



**CALIFORNIA ASSOCIATION
FOR RESEARCH IN ASTRONOMY
DBA W. M. KECK OBSERVATORY**
(A Nonprofit California Public Benefit Corporation)

Financial Statements

September 30, 2007 and 2006

(With Independent Auditors' Report Thereon)



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

The Board of Directors
California Association for Research in Astronomy:

We have audited the accompanying statements of financial position of California Association for Research in Astronomy (CARA) as of September 30, 2007 and 2006, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of CARA's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CARA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, 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 financial statements referred to above present fairly, in all material respects, the financial position of California Association for Research in Astronomy as of September 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Honolulu, Hawaii
February 26, 2008

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Statements of Financial Position

September 30, 2007 and 2006

Assets	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 14,132,893	13,485,943
Receivables, net:		
Jet Propulsion Laboratory (note 4)	483,012	591,618
Department of Homeland Security – FEMA (note 7)	349,148	—
National Science Foundation (note 6)	59,273	10,739
National Aeronautics and Space Administration (note 3)	19,470	559,344
University of California	16,753	14,778
Center for Adaptive Optics	2,544	26,220
Contributions receivable, net (note 8)	1,628,033	3,155,871
Other	61,764	67,436
Prepaid expenses	129,073	127,160
Total current assets	<u>16,881,963</u>	<u>18,039,109</u>
Property and equipment, at cost less accumulated depreciation (notes 9 and 12)	<u>81,805,326</u>	<u>76,051,176</u>
Total assets	<u><u>\$ 98,687,289</u></u>	<u><u>94,090,285</u></u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses:		
University of California	\$ 457,415	315,968
California Institute of Technology	459,915	71,667
Other	2,038,534	2,178,899
Advances (note 2):		
University of California:		
Observatory operations	7,968,684	7,506,739
Observatory instrumentation	119,661	119,661
Association of Universities for Research in Astronomy (note 5)	860,194	2,379,995
Other	27,427	7,020
Total current liabilities	<u>11,931,830</u>	<u>12,579,949</u>
Net assets:		
Unrestricted:		
Undesignated	81,821,975	76,067,824
Board designated (note 13)	127,516	20,836
Temporarily restricted (note 14)	<u>4,805,968</u>	<u>5,421,676</u>
Total net assets	86,755,459	81,510,336
Commitments (notes 12 and 15)		
Total liabilities and net assets	<u><u>\$ 98,687,289</u></u>	<u><u>94,090,285</u></u>

See accompanying notes to financial statements.

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Statements of Activities

Years ended September 30, 2007 and 2006

	2007	2006
Changes in unrestricted net assets (notes 1 and 2):		
Unrestricted operating support and revenues:		
Contributions (note 13)	\$ 106,680	37,484
Operating revenue:		
University of California:		
Observatory operations	10,796,966	10,323,207
Observatory instrumentation	—	424,812
Other	81,866	32,777
National Aeronautics and Space Administration (note 3):		
Observatory operations	3,221,139	3,279,481
Observatory instrumentation	762,765	363,243
Jet Propulsion Laboratory (note 4)	2,988,510	3,327,535
Association of Universities for Research in Astronomy (note 5)	2,748,216	1,855,581
Department of Homeland Security – FEMA (note 7)	420,902	—
National Science Foundation (note 6)	366,870	93,448
Change Happens Foundation	203,992	—
Other	64,928	258,213
Interest income:		
Operations	444,097	425,686
Observatory instrumentation	8,661	15,133
Net assets released from restriction:		
Satisfaction of equipment acquisition restrictions (note 14)	976,554	881,795
Total unrestricted operating support and revenues	23,192,146	21,318,395
Expenditures (notes 11 and 15):		
Program services:		
Observatory operations, including loss from instrument abandonments of \$0 in 2007 and \$17,189,348 in 2006 (note 9)	13,814,945	29,513,272
Research	286,523	298,363
Administrative and general	2,788,555	3,585,462
Fund-raising	441,292	423,509
Total expenditures	17,331,315	33,820,606
Change in unrestricted net assets	5,860,831	(12,502,211)
Change in temporarily restricted net assets (note 14):		
Contributions, net	201,066	4,820,305
Interest earned	159,780	99,933
Net assets released from restriction	(976,554)	(881,795)
Change in temporarily restricted net assets	(615,708)	4,038,443
Change in net assets	5,245,123	(8,463,768)
Net assets at beginning of year	81,510,336	89,974,104
Net assets at end of year	\$ 86,755,459	81,510,336

