Profiles in Problem-Solving
Our strength is our people.
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Certain elements of policy analysis are fundamental to resolving most kinds of public policy problems. The stock and trade consists of comparing the costs and benefits of alternative courses of action, accounting for the likely winners and losers, spotting the opportunities for greater effectiveness and efficiency, recognizing the residual risks, and anticipating the unintended consequences.

But beyond this common professional baseline, there are just as many methods of policy analysis as there are policy analysts. And that is a very good thing. Given the many facets of the challenges facing our varied yet interdependent world, we will all be better off the more we can expand the universe of our potential solutions. One of the most exciting aspects of working in policy analysis is that each person can bring his or her own special skills and perspectives to the collective enterprise, as portrayed on the following pages.

To help counter terrorism and curb political violence, Kim Cragin’s scholarly analysis of the phenomena includes meeting with the perpetrators themselves, inviting them to explain their goals on their own terms, and distinguishing between the religious motivations and the political ones. Her unique training, education, and interests have prepared her to conduct this unique combination of fieldwork and strategic analysis.

After eight years of policy research at Hudson Institute, Bill Overholt became a regional strategist for several international banks. On the side, he used his policy skills to improve the lives of people in the Philippines, Burma, Thailand, and other countries. Now the director of the RAND Center for Asia Pacific Policy, he analyzes economic, political, and regulatory developments to help governments and companies improve their policies.

As director of the logistics program in the RAND Arroyo Center, Eric Peltz has helped to ensure that U.S. Army troops in Iraq have the supplies they need when they need them. A former army officer who then became a production and engineering manager at a major U.S. auto manufacturer, Peltz has applied the lessons of private-sector supply chain management to the transportation and distribution of U.S. military assets in wartime.

These are just three examples of the many profiles in problem-solving that characterize the RAND Corporation. Our strength is our people. The greater the diversity in our backgrounds and experiences, the greater the problems we can solve together, and the greater the service we can be to the world.

Ann McLaughlin Korologos, Chairman
James A. Thomson, President and CEO
Shortly after hurricanes Katrina and Rita devastated the southeastern United States, RAND Health researcher Lisa Jaycox received calls from schools in the affected region seeking guidance on how to help the many displaced, traumatized students that were enrolling in their schools. Several years earlier, Jaycox and other RAND colleagues had developed a well-regarded school-based mental health intervention program—the Cognitive-Behavioral Intervention for Trauma in Schools (CBITS)—to help students cope with the adverse mental and emotional effects of exposure to high levels of community violence. Left untreated, trauma can have serious long-term consequences for young people, including poor performance in school and behavioral and emotional problems.

“In the aftermath of the hurricanes, we saw a big information gap that needed to be filled,” says Jaycox. “There are a number of really good youth intervention programs specifically targeted to ameliorating the negative effects of trauma, whether it be from living through natural disasters, witnessing violence, undergoing assault or abuse, or experiencing acts of terrorism. But schools didn’t know about them. I couldn’t find a comprehensive, understandable source of information to point people to, so we decided to create that resource ourselves.”

With immediate funding from RAND’s self-initiated research fund—discretionary monies made possible by RAND donors and through fees earned on contract work—Jaycox and her colleagues Terri Tanielian and Bradley Stein leapt to work on the project, surveying school districts to better
understand their needs and synthesizing information about relevant intervention programs from a variety of disparate sources. The resulting resource guide, *How Schools Can Help Students Recover from Traumatic Experiences: A Tool Kit for Supporting Long-Term Recovery*, is a user-friendly compendium of school-based trauma intervention programs that describes the core attributes of relevant programs, helps schools identify their intervention needs and select students for trauma programs, and suggests funding options to obtain program materials and train staff. Initially hand-bound by RAND staff members in the Washington Office to expedite its delivery to more than 120 schools in the Gulf States region, the tool kit has since been formally published and distributed to an even larger number of schools, and has also been translated into an innovative Web-based decision tool to help schools zero in on the programs that best match their needs.

“This outreach project was very rewarding,” says Jaycox, whose current work through the RAND Gulf States Policy Institute focuses on community-based mental health initiatives and regional capacity-building. “To hear people say ‘Thank you for not forgetting about us down here’ was personally and professionally gratifying,” says Jaycox.

“Still, there is a push for people to move on with their lives, and for schools to get kids back on track academically. My hope is that schools don’t see their focus on academics as mutually exclusive from continuing with needed trauma intervention. Effective mental health interventions play an important role in supporting academic achievement.”

Jaycox, who joined RAND nine years ago, first became interested in mental health interventions for young people after working with adult rape victims whose lives had been disrupted for many years by untreated post-traumatic stress disorder. “Getting treatment to these patients so late was heartbreaking. It made me think about the good we could do by incorporating effective intervention elements into school-based programs so as to reach individuals earlier on.”

At RAND, Jaycox is committed to conducting research that helps make a difference. “We’re not conducting experiments in a lab with clean, randomized controlled data. We need to find out what works in the real world.”
Senior economist C. Richard Neu has been affiliated with RAND for more than 30 years. During that time, Neu has conducted analyses for almost every research division at RAND and has served as Assistant to the President of RAND for Research on Counterterrorism, associate dean of the RAND Graduate School (now the Pardee RAND Graduate School), and associate director of RAND Project AIR FORCE. Neu has also served as a member of the National Intelligence Council and as an economic analyst for the Congressional Budget Office and the First National Bank of Chicago.

“RQPI’s initial projects have been exciting. Qatar is an energy-rich country whose nationals enjoy a high standard of living. In many ways, they don’t face the same necessities to change that you find in other countries. But the nation’s leadership is committed to modernizing Qatar’s social and economic systems to enable its citizens to benefit from the opportunities afforded by an increasingly global economy, and to serve as a model of reform in the region.”

Originally, Neu was scheduled to depart for Qatar on September 11, 2001, to begin work on an education project. Although that flight was canceled in the wake of the terrorist attacks in New York City and Washington, D.C., Neu did make the trip just one month later and began work in Qatar in October 2001. Subsequently, Her Highness Sheikha Mozah bint Nasser al-Missned, chairperson of the Qatar Foundation, praised RAND’s commitment to the region at a time when others were fleeing the Middle East.

“I believe RQPI’s work has been well-received in Qatar because RAND does not approach its work with a political agenda,” observes Neu. “Our aim is to help clients understand the consequences of different policy options so that they may achieve their goals.”

In October 2006, Neu returned to Santa Monica from a three-year appointment as the founding director of the RAND-Qatar Policy Institute (RQPI), a collaboration between RAND and the Qatar Foundation for Education, Science, and Community Development. RQPI’s mission is to analyze complex policy problems and implement enduring solutions for clients across the Middle East, North Africa, and South Asia in areas such as education, health, infrastructure, public safety, and international security.

As director of RQPI, Neu oversaw projects to improve health care systems and K–12 and university-level education in Qatar, and to restructure and make more efficient the country’s labor market. Says Neu of the experience, “RQPI’s initial projects have been exciting. Qatar is an energy-rich country whose nationals enjoy a high standard of living. In many ways, they don’t face the same necessities to change that you find in other countries. But the nation’s leadership is committed to modernizing Qatar’s social and economic systems to enable its citizens to benefit from the opportunities afforded by an increasingly global economy, and to serve as a model of reform in the region.”

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In October 2006, Neu turned over the directorship of the RQPI to RAND colleague Richard Darilek. Now back at RAND’s Santa Monica research facility, Neu will contribute to RAND’s efforts to develop project work in India and manage RAND’s self-initiated research program, the system by which RAND invests its own resources earned from the generosity of donors and the fees earned on client-funded research to investigate issues that may not otherwise receive funding.

“RAND’s self-initiated research program allows us to get ahead of current thinking on emerging or unpopular policy issues. Some of our most visionary analyses have been made possible through self-initiated funding. I am honored to help guide this system for fostering innovation.”
Senior economist Michael Kennedy keeps a small sign in his office that reads, “Quid Marius faciat”—Latin for “What would Marius do?” and a reference to first-century B.C. Roman leader Gaius Marius, whose innovative leadership reformed and strengthened the Roman military. This reminder of the transformative power of sound decisionmaking has served Kennedy well in his 30-year career with RAND, most recently during the last several years when Kennedy led a very large RAND project team to help guide the Air Force’s $200 billion decision to replace its aging fleet of aerial refueling tankers. The tankers are an essential asset in the United States’ national security activities and have recently been the unlikely focal point of congressional inquiry into scandal.

“Aerial refueling tankers enable the Air Force to rapidly and effectively undertake important missions in distant places such as Iraq and Afghanistan. They improve our ability to maintain surveillance of U.S. airspace for homeland security purposes, and can play an important role in aiding relief efforts in the wake of overseas disasters, like the 2004 Asian tsunami,” explains Kennedy. “It’s uncommon, however, for acquisition issues related to large aircraft to become newsworthy events.”

But that’s exactly what happened in 2003 and 2004 when the Air Force’s plan to replace its aging aerial refueling tanker fleet by leasing aircraft from a single manufacturer came under fire from Congress for alleged waste and improper dealing with industry. In reconsidering its initial plan, the Air Force engaged RAND to conduct a thorough, impartial analysis of alternatives for recapitalizing the fleet. RAND’s task to evaluate the cost-effectiveness of a wide range of replacement aircraft and schedules was complex; the findings of Kennedy’s team were delivered in 2006.

“It’s a real testament to RAND’s reputation for integrity, independence, and high-quality analytical work that the Air Force turned to us for assistance during this time of intense scrutiny,” remarked Kennedy. “The project was tough; it was the biggest, most heavily scrutinized, and most politically controversial project I’ve ever worked on at RAND. But we had a great project team, and thanks to their strong work and diligence we delivered what the Air Force needed.” Currently, the Air Force is following the majority of RAND’s recommendations with the support of those who had attacked its previous plan. Notes Kennedy, “It’s rewarding to see that strong analytical work can help quell controversy and facilitate consensus on a complicated problem.”

Kennedy joined RAND in 1977 as an energy policy analyst but subsequently became interested in national security issues. The majority of his career at RAND has been spent addressing challenges confronting the Air Force. He’s also contributed to the development of future generations of policy analysts through teaching posts at the Pardee RAND Graduate School and with current responsibilities for RAND Project AIR FORCE staff development.

“The United States faces a host of complicated national security challenges that, in many instances, are very different from what we’ve seen in the past. It’s gratifying that the work we do at RAND can help our military to be prepared for future contingencies and to accomplish current objectives in a manner that is both effective and efficient.”

“I’m proud that in the midst of controversy, the Air Force trusted RAND to deliver effective and credible recommendations on a matter of great importance to national security.”
International policy analyst R. Kim Cragin studies political violence to give policymakers a richer understanding of issues associated with terrorism such as suicide bombings, terrorist recruitment, and the potential for socioeconomic development to inhibit terrorism. Since the terrorist attacks of September 11, 2001, Cragin has increasingly focused on the relationship between terrorist groups and their support communities—how these relationships evolve and how the terrorist groups survive.

“I began exploring Hamas and what they were trying to achieve,” recalls Cragin. “From the beginning, my research involved intensive fieldwork—visiting Hamas-controlled cities in the West Bank and Gaza and conducting in-person interviews with their members and supporters.”

