to reimburse certain other research-related costs. In return, the host institution provides laboratory and office space together with related maintenance and repairs, and a range of services including animal care, laboratory safety, hazardous materials purchasing, management and disposal, and management of intellectual property created by Institute scientists. The Institute typically has contractual rights to occupy host institution facilities for as long as there are Institute investigators at that host institution. In most cases, the Institute's obligation to pay occupancy charges is not fixed and will vary depending on the space occupied.

In addition to its basic research activities the Institute funds grants to both institutions and individuals in support of a wide range of science and research-related initiatives, including precollege and undergraduate science education, pre- and post-doctoral research fellowships, and international research scholars. Most of the Institute's grant awards to individuals are administered by the grantee's institution for the benefit of the grantee.

The consolidated financial statements include the accounts of the Institute's single member limited liability companies, which are used primarily in connection with investment activities. All intra-company transactions and accounts have been eliminated.

Basis of Presentation - The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require that management make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingencies at the dates of the financial statements, and reported revenues and expenses for the years then ended. Actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents includes both US and non-US currency held at the Institute's custodians, prime brokers, clearing agents, and banking institutions held for investment or spending purposes and short-term interest-bearing marketable instruments with original maturities of 90 days or less from the initial purchase date. Cash equivalents include short-term US Treasury Bills and other short-term, highly liquid investments that are carried at cost, which approximates fair value. Cash equivalents may also include US Treasury Notes/Bonds, Sovereign Debt and Corporate Debt that are carried at fair value if they were initially purchased within 90 days of maturity.

During fiscal year 2013, the Institute changed its accounting policy for the presentation of cash and cash equivalents. As such, prior year balances were reclassified to reflect this change. In prior years, the cash and cash equivalents held at custodians, prime brokers, clearing agents, and banking institutions that was presented in *Investments* is now included in *Cash and Cash Equivalents* in the Consolidated Statements of Financial Position. The accounting policy was changed as it better reflects the Institute's actual cash positions.

The total cash and cash equivalents maintained at various institutions exceeds the amount guaranteed by federal agencies and, therefore, bears some risk. The Institute has not experienced any loss due to this risk.

Escrowed Bond Proceeds - Escrowed bond proceeds are restricted to the construction of an apartment complex at the Janelia Farm Research Campus located in Loudoun County, Virginia. These funds are maintained in an interest bearing account.

Restricted Funds - The Institute does not currently have funds from contributions that entail restrictions on how the funds may be used. As a result, there are no restrictions on net assets.

Intellectual Property - The Institute receives licensing fees and royalty income in connection with the commercialization of intellectual property created by its scientists. Licensing fees and royalty income are recorded as revenue in the Consolidated Statements of Operations and Changes in Net Assets at the time of receipt.

In addition, the Institute has an interest in equity in some startup companies formed to commercialize inventions created by its investigators. Such equity interests are held in the host institution's name for the benefit of HHMI until such time as the host institution disposes of that interest. As a result, recognition of value related to such equity interests is recorded only upon notification to HHMI by the host institution that its equity interest has been sold, and the Institute's share of the proceeds has been determined. No value for such equity interests is carried on the balance sheet.

Investments - The Institute's investments are its principal source of support. A majority of the Institute's spending is made under its medical research program in which it makes multi-year employment and spending commitments to its principal investigators, and a grants program in which it makes multi-year grant commitments for science education. These attributes of the Institute's mode of operation present the need to balance longer-term investment fund growth, stability of investment returns, and liquidity for a significant part of the fund. The Institute's long-range investment goal is to manage the fund in a prudent manner that will support the Institute's programs in perpetuity. Significant accounting policies related to investments are as follows:

1. Investment transactions are accounted for on a trade-date basis. Net realized and change in unrealized gains and losses are calculated using the average cost of investments and are recognized in the Consolidated Statements of Operations and Changes in Net Assets. Investment income, including interest, is accrued as earned. Dividend income is recorded on the ex-dividend date.

2. Investments are valued based on quoted market prices whenever available. For certain alternative investments such as private equity, hedge, and commingled funds, the detailed composition of holdings and their values may not be readily available. The estimated fair value for alternative investments is determined by management after consideration of valuations provided by the external investment managers adjusted for receipts, disbursements, distributions, and management fees. The valuations for these alternative investments may involve estimates, appraisals, assumptions, and methods which are evaluated by the Institute.

3. Derivatives, such as futures, options, credit default swap contracts, and foreign currency forwards are recorded at fair value with the resulting gain or loss recognized in the *Realized Gain on Investment Sales* or *Change in Unrealized Gains of Investments.*

Laboratory Space, Equipment and Other Property - Costs of constructing and renovating laboratory space under lease from host institutions, and leasehold improvements in excess of the Institute's capitalization threshold, are currently capitalized and amortized over the lesser of 5 years or the remaining appointment term of the investigator for whom renovations are being made. Buildings, building improvements, and equipment having a useful life of more than one year and a unit cost that exceeds the Institute's capitalization threshold are capitalized. Interest paid on construction debt is capitalized as a component of the building cost. There is no interest cost associated with any renovations. Repair and maintenance costs are expensed as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives as follows:

Classification	Estimated Useful Life
Equipment and furniture	5
Leasehold Improvements	5-10
Buildings	35

Grant Commitments - The Institute awards domestic and international grants for periods ranging from one to five years. Awards may be deferred by the Institute in its discretion, if the awardee requests deferral. Deferred awards continue to be unconditional commitments for which there are no additional contingencies, and are included in the grant commitment liability at August 31, 2013. For multi-year awards, grant commitments are recorded as expenses in the Consolidated Statements of Operations and Changes in Net Assets in the year the grant commitment is made, and the present value of the grant commitment liability is reflected in the Consolidated Statements of Financial Position. The discount rate used to arrive at the present value of future payments is based on the rates for US Treasury Notes with maturities in the years in which the payments will be made.