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended September 30, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Change in net assets	\$ 5,245,123	(8,463,768)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	4,886,143	4,315,745
Net loss on disposal of property and equipment	40,279	17,174,001
Decrease (increase) in assets:		
Receivables, net	1,806,009	1,048,806
Prepaid expenses	(1,913)	16,770
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	389,330	456,291
Advances	(1,037,449)	(178,247)
Net cash provided by operating activities	11,327,522	14,369,598
Cash flows from investing activities:		
Purchases of property and equipment	(10,723,667)	(8,988,846)
Proceeds on sale of property and equipment	43,095	38,795
Net cash used in investing activities	(10,680,572)	(8,950,051)
Net increase in cash and cash equivalents	646,950	5,419,547
Cash and cash equivalents at beginning of year	13,485,943	8,066,396
Cash and cash equivalents at end of year	\$ 14,132,893	13,485,943

See accompanying notes to financial statements.

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Notes to Financial Statements

September 30, 2007 and 2006

(1) Description of Reporting Entity

California Association for Research in Astronomy (CARA) is a nonprofit corporation formed by the California Institute of Technology (Caltech) and the University of California (UC) in January 1985 to build and operate the W. M. Keck Observatory (Observatory) on the summit of Mauna Kea in Hawaii. Tax exempt under Section 501(c)(3) of the Internal Revenue Code, CARA is a nonprofit California public benefit corporation and, as such, is qualified as a nonprofit corporation in the state of Hawaii.

The principal purpose of CARA is to foster astronomical research and to provide technical direction for the development and operation of astronomical facilities on the island of Hawaii, principally on land owned by the state of Hawaii, leased to the University of Hawaii, and subleased to Caltech. The Observatory is owned by Caltech and is leased to CARA for \$1 per year. In consideration for subleasing the land to Caltech for \$1 per year through 2033, the University of Hawaii receives an opportunity to use the Observatory and related facilities and improvements. The astronomical facilities include two ten-meter telescopes (Keck I and Keck II), related instrumentation, adaptive optics technology, support facilities, and required infrastructure improvements.

The costs of development of the Observatory and the development of adaptive optics technology were borne by Caltech, the majority of which were funded by grants from the W. M. Keck Foundation (Foundation). Caltech's maximum liability for Keck I and Keck II development costs is \$75,222,000, measured in 1984 dollars, and \$78,600,000, measured in 1990 dollars, respectively. The Foundation's grant to Caltech for adaptive optics technology is \$6,300,000.

UC provided financial support to CARA for pre-operating costs during the Observatory's development periods, acquisition of focal plane instrumentation, and observatory operations. For fiscal years 2007 and 2006, UC provided continuing operating support for Keck I operations in the amount of \$3,500,000 per year, which continues through fiscal year 2017, and \$1,750,000 for the six-month period ending March 31, 2018, all measured in 1984 dollars. For fiscal years 2007 and 2006, UC provided support for Keck II operations in the amount of \$2,105,000 per year, which continues through fiscal year 2017, and \$1,052,500 for the six-month period ending March 31, 2018, all measured in 1990 dollars.

During 1993, Caltech and UC modified their original funding and governance agreement. Certain modifications provided for third-party participation by the National Aeronautics and Space Administration (NASA) in the funding of the costs of the Observatory. In a cooperative agreement between Caltech and NASA, NASA contributed \$44,005,000 to Caltech through fiscal year 2000 in return for collaboration in the project.