This interactive approach has become the foundation of the research Cragin does today, and her fieldwork has taken her to places such as Colombia, Northern Ireland, Lebanon, Egypt, Thailand, Indonesia, and the Philippines. “[Former RAND researcher] Bruce Hoffman pioneered the approach of listening to terrorist rhetoric to help inform more effective counterterrorism policy,” notes Cragin. “Following in this tradition, I’ve tried to base my findings at least in part on interviews with known or suspected terrorists.”

Cragin is regularly and sometimes incredulously asked how she gains access to her subjects. “People get involved with terrorism because they are trying to achieve something. But their goals and motivations can be misunderstood. They feel it is in their best interest to talk to us and explain their point of view.”

On a more strategic level, Cragin led a study in 2006 that examined factors that have allowed terrorist groups to successfully exchange new technologies. The findings, available in Sharing the Dragon’s Teeth (2007), are helping policymakers better anticipate terrorists’ technological innovations. Additionally, Cragin’s current work involves a reassessment of the global war on terrorism and U.S. objectives more than five years after 9/11. The goal of the study is to help U.S. policymakers develop new strategies for the war from this point forward.

“One of the great things about RAND is that I am encouraged to ask seemingly unanswerable questions, to expose the gaps in our knowledge that, if left unfilled, can undermine U.S. national security. Being at RAND allows me to continuously push the boundaries of what we know or think we know about terrorism.”
Numerous statistics can be used to illustrate the United States’ health care challenges. Consider that despite spending over $2 trillion annually on health care—roughly four times the national defense budget—Americans receive just half of recommended medical care and more than 46 million Americans do not have health insurance. For economist Melinda Beeuwkes Buntin, helping policymakers develop effective reforms requires understanding the complex interplay between cost, quality, and access to care.

“The need for improvement is clear to everyone, and so there are a lot of proposed reforms out there. Oftentimes, a reform proposal will seem like a good idea, but when we evaluate its actual impact, we find unintended, adverse consequences, particularly for poor and less healthy individuals. As someone who studies health care financing, my goal is to investigate what combination of incentives will help us achieve greater efficiency in health care delivery without sacrificing quality of care or innovation in services.”

Buntin is codirector of the RAND Bing Center for Health Economics, a research center within RAND Health created with the generous philanthropic support of former RAND trustee Peter Bing. In her six years at RAND, Buntin’s research and analyses have contributed to greater efficiencies in Medicare payment systems, and her work on consumer decision-making in the individual insurance market has helped advance the debate about strategies to increase medical coverage among the uninsured.

“My passion for public policy began as an undergraduate when I studied nonproliferation and interned at the Pentagon. The combination of urgency and complexity really hooked me on policy analysis. When I began to examine the United States’ domestic challenges, I was drawn to the nation’s health care problems and the enormous consequences of formulating sound policy in this area.”

In 2006, Buntin published one of the first comprehensive analyses of consumer-directed health plans, a model for financing health care that attempts to reduce costs by requiring consumers to share more in the costs of their medical care, typically by paying higher deductibles in exchange for lower monthly premiums. The theory behind the plans is that if consumers have to pay more out-of-pocket for doctor visits, prescriptions, and hospital care, they will be incentivized to avoid unnecessary care, and demand higher quality and better prices for the care they do need.

“Our analysis found that consumer-directed plans can lower costs by reducing unnecessary care—an effect of high deductibles that we’ve known about since RAND’s groundbreaking Health Insurance Experiment in the 1970s,” explains Buntin. “But lowering costs isn’t everything. The effect of these plans on overall health is potentially worrisome, as people experiencing higher out-of-pocket expenses also tend to forgo necessary care, which can jeopardize their health.”

With consumer-directed plans receiving significant attention from policymakers as a potential panacea to the nation’s health care financing crisis, Buntin’s findings and ongoing analyses will help ensure that the plans’ effects on people’s health and the quality of care delivered are duly considered alongside their potential for lowering costs.

“Early in my career, I watched the debate over health care reform from the sidelines. I joined RAND because I wanted to help policymakers develop solutions that work.”
As director of the military logistics program in the RAND Arroyo Center, the Army’s federally funded research and development center for policy analyses, Eric Peltz and his dedicated team of analysts help improve the military’s joint supply chain system to ensure that American troops at home and overseas have the supplies they need when and where they need them. The joint supply chain is a complex system that requires effective coordination of numerous actors, including the public- and private-sector depots and firms that manufacture supplies, the defense agencies responsible for procurement and worldwide transportation, and the distribution organizations on the ground that deliver supplies directly to the troops.

“Our work on supply chain improvement tends to focus on equipment spare parts. This can be especially complicated because of the wide variety of parts needed to sustain complex military operations, the high variability in demand for these parts, and their high cost,” explains Peltz. “When units are not receiving needed supplies in a timely manner, our challenge is to look across the joint supply chain to locate the source of a problem, identify the root cause, and then recommend a solution that is both effective and efficient. In doing so, we also step back and examine whether there are policy changes that would prevent similar problems in the future.”

During Operation Iraqi Freedom, Peltz and his colleagues have focused on opportunities for strengthening the supply chain so that it can better satisfy the continuing high demands of war. Their work has contributed to significantly improved logistical
“RAND's analysis of the logistics problems that hampered the initial stages of Operation Iraqi Freedom have helped cut distribution times of supplies to troops in Iraq by more than 50 percent and transportation costs by several hundred million dollars.”

In addition to supply chain management, Peltz also conducts and manages projects for the Army on logistics force development, fleet management and modernization, and infrastructure management. Because of his history of high-quality research engagement with the Army, Peltz is frequently asked to speak at Army conferences and has served on an Army Logistics Transformation Task Force, assisted the Army Science Board, and been made an honorary member of the Army Ordnance Corps.

In 2003, Peltz journeyed to Iraq with an Army team; over the course of two weeks, they visited almost every major unit stationed in the country. “This type of interaction helps us better connect the data we analyze back at RAND with the reality of how the supply system is carried out on the ground,” explains Peltz. “It enables us to develop more-effective solutions and, just as importantly, to explain our findings and recommendations in terms of an operational context that is most likely to engender acceptance and implementation.”

Reflecting on the long-term contribution of RAND’s logistics analyses, Peltz concludes, “Ten years ago, the Army was collecting a lot of supply chain data, but was not effectively leveraging it. RAND’s development of metrics for measuring supply chain performance and costs has helped the Army detect and resolve emergent problems more quickly while also supporting continuous improvement to the overall system. I’m proud of the innovations my colleagues and I have contributed to the broader effort of improving our military’s efficiency and effectiveness.”

Eric Peltz

support to troops in Iraq; and in 2006, Peltz and his colleagues Marc Robbins and Ken Girardini received the Institute for Defense and Government Advancement award for outstanding achievement in military logistics strategy.

Peltz, a former Army officer, is a graduate of the U.S. Military Academy at West Point and earned his M.B.A. from the University of Michigan. Prior to joining RAND, he held positions in production and engineering management at a major American auto manufacturer. Remarks Peltz, “The supply chain issues I analyze for the Army bear some similarity to issues I encountered in the private sector. But at RAND, and particularly working in Arroyo, I feel gratified that my work can make a positive difference for our forces.”
In 2006, Jonathan Grant—policy analyst and recently appointed president of RAND Europe—found himself at the center of a media frenzy. Grant and his team had just released findings about the potential for certain technologies to mitigate the adverse consequences of low fertility and population aging in Europe. Reports of the analysis appeared in more than 40 newspapers in 10 countries, reaching the front page of the UK’s Independent newspaper and featured in a televised BBC broadcast.

“Europe is facing economic, social, and health care challenges as a result of its rapidly aging population and low fertility rates,” explains Grant. “RAND’s investigation of the role of government-subsidized assisted reproductive technologies—for instance, in vitro fertilization—as one part of the solution did a great deal to elevate the profile of the problem on a broad scale.” With higher awareness of the significant consequences of current demographic trends, governments are beginning to acknowledge and even address the issue strategically in ways they may have been reluctant to do previously. Looking ahead, Grant thinks that these technologies that provide women more choice about when to have children could have as big a social impact as the contraceptive pill has had since its introduction in the early 1960s.

RAND Europe aims to inform sound decision-making on a range of matters confronting wider Europe. Its researchers analyze challenges in areas such as health policy, transportation, science and technology, defense and security policy, and government organization and accountability. Clients include European governments, foundations, supreme audit bodies, and international organizations such as the European Commission. Grant joined RAND Europe in 2002, having been Head of Policy at the Wellcome Trust, the UK’s largest nongovernment funder of biomedical research. Under his tenure, RAND Europe’s headquarters in Cambridge, UK, has roughly quadrupled in size, number of staff, and volume of work.

Grant’s own research focuses primarily on science and technology policy, government accountability, and population policy. Recently, Grant and colleagues provided analytic support to the UK Department of Health’s new and internationally acclaimed R&D strategy, Best Research for Best Health, a project that Grant says has significant potential for improving health in the UK by supporting high-quality research focused on the needs of patients and the public. Notes Grant, “I have always been interested in how the intersection between social and biomedical sciences can help government and private-sector decisionmakers make choices that will have the greatest possible benefit for people. RAND is uniquely positioned to deliver value using such a multidisciplinary approach.”

One of Grant’s most recent contributions to RAND Europe is the creation of an “emerging areas” practice that will develop new and cutting-edge approaches to policy challenges still over the horizon. Grant sees this as a needed ideas incubator for Europe. He says, “Our strength is our people—bright, dedicated, and enthusiastic. Give them a problem and they will find an effective solution. The challenge is that we don’t always know what the next problem will be. Our ambition is to stay intellectually nimble with an entrepreneurial outlook to address emerging opportunities to make a positive change in policy and practice.”

“RAND Europe offers decisionmakers across Europe a unique blend of independent and innovative analysis. By separating fact from fiction, we can identify solutions that really work.”
ANGELO RABASA IS A SENIOR POLITICAL SCIENTIST at RAND whose research and analyses address problems of international security and religious extremism. Rabasa joined RAND after two decades of service with the Departments of State and Defense in a variety of political-military positions. He served as acting political advisor to the commander of NATO forces in the southern flank during the Gulf War; was responsible for European and Latin American affairs in the Department of Defense’s Policy Planning Office during the first Bush administration; and was senior advisor to the Task Force on Military Stabilization in the Balkans at the time of the Bosnian war. In this last position, Rabasa helped to organize the effort to train and equip the armed forces of the Bosnian Federation.

“As policy analysts, we must go beyond enumerating problems and making theoretical recommendations. Our job is to extract from our findings specific, actionable recommendations that provide policymakers with a road map for achieving positive change.”

“When I was serving in the government, I knew RAND analysts and I respected the high quality and integrity of their work,” says Rabasa. “I joined RAND to operate at the intersection of academia and policy, to use scholarly analysis to make a difference in how we solve real-world problems.”