Leases – Lease agreements are evaluated to determine whether they are capital or operating leases in accordance with Accounting Standards Codification ("ASC") 840, *Leases* ("ASC 840"). When substantially all of the risks and benefits of property ownership have been transferred to the Institute, as determined by the criteria in ASC 840, the lease then qualifies as a capital lease. Capital leases are capitalized at the lower of the net present value of the total amount of rent payable under the leasing agreement or the fair market value of the leased asset. Capital lease assets are depreciated on a straight-line basis over a period consistent with the Institute's depreciation policy for equipment, but not exceeding the lease term. Interest charges are expensed over the period of the lease in relation to the carrying value of the capital lease obligation.

Self-Insurance - The Institute generally self-insures for property and casualty risks. Third party insurance is purchased to cover certain risks to individuals under Directors' and Officers' liability and fiduciary liability. The Institute also purchases workers' compensation insurance, commercial automobile liability coverage, media liability and coverage for international risks. Other insurance policies are purchased from time to time in response to specific needs.

Reclassifications – Certain prior year amounts have been reclassified in order to conform with the current year's presentation.

Recent Accounting Pronouncements – In May 2011 the FASB issued ASU 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* ("ASU 2011-04"). ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles related to measuring fair value, and requires additional disclosure about fair value measurements. Specifically, the guidance specifies that the concepts of highest and best use and valuation premise in a fair value measurement are only relevant when measuring the fair value of nonfinancial assets whereas they are not relevant when measuring fair value of financial assets and liabilities. Required disclosures are expanded under the new guidance, especially for fair value measurements that are categorized within Level 3 of the fair value hierarchy, for which quantitative information about the unobservable inputs used and a narrative description of the valuation processes in place is required. ASU 2011-04 was adopted by the Institute on September 1, 2012 and the required additional disclosures are reflected in these financial statements.

2. INVESTMENTS

There have been no changes in the valuation methodology for the fiscal years ending August 31, 2013 and 2012. The fair value hierarchy prioritizes the use of market-based information over entity-specific information, and establishes a three-level hierarchy for fair value measurement based on the transparency of information, such as the pricing source used in the valuation of an asset or liability as of the measurement date. It consists of observable and unobservable inputs at three levels. Observable inputs are based on market data obtained from sources independent of the reporting entity; unobservable inputs are based on the best information available in the circumstances.

- Level 1 inputs consist of quoted prices in active markets for identical assets or liabilities.

- Level 2 inputs are from sources other than quoted prices that are observable for an asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates, and market corroborated inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 inputs are unobservable inputs for the asset or liability. They are used to measure fair value when observable inputs are not available, including situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The availability of inputs relevant to the asset or liability and the reliability of the inputs determines the selection of appropriate valuation techniques. Valuation techniques applied to HHMI's investments can include a combination of both observable and unobservable inputs. When there is little, if any, market activity for the asset or liability at the measurement date, models or other

valuation methodologies that require varying degrees of judgment are used, including management estimates, where appropriate.

Valuation techniques have been selected and applied as considered appropriate in the circumstances. Once selected, they have been consistently applied. A change in a valuation technique or its application will be made only if the change results in a measurement that management believes is more representative of fair value in the circumstances. The valuation methods used by management described in Note 1 may produce a fair value estimate that may not be indicative of the ultimate net realizable value, or reflective of future fair values.

The following tables present the financial instruments carried at fair value as of August 31, 2013 and 2012 according to the valuation hierarchy defined above.

August 31, 2013
(In thousands)

	Quoted Market Prices (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Assets				
Investments:				
Equity	$ 4,003,689	$ 2,583	$ 67,286	$ 4,073,558
Fixed income securities	-	2,847,168	115,456	2,962,624
Preferred securities	37,035	55,968	4,575	97,578
Convertible securities	7,291	3,499	-	10,790
Alternative Investments	-	-	10,892,033	10,892,033
Derivatives	-	20,075	-	20,075
Total investments	4,048,015	2,929,293	11,079,350	18,056,658
Deferred compensation plan assets	15,179	7,578	3,282	26,039
Total Assets	$ 4,063,194	$ 2,936,871	$ 11,082,632	$ 18,082,697
Liabilities				
Investments and derivatives:				
Interest rate swaps payable	$ -	$ 61,111	$ -	$ 61,111
Short Positions	142,253	-	-	142,253
Derivatives	251	14,636	-	14,887
Total investments and derivatives	142,504	75,747	-	218,251
Total Liabilities	$ 142,504	$ 75,747	$ -	$ 218,251

August 31, 2012
(In thousands)

	Quoted Market Prices (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value
Assets				
Repurchase obligations collateral	$ -	$ 103,294	$ -	$ 103,294
Investments:				
Equity	3,763,369	3,001	340,893	4,107,263
Fixed income securities	203	2,323,736	154,292	2,478,231
Preferred securities	35,031	250	30,183	65,464
Convertible securities	-	7,393	2,335	9,728
Alternative Investments	-	-	9,325,212	9,325,212
Derivatives	27,429	38,952	-	66,381
Total investments	3,826,032	2,373,332	9,852,915	16,052,279
Deferred compensation plan assets	10,234	5,978	2,890	19,102
Total Assets	$ 3,836,266	$ 2,482,604	$ 9,855,805	$ 16,174,675
Liabilities				
Repurchase obligations	$ -	$ 103,199	$ -	$ 103,199
Investments and derivatives:				
Interest rate swaps payable	-	171,722	-	171,722
Short Positions	115,229	215	-	115,444
Derivatives	1,220	9,228		10,448
Total investments and derivatives	116,449	181,165	-	297,614
Total Liabilities	$ 116,449	$ 284,364	$ -	$ 400,813

The following table is a rollforward of instruments classified within Level 3 of the fair value hierarchy defined above:

(In thousands)