(2) Summary of Significant Accounting Policies

(a) Financial Statement Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP).

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CARA follows the requirements of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under FASB Statement No. 117, CARA is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets, based upon the existence of any donor-imposed stipulations. Accordingly, net assets of CARA and changes therein are classified and reported as follows:

Unrestricted Net Assets – net assets not subject to donor-imposed stipulations and that may be expended for any purpose in performing the objectives of CARA.

Temporarily Restricted Net Assets – net assets subject to donor-imposed stipulations that may or will be met either by actions and/or the passage of time. As the restrictions are satisfied, temporarily restricted net assets are reclassified and reported in the accompanying financial statements as net assets released from restriction.

Permanently Restricted Net Assets – net assets subject to donor-imposed stipulations that resources must be maintained in perpetuity. As of September 30, 2007 and 2006, CARA had no permanently restricted net assets.

(b) Cash Equivalents

For purposes of the statements of cash flows, CARA considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

(c) Property and Equipment

Expenditures incurred by CARA for observatory instrumentation and facilities, operating equipment, and vehicles are capitalized at cost, and depreciated when placed in service. Depreciation is provided over the estimated useful lives of the respective assets using the straight-line method. The estimated useful lives are as follows:

Class of assets	Estimated useful lives
Observatory instrumentation	10 – 20 years
Observatory facility	3 – 15 years
Vehicles and equipment	3 – 25 years

CARA reports contributions designated by donors to acquire long-lived assets as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, CARA reports expirations of donor restrictions when the acquired long-lived assets are placed in service.

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(d) *Advances*

Operating and instrumentation funds received from UC are recorded as advances until expended for operating expenditures, observatory instrumentation, or vehicles and equipment. Funds received from the Association of Universities for Research in Astronomy (AURA) for the purpose of developing certain instruments for the Keck II telescope or adaptive optics development are recorded as advances until expended for their stated purpose.

(e) *Contributions*

Contributions are recorded in the period received. CARA reports gifts as restricted support if they are received with donor-imposed 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 statements of activities as net assets released from restrictions.

As described in note 1 to the financial statements, CARA leases the observatory and related facilities and improvements from Caltech for \$1 per year. As the use of the Observatory is so specific that there is no assignable value, it is impractical to determine a fair rental value to be reported as contribution revenue in the accompanying statements of activities.

(f) *Use of Estimates*

The preparation of the financial statements in accordance with GAAP requires management of CARA to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the period. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment and valuation allowances for receivables. Actual results could differ from those estimates.

(g) *Impairment of Long-Lived Assets*

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statements of financial position and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the

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statements of financial position. There were no events or changes in circumstances during fiscal years 2007 and 2006, which indicated that the carrying amount of CARA's assets may not be recoverable, except as otherwise recorded in the accompanying financial statements.

(h) *Sponsored Programs, Grants, and Contracts*

Governmental and private grants and contracts normally provide for the recovery of direct and indirect costs, subject to audit. CARA recognizes revenues associated with direct and indirect as direct costs are incurred. Indirect costs recovered on federally sponsored programs are based on cost reimbursement rates negotiated with CARA's cognizant agency, the Office of Naval Research. Indirect costs recovered on all other grants and contracts are based on rates negotiated with the respective parties.

(i) *Reclassifications*

Certain reclassifications have been made to the 2006 financial statements to conform to the 2007 presentation. Such reclassifications had no effect on previously reported change in net assets.

(3) National Aeronautics and Space Administration (NASA) Funding Agreements

In 2005, NASA awarded CARA a three-year cooperative agreement for telescope viewing time and the development of an archived database. Revenues under the cooperative agreement were \$3,221,139 and \$3,279,481 in 2007 and 2006, respectively.