In one early project at RAND, Rabasa took a fresh look at U.S. foreign policy toward Colombia and the struggle by this Latin American country to combat a tenacious drug trade and multiple armed insurgencies that threatened to destabilize the region. “At the time, the U.S. approach to the Colombian crisis focused exclusively on countering the illegal narcotics trade,” explains Rabasa. “Our analysis made a strong case that the more significant source of instability was the government’s lack of control over territory.” Published in both English and Spanish, the study influenced the U.S. and Colombian governments to redirect their efforts toward reversing the downside trends and reestablishing state authority in areas contested by insurgents and drug traffickers.

Since September 11, 2001, Rabasa has sought to broaden U.S. thinking on terrorism and refine our understanding of the Muslim world. His team’s The Muslim World After 9/11 (2003) received wide acclaim for its comprehensive synthesis of the trends and historical factors across the different regions of the Muslim world that have contributed to the growth of Islamist radicalism. Rabasa is also the lead author of Beyond al-Qaeda (2006)—a two-volume collection of analyses that tracks today’s global jihadist movement and brings into focus the role of ideology in sustaining Islamist terrorism—and of the forthcoming Ungoverned Territories, which explores the conditions that give rise to these areas and their role as incubators of terrorism.

In 2007, Rabasa and coauthors Cheryl Benard and Lowell Schwartz will issue Building Moderate Muslim Networks, which includes findings from their examination of the experience of the United States and its allies during the Cold War in building democratic networks and institutions. In it, the authors derive lessons that may be applicable to the situation in the Muslim world today and develop a road map for the creation of moderate Muslim networks.

“The struggle in the Muslim world is essentially a war of ideas, the outcome of which will determine the future direction of the Muslim world and profoundly affect vital U.S. security interests,” remarks Rabasa. “While only Muslims themselves can effectively challenge the message of radical Islam, there is much the United States and likeminded countries can do to empower Muslim moderates in this ideological struggle. Our goal is to provide policymakers with the tools to do this.”
Asia Policy in a Globalized World
A Long-Term View

William Overholt, Director of the RAND Center for Asia Pacific Policy (CAPP), is a leading expert on Asian geopolitics and economic development. Drawing on more than 30 years of experience working in and studying Asia as a research analyst, economic strategist, and political consultant, Overholt’s mission as the leader of CAPP is to help public- and private-sector leaders make better-informed decisions about the numerous political, economic, social, and military issues affecting or impacted by the Asia-Pacific region.

Overholt’s passion for Asian policy was inspired by several early experiences. Originally determined to become a mathematical physicist, he spent a year living in the Philippines before college and developed a lifelong interest in foreign affairs and the challenges facing developing countries. Recalls Overholt, “I continued studying math at university, but more and more I felt the pull of the developing world. I spent a summer vaccinating people in Ethiopia and another summer studying the communist insurgency in the Philippines, interviewing military leaders and guerrilla rebels. Eventually, I realized that I wanted to apply the disciplined analysis I’d developed as an aspiring mathematician to the challenges and opportunities that affected peoples’ lives in developing areas, particularly in Asia.”

After earning an M. Phil. and Ph.D. in political science, Overholt refined his Asian expertise in several prominent posts. As a research analyst at the Hudson Institute (the think tank founded by
legendary former RAND analyst Herman Kahn), Overholt’s assignments included advising the Army War College Strategic Studies Institute on military deployments in Asia. Later, he spent 16 years working in Hong Kong as a high-level regional strategist for several international banks. While working in Asia, Overholt made good use of his “spare time”—writing *The Rise of China*, an award-winning book that presciently argued (against the conventional wisdom of the day) that China would become a great economic success with significant consequences for the world economy; serving as political advisor to several of Asia’s major political figures; and occasionally discussing/debating economic and political policies with top Chinese leaders such as Zhu Rongji and Li Peng.

Remarks Overholt, “During my time in Asia, I was fortunate to become involved with a number of important issues—the Philippine crisis of 1986, some political issues in Thailand, the plight of Burma’s upland tribal peoples, and Hong Kong’s transition to Chinese rule. I developed a reputation as a hands-on problem-solver. When it was time to come back to the United States, RAND’s style of problem-solving—nonpartisan, fact-based, and focused on making a real-world difference—was a good match for me.”

Overholt joined RAND in 2002. As director of CAPP, he oversees a broad research agenda that addresses development issues such as infrastructure planning and security, capital markets, and environmental issues, as well as business strategy matters such as risk analysis, regulatory trends, market drivers, and currency. While at RAND, he has advised Congress on Hong Kong elections and the effects of China on the globalized economy; participated in studies of China’s international role; and led a series of studies of the Chinese, Indian, and Russian car markets for a major Asian auto manufacturer. Overholt is currently completing a new book on the future of Asian geopolitics, which he describes as an iconoclastic look at post–Cold War regional politics that emphasizes the importance of maintaining a balanced relationship between China and Japan.

“I am particularly interested in long-term policy analysis,” notes Overholt, “taking a range of possible policy choices that could be made today and mapping the upsides and downsides of those decisions over the next month, the next year, the next decade, and so on, until we’ve got a comprehensive set of scenarios to illustrate how each alternative could play out. To develop policy that’s right, to avoid short-sightedness, and to do what’s going to work for people in the long run, you have to take this approach.”

“Asia is undergoing tremendous change, particularly with the expansion of China’s and India’s economies, the political situation in Korea, and so on. My ambition is that decisionmakers in the United States, in Asia, and throughout the world respond to these changes not based on irrational fears or ideological or nationalistic agendas but, rather, based on a reasoned understanding of what’s going to produce the greatest net benefit for people’s lives and for peace.”
RAND Staff

Approximately 1,600 people from more than 80 countries work at RAND, representing diversity in work experience; political and ideological outlook; race, gender, and ethnicity; and academic training. This diversity reinforces RAND's core values of quality and objectivity by promoting creativity, deepening understanding of the practical effects of policy, and ensuring multiple viewpoints and perspectives.

To provide the comprehensive expertise needed to fully address public policy issues, RAND hires staff from a variety of disciplines. Our researchers represent nearly every academic field and profession, from engineering and behavioral science to medicine and economics.

Most staff members work at RAND’s three principal U.S. locations: Santa Monica, California; Arlington, Virginia; and Pittsburgh, Pennsylvania. Others operate from the RAND Gulf States Policy Institute in Jackson, Mississippi; RAND Europe in Cambridge, UK; and the RAND-Qatar Policy Institute in Doha, Qatar.

President’s Awards recognize individuals whose work exemplifies RAND’s two core values of quality and objectivity and who have also recently made exemplary contributions to the RAND community, through new business development or fund-raising initiatives, outstanding outreach and dissemination efforts, or effective participation in internal activities aimed at improving the efficiency of our research environment. Made possible by the generosity of donors to the RAND Policy Circle, the awards provide staff with research time and support to pursue activities related to career development or exploratory research.
President’s Awards

**Daniel McCaffrey**, senior statistician and head of the Statistics Group, for his pathbreaking methodological advances in the area of measuring the effectiveness of educational programs and extensive efforts to develop the breadth and depth of RAND’s quantitative methods.

**Sage Newman**, legislative analyst, for conceiving and carrying out a wide range of new outreach and dissemination initiatives that have substantially expanded congressional use of RAND’s products and expertise in the areas of defense, homeland security, international relations, and terrorism.

**Kenneth Girardini**, senior operations researcher, for his development and application of innovative new methods of inventory optimization and his contributions to improving the Army combat operations in Afghanistan and Iraq.

**Suzanne Wenzel**, senior behavioral scientist and RAND Health’s quality assurance coordinator, for her far-reaching research on the problems of substance abuse, health care for indigent persons, and homelessness, as well as her creative efforts to develop a strong funding base for research on domestic violence.

**Olga Oliker**, senior international policy analyst, for her leadership and contribution to RAND’s work on the intersection of development and security, including her work for the president of Liberia, for the Coalition Provisional Authority in Iraq, and on U.S. assistance efforts in countries in transition throughout the world.

**Lora Bensahel**, senior political scientist, for her insightful research on various dimensions of coalition operations and post-conflict reconstruction, especially on Iraq, and her effectiveness in numerous external settings.

**Sage Newman**, legislative analyst, for her insightful research on various dimensions of coalition operations and post-conflict reconstruction, especially on Iraq, and her effectiveness in numerous external settings.

**Lisa Jaycox**, senior behavioral scientist, for her skillful leadership of a project that implemented in the region devastated by Hurricane Katrina comprehensive assessment of school-based mental health programs designed specifically to help children who had experienced natural disasters or other trauma.

**Paul Koegel**, associate director of RAND Health and Pardee RAND Graduate School Professor of Policy Analysis, for his outstanding efforts to help build RAND Health research capabilities in the Pittsburgh Office and his leadership in the development of effective approaches for community-based participatory research.

**Hans Pung**, director of RAND Europe’s Defence and Security program, for his success at leading and carrying out influential research on issues related to defense planning and acquisition in the United Kingdom and his contributions to stronger transatlantic connections within RAND.

**David Loughran**, economist and Pardee RAND Graduate School Professor of Economics, for his contributions to the redesign of the PRGS curriculum and his growing body of creative research spanning several national security and domestic policy areas, including military personnel policy, marriage and fertility, retirement, and auto insurance.

**Nora Bensahel**, senior political scientist, for her insightful research on various dimensions of coalition operations and post-conflict reconstruction, especially on Iraq, and her effectiveness in numerous external settings.
The Pardee RAND Graduate School
With 53 professors and a student body of 90, PRGS enjoys one of the most favorable faculty–student ratios in higher education. Its student body is remarkable and remarkably diverse. Most students have already earned advanced degrees, ranging from doctorates in the sciences or in medicine to master's degrees in a variety of disciplines. Graduates have gone to high-level positions in government, the private sector, academia, and nonprofit groups. In all their diversity, these students have three things in common: passion, discipline, and intellectual power. The PRGS Ph.D. in policy analysis is designed to train creative thinkers to play important roles in solving major problems facing the nation and the world. Rigorous courses all operate as seminars, and students get the opportunity to work alongside top RAND researchers on a broad range of projects as part of their on-the-job training. All students receive fellowships that pay for all tuition costs and health care, and a stipend based on the work they perform on RAND research projects.

The RAND Graduate Student Summer Associate Program
The Graduate Student Summer Associate Program is designed for students who have completed at least two years in a graduate program leading to a doctorate or other advanced degree. Each summer associate conducts independent research during the approximately 12 weeks that he or she spends at RAND assigned to a research project and mentored by a research staff member. In 2006, 25 summer associates from 16 different universities applied their skills to the analysis of a wide range of public policy problems. A sample of summer associate research projects in 2006 includes

- an examination of how the recent breakthroughs in HIV treatment have impacted the sexual behavior of the uninfected population in the United States
- a study that predicts the development of Acute Stress Disorder following trauma exposure
- a comparison of Chinese and Indian security policies and international behavior
- an analysis of how employment opportunities in the civilian world influence retention decisions in the Army Reserves and National Guard
- an evaluation of a comprehensive math/science partnership project in southwestern Pennsylvania involving 48 school districts and four small universities/colleges
- an analysis of the relationship between religion, politics, and conflict that surveys the likely future relevance of religious mobilization and violence to American foreign policy
• an investigation of risky health habits and behaviors, the possible effect of insurance on individuals’ choices, and how health insurance might be designed to incentivize healthy behavior
• an analysis of new uses of information sharing currently employed by the U.S. Army.