For the year ending August 31, 2013

	Fair Value Beginning Balance	Realized / Unrealized G/(L)	Acquisitions	Dispositions	Transfers In	Transfers Out	Fair Value Ending Balance
Equity	$ 340,893	$ (237,914)	$ 408,583	$ (463,217)	$ 19,046	$ (105)	$ 67,286
Fixed income securities	154,292	(828)	30,032	(29,790)	695	(38,945)	115,456
Preferred securities	30,183	-	-	-	843	(26,451)	4,575
Convertible securities	2,335	-	-	(2,335)	-	-	-
Alternative Investments	9,325,212	1,516,621	3,324,228	(3,278,700)	6,687	(2,015)	10,892,033
Deferred compensation funds	2,890	343	49	-	-	-	3,282
Totals	$ 9,855,805	$ 1,278,222	$ 3,762,892	$ (3,774,042)	$ 27,271	$ (67,516)	$ 11,082,632

For the year ending August 31, 2012

	Fair Value Beginning Balance	Realized / Unrealized G/(L)	Acquisitions	Dispositions	Transfers In	Transfers Out	Fair Value Ending Balance
Equity	$ 510,551	$ 52,135	$ 17,796	$ (218,545)	$ 499	$ (21,543)	$ 340,893
Fixed income securities	90,752	(1,118)	79,125	(17,433)	2,966	-	154,292
Preferred securities	13,135	10,957	7,775	(5,416)	3,982	(250)	30,183
Convertible securities	2,783	(448)	-	-	-	-	2,335
Alternative Investments	8,724,501	659,578	1,964,644	(2,029,077)	31,156	(25,590)	9,325,212
Deferred compensation funds	2,526	334	30	-	-	-	2,890
Totals	$ 9,344,248	$ 721,438	$ 2,069,370	$ (2,270,471)	$ 38,603	$ (47,383)	$ 9,855,805

For Level 3 holdings, net change in unrealized gains/(losses) relating to assets held during the year ended August 31, 2013 and 2012 totaled approximately $625 million and ($96) million, respectively. These gains and losses are included in *Change in Unrealized Gains of Investments.*

The following table summarizes the fair value transfers between Level 1 and Level 2 for positions that exist as of August 31, 2013:

(In thousands)

Transfers from Level 1 into Level 2	$	467
Transfers from Level 2 into Level 1	$	1,039

Management reviews and re-evaluates, if necessary, the investment levels for reporting purposes. Several investments were re-classified in fiscal year August 31, 2013, to appropriately reflect the Institute's policy regarding observable and unobservable inputs. Any transfers between categories are measured at the beginning of the period.

Fair value for Level 3 holdings, which primarily consist of limited partnership interests in absolute return, hedge, private equity, real estate, and natural resources funds, is based on valuation techniques that use significant inputs that are unobservable. The fair values of securities that do not have readily determinable fair values held by these alternative investment entities are determined by the entity's management. They are based on historical cost, appraisals, pricing models, discounted cash flows or other estimates that require varying degrees of professional

judgment. If no public market exists for the securities, the fair value is determined by the entity's management taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, risk inherent in the valuation techniques, risk inherent in the inputs to the valuation models, and subsequent developments concerning the issuer. These fair value estimates are then subject to the review and approval of the Institute's management.

The following table summarizes the quantitative inputs and assumptions used for items categorized in Level 3 of the fair value hierarchy as of August 31, 2013:

(In thousands)

Asset Class	Valuation Techniques	Fair Value	Unobservable Inputs	Range of Inputs
Alternative investments	NAV as fair value	$ 10,879,827	n/a	n/a
	Performance return calculation	12,206	Performance return	(0.10%) - 1.4%
Equity	Value at acquisition	10,000	n/a	n/a
	Derived from fund statement	57,286	Price per share	$0 - $2,035
Fixed income	Cost plus accrued interest	115,456	n/a	n/a
Preferred securities	Derived from fund statement	4,575	Price per share	$119 - $145
Total		$ 11,079,350		

The inputs for the valuation techniques used in the fair value measurement of Level 3 investments are provided by external investment managers. Inputs for derived valuations include performance returns and price per share information from investment schedules of fund financial statements. Fund level performance returns, such as time weighted returns or internal rates of return, are received on a monthly basis from investment managers. These inputs are applied proportionately to the Institute's most recently issued investor Net Asset Value ("NAV") to derive a fair value at August 31, 2013. Fund financial statements that include a detailed schedule of investments are received on a quarterly basis. A price per share is determined and applied to the Institute's outstanding shares to derive fair value at August 31, 2013. All valuation techniques described above are evaluated and approved by the Institute. Since August 31, 2012, there have been no changes in valuation techniques within Level 2 and Level 3 that have had a material impact on the valuation of financial instruments.

NAV is used as fair value for investments which (a) do not have a readily determinable fair value and (b) the entity either prepares its financial statements consistent with the measurement principles of an investment company or has the attributes of an investment company. Investments that can be redeemed at NAV by the Institute on the measurement date or in the near term may be classified as Level 2. Investments that cannot be redeemed at the measurement date or in the near term are classified as Level 3.

The following table includes level 2 and 3 by major category:

(In thousands)

	Fair Value		Unfunded Commitment	
Assets	2013	2012	2013	2012
Alternative investments	$ 10,879,827	$ 9,159,522	$ 2,972,013	$ 2,395,109

Alternative investments include investments primarily held in fund structures across multiple strategies including private equity, distressed and credit sensitive, hedged and long-only equity, and real assets. At August 31, 2013, approximately 65% of the investments are not redeemable and are generally held for the life of the investment. The remaining 35% of the investments may be redeemed on a daily, monthly, quarterly, semi-annual, or annual basis with advance notice of 30 to 180 days. At August 31, 2012, approximately 78% of the investments were not redeemable, with 22% redeemable on a monthly, quarterly, semi-annual, or annual basis with advance notice of 30 to 180 days. A small number of funds also contain one time or revolving lock-up provisions that limit the frequency a redemption may be initiated.

As noted above, the Institute has made contractual commitments to fund various investments. The Institute expects these commitments to be called over the next 1 to 7 years. Investment returns are expected to be received over the next 1 to 12 years.