In 2004, NASA awarded CARA a three-year fixed price contract for instrumentation development. Revenues recognized under these contracts amounted to \$762,765 and \$363,243 in 2007 and 2006, respectively.

(4) Jet Propulsion Laboratory (JPL) Agreements

In 2005, CARA entered into a \$7,284,011 cost-reimbursement subcontract with JPL for the Keck interferometer project. In 2007, JPL renewed the contract for an additional \$5,142,000 through September 30, 2008. During 2007 and 2006, \$3,097,116 and \$3,001,095, respectively, was received under the subcontract. Revenues under the cost-reimbursement subcontract were \$2,988,510 and \$3,327,535 in 2007 and 2006, respectively. Amounts due to CARA under the cost-reimbursement subcontract of \$483,012 and \$591,618 as of September 30, 2007 and 2006, respectively, are included as receivables in the accompanying statements of financial position.

(5) Association of Universities for Research in Astronomy Agreements

In 2004, CARA entered into a fixed price contract with AURA for adaptive optics development. CARA was awarded \$1,080,981 for the development of the next generation of optical wavefront sensor detectors, of which \$113,611 and \$125,274 was received in 2007 and 2006, respectively.

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In 2005, CARA entered into a fixed price contract with AURA for Keck I instrumentation development. In 2005, CARA was awarded \$2,452,629 for the design of MOSFIRE, a Multi-Object Spectrograph for Infra-Red Exploration. In 2007, the fixed price contract was revised to provide additional funding of \$4,913,664 for the MOSFIRE project.

Revenues recognized under these contracts with AURA amounted to \$2,748,216 and \$1,855,581 in 2007 and 2006, respectively. As of September 30, 2007 and 2006, unspent receipts under the AURA contracts amounted to \$860,194 and \$2,379,995, respectively, and are included as advances in the accompanying statements of financial position.

(6) National Science Foundation (NSF) Award

In 2004, NSF awarded CARA a three-year research grant that was subsequently extended for two additional years. As of September 30, 2007, the total award was \$539,968, of which \$142,751 and \$80,601, respectively, was received in 2007 and 2006.

In 2006, NSF awarded CARA a two-year \$1,958,000 grant to upgrade the Interferometer instrument of which \$175,585 and \$0, respectively, was received in 2007 and 2006.

(7) Department of Homeland Security – Federal Emergency Management Agency (FEMA)

During 2007, CARA had expenditures totaling \$420,902 to be reimbursed by FEMA related to repairs for telescope and headquarters damage sustained from the two Kilocho Bay earthquakes on October 15, 2006. As of September 30, 2007, \$71,754 has been received.

(8) Contributions Receivable

Contributions receivable represent unconditional promises to give by donors. In accordance with FASB Statement of Financial Accounting Standards No. 116, *Accounting for the Contributions Received and Contributions Made*, contributions receivable are recorded at their estimated fair value. Amounts due more than one year later are recorded at the present value of the estimated future cash flows, discounted at a risk-free rate ranging from 4.3% to 3.1% applicable to the year in which the promise was received. Contributions receivable expected to be received at September 30, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
Amounts due in:		
One year or less	\$ 1,374,363	1,581,290
Between one and five years	281,458	1,655,821
Gross contributions receivable	1,655,821	3,237,111
Less – discount to present value	(27,788)	(81,240)
Contributions receivable, net	<u>\$ 1,628,033</u>	<u>3,155,871</u>

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(9) Property and Equipment

A summary of property and equipment at September 30, 2007 and 2006 follows:

	<u>2007</u>	<u>2006</u>
Observatory instrumentation:		
Property and equipment:		
Keck I	\$ 15,954,423	14,519,774
Keck II	34,778,478	34,650,228
Adaptive Optics	9,909,205	9,740,309
Construction in progress:		
Keck II	41,691,514	34,688,485
	<u>102,333,620</u>	<u>93,598,796</u>
Observatory facility:		
Property and equipment	4,066,596	4,031,182
Construction in progress	4,138,777	2,915,069
Vehicles and equipment	3,807,876	3,565,789
	<u>114,346,869</u>	<u>104,110,836</u>
Less accumulated depreciation	<u>(32,541,543)</u>	<u>(28,059,660)</u>
	<u>\$ 81,805,326</u>	<u>76,051,176</u>

Depreciation expense amounted to \$4,886,143 and \$4,315,745 in 2007 and 2006, respectively.