Other Educational Opportunities
Several specialized pre- and postdoctoral programs are conducted under the auspices of individual research units. The programs offer formal and informal training and extensive collaboration with RAND researchers.

RAND Labor and Population offers the RAND Postdoctoral Training Program in Population Studies and the RAND Postdoctoral Training Program in the Study of Aging. The programs enable outstanding junior scholars in demographic and aging research to sharpen their analytic skills, learn to communicate research results effectively, and advance their research agenda.

Participants in the Robert Wood Johnson Clinical Scholars Program at the University of California, Los Angeles (UCLA), have the opportunity to involve themselves in RAND Health projects as part of their training. The program is designed to allow young physicians committed to clinical medicine to acquire new skills and training in the nonbiological sciences that are important to medical care systems. RAND Health and the UCLA School of Public Health jointly sponsor a postdoctoral training program that offers training in health services research methods and policy analysis and research experience through ongoing research projects at RAND or UCLA.

The RAND Summer Institute (RSI) consists of two annual conferences that address critical issues facing our aging population: the MiniMedical School for Social Scientists and a workshop on Demography, Economics, and Epidemiology of Aging. The MiniMedical School, sponsored by the National Institute on Aging and the NIH Office of Behavioral and Social Sciences Research, is offered to non-medically trained scholars whose research relates to the aging process and the medical treatment of the elderly.

RAND is also one of the participating institutions in the Transatlantic Postdoctoral Fellowship for International Relations and Security. The program is open to candidates who have recently received their doctorate in social and political sciences or economics and whose research focuses on topics of international relations and security. Fellows have three eight-month stays at research institutions or think tanks participating in the program—at least one on the Eastern and one on the Western side of the Atlantic.
Making a Difference Through Philanthropy and Participation

RAND’s objective research and analysis is needed now more than ever in addressing the challenges that confront our nation and the world. A growing number of people are finding that their involvement with RAND is making a difference on issues they care deeply about.

Throughout the year, the Policy Forum and Distinguished Speaker series provide a window into RAND’s work for new friends and longtime supporters who value the insights and intellectual exchange offered by these well-attended briefings. In 2006, for instance, Policy Circle members had the opportunity to participate in roundtable discussions with leading RAND analysts on such topics as recent events in the Middle East, the challenges of school reform, and a vision for the arts in their local communities.

The RAND Board of Trustees is a group of outstanding public leaders who dedicate their time and considerable talents to the governance of RAND. Both current and former trustees are among the most loyal donors to RAND.

Members of advisory boards support RAND’s research units and centers by helping to frame the research agenda, providing feedback on breakthrough research findings, and disseminating the results among decisionmakers. Advisory boards introduce RAND to new clients and are a major source of philanthropic support for endowed chairs and cutting-edge research. The Pardee RAND Graduate School Board of Governors takes an active role in the life of the school, as well as providing generous philanthropic support to the fellows, faculty, and curriculum in this highly regarded doctoral program in policy analysis. A full list of all advisory boards can be found on pages 38–43.

More than 2,000 people belong to the RAND Alumni Association. Whether they worked for RAND for 40 years or simply served as summer interns, RAA members have a strong bond to the organization and take enormous pride in the pioneering research to which they contributed. Both current and former employees support RAND-initiated research with annual gifts.

Our supporters enable RAND to conduct research in the public interest that is only made possible by private donations. In 2006, donor-supported research included:

- helping state and local officials in post-Katrina Louisiana and Mississippi plan for the return of evacuees, in areas such as housing and education
- informing decisionmakers about choices affecting America’s volunteer armed forces
- supporting the development of innovative research methods, and the application of those methods to health care markets
- improving the ability of responders to protect the public against terrorist threats, and helping the public better understand the nature of such threats.

Policymaking affects the lives of millions of people. With the help of our donors, RAND’s nonpartisan approach to research and analysis allows decisionmakers to implement effective, enduring solutions for the public good.
“It has been and remains a privilege to be associated with RAND. I have watched this organization evolve and expand into new and purposeful directions, always building upon its solid tradition of objectivity and nonpartisanship. In a time when so many perspectives seem extreme and divisive, it is encouraging to know that RAND offers a voice of reason rooted in scientific analysis. It is especially meaningful for me to participate in this exciting institution as so did my father.”  

Lovida Coleman, Jr., RAND trustee

“What initially appealed to me about RAND was knowing I would be interacting with informed and insightful people. The opportunity to debate and discuss compelling issues with RAND leadership as well as fellow volunteers continues to engage me. Membership in the RAND Policy Circle puts me on the inside and directly connects me to the facts and findings on significant issues of the day.”  

Rob Deutschman, Policy Circle member
“My involvement with RAND has always been gratifying and has certainly deepened over time. The quality of the people—other board members as well as staff—and the excellence of the work continue to impress me. It is particularly exciting to see the organization broadening its global reach, adapting and applying what has been developed domestically over the past six decades to other places around the world. I am happy to support RAND in any way that I can.”  

Roy Doumani, research unit advisory board member

“One of RAND’s important, but often neglected, products is its export of talented, skilled, innovative, and productive people. These invaluable exports go to academia, to the world of international business, and to other pursuits. RAND’s style of objective analysis and effective solutions frequently leaves a larger footprint, as a result.”  

Dr. Charles Wolf, Jr., RAND Alumni Association member
Massachusetts native and Boston University graduate Fred Pardee worked as an economist and systems analyst at RAND from 1957 to 1971. He subsequently pursued a successful career as a real estate investor. However, he maintains his fascination with the analysis of social, economic, political, and technological change, and through his philanthropy has inspired RAND to focus attention on the challenges that will face future generations. In 2001, a generous gift from Fred helped establish the RAND Frederick S. Pardee Center for Longer Range Global Policy and the Future Human Condition. And in 2003, he invested in the education of future policy analysts with an unprecedented donation to the graduate school that now bears his name: the Pardee RAND Graduate School.

Always visionary, always curious, and always concerned about improving the condition of people living in the developing countries, Fred continues to champion RAND’s objective research and analysis as the hallmark of good public policy and decisionmaking.

The graduates of PRGS are trained to always ask the question: “What does this policy mean for the poorest of people in the world?” That is clearly an influence of Fred Pardee.

“The question that concerns me most about the future is, As development accelerates throughout our world, how will the outcomes affect humankind’s values?”

Frederick S. Pardee
Founder, PBM Quality Apartment Homes; member, Pardee RAND Graduate School Board of Governors
Comprehensive Assessment of Reform Efforts (COMPARE)

The COMPARE initiative provides real-world testament to the valuable role that advisory boards and donors play in shaping and supporting RAND’s research agenda. In late 2005, the RAND Health Board of Advisors helped to establish this ambitious and innovative program based on their belief that the organization is uniquely positioned to provide the facts, analysis, and environment for critical policy debate that can help to break the current impasse on health care reform. Thanks to generous funding from individuals, corporations, and foundations, RAND researchers have made great strides toward the development of simulation models that can be used to objectively analyze and evaluate proposed reform options as well as evaluate how the health care system will function over the next years, absent any changes. As the nation looks toward the 2008 presidential election, RAND—through the COMPARE initiative—will engage a broad base of corporate leaders, government officials, and the general public in a compelling debate on health care reform that will motivate the much-needed change.

“RAND’s COMPARE project will provide readily accessible comparative information from an objective, trusted, independent source.”

Gail L. Warden
President Emeritus,
Henry Ford Health System

RAND gratefully acknowledges the financial support of COMPARE from the following individuals and organizations:

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“The COMPARE project will provide an innovative mechanism for evaluating health care reform proposals that will improve both the public policy debate and legislation on this vital topic.”

Leonard D. Schaeffer
Founding Chairman and CEO,
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RAND HOSTED A VARIETY OF EVENTS IN 2007 to enrich the public debate on a broad spectrum of important policy problems. To celebrate the opening of RAND’s new office building in Pittsburgh, RAND researchers—joined by regional business, government, and community leaders—delivered a series of presentations on topics such as improving outcomes for students in the Pittsburgh Public Schools; strategies for making high-quality, affordable health care more widely available; and reaping the benefits of investing in early childhood education. In Santa Monica and Washington, RAND Policy Forums united RAND experts with prominent local policymakers and preeminent thinkers to foster dialogue on creating a sustainable vision for the arts in Los Angeles; addressing long-term recovery challenges in the hurricane-ravaged U.S. Gulf States; and new strategies for the United States to fight terrorism at home and abroad. RAND also hosted lectures by visiting dignitaries, including Paul O’Neill, former Secretary of the Treasury and RAND trustee; His Excellency Nabil Fahmy, the Ambassador of the Arab Republic of Egypt to the United States; and Francis Fukuyama, political theorist, best-selling author, and member of the Pardee RAND Graduate School Board of Governors.
“At any RAND event I know I will be exposed to some of the clearest thinking about some of the world’s most complex problems. I always feel informed and also challenged; that is, I feel compelled to further investigate and study the issues. RAND makes me a better citizen of the world.”

Jane Bensussen
Member, RAND Policy Circle; Founding Cochair, RAND Global Affiliates
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Report of Independent Auditors

To the Board of Trustees
The RAND Corporation

In our opinion, the accompanying consolidated statement of financial position and the related consolidated statements of activities and changes in net assets and of cash flows present fairly, in all material respects, the financial position of The RAND Corporation and its subsidiaries at September 24, 2006, and the changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of The RAND Corporation’s management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The prior year summarized consolidated comparative information included in the financial statements referred to above has been derived from The RAND Corporation’s September 25, 2005 consolidated financial statements, and in our report dated January 31, 2006, we expressed an unqualified opinion on those financial statements.