Derivatives

The Institute invests in derivative financial instruments to control market risks, manage its portfolio exposure, reduce investment implementation costs, and enhance returns. Derivatives are recorded at fair value with the resulting gain or loss recognized in the Consolidated Statements of Operations and Changes in Net Assets. Most derivative trades are transacted with counterparties that are operating under master netting agreements. As a result of investing in derivative financial instruments, the Institute is exposed to potential credit-related losses in the event of nonperformance by counterparties. The Institute limits its exposure by evaluating the creditworthiness of potential counterparties before investing. Derivatives in which the Institute invests are principally foreign currency forwards, futures contracts, and options.

The following tables present the value of derivatives held as of August 31, 2013 and 2012, respectively, by their primary underlying risk exposure and respective location on the Consolidated Statements of Financial Position. These derivatives are not designated as hedging instruments under ASC 815 *Derivatives and Hedging.*

August 31, 2013
(In thousands)

Underlying Risk	Option Contracts	Futures Contracts	Foreign Exchange Contracts	Swaps	Swaption	Contracts for Difference	Total Fair Value
Assets							
Interest rate	$ -	$ 82	$ -	$ -	$ -	$ -	$ 82
Foreign currency	-	538	19,743	-	-	-	20,281
Equity	-	1,868	-	31	-	301	2,200
Totals	$ -	$ 2,488	$ 19,743	$ 31	$ -	$ 301	$ 22,563
Liabilities							
Interest rate	$ -	$ 88	$ -	$ 61,111	$ -	$ -	$ 61,199
Foreign currency	-	1,835	13,325	-	-	-	15,160
Equity	-	816	-	523	-	-	1,339
Credit	-	-	-	788	-	-	788
Totals	$ -	$ 2,739	$ 13,325	$ 62,422	$ -	$ -	$ 78,486

August 31, 2012
(In thousands)

Underlying Risk	Option Contracts	Futures Contracts	Foreign Exchange Contracts	Swaps	Swaption	Contracts for Difference	Total Fair Value
Assets							
Interest rate	$ -	$ -	$ -	$ -	$ 296	$ -	$ 296
Foreign currency	23	972	15,114	-	2	-	16,111
Equity	24,997	2,774	-	105	-	14,395	42,271
Credit	-	-	-	10,341	-	-	10,341
Totals	$ 25,020	$ 3,746	$ 15,114	$ 10,446	$ 298	$ 14,395	$ 69,019
Liabilities							
Interest rate	$ -	$ 160	$ -	$ 171,722	$ -	$ -	$ 171,882
Foreign currency	-	1,028	9,184	-	-	-	10,212
Equity	1,220	149	-	44	-	1,020	2,433
Credit	-	-	-	281	-	-	281
Totals	$ 1,220	$ 1,337	$ 9,184	$ 172,047	$ -	$ 1,020	$ 184,808

The above derivative assets are included in *Investments* and the above derivative liabilities are included in *Investments and Derivative Liabilities.*

The following tables present the effect of derivatives on the Consolidated Statements of Operations as of August 31, 2013 and 2012, respectively. Realized gain or (loss) on derivatives is included in *Realized Gain on Investment Sales.* Change in unrealized appreciation or (depreciation) on derivatives is included in *Change in Unrealized Gains of Investments.*

August 31, 2013
(In thousands)

Underlying Risk	Option Contracts	Futures Contracts	Foreign Exchange Contracts	Swaps	Swaption	Contracts for Difference	Total
Realized Gain/(Loss) on Derivatives Recognized in Revenue							
Interest rate	$ -	$ (2,923)	$ -	$ -	$ (7,408)	$ -	$ (10,331)
Foreign currency	(188)	7,052	(20,390)	-	(718)	-	(14,244)
Equity	(6,698)	1,337	-	(1)	-	15,738	10,376
Credit	-	-	-	1,801	-	-	1,801
Totals	$ (6,886)	$ 5,466	$ (20,390)	$ 1,800	$ (8,126)	$ 15,738	$ (12,398)
Change in Unrealized Gains on Derivatives Recognized in Revenue							
Interest rate	$ -	$ 98	$ -	$ -	$ 7,101	$ -	$ 7,199
Foreign currency	188	(1,183)	1,401	-	717	-	1,123
Equity	(7,259)	(1,575)	-	(551)	-	(13,074)	(22,459)
Credit	-	-	-	(2,905)	-	-	(2,905)
Totals	$ (7,071)	$ (2,660)	$ 1,401	$ (3,456)	$ 7,818	$ (13,074)	$ (17,042)

August 31, 2012
(In thousands)

Underlying Risk	Option Contracts	Futures Contracts	Foreign Exchange Contracts	Swaps	Swaption	Contracts for Difference	Total
Realized Gain/(Loss) on Derivatives Recognized in Revenue							
Interest rate	$ -	$ 4,175	$ -	$ -	$ (1,686)	$ -	$ 2,489
Foreign currency	(2,002)	7,992	(31,447)	-	(642)	-	(26,099)
Equity	143	5,475	-	(5)	-	13,527	19,140
Credit	-	-	-	6,449	-	-	6,449
Totals	$ (1,859)	$ 17,642	$ (31,447)	$ 6,444	$ (2,328)	$ 13,527	$ 1,979
Change in Unrealized Gains on Derivatives Recognized in Revenue							
Interest rate	$ -	$ (2,312)	$ -	$ -	$ (4,558)	$ -	$ (6,870)
Foreign currency	1,765	(3,146)	(9,397)	-	43	-	(10,735)
Equity	7,621	304	-	(1,296)	-	(18,798)	(12,169)
Credit	-	-	-	(3,488)	-	-	(3,488)
Totals	$ 9,386	$ (5,154)	$ (9,397)	$ (4,784)	$ (4,515)	$ (18,798)	$ (33,262)

Derivative notional amounts and values as of August 31, 2013 and 2012 discussed below are indicative of the volume of the Institute's activities for the years then ended.