In 2006, CARA recorded a \$17,122,774 loss from the abandonment of its Interferometer project's outrigger telescopes and enclosures, and a \$66,574 loss from the abandonment of its Long-Wavelength Spectrometer. The losses are included in observatory operations expenditures in the accompanying statements of activities.

(10) Income Taxes

CARA is an organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and Section 23701d of the California Revenue and Taxation Code and is generally not subject to federal or state income taxes. However, CARA is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the basic financial statements taken as a whole.

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(11) Related-Party Transactions

Caltech and UC provide various instrument and adaptive optics development services to CARA. During fiscal years 2007 and 2006, total expenditures for these services charged to CARA were \$1,214,073 and \$476,825, respectively, by Caltech, and \$2,038,817 and \$841,431, respectively, by UC.

(12) Commitments

CARA entered into various contractual agreements for observatory construction and development of instrumentation, laser guide star and adaptive optics systems, operations, and interferometry systems. A summary of commitments at September 30, 2007 is as follows:

Instrumentation	\$ 3,907,313
Interferometry	871,315
Laser Guide Star and Adaptive Optics Systems	853,408
Operations	780,281
Total	\$ 6,412,317

(13) Board-Designated Net Assets

In 2006, CARA established a board-designated Director's Fund separate from its unrestricted, undesignated net assets for receipt of all unrestricted contributions and their subsequent expenditures. In 2007 and 2006, CARA received contributions of \$106,680 and \$37,484, respectively, which were board designated for the Director's Fund. At September 30, 2007 and 2006, \$127,516 and \$20,836, respectively, was available in the fund.

(14) Temporarily Restricted Net Assets

In 2004, the W. M. Keck Foundation made a contribution of \$2,000,000 to CARA for the purpose of upgrading and optimizing the existing adaptive optics system. In 2007 and 2006, \$305,926 and \$881,795, respectively, of temporarily restricted net assets were released from restriction in satisfaction of equipment acquisition restrictions. At September 30, 2007 and 2006, \$263,690 and \$551,128, respectively, was available for the purpose of upgrading and optimizing the existing adaptive optics system.

In December 2005, CARA received a restricted contribution pledge of \$4,899,875 for Keck I instrumentation development of MOSFIRE. In 2007 and 2006, \$625,378 and \$0, respectively, of temporarily restricted net assets were released from restriction in satisfaction of equipment acquisition restrictions. At September 30, 2007 and 2006, after discounting the pledge and receipt of interest earned and pledge payments, \$4,439,244 and \$4,869,878, respectively, was available for instrument development.

In 2006, CARA established a Rising Stars fund to accept contributions in support of the Observatory's sponsored education programs. At September 30, 2007 and 2006, \$3,034 and \$670, respectively, was available in this program.

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In 2007, CARA received various restricted contributions for instrument development and advancement activities totaling \$145,250. In 2006, \$45,250 of temporarily restricted net assets was released from restriction in satisfaction of equipment acquisition and advancement activity restrictions.

(15) Deferred Compensation 403(b) Plan

CARA has a defined contribution retirement plan (the Plan), which was established under Section 403(b) of the U.S. Internal Revenue Code. All eligible employees can participate in the Plan. An eligible employee is defined as an employee regularly scheduled to work at least 20 hours per week subject to the appropriate waiting period as defined in the Plan. CARA is required to make contributions to the Plan at various percentages of base salary depending on the participant's age and grade. Contributions to the Plan amounted to \$784,556 and \$721,596 for fiscal years 2007 and 2006, respectively.