PricewaterhouseCoopers LLP

January 29, 2007
The RAND Corporation

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

with summarized financial information for the year ended September 25, 2005
(in thousands)

<table>
<thead>
<tr>
<th></th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
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<tbody>
<tr>
<td><strong>ASSETS</strong></td>
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<tr>
<td><strong>Current assets</strong></td>
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</tr>
<tr>
<td>Cash and cash equivalents</td>
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</tr>
<tr>
<td>Billed and unbilled costs and fees</td>
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<tr>
<td>Other receivables</td>
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<td>5,486</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>4,729</td>
<td>3,393</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>78,532</td>
<td>74,139</td>
</tr>
<tr>
<td><strong>Property and equipment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>1,334</td>
<td>1,334</td>
</tr>
<tr>
<td>Buildings and improvements</td>
<td>105,965</td>
<td>106,904</td>
</tr>
<tr>
<td>Leasehold improvements</td>
<td>14,592</td>
<td>4,153</td>
</tr>
<tr>
<td>Equipment</td>
<td>42,982</td>
<td>40,824</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>1,143</td>
<td>1,418</td>
</tr>
<tr>
<td><strong>Less: Accumulated depreciation and amortization</strong></td>
<td>(31,887)</td>
<td>(23,964)</td>
</tr>
<tr>
<td><strong>Net property and equipment</strong></td>
<td>134,129</td>
<td>130,669</td>
</tr>
<tr>
<td><strong>Long-term investments</strong></td>
<td>186,261</td>
<td>173,012</td>
</tr>
<tr>
<td>Building project fund investments</td>
<td>5,759</td>
<td>22,244</td>
</tr>
<tr>
<td><strong>Other assets</strong></td>
<td>6,215</td>
<td>9,814</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$410,896</td>
<td>$409,878</td>
</tr>
<tr>
<td><strong>LIABILITIES AND NET ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable and other liabilities</td>
<td>$27,839</td>
<td>$39,672</td>
</tr>
<tr>
<td>Unexpended portion of grants and contracts received</td>
<td>14,724</td>
<td>18,036</td>
</tr>
<tr>
<td>Accrued compensation and vacation</td>
<td>14,574</td>
<td>13,287</td>
</tr>
<tr>
<td>Current portion of long-term debt</td>
<td>1,785</td>
<td>2,415</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td>58,922</td>
<td>73,410</td>
</tr>
<tr>
<td>Accrued postretirement benefit liability</td>
<td>12,736</td>
<td>12,113</td>
</tr>
<tr>
<td>Deferred rent</td>
<td>12,951</td>
<td>—</td>
</tr>
<tr>
<td>Long-term debt, less current portion</td>
<td>125,971</td>
<td>127,756</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>210,580</td>
<td>213,279</td>
</tr>
<tr>
<td><strong>Commitments and contingencies (Note 8)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted operations</td>
<td>—</td>
<td>8,453</td>
</tr>
<tr>
<td>Designated for investment</td>
<td>134,079</td>
<td>130,922</td>
</tr>
<tr>
<td>Designated for special use</td>
<td>9,375</td>
<td>7,730</td>
</tr>
<tr>
<td><strong>Total unrestricted</strong></td>
<td>143,454</td>
<td>147,105</td>
</tr>
<tr>
<td>Temporarily restricted</td>
<td>21,670</td>
<td>15,931</td>
</tr>
<tr>
<td>Permanently restricted</td>
<td>35,192</td>
<td>33,563</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td>200,316</td>
<td>196,599</td>
</tr>
<tr>
<td><strong>Total liabilities and net assets</strong></td>
<td>$410,896</td>
<td>$409,878</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these consolidated financial statements.
## CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

with summarized financial information for the year ended September 25, 2005  
(in thousands)

<table>
<thead>
<tr>
<th>For the Years Ended</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unrestricted Net Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Operations</td>
<td>Designated</td>
</tr>
<tr>
<td><strong>REVENUE, GAINS, AND OTHER SUPPORT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contracts and grants</td>
<td>$215,528</td>
<td>$ —</td>
</tr>
<tr>
<td>Fees</td>
<td>11,187</td>
<td>—</td>
</tr>
<tr>
<td>Income on investments, net</td>
<td>—</td>
<td>4,319</td>
</tr>
<tr>
<td>Net realized gains on investments</td>
<td>—</td>
<td>6,810</td>
</tr>
<tr>
<td>Net unrealized gains on investments</td>
<td>—</td>
<td>1,927</td>
</tr>
<tr>
<td>Contributions</td>
<td>5,681</td>
<td>—</td>
</tr>
<tr>
<td>Other investment income</td>
<td>486</td>
<td>—</td>
</tr>
<tr>
<td>Transfer of designated net assets to operations</td>
<td>8,254</td>
<td>(8,254)</td>
</tr>
<tr>
<td>Net assets released from restrictions due to satisfaction of program restrictions</td>
<td>4,336</td>
<td>—</td>
</tr>
<tr>
<td><strong>Total revenues, gains, and other support</strong></td>
<td>245,472</td>
<td>4,802</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research</td>
<td>185,520</td>
<td>—</td>
</tr>
<tr>
<td>Management and general</td>
<td>57,398</td>
<td>—</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>242,918</td>
<td>—</td>
</tr>
<tr>
<td><strong>Change in net assets before other items</strong></td>
<td>2,554</td>
<td>4,802</td>
</tr>
<tr>
<td>Remediation related to land sale (Note 8)</td>
<td>(5,551)</td>
<td>—</td>
</tr>
<tr>
<td><strong>Change in net assets before extraordinary items</strong></td>
<td>(2,997)</td>
<td>4,802</td>
</tr>
<tr>
<td>Discontinued operations (Note 12)</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td><strong>Change in net assets</strong></td>
<td>(2,997)</td>
<td>4,802</td>
</tr>
<tr>
<td>Net assets at beginning of year</td>
<td>8,453</td>
<td>138,652</td>
</tr>
<tr>
<td>Adjustment to beginning net assets (Note 2)</td>
<td>(5,456)</td>
<td>—</td>
</tr>
<tr>
<td><strong>Net assets at end of year</strong></td>
<td>$ —</td>
<td>$143,454</td>
</tr>
</tbody>
</table>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

with summarized financial information for the year ended September 25, 2005
(in thousands)

<table>
<thead>
<tr>
<th></th>
<th>For the Year Ended</th>
<th>For the Year Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>September 24, 2006</td>
<td>September 25, 2005</td>
</tr>
</tbody>
</table>

Cash flows from operating activities:

<table>
<thead>
<tr>
<th></th>
<th>$ 9,173</th>
<th>$ 18,407</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in net assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjustments to reconcile change in net assets to net cash provided by operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>8,237</td>
<td>7,727</td>
</tr>
<tr>
<td>Termination benefits</td>
<td>1,536</td>
<td>—</td>
</tr>
<tr>
<td>Bad debt</td>
<td>501</td>
<td>—</td>
</tr>
<tr>
<td>Foreign exchange (gain) loss</td>
<td>(188)</td>
<td>172</td>
</tr>
<tr>
<td>Loss on disposition of property and equipment</td>
<td>268</td>
<td>549</td>
</tr>
<tr>
<td>Permanently restricted contributions</td>
<td>(1,629)</td>
<td>(3,611)</td>
</tr>
<tr>
<td>Net realized/unrealized gains</td>
<td>(10,548)</td>
<td>(12,931)</td>
</tr>
<tr>
<td>(Increase) decrease in billed and unbilled costs and fees</td>
<td>(2,399)</td>
<td>754</td>
</tr>
<tr>
<td>(Increase) decrease in receivables</td>
<td>(2,342)</td>
<td>149</td>
</tr>
<tr>
<td>(Increase) decrease in prepaid expenses and other current assets</td>
<td>(824)</td>
<td>874</td>
</tr>
<tr>
<td>Decrease in other long-term assets</td>
<td>3,686</td>
<td>63</td>
</tr>
<tr>
<td>Decrease in accounts payable and other liabilities</td>
<td>(4,031)</td>
<td>3,946</td>
</tr>
<tr>
<td>Increase in postretirement benefit liability</td>
<td>623</td>
<td>642</td>
</tr>
<tr>
<td>Decrease in unexpended portion of grants and contracts received</td>
<td>(3,312)</td>
<td>(1,060)</td>
</tr>
<tr>
<td>Increase in deferred rent</td>
<td>3,057</td>
<td>—</td>
</tr>
<tr>
<td>Increase in accrued compensation and vacation</td>
<td>1,287</td>
<td>468</td>
</tr>
<tr>
<td>Net cash provided by operating activities</td>
<td>3,095</td>
<td>16,149</td>
</tr>
</tbody>
</table>

Cash flows from investing activities:

|                                |                    |                    |
| Purchases of investments       | (40,570)           | (38,799)           |
| Sales of investments           | 37,790             | 40,090             |
| Sales of building project fund investments | 16,485            | 16,361             |
| Purchases of property and equipment | (17,313)         | (17,236)           |
| Net cash (used in) provided by investing activities | (3,608)           | 416                |

Cash flows from financing activities:

|                                |                    |                    |
| Principal payments on long-term debt | (2,415)           | —                  |
| Contributions restricted for purchase of property and equipment | 73                | 344                |
| Permanently restricted contributions received in cash | 3,629             | 3,611              |
| Net cash provided by financing activities | 1,287             | 3,955              |
| Effect of currency exchange rate changes on cash | 116               | (57)               |
| Net increase in cash and cash equivalents | 890               | 20,463             |
| Cash and cash equivalents at beginning of year | 26,190            | 5,727              |
| Cash and cash equivalents at end of year | $ 27,080          | $ 26,190           |

The accompanying notes are an integral part of these consolidated financial statements.
1. Corporate Organization:

RAND Corporation (RAND) is a nonprofit, tax-exempt corporation performing research and analysis funded by contracts, grants, and contributions. In addition, RAND conducts educational programs that provide graduate training.

The consolidated financial statements of RAND include the accounts of a controlled affiliate: RAND Europe, a foundation domiciled in The Netherlands. A second controlled affiliate, the Council for Aid to Education (CAE), a nonprofit organization in New York, was divested on September 30, 2005 (see Note 12). All intercompany balances and transactions have been eliminated in consolidation.

2. Summary of Significant Accounting Policies:

Fiscal Year. RAND's fiscal reporting for both financial statement and tax purposes is based on a 52- or 53-week year ending on the Sunday closest to September 30. The fiscal years include operations for 52-week periods in 2006 and 2005.

Basis of Presentation. The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and in accordance with the American Institute of Certified Public Accountants Audit and Accounting Guide, “Not-for-Profit Organizations.”

Net assets are classified into three categories according to donor-imposed restrictions, as follows:

- Permanently restricted—Net assets subject to donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of RAND. Generally, the donors of these assets permit RAND to use all or part of the investment return on these assets.

- Temporarily restricted—Net assets whose use by RAND is subject to donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of RAND.

- Unrestricted—Net assets that are not subject to donor-imposed stipulations. Unrestricted assets may be designated for specific purposes by action of the Board of Trustees.

The financial statements include certain prior-year summarized comparative information in total but not by net asset category. Such information should be read in conjunction with RAND's financial statements and disclosures of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amount of revenues, expenses, or other changes in net assets during the reporting period. Actual results could differ from these estimates.

Revenue and Expense Recognition. Contract and grant revenues are recognized as the related services are performed in accordance with the terms of the contract or grant or using the percentage of completion method.

Contributions, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Donor-restricted contributions that are received and either spent or deemed spent within the same fiscal year are reported as unrestricted revenue.

Expenses are generally reported as decreases in unrestricted net assets. Expirations of donor-imposed stipulations or of board designations that simultaneously increase one class of net assets and decrease another are reported as transfers between the applicable classes of net assets.

Concentrations of Risk. Cash and cash equivalents are maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and therefore bear minimal credit risk.

RAND derived 79 percent and 74 percent of its research revenues in fiscal years 2006 and 2005, respectively, from contracts, grants, and fees with agencies of the federal government.

Cash and Cash Equivalents. RAND considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. RAND reclassified $1,322,000 and $3,811,000 of outstanding checks from cash to accounts payable as of September 24, 2006, and September 25, 2005, respectively.