Certain currency contracts described below are entered into by single-member Limited Liability Companies of the Institute. The Institute has issued a guarantee and commitment for one Limited Liability Company with a face value of $25 million for the net settlement of trades by them.

Foreign exchange contracts are over-the-counter contractual agreements primarily used to sell or buy certain amounts of foreign currencies as a means to control foreign exchange risk. These contracts are actively traded for the purpose of exploiting opportunities for arbitrage in the foreign currency market. The notional value of open forward contract purchases and sales totaled approximately $772.0 million and $435.4 million, respectively, at August 31, 2013 and $665.9 million and $501.2 million, respectively, at August 31, 2012.

Futures contracts are commitments to purchase or sell a financial instrument at a stated time and price in the future. They are generally used to increase exposure to a specific market or to reduce a specific risk. These contracts are settled daily to reflect the changes in their market values.

As of August 31, 2013 and 2012, the Institute had entered into various futures contracts with notional exposures at fair values as follows:

(In thousands)

	2013		2012	
	Buy	Sell	Buy	Sell
Equity Indexes	$ 49,599	$ 10,405	$ 33,060	$ 3,714
Commodities	29,169	7,906	32,370	7,666
Fixed Income	322,237	695,200	601,993	557,338
Total	$ 401,005	$ 713,511	$ 667,423	$ 568,718

Option contracts are typically contractual agreements to buy or to sell an underlying security or index at a fixed price. The Institute uses options as a means to manage exposure or risk to a specific equity, equity index, commodity or foreign currency. There were no notional amounts of open purchased or written option contracts as of August 31, 2013. As of August 31, 2012 the notional amount of open purchase option contracts was $976.0 million. The notional amount of open written contracts was $54 million as of August 31, 2012.

A swaption is an option to enter into an interest rate swap. The notional amount of open purchased swaptions as of August 31, 2013 and 2012 was $30.0 million and $643.3 million, respectively. There were no open written swaption contracts as of August 31, 2013 and 2012.

Contracts for differences are agreements between a buyer and a seller to exchange the difference between the opening value of a share, currency, commodity, index or other tradable financial instrument and its closing value at the end of the contract. Contracts for differences are used by the Institute for the purpose of gaining financial exposure to an underlying security or index without the need to own the underlying shares. The notional amount of open contract for differences was $1.2 million and $4.3 million as of August 31, 2013 and 2012, respectively.

A swap is a derivative in which one party exchanges a stream of interest payments for another party's stream of cash flows. Interest rate swaps are used to manage the Institute's fixed or floating assets and liabilities. Interest rate swaps related to the Institute's bonds and notes payable are discussed in Notes 4 and 6. There were no open interest rate swaps related to investment strategies at August 31, 2013 and 2012.

Equity swaps are exchanges of cash flows in which at least one of the indices is an equity index. An equity index is a measure of the performance of an individual stock or a basket of stocks. The notional amount was $6.3 million and $8.4 million as of August 31, 2013 and 2012, respectively.

Credit default swap contracts are used as a means to transfer credit risk of fixed income securities. Credit default swaps notional amounts were $11.2 million and $275.6 million at August 31, 2013 and 2012, respectively.

Receivables and Payables

The Institute's investment receivables and payables as of August 31, 2013 and 2012 consist of the following:

(In thousands)

	2013		2012	
	Receivable	Payable	Receivable	Payable
Securities Pending Settlement	$ 111,016	$ 66,100	$ 96,648	$ 73,698
Interest and Dividend Receivable	21,826	-	16,929	-
Management Fees	-	11,065	-	10,942
Other	50	24	144	3,018
Total	$ 132,892	$ 77,189	$ 113,721	$ 87,658

Commitments, Obligations and Other

The Institute has unfunded commitments of approximately $3.0 billion to fund investments in non-public entities as of August 31, 2013. The Institute had loaned securities to third parties with a market value of approximately $49.0 million and $62.9 million at August 31, 2013 and 2012, respectively, and are included in the Consolidated Statements of Financial Position in *Investments*. In connection with the securities lending program, collateral must be maintained at 102% and 105% of the market value of domestic and foreign loaned securities, respectively. During the period securities are on loan all dividends and interest accrue to the third party. Collateral designated for the Institute's benefit by third parties is held at the Institute's custodian bank and not included in the Consolidated Statements of Financial Position. Loaned securities and collateral, which may consist of cash or U.S. Treasuries, are marked to market daily. The value of collateral posted was $50.9 million and $65.7 million at August 31, 2013 and 2012, respectively. Income from securities lending activities totaled approximately $1.2 million and $0.8 million for August 31, 2013 and 2012, respectively, and is included in *Interest, Dividends, and Other Income from Investments.*

The Institute has entered into repurchase obligations as part of its overall investment strategy to leverage its operational needs and changes in interest rates. These repurchase agreements and related collateral, which consists of US Treasury notes and bonds with maturity dates that range up to eighteen years, are reflected in the Consolidated Statements of Financial Position as *Repurchase*

Obligations and Securities Pledged as Collateral. The Institute has no repurchase obligations as of August 31, 2013. The Institute held $103.2 million of marketable securities and provided collateral of $103.3 million to its counterparties as of August 31, 2012.

The Institute incurred expenses in the production of investment income, which include routine internal operating expenditures, external management and incentive fees, custodial fees and interest expense related to the repurchase obligations mentioned earlier. These expenses totaled $97.0 million and $92.6 million for the fiscal years ended August 31, 2013 and 2012, respectively.

3. LABORATORY SPACE, EQUIPMENT AND OTHER PROPERTY

The cost and accumulated amortization and depreciation of the Institute's investment in laboratory space, equipment and other property at August 31, 2013 and 2012 are as follows:

(In thousands)	2013	2012
Laboratory space and leasehold improvements	$ 428,924	$ 424,862
Equipment, furniture and fixtures	575,945	547,743
Buildings	699,986	690,610
Land	89,763	89,763
	1,794,618	1,752,978
Construction in progress	6,034	-
Less: accumulated depreciation and amortization	(986,220)	(919,283)
Total	$ 814,432	$ 833,695

Approximately $2.4 million and $4.6 million related to construction at the Headquarters and Janelia Farm campuses, equipment and other property was included in *Accounts Payable and Accrued Liabilities* at August 31, 2013 and 2012, respectively.