Property and Equipment. Property and equipment is stated at cost. Depreciation is computed by the straight-line method over the following estimated useful lives of the assets: 5 to 40 years for building and improvements and 3 to 20 years for equipment. Leasehold improvements are amortized by the straight-line method over the shorter of the estimated useful lives of the assets or the term of the lease. Construction in progress will be amortized over the estimated useful lives of the respective assets when they are ready for their intended use. Certain computer systems and software are internally developed. Costs associated with the application development stage are capitalized and depreciated over the useful life of the system or software. All other costs are expensed as incurred. Included in equipment was $6,800,000 and $6,600,000 of computer systems and software at September 24, 2006, and September 25, 2005, respectively.
When assets are retired, the assets and related allowances for depreciation and amortization are eliminated from the accounts and any resulting gain or loss is reflected in operations. As of September 24, 2006, and September 25, 2005, approximately $11,593,000 and $4,584,000, respectively, of fully depreciated assets were in use.

**Investments.** All investments of permanently restricted net assets and unrestricted net assets board designated for investment are pooled in a long-term investment fund. Income on pooled investments is allocated to the general use or individual special use funds based on the average balance for each fund (see Note 9).

The percentage of board-designated funds distributed for unrestricted use was 4.00 percent and 3.75 percent in fiscal years 2006 and 2005, respectively, based on the average of the trailing twelve-quarter market values of the unrestricted funds. The total distribution was $4,754,000 and $4,246,000 for fiscal years 2006 and 2005, respectively. Primarily due to RAND’s adoption of SAB 108 (see New Accounting Pronouncements in Note 2), an additional $3,500,000 transfer of board-designated net assets (non-cash) to operations was required during fiscal year 2006 to bring ending unrestricted net assets from operations to zero. This transfer will be reversed in future years as unrestricted net assets from operations become available.

Gains and losses on investments and investment income are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation.

**Building Project Fund Investments.** The net proceeds from the tax-exempt bond issuance (see Note 7) were invested under a collateralized flexible draw investment agent that expired on October 1, 2005. The balance has since been invested in short-term AAA-rated 30-day commercial paper and/or a money market fund.

These proceeds are subject to arbitrage rebate and yield restriction rules under the Internal Revenue Code in which excess earnings on tax-exempt bond proceeds must be rebated to the federal government if the yield on the investments exceeds the effective yield on the related tax-exempt bonds. The liability, if any, is accrued on an annual basis and must be remitted to the Internal Revenue Service after the end of every fifth bond year and upon full retirement of the bonds. A yield reduction liability of $115,000 and $0 was included in Accounts payable and other liabilities in the Consolidated Statements of Financial Position as of September 24, 2006, and September 25, 2005, respectively.

Other investment income includes interest earned on these investments, net of yield restriction, totaling $472,000 and $762,000 for fiscal years ended September 24, 2006, and September 25, 2005, respectively.

**Bond Issuance Costs.** Bond issue costs represent expenses incurred in connection with issuing RAND’s revenue bonds (see Note 7) and are being amortized over the term of the related bond issue. Unamortized costs were $3,088,000 and $3,150,000 at September 24, 2006, and September 25, 2005, respectively, and are included in Other assets on the Consolidated Statements of Financial Position.

**Income Tax Status.** RAND is exempt from income tax under Section 501(c)(3) of the U.S. Internal Revenue Code and corresponding California provisions and has qualified for the 50 percent charitable contributions limitation. RAND has been classified as an organization that is not a private foundation under Section 509(a)(1) and has been designated a “publicly supported” organization under Section 170(b)(1)(A)(vi) of the Internal Revenue Code.

**Foreign Currency Translation.** The assets and liabilities of RAND Europe are translated at year-end exchange rates; transactions are translated at the average exchange rates during the year. The effects from the translation of foreign currencies in the current and prior year are cumulatively immaterial to the consolidated financial statements.

**Supplemental Cash Flow Information.** Cash paid for interest was $4,211,000 in fiscal year 2006 and $3,493,000 in fiscal year 2005.

**New Accounting Pronouncements.** In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). FIN 47 states that companies must recognize a liability for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. This interpretation applies to RAND’s corporate headquarters as well as to office site leases. RAND adopted FIN 47 during the fiscal year ended September 24, 2006. The adoption of FIN 47 did not have a material impact on RAND’s Consolidated Statements of Financial Position or Consolidated Statements of Activities and Changes in Net Assets.

In September 2006, the U.S. Securities and Exchange Commission staff issued Staff Accounting Bulletin (SAB) No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,” which provides interpretative guidance on the consideration of the effects of prior-year misstatements in quantifying current-year misstatements for the purpose of a materiality assessment.

SAB 108 requires companies to apply its provisions either by (i) restating prior financial statements or (ii) recording the cumulative effect as adjustments to the carrying values of assets and liabilities as of the beginning of the year of adoption with an offsetting adjustment recorded to the opening balance of Unrestricted Net Assets. The cumulative effect method of initially applying SAB 108 is permitted if the amount of the adjustment would have been material to the annual financial statements for the year preceding the adoption of SAB 108 or if the effect of recording the adjustment in the year of adoption would be material to those financial statements.

As more fully described below, RAND had misstatements in prior periods related to lease accounting and deferred compensation. These misstatements were not material to any individual prior period, but the correction of such errors during fiscal year 2006 on a cumulative basis would have been material to the RAND fiscal year 2006 consolidated financial statements. As such, RAND adopted SAB 108 in accordance with (ii) above using the cumulative effect method and adjusted the carrying values of its assets and liabilities with an offsetting adjustment to Unrestricted Net Assets as of September 26, 2005. The following table summarizes the effects of the adoption of SAB 108 (in thousands):
Period in Which the Misstatements Originated

<table>
<thead>
<tr>
<th>Leasedhold improvements(^1)</th>
<th>$6,962</th>
<th>$6,962</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation(^1)</td>
<td>(1,479)</td>
<td>(545)</td>
</tr>
<tr>
<td>Deferred rent(^1)</td>
<td>(10,137)</td>
<td>243</td>
</tr>
<tr>
<td>Deferred compensation(^2)</td>
<td>(463)</td>
<td>(37)</td>
</tr>
<tr>
<td>Impact on changes in net assets(^3)</td>
<td>(5,117)</td>
<td>(339)</td>
</tr>
<tr>
<td>Net assets(^4)</td>
<td>$5,456</td>
<td>$5,456</td>
</tr>
</tbody>
</table>

\(^1\) RAND did not recognize rent expense for the operating leases of various office sites in accordance with GAAP, which requires recognition of scheduled lease payment increases, rent incentives, and other charges and credits on a straight-line basis over the term of the lease. In addition, RAND did not capitalize leasehold improvements paid for by the landlords as is required by GAAP. As a result, rent and depreciation expense were understated by $4,654,000 (cumulatively) in years prior to fiscal year 2005 and by $302,000 in fiscal year 2005. RAND recorded a $6,962,000 increase in leasehold improvements, a $2,024,000 increase in accumulated depreciation, and a $9,894,000 increase in liability for deferred rent as of September 26, 2005, to correct these misstatements.

\(^2\) Pursuant to an employee deferred compensation plan, RAND did not accrue compensation expense totaling $463,000 (cumulatively) in years prior to fiscal year 2005 and $37,000 in fiscal year 2005. RAND recorded a total deferred compensation accrual of $500,000 as of September 26, 2005, to correct this misstatement.

\(^3\) Represents the net overstatement of change in net assets for the indicated periods resulting from these misstatements.

\(^4\) Represents the net overstatement of change in net assets for the indicated periods resulting from these misstatements.

3. Billed and Unbilled Costs and Fees:

The following table summarizes the components of billed and unbilled contract and grant costs and fees (in thousands):

<table>
<thead>
<tr>
<th>U.S. government agencies</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billed</td>
<td>$13,977</td>
<td>$10,314</td>
</tr>
<tr>
<td>Unbilled</td>
<td>14,905</td>
<td>14,644</td>
</tr>
<tr>
<td></td>
<td>28,882</td>
<td>24,958</td>
</tr>
<tr>
<td>State, local, and private sponsors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Billed</td>
<td>6,816</td>
<td>8,549</td>
</tr>
<tr>
<td>Unbilled</td>
<td>5,771</td>
<td>5,563</td>
</tr>
<tr>
<td></td>
<td>12,587</td>
<td>14,112</td>
</tr>
<tr>
<td>Allowance for bad debt</td>
<td>(501)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>39,070</td>
</tr>
</tbody>
</table>

Unbilled amounts principally represent recoverable costs and accrued fees billed in the first quarter of fiscal year 2007 and fiscal year 2006, respectively.

No significant contract terminations are anticipated at present, and past contract terminations have not resulted in significant unreimbursed costs.

4. Contributions Receivable:

Unconditional promises to give were $7,242,000 and $6,833,000 at September 24, 2006, and September 25, 2005, respectively. The receivables are recorded net of the discount for future cash flows, using the risk-free rate of return appropriate for the expected term of the promise to give determined at the time the unconditional promise to give is initially recognized (5–7%). Receivables expected in one year or less are included in Other receivables and receivables expected after one year are included in Other assets on the Consolidated Statements of Financial Position. The carrying amount of Contributions Receivable is deemed a reasonable estimate of their fair value.

Realization of the pledges is expected in the following periods (in thousands):

<table>
<thead>
<tr>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>In one year or less</td>
<td>$5,173</td>
</tr>
<tr>
<td>Between one year and five years</td>
<td>2,232</td>
</tr>
<tr>
<td>Five years or more</td>
<td>7,405</td>
</tr>
<tr>
<td>Less discount</td>
<td>(163)</td>
</tr>
<tr>
<td></td>
<td>$7,242</td>
</tr>
</tbody>
</table>
As more fully described in Note 9, contributions receivable are primarily intended for the following uses (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Temporarily restricted</td>
<td>$6,637</td>
<td>$4,245</td>
</tr>
<tr>
<td>Permanently restricted</td>
<td>605</td>
<td>2,588</td>
</tr>
<tr>
<td></td>
<td>$7,242</td>
<td>$6,833</td>
</tr>
</tbody>
</table>

During the fiscal year ended September 24, 2006, RAND received payments of prior-year pledges in the amount of $5,237,000. No allowance for uncollectible pledges was deemed necessary at September 24, 2006, or September 25, 2005.

Donors have made conditional promises to give of $2,999,000 and $2,948,000 as of September 24, 2006, and September 25, 2005, respectively. These conditional pledges, which include revocable deferred gifts, are not recorded in these consolidated financial statements.

5. Long-Term Investments:

Cash and cash equivalents included in long-term investments consist of commercial paper, money market funds, and other short-term investments and are carried at cost, which approximates fair value.

Long-term investments are presented at fair value and all related transactions are recorded on the trade date. The investments consist of funds in both domestic and foreign equity securities and bonds. Bond funds and equity funds include funds that are traded in public markets or that are available exclusively to institutional investors. For funds that are available exclusively to institutional investors, the underlying assets of the funds are traded in public markets. Alternative investments include RAND’s share of private equity funds and limited partnership arrangements for which there is no readily available market value. Alternative investments are carried at RAND’s net contribution and allocated share of undistributed profits and losses. The underlying value of the alternative investments may include assets for which the fair value is provided by the investment manager in good faith. Some of these investments have restrictions that limit RAND’s ability to withdraw funds as specified in the arrangements. RAND believes the carrying amount of these investments is a reasonable estimate of fair value.

As of September 24, 2006, and September 25, 2005, RAND had commitments outstanding to purchase alternative investments of $364,000 and $2,468,000, respectively.

Investment income is shown net of related expenses of $208,000 and $817,000, for the fiscal years ended September 24, 2006, and September 25, 2005, respectively.

Long-term investments consist of the following (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>$8,836</td>
<td>$2,035</td>
</tr>
<tr>
<td>Shares of bond funds, at fair value (cost, 2006—$74,095, and 2005—$70,643)</td>
<td>72,384</td>
<td>69,678</td>
</tr>
<tr>
<td>Shares of equity funds, at fair value (cost, 2006—$46,943, and 2005—$44,217)</td>
<td>71,263</td>
<td>61,550</td>
</tr>
<tr>
<td></td>
<td>$186,261</td>
<td>$173,012</td>
</tr>
</tbody>
</table>

6. Postretirement Benefits Other Than Pensions:

In addition to providing certain retirement benefits, RAND provides health care benefits to certain employees who retire having met the required age and years of service with RAND. This coverage also applies to their dependents. Retirees may elect coverage under the Preferred Provider Organization, various HMOs, or reimbursement of individually purchased Medigap policies. Medicare becomes the primary coverage for retirees when they reach age 65. Retirees and dependents share substantially in the cost of coverage. RAND retains the right, subject to existing agreements, to change or eliminate these benefits.

During 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the “Act”) was signed into law. The Act expanded Medicare to include, for the first time, coverage for prescription drugs (Medicare Part D). This new coverage was generally effective January 1, 2006. As of September 25, 2005, Medicare Part D subsidies are being reflected with respect to RAND’s postretirement benefit liabilities.

RAND’s retiree medical program already provides prescription drug coverage for retirees over age 65 that equals or exceeds the benefit to be provided under Medicare. As long as the retirees remain in the Company medical plan rather than enrolling in the new Medicare prescription drug coverage, Medicare will share the cost of the plan with the Company and the employees. This legislation has therefore reduced RAND’s share of the obligations for future retiree medical benefits.
The following table sets forth the plan’s funded status reconciled with the amount shown in the Consolidated Statements of Financial Position (in thousands):

<table>
<thead>
<tr>
<th>Change in benefit obligation</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit obligation at beginning of year</td>
<td>$ 20,292</td>
<td>$ 20,171</td>
</tr>
<tr>
<td>Service cost</td>
<td>655</td>
<td>690</td>
</tr>
<tr>
<td>Increase due to passage of time</td>
<td>1,146</td>
<td>1,210</td>
</tr>
<tr>
<td>Plan participants’ contributions</td>
<td>386</td>
<td>312</td>
</tr>
<tr>
<td>Actuarial (gain) loss</td>
<td>(1,422)</td>
<td>(1,075)</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(888)</td>
<td>(1,016)</td>
</tr>
<tr>
<td>Benefit obligation at end of year</td>
<td>20,169</td>
<td>20,292</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change in plan assets</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets at beginning of year</td>
<td>5,365</td>
<td>4,525</td>
</tr>
<tr>
<td>Actual return on plan assets</td>
<td>285</td>
<td>367</td>
</tr>
<tr>
<td>Employer contributions</td>
<td>942</td>
<td>1,177</td>
</tr>
<tr>
<td>Plan participants’ contributions</td>
<td>386</td>
<td>312</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(888)</td>
<td>(1,016)</td>
</tr>
<tr>
<td>Fair value of plan assets at end of year</td>
<td>6,090</td>
<td>5,365</td>
</tr>
<tr>
<td>Unfunded obligation</td>
<td>14,079</td>
<td>14,927</td>
</tr>
<tr>
<td>Unrecognized net actuarial gain</td>
<td>(1,338)</td>
<td>(2,902)</td>
</tr>
<tr>
<td>Unrecognized prior service cost</td>
<td>(5)</td>
<td>88</td>
</tr>
<tr>
<td>Accrued benefit pension cost</td>
<td>$ 12,736</td>
<td>$ 12,113</td>
</tr>
</tbody>
</table>

The following table provides the relevant weighted-average assumptions used:

<table>
<thead>
<tr>
<th>Assumption</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate used to determine benefit obligation</td>
<td>6.00%</td>
<td>5.75%</td>
</tr>
<tr>
<td>Discount rate used to determine net periodic postretirement benefit cost</td>
<td>5.75%</td>
<td>6.10%</td>
</tr>
<tr>
<td>Long-term rate of return on plan assets</td>
<td>8.00%</td>
<td>8.00%</td>
</tr>
</tbody>
</table>

Assumed health care cost trend rates are as follows:

<table>
<thead>
<tr>
<th>Assumption</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health care cost trend rate assumed for next year</td>
<td>9.50%</td>
<td>9.50%</td>
</tr>
<tr>
<td>Rate to which the cost trend rate is assumed to decline</td>
<td>5.00%</td>
<td>5.00%</td>
</tr>
<tr>
<td>Year that the rate reaches the ultimate trend rate</td>
<td>2013</td>
<td>2012</td>
</tr>
</tbody>
</table>

The health care cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the service cost and increase due to passage-of-time components of the fiscal year 2006 expense by $350,000 and the accumulated postretirement benefit obligation as of September 24, 2006, by $3,022,000. Decreasing the assumed health care cost trend rates by one percentage point in each year would decrease the service cost and decrease due to passage-of-time components of the fiscal year 2006 expense by $281,000 and the accumulated postretirement benefit obligation as of September 24, 2006, by $2,487,000.

The net periodic postretirement benefit cost for fiscal years ended September 24, 2006, and September 25, 2005, included the following components (in thousands):

<table>
<thead>
<tr>
<th>Component</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost-benefits attributed to service during the period</td>
<td>$ 655</td>
<td>$ 690</td>
</tr>
<tr>
<td>Increase in the accumulated postretirement benefit obligation to recognize the effects of the passage of time</td>
<td>1,146</td>
<td>1,210</td>
</tr>
<tr>
<td>Return on plan assets</td>
<td>(333)</td>
<td>(373)</td>
</tr>
<tr>
<td>Recognition of loss</td>
<td>190</td>
<td>385</td>
</tr>
<tr>
<td>Recognition of prior service cost</td>
<td>(93)</td>
<td>(93)</td>
</tr>
<tr>
<td>Net periodic postretirement benefit cost</td>
<td>$ 1,565</td>
<td>$ 1,819</td>
</tr>
</tbody>
</table>
The net periodic benefit cost for the fiscal year ended September 25, 2005, does not reflect Medicare Part D reimbursement, as the coverage was not effective until January 1, 2006. If the net periodic benefit cost for the fiscal year ended September 24, 2006, did not include Medicare Part D reimbursement, the net periodic benefit cost would have been $2,394,000.

The following benefit payments, which reflect expected future service and Medicare Part D subsidies, as appropriate, are expected to be paid (in thousands):

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Benefit Payments</th>
<th>Medicare Part D Subsidies</th>
<th>Net Benefit Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$767</td>
<td>$56</td>
<td>$711</td>
</tr>
<tr>
<td>2008</td>
<td>863</td>
<td>67</td>
<td>796</td>
</tr>
<tr>
<td>2009</td>
<td>980</td>
<td>80</td>
<td>900</td>
</tr>
<tr>
<td>2010</td>
<td>1,067</td>
<td>92</td>
<td>975</td>
</tr>
<tr>
<td>2011</td>
<td>1,152</td>
<td>105</td>
<td>1,047</td>
</tr>
<tr>
<td>Next five years</td>
<td>6,857</td>
<td>758</td>
<td>6,099</td>
</tr>
</tbody>
</table>

Asset allocations at September 24, 2006, and September 25, 2005, by asset category are as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and short term</td>
<td>27%</td>
<td>22%</td>
</tr>
<tr>
<td>Shares of bond funds, at fair value</td>
<td>29</td>
<td>27</td>
</tr>
<tr>
<td>Shares of equity funds, at fair value</td>
<td>26</td>
<td>32</td>
</tr>
<tr>
<td>Alternative investments</td>
<td>18</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

RAND contributes to a Voluntary Employee Benefit Association irrevocable trust that is used to partially fund health care benefits for future retirees. In general, retiree health benefits are paid as covered expenses are incurred.

7. Borrowing Arrangements:

Revenue Bonds. In July 2002, RAND issued $130,000,000 of tax-exempt revenue bonds to finance construction of its new Santa Monica facility. The payment of the principal and interest on the bonds is insured by a third party. Long-term debt, including unamortized bond premium, is as follows (in thousands):

<table>
<thead>
<tr>
<th>Bond Description</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>California Infrastructure and Economic Development Fixed Rate Revenue Bonds,</td>
<td>$32,326</td>
<td>$32,671</td>
</tr>
<tr>
<td>Series 2002A, issued in the original principal amount of $32,500,000, in connection with the construction of a new facility in Santa Monica, California, in July 2002; interest rates ranging from 3.50% to 5.50%; annual principal payments ranging from $345,000 to $1,905,000, beginning April 1, 2006, and ending April 1, 2042, including unamortized bond premium of $171,000 and $176,000 as of September 24, 2006, and September 25, 2005, respectively</td>
<td>$32,326</td>
<td>$32,671</td>
</tr>
<tr>
<td>California Infrastructure and Economic Development Bank Variable Rate Revenue Bonds, Series 2002B, issued in the original principal amount of $97,500,000, in connection with the construction of a new facility in Santa Monica, California, in July 2002; average interest rate of 3.4% and 3.1% as of September 24, 2006, and September 25, 2005, respectively; annual principal payments ranging from $1,430,000 to $4,400,000, beginning April 1, 2006, and ending April 1, 2042</td>
<td>$95,430</td>
<td>$97,500</td>
</tr>
<tr>
<td></td>
<td>$127,756</td>
<td>$130,171</td>
</tr>
</tbody>
</table>

Annual bond principal payments are required in the following fiscal years (in thousands):

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$1,785</td>
</tr>
<tr>
<td>2008</td>
<td>$1,835</td>
</tr>
<tr>
<td>2009</td>
<td>$1,910</td>
</tr>
<tr>
<td>2010</td>
<td>$1,970</td>
</tr>
<tr>
<td>2011</td>
<td>$ 2,040</td>
</tr>
<tr>
<td>Thereafter</td>
<td>$118,045</td>
</tr>
<tr>
<td></td>
<td>$127,585</td>
</tr>
</tbody>
</table>
Accrued interest payable relating to the bonds was $1,035,000 and $987,000 as of September 24, 2006, and September 25, 2005, respectively. The estimated fair value of RAND’s revenue bonds, including the current portion, was $129,139,000 and $131,407,000 as of September 24, 2006, and September 25, 2005, respectively.

**Line of Credit.** RAND has an uncollateralized line of credit in the principal amount of $18,000,000 at September 24, 2006, which expires in May 2007. The line of credit contains covenants that require RAND to maintain a minimum amount of liquid assets and tangible net worth. There were no amounts outstanding at September 24, 2006, and September 25, 2005. Under the terms of the credit agreement, interest is payable monthly at either the prime rate less .75 percent or the LIBOR rate plus 1.5 percent, as selected by RAND. No amounts were drawn on the line of credit agreement in fiscal year 2006 and the largest amount drawn on the line-of-credit agreement was $4,600,000 in fiscal year 2005.