4. ECONOMIC DEVELOPMENT BONDS PAYABLE

On February 27, 2003, the Institute issued $500 million in tax-exempt bonds through The Industrial Development Authority of Loudoun County, Virginia ("IDA") to finance construction of the Janelia Farm Research Campus. The bonds carry a variable interest rate determined on a weekly basis and mature on February 15, 2038. Concurrently, the Institute entered into receive-variable, pay-fixed interest rate swaps with a total notional amount of $450 million. During the fiscal year ended August 31, 2010, the Institute entered into a receive-variable pay-fixed 30-year interest rate swap with a single counterparty for the remaining $50 million of bonds. The interest rate swaps were entered into with several counterparties and had terms of 10 and 30 years. In March 2013, the Institute replaced the expiring 10-year $150 million swap with a 20-year swap in the same notional amount with a different counterparty. The net composite interest rate on the bonds and interest rate swaps for the fiscal years ended August 31, 2013 and 2012 was 2.91% and 3.04%, respectively. The interest expense for the fiscal years ended August 31, 2013 and 2012 was $14.5 million and $15.2 million respectively, which approximates the net cash paid. The unrealized loss reflecting the market value of the swaps was $34.5 million and $96.7 million at August 31, 2013 and August 31, 2012, respectively which is included in *Investment and Derivative Liabilities*. The total estimated fair value of the Institute's taxable bonds approximated the carrying value as of August 31, 2013.

On February 15, 2008, the Institute issued $83.5 million in tax-exempt bonds through the Maryland Economic Development Corporation ("MEDCO") to finance the expansion of the Institute's existing headquarters and conference facilities. The bonds carry a variable interest rate determined on a weekly basis and mature on February 15, 2043. The Institute entered into a receive-variable, pay-fixed interest rate swap with a total notional amount of $83.5 million. The interest rate swap was entered into with a single counterparty with a term of 30 years. The net composite interest rate on the bonds and interest rate swap for the fiscal years ended August 31, 2013 and 2012 was 3.27% and 3.27% respectively. The interest expense for the fiscal years ended August 31, 2013 and 2012 was $2.7 million and $2.7 million respectively, which approximates the net cash paid. The unrealized loss reflecting the market value of the swap was $13.2 million and $28.6 million at August 31, 2013 and 2012, respectively, which is included in *Investment and Derivative Liabilities*. The total estimated fair value of the Institute's taxable bonds approximated the carrying value as of August 31, 2013.

On May 15, 2008, the Institute issued $76.5 million of bonds through MEDCO to refund $76.5 million of outstanding bonds issued on November 8, 1990 to finance the construction of the Institute's headquarters and conference center complex. The bonds carry a variable interest rate determined on a weekly basis, and mature on May 15, 2043. The Institute entered into a receive-variable, pay-fixed interest rate swap with a total notional amount of $76.5 million. The swap is with a single counterparty. The net composite interest rate on the bonds and interest rate swap for the fiscal years ended August 31, 2013 and 2012 was 3.45% and 3.45%, respectively. The interest expense for the fiscal years ended August 31, 2013 and 2012 was $2.6 million and $2.6 million respectively, which approximates the net cash paid. The unrealized loss reflecting the market value of the swaps was $13.9 million and $27.9 million at August 31, 2013 and 2012, respectively, which is included in *Investment and Derivative Liabilities*. The total estimated fair value of the Institute's taxable bonds approximated the carrying value as of August 31, 2013.

On October 2, 2009, the Institute issued $23 million of tax-exempt bonds through the IDA to finance the construction of a 60-unit apartment building at the Janelia Farm Research Campus, to be used by scientists and others engaged in research and administration at the Campus. The bonds carry a variable interest rate determined on a weekly basis and mature on October 1, 2039. For these bonds and the remaining balance of the $50 million of Loudoun County Industrial Development Authority bonds described above, the Institute entered into receive-variable, pay-fixed interest rate swap with a total notional amount of $73 million. The interest rate swap was executed with one counterparty and has a term of 30 years. The net composite interest rate on the bonds and interest rate swap for the fiscal years ended August 31, 2013 and 2012 was 2.75% and 2.72%, respectively. Interest expense for the fiscal years ended August 31, 2013 and 2012 was $0.6 million and $0.6 million, which approximates the net cash paid. The unrealized loss reflecting the market value of the swaps was $1.5 million and $17.5 million at August 31, 2013 and 2012, respectively, which is included in *Investment and Derivative Liabilities*. The total estimated fair value of the Institute's taxable bonds approximated the carrying value as of August 31, 2013.

On May 15, 2013, the Institute issued $33.13 million of tax-exempt bonds through the IDA to finance the construction of an 86-unit apartment building at the Janelia Farm Research Campus, to be used by scientists and others engaged in research and administration at the Campus. Effective June 1, 2013 the Institute entered into a receive-variable, pay-fixed interest rate swap with a total notional amount of $33.13 million. The interest rate swap was executed with a single counterparty and has a term of 30 years. The net composite interest rate on the bonds and interest rate swap for

the fiscal year ended August 31, 2013 was 1.77%. Interest expense for the fiscal year ended August 31, 2013 was $173 thousand which approximates the net cash paid. The unrealized gain reflecting the market value of the swap was $2.0 million at August 31, 2013 which is included in *Investment and Derivative Liabilities*. The total estimated fair value of the Institute's taxable bonds approximated the carrying value as of August 31, 2013.