RAND’s total interest expense was $4,718,000 and $3,694,000 for the fiscal years ended September 24, 2006, and September 25, 2005, respectively.

8. **Commitments and Contingencies:**

**Lease Commitments.** Operating lease commitments, net of $6,367,000 representing subleases, are as follows (in thousands):

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>7,007</td>
</tr>
<tr>
<td>2008</td>
<td>7,382</td>
</tr>
<tr>
<td>2009</td>
<td>8,042</td>
</tr>
<tr>
<td>2010</td>
<td>8,214</td>
</tr>
<tr>
<td>2011</td>
<td>8,268</td>
</tr>
<tr>
<td>Thereafter</td>
<td>32,687</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>71,600</strong></td>
</tr>
</tbody>
</table>

Future minimum rentals are primarily comprised of office, equipment, and warehouse space leases. Certain of RAND’s office leases contain rent escalation clauses and fair-market renewal options. All property leases generally require RAND to pay for utilities, insurance, taxes, and maintenance. RAND’s net rental expense was $8,285,000 and $6,911,000 for the fiscal years ended September 24, 2006, and September 25, 2005, respectively.

**Construction Commitment.** Under the Final Guaranteed Maximum Price Contract related to the construction of its new headquarters facility in Santa Monica, California, RAND’s total obligation was $77,579,000. As of September 24, 2006, and September 25, 2005, $77,240,000 and $75,545,000, respectively, had been billed under the contract. The building was placed in service September 27, 2004. RAND’s remaining obligation of $530,000 and $2,661,000 as of September 24, 2006, and September 25, 2005, respectively, was included in Accounts payable and other liabilities in the Consolidated Statements of Financial Position.

**Other Commitments.** Contract costs billed to government clients are subject to audit by the Defense Contract Audit Agency (“DCAA”). Resulting indirect cost adjustments, if any, are prorated to all contracts. Contract costs billed prior to September 25, 2005, have been audited and accepted. To date, there have been no significant cost disallowances. In the opinion of management, contract costs billed subsequent to September 25, 2005, are allowable, and any potential cost disallowance would not materially affect RAND’s consolidated financial position, results of operations, or cash flows.

RAND has certain contingent liabilities with respect to claims arising from the ordinary course of business. In the opinion of management, such contingent liabilities will not result in any loss that would materially affect RAND’s financial position, results of operations, or cash flows.

**Environmental Remediation.** Under the terms of an agreement with the City of Santa Monica (the “City”) for the sale of land owned by RAND, RAND is responsible for the demolition of existing buildings on the site and environmental remediation with respect to the underlying land.

During 2006, RAND reevaluated its estimate of costs related to the demolition and remediation. Based on the most current information available, RAND accrued an additional $5,551,000, which is included in Remediation related to land sale on the Consolidated Statements of Activities and Changes in Net Assets. The estimated outstanding liability associated with the demolition and environmental remediation is $3,497,000 and $7,392,000 as of September 24, 2006, and September 25, 2005, respectively. In accordance with the terms of the agreement, an escrow account has been established to ensure performance of these matters. Also, under the terms of the agreement with the City, RAND must indemnify the City for claims related to the presence of hazardous materials at the site for a period until ten years after the demolition of the old buildings and completion of soil and groundwater remediation. There can be no assurance that future claims for indemnity will not have a material adverse effect on RAND’s consolidated results of operations or cash flows.

During December 2006, the City advised RAND that all demolition and remediation requirements under the terms of the agreement had been fulfilled and authorized release of the remaining funds from the escrow account. RAND received $1,058,000 in January 2007.
9. **Net Assets:**

**Board-Designated Net Assets.** Board-designated net assets are available for the following purposes (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Designated for investment</td>
<td>$134,079</td>
<td>$130,922</td>
</tr>
<tr>
<td>Designated for special use:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RAND Education</td>
<td>3,150</td>
<td>2,754</td>
</tr>
<tr>
<td>RAND Institute for Civil Justice</td>
<td>2,355</td>
<td>2,140</td>
</tr>
<tr>
<td>National Security Research and Training</td>
<td>2,350</td>
<td>2,013</td>
</tr>
<tr>
<td>President's Fund</td>
<td>514</td>
<td>439</td>
</tr>
<tr>
<td>Bing Center for Health Economics</td>
<td>369</td>
<td>—</td>
</tr>
<tr>
<td>Pardee RAND Graduate School</td>
<td>207</td>
<td>104</td>
</tr>
<tr>
<td>Lectureship on Science Policy</td>
<td>151</td>
<td>125</td>
</tr>
<tr>
<td>Other</td>
<td>279</td>
<td>155</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>9,375</td>
<td>7,730</td>
</tr>
<tr>
<td><strong>$143,454</strong></td>
<td><strong>$138,652</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Temporarily Restricted Net Assets.** Temporarily restricted net assets are available for the following purposes (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pardee RAND Graduate School</td>
<td>$3,326</td>
<td>$3,047</td>
</tr>
<tr>
<td>RAND Center for Middle East Public Policy</td>
<td>2,756</td>
<td>3,165</td>
</tr>
<tr>
<td>RAND Health</td>
<td>2,180</td>
<td>752</td>
</tr>
<tr>
<td>Bing Center for Health Economics</td>
<td>1,818</td>
<td>—</td>
</tr>
<tr>
<td>National Security Research and Training</td>
<td>1,809</td>
<td>1,706</td>
</tr>
<tr>
<td>RAND Center for Russia and Eurasia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RAND Business Leaders Forum</td>
<td>1,391</td>
<td>1,257</td>
</tr>
<tr>
<td>General support</td>
<td>228</td>
<td>337</td>
</tr>
<tr>
<td>RAND Institute for Civil Justice</td>
<td>1,209</td>
<td>271</td>
</tr>
<tr>
<td>LRN-RAND Center for Corporate Ethics, Law, and Governance</td>
<td>911</td>
<td>28</td>
</tr>
<tr>
<td>RAND Headquarters</td>
<td>900</td>
<td>854</td>
</tr>
<tr>
<td>RAND Center for Domestic and International Health Security</td>
<td>815</td>
<td>1,255</td>
</tr>
<tr>
<td>RAND Center for Asia Pacific Policy</td>
<td>766</td>
<td>329</td>
</tr>
<tr>
<td>RAND Pardee Center for Longer Range Global Policy</td>
<td>671</td>
<td>494</td>
</tr>
<tr>
<td>Paul O'Neill Alcoa Professorship in Policy Analysis</td>
<td>617</td>
<td>497</td>
</tr>
<tr>
<td>RAND Child Policy</td>
<td>483</td>
<td>513</td>
</tr>
<tr>
<td>RAND Center for Terrorism and Risk Management Policy</td>
<td>400</td>
<td>10</td>
</tr>
<tr>
<td>RAND Infrastructure, Safety, and Environment</td>
<td>307</td>
<td>33</td>
</tr>
<tr>
<td>Kauffman Center for Small Business Regulation</td>
<td>278</td>
<td>709</td>
</tr>
<tr>
<td>Other</td>
<td>805</td>
<td>674</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$21,670</td>
<td>$15,931</td>
</tr>
</tbody>
</table>
Permanently Restricted Net Assets. Permanently restricted assets are shown below by the purpose designated by the donor. The assets are invested in perpetuity and the income is available to support the restricted activities (in thousands):

<table>
<thead>
<tr>
<th>Purpose</th>
<th>September 24, 2006</th>
<th>September 25, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pardee RAND Graduate School</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General support</td>
<td>$11,711</td>
<td>$10,238</td>
</tr>
<tr>
<td>Awards and scholarships</td>
<td>2,862</td>
<td>2,682</td>
</tr>
<tr>
<td>National Security Research and Training</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td>RAND Institute for Civil Justice</td>
<td>4,134</td>
<td>4,134</td>
</tr>
<tr>
<td>RAND Pardee Center for Longer Range Global Policy</td>
<td>3,670</td>
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<tr>
<td>RAND—general support</td>
<td>3,565</td>
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<tr>
<td>Paul O’Neill Alcoa Professorship in Policy Analysis</td>
<td>2,479</td>
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<td>Research Position Endowment</td>
<td>1,500</td>
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<td>RAND Education</td>
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<td>RAND Center for Russia and Eurasia</td>
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<tr>
<td>Lectureship on Science Policy</td>
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<tr>
<td>Other</td>
<td>5</td>
<td>31</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$35,192</strong></td>
<td><strong>$33,563</strong></td>
</tr>
</tbody>
</table>

10. Employee Retirement Plans:
RAND has three defined contribution employee plans: a Qualified Retirement Plan ("QRP"), a Supplemental Retirement Annuity Plan ("SRAP"), and a Nonqualified Supplementary Plan ("NSP"). Most full-time, regular employees are eligible to participate in the QRP and SRAP. Certain employees are eligible to participate in the NSP. RAND has reserved the right to terminate the plans at any time, but in such an event, the benefits already purchased by the participant and contributions already made by RAND would not be affected. The QRP and the NSP are entirely RAND-financed. RAND's contributions to the Plans for eligible employees range from 5 percent to 14 percent of salaries, depending on the level of wages and age of the participating employee. RAND's contributions to the QRP vest at the earlier of retirement or four years of service. Vesting begins after two years of service and increases weekly to 100 percent at the end of four years of service. The NSP vests under various conditions specified in the plan. All contributions made by RAND are charged to operations. RAND's contributions were $9,490,000 and $9,355,000 for the fiscal years ended September 24, 2006, and September 25, 2005, respectively. The SRAP only requires employee contributions and RAND does not contribute to this plan.

11. Termination Benefits:
FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities (FAS 146), includes a provision that a liability for one-time termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement must be recognized in the period(s) in which the liability is incurred. During fiscal year 2006, RAND initiated the centralization of the operations of RAND Europe to its Cambridge office. This centralization includes closure of its offices in Berlin, Germany (completed in fiscal year 2006) and Leiden, The Netherlands (to be completed in fiscal year 2007). Included in management and general expenses on the Consolidated Statement of Activities and Changes in Net Assets and in accounts payable and other liabilities on the Consolidated Statement of Financial Position is $1,536,000 in one-time termination benefits for certain employees of RAND Europe who were involuntarily terminated. An additional $203,000 in termination benefits is anticipated to be incurred during fiscal year 2007.

12. Discontinued Operations:
At the close of business on September 30, 2005, CAE separated from RAND. Under the terms of the separation agreement, RAND released any claims to CAE’s intellectual property. In return, CAE agreed to pay RAND $600,000 in cash and to provide a $631,000 noninterest-bearing promissory note collateralized by CAE’s intellectual property and payable in installments of $400,000 at September 30, 2006, and $231,000 at September 30, 2007. There was no gain or loss recognized on separation.
CAE’s revenues and expenses were approximately $2,600,000 and $2,500,000, respectively, for the year ended September 25, 2005. These operating results were reclassified to Discontinued operations on the Consolidated Statements of Activities and Changes in Net Assets.
Upon separation, CAE and RAND entered into contracts for each organization to provide services to the other for research or consulting on specific projects.
The greater diversity in our backgrounds and experiences, the greater the problems we can solve together, and the greater the service we can be to the world.
The RAND Corporation is a nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world.

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