Prior to the maturity of each of these tax-exempt bond issues, the Institute is obligated upon seven-day notice from a holder to redeem any or all bonds unless the remarketing agent is able to place the bonds with another party. To date, no remarketing agent has failed to fulfill their obligations under their respective remarketing agreements. The Institute maintains sufficient cash and marketable securities to pay any bondholder redemption of part or all of the $716.13 million outstanding.

5. BONDS PAYABLE

On August 12, 2009, the Institute issued $600 million of taxable fixed rate bonds to establish a program spending reserve. The bonds carried an interest rate of 3.45% with interest payable semi-annually in March and September. The effective interest rate on the bonds for the fiscal years ended August 31, 2013 and 2012 was 3.62%. On August 16, 2013, the Institute redeemed its $600 million of taxable fixed rate bonds prior to the September 1, 2014 maturity date. The $20.7 million loss on extinguishment of debt in the Consolidated Statements of Operations and Changes in Net Assets for 2013 represents the difference between the $619.8 million redemption price and the $599.1 million net carrying amount of the bonds repurchased. The Institute had been amortizing the loan origination costs and original issue discount, of which $0.9 million had not yet been recognized at the time of the redemption. The funds used to retire the bonds were obtained from the existing program spending reserve. Interest expense for the fiscal years ended August 31, 2013 and 2012 was $20.8 and $21.7 million, respectively. Accrued interest at August 31, 2013 and 2012 was $0 and $10.4 million respectively, and is included in *Accounts Payable and Accrued Liabilities*. The Institute's taxable bonds payable are stated at face value as of August 31, 2012. Fair value has been calculated by determining the net present value of future cash outlays under the debt agreement and using the effective interest rate. The total estimated fair value of the Institute's taxable bonds as of August 31, 2012 was $636 million.

On July 22, 2013, the Institute issued $1.2 billion of taxable fixed rate bonds to establish a program spending reserve. The bonds carry a fixed interest rate of 3.5%, a yield to maturity of 3.52%, and a maturity date of September 1, 2023. Interest is payable semi-annually in March and September. In connection with the issuance of the $1.2 billion of taxable fixed rate bonds, the Institute entered into several forward contracts realizing a hedge gain of $49.3 million, which is included in *Realized Gain on Investment Sales*. Accrued interest at August 31, 2013 was $4.6 million, and is included in *Accounts Payable and Accrued Liabilities*. The Institute's taxable bonds payable are stated at face value as of August 31, 2013. The total estimated fair value of Institute's taxable bonds as of August 31, 2013 was $1.19 billion.

6. NOTES PAYABLE

In June 2003, the Institute entered into a 1-year renewable promissory note to finance the commercially-used land and buildings at the Janelia Farm Research Campus that could not be financed with tax-exempt debt. In May 2013, the Institute renewed the note, which has a current balance of $40.4 million and carries monthly interest payments based on the one-month LIBOR rate plus 0.145%. In May 2012 the Institute entered into a receive-variable, pay-fixed interest rate swap with a total notional amount of $40.4 million. The interest rate swap is with a single counterparty and has a term of 5 years. The net composite interest rate on the note and interest rate swap was 1.32% and 3.87% for the fiscal years ended August 31, 2013 and 2012 respectively. The unrealized loss reflecting the market value of the swap was $0 and $1.0 million at August 31, 2013 and 2012, respectively, which is included in *Investments and Derivative Liabilities.* Interest expense for the fiscal years ended August 31, 2013 and 2012 was $0.5 and $1.6 million, respectively, which approximates the net cash paid.

Net bond and note interest paid in cash was approximately $61.0 million and $45.3 million for the years ended August 31, 2013 and 2012, respectively.

The annual principal payments required for bond and notes payable are as follows:

(In thousands)

Year		
2014	$	40,376
2015		-
2016		-
2017		-
2018		-
Thereafter		1,916,130
Total	$	1,956,506

7. COMMITMENTS AND CONTINGENCIES

Lease obligations - The Institute occupies space that it uses for medical research at each of its host institutions. The Institute's agreements with its host institutions include provisions for the payment by the Institute of utilities and other space-related charges. These agreements are typically for an indefinite term that runs for as long as the Institute has one or more investigators at the host institution. Minimum annual occupancy fees under these agreements generally are not fixed and vary from year to year depending on the number of investigators at the host institution and the amount of space each investigator occupies, up to per-investigator limits set by the Institute.

Laboratory and other space charges, excluding amortization of leasehold improvements, totaled $84.6 million and $83.8 million for the years ended August 31, 2013 and 2012, respectively.

Estimated minimum annual rent and other payments due under these agreements as of August 31, 2013 are summarized below:

(In thousands)

Year	
2014	$ 84,452
2015	84,700
2016	84,772
2017	84,881
2018	84,868
2019 - 2031	97,426
Total	$ 521,099

As of August 31, 2013, the Institute had entered into 32 capital leases totaling $34.6 million to cover scientific and information technology equipment. Interest paid on these obligations for the year ended August 31, 2013 and 2012 was $423 thousand and $293 thousand, respectively. The Institute's capital lease obligation at August 31, 2013 and 2012 was $19.0 million and $19.9 million, respectively. Assets held under capital leases of $35.6 million and $26.3 million, net of accumulated amortization of $12.6 million and $8.0 million, are included in *Laboratory Space, Equipment, Buildings and Other Property, net* at August 31, 2013 and 2012, respectively. Amortization of assets under capital leases is included in either *Medical Research* or *General Administration* Expenses, depending upon the use of the asset. The following table presents future annual lease payments for the year ending August 31, 2013:

(In thousands)

Year	
2014	$ 11,033
2015	7,670
2016	2,243
Total	$ 20,946

Grant commitments - The timing of the Institute's grant payments and the associated discount is presented below:

(In thousands)

Year	
2014 - 2017	$107,209
Discount	(959)
Net Liability	$106,250

Letter of Credit – The Institute holds an irrevocable standby letter of credit with a bank in the amount not to exceed $10 million, with an original expiration date of November 29, 2012. The letter of credit includes an automatic renewal provision for one year unless notification is received sixty days prior to the expiration date. The current letter of credit expires on November 29, 2013 and has been renewed for one year.

8. EMPLOYEE BENEFITS

Defined Contribution Retirement Plans - The Institute contributes to defined contribution retirement plans offered through the Teachers Insurance and Annuity Association, College Retirement Equities Fund, and Vanguard Funds for substantially all of its employees. The Institute's contributions to these plans were $24.1 million and $22.4 million for the years ended August 31, 2013 and 2012, respectively.

Deferred Compensation Plan - The Institute has an unfunded deferred compensation plan in accordance with Section 457(b) of the Internal Revenue Code. The fair value of the assets and related liability to employees in the amount of approximately $26.0 million and $19.1 million at August 31, 2013 and 2012 respectively, is reflected in the Consolidated Statements of Financial Position within *Other Assets* and *Accounts Payable and Accrued Liabilities.*

9. POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS

The Institute maintains unfunded defined postretirement and postemployment benefit plans that provide eligible retirees with medical, prescription drug, vision, dental, life insurance, and disability programs. The total obligation for these benefits reflected in the Consolidated Statements of Financial Position was $311.2 million and $287.3 million at August 31, 2013 and 2012, respectively, which is the measurement date.

The following tables summarize the postretirement plan's funded status and the amount of the accumulated postretirement benefit plan costs for the years ended August 31, 2013 and 2012:

(In thousands)		
Accrued Benefit Liability:	2013	2012
Accumulated postretirement benefit obligation, beginning of year	$ 283,252	$ 259,131
Service cost	15,698	15,051
Interest cost	13,015	11,683
Employee contributions	107	144
Benefits paid net of contributions	(4,110)	(3,843)
Net actuarial loss	1,528	1,086
Medicare subsidies received	137	-
Accumulated benefit obligation, end of year	$ 309,627	$ 283,252
Change in fair value of plan assets:		
Fair value of plan assets, beginning of year	$ -	$ -
Employer contributions	4,003	3,699
Employee contributions	107	144
Employer contributions less subsidy received	-	-
Benefits paid	(4,110)	(3,843)
Fair value of plan assets, end of year	$ -	$ -

Reconciliation of funded status:		
Funded status	$ (309,627)	$ (283,252)
Unrecognized actuarial (gain)/loss	n/a	n/a
Unrecognized transition (asset)/obligation	n/a	n/a
Unrecognized prior term cost	n/a	n/a
Accumulated postretirement benefit liability included in the Consolidated Statements of Financial Position	$ (309,627)	$ (283,252)

The Institute's policy is to fund postretirement benefits as payments are made.

Components of net periodic benefit cost:		
Term/service cost	$ 15,698	$ 15,051
Interest cost	13,015	11,683
Immediate recognition of net actuarial loss	1,528	1,086
Net periodic benefit cost	$ 30,241	$ 27,820

The Institute's policy is to immediately recognize all actuarial gains and losses; consequently there are no amounts not recognized in net periodic benefit cost. Because all gains and losses are recorded in the current period there are no amounts currently to be amortized from net assets into net periodic benefit cost for the year ended August 31, 2013.

The net periodic benefit cost for the postretirement benefit plan was $30.2 million and $27.8 million for the years ended August 31, 2013 and 2012, respectively. The discount rate assumed in determining the actuarial present value of accumulated postretirement benefit obligations was 4.9% and 4.3% as of August 31, 2013 and 2012, respectively. The average health care cost trend rate assumption used to determine the accumulated postretirement benefit obligation at August 31, 2013 was 7.0% for fiscal year 2013 and decreases each successive year until it reaches 4.5% in fiscal year 2029. A 1% increase in each year of this annual trend rate would increase the accumulated postretirement benefit obligation at August 31, 2013 by approximately $59.8 million. A 1% decrease in the trend rate would decrease the accumulated postretirement benefit obligation at August 31, 2013 by approximately $47.4 million.

Health insurance is provided to disabled employees until the age of 65. This postemployment benefit (income)/cost was $(1.9) million and $0.9 million for the years ended August 31, 2013 and 2012, respectively.

Under the provisions of the Medicare Prescription Drug, Improvement, and Modernization Act, the Institute is eligible for a 28% subsidy from Medicare on its prescription drug benefits for Medicare-eligible retirees. The Medicare subsidy was offset against the obligation as of August 31, 2013.

The postretirement benefits that are expected to be paid out under the plan in each of the next five fiscal years, which reflects expected future service, and in the aggregate for the five fiscal years thereafter, together with the related Medicare subsidy, are as follows:

(In thousands)

Year	Expected Benefit Payments	Expected Medicare Subsidy
2014	$ 6,033	$ 335
2015	7,041	402
2016	8,114	473
2017	9,209	546
2018	10,454	626
2019 - 2023	75,359	4,782

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents and receivables approximate fair value due to the short maturity of these financial instruments. Investments are reported at fair value as of the date of the consolidated financial statements. The carrying amounts of accounts payable, accrued payroll and related accruals approximates fair value due to their short maturity. The carrying amounts of notes and bonds payables with variable interest rates approximates their fair value because the variable rates reflect current market rates for bonds with similar maturities and credit quality.

11. TAXES

Net tax refunds due or received on income totaled approximately $0.1 million and $0.8 million for the years ended August 31, 2013 and 2012, respectively. Taxes paid on income totaled approximately $0.6 million and $0.2 million for the years ended August 31, 2013 and 2012 respectively.

12. MEDICAL RESEARCH ORGANIZATION

The Institute is classified as a medical research organization for federal income tax purposes under section 170 (b)(1)(A)(iii) of the Internal Revenue Code of 1986, as amended (the "Code"). The Institute is not a private foundation under Chapter 42 of the Code.

13. SUBSEQUENT EVENTS

Management has performed an evaluation of subsequent events through October 25, 2013 which is the date that the financial statements were available to be issued, noting no events which materially affect the financial statements as of August 31, 2013.