Notes to Consolidated Financial Statements

June 30, 2011 and 2010

Note 1—Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation: The University of Michigan (the "University") is a state-supported institution with an enrollment of approximately 59,000 students on its three campuses. The financial statements include the individual schools, colleges and departments, the University of Michigan Hospitals and Health Centers, Michigan Health Corporation (a wholly-owned corporation created to pursue joint venture and managed care initiatives) and Veritas Insurance Corporation (a wholly-owned captive insurance company). While the University is a political subdivision of the state of Michigan, it is not a component unit of the State in accordance with the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*. The University is classified as a state instrumentality under Internal Revenue Code Section 115, and is also classified as a charitable organization under Internal Revenue Code Section 501(c)(3), and is therefore exempt from federal income taxes. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, as prescribed by GASB and the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Audits of State and Local Governments*. The statements of net assets, revenues, expenses and changes in net assets and of cash flows are reported on a consolidated basis, and all intra-university transactions are eliminated as required by GASB. The University has the option of applying pronouncements issued by the Financial Accounting Standards Board ("FASB") after November 30, 1989, provided that such pronouncements do not conflict or contradict GASB pronouncements. The University has elected not to apply any FASB pronouncements issued after the applicable date.

The financial statements of all controlled organizations are included in the University's financial statements; affiliated organizations that are not controlled by, and not dependent on the University, such as booster and alumni organizations, are not included.

Net assets are categorized as:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:

  Nonexpendable—Net assets subject to externally imposed stipulations that they be maintained permanently. Such net assets include the corpus portion (historical value) of gifts to the University's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

  Expendable—Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time. Such net assets include net appreciation of the University's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- Unrestricted: Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents. Substantially all unrestricted net assets are designated for academic and research programs and initiatives and capital programs.

Note 1—Organization and Summary of Significant Accounting Policies, continued

Summary of Significant Accounting Policies: The accompanying financial statements have been prepared on the accrual basis. The University reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

For purposes of the statement of cash flows, the University considers all highly liquid investments purchased with a maturity of three months or less, to be cash equivalents. Cash equivalents representing assets of the University's endowment, life income and other investments are included in noncurrent investments as these funds are not used for operating purposes.

Investments are reported in four categories in the statement of net assets. Investments reported as endowment, life income and other investments are those funds invested in portfolios that are considered by management to be of a long duration. Investments for student loan and capital activities are those funds that are intended to be used for these specific activities. All other investments are reported as operating investments.

Investments in marketable securities are carried at fair value, as established by the major securities markets. Purchases and sales of investments are accounted for on the trade date basis. Investment income is recorded on the accrual basis. Realized and unrealized gains and losses are reported in investment income.

Investments in nonmarketable limited partnerships are generally carried at fair value provided by the management of the investment partnerships as of March 31, 2011 and 2010, as adjusted by cash receipts, cash disbursements and securities distributions through June 30, 2011 and 2010, in order to provide an approximation of fair value at June 30. In addition, the carrying amount of these investments is adjusted for June 30 information from management of the investment partnerships when necessary to provide a reasonable estimate of fair value as of June 30, 2011 and 2010. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed and such differences could be material.

Derivative instruments, such as financial futures, forward foreign exchange contracts and interest rate swaps held in investment portfolios, are recorded on the contract date and are carried at fair value using listed price quotations or amounts that approximate fair value. To facilitate trading in financial futures, the University is required to post cash or securities to satisfy margin requirements of the exchange where such futures contracts are listed. The University monitors the required amount of cash and securities on deposit for financial futures transactions and withdraws or deposits cash or securities as necessary.

Investments denominated in foreign currencies are translated into U.S. dollar equivalents using year-end spot foreign currency exchange rates. Purchases and sales of investments denominated in foreign currencies and related income are translated at spot exchange rates on the transaction dates.

Accounts receivable are recorded net of a provision for uncollectible accounts receivable. The provision is based on management's judgment of potential uncollectible amounts, which includes such factors as historical experience and type of receivable.

The University receives pledges and bequests of financial support from corporations, foundations and individuals. Revenue is recognized when a pledge representing an unconditional promise to pay is received and all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Permanent endowment pledges do not meet eligibility requirements, as defined by GASB, and are not recorded as assets until the related gift is received.

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are made, commensurate with expected future payments. An allowance for uncollectible pledges receivable is provided based on management's judgment of potential uncollectible amounts. The determination includes such factors as prior collection history, type of gift and nature of fundraising.

Capital assets are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided on a straight-line basis over the estimated useful lives of the respective assets, which primarily range from four to 40 years. The University does not capitalize works of art or historical treasures that are held for exhibition, education, research or public service. These collections are neither disposed of for financial gain nor encumbered in any means. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Deferred revenue consists primarily of cash received from grant and contract sponsors which has not yet been earned under the terms of the agreement. Deferred revenue also includes amounts received in advance of an event, such as student tuition and advance ticket sales related to future fiscal years.

Deposits of affiliates and others represent cash and invested funds held by the University as a result of agency relationships with various groups. Noncurrent deposits of affiliates represent the portion of endowment and similar funds held by the University on behalf of others.

The University holds life income funds for beneficiaries of the pooled income fund, charitable remainder trusts and the gift annuity program. These funds generally pay lifetime income to beneficiaries, after which the principal is made available to the University in accordance with donor intentions. All life income fund assets, including those held in trust, are recorded at fair value. The present value of estimated future payments due to life income beneficiaries is recorded as a liability.

For donor restricted endowments, the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate amounts for endowment spending rule distributions as is considered prudent. The University's policy is to retain net realized and unrealized appreciation with the endowment after spending rule distributions. Net appreciation of permanent endowment funds, which totaled $1,312,000,000 and $924,000,000 at June 30, 2011 and 2010, respectively, is recorded in restricted expendable net assets. The University's endowment spending rule is further discussed in Note 2.

Student tuition and residence fees are presented net of scholarships and fellowships applied to student accounts, while stipends and other payments made directly to students are presented as scholarship and fellowship expenses.

Patient care revenues are reported net of contractual allowances and bad debt expenses. Patient care services are primarily provided through the University of Michigan Health System, which includes the Hospitals and Health Centers, the Faculty Group Practice of the University of Michigan Medical School and the Michigan Health Corporation. Patient care services are also provided through University Health Services, which provides health care services to students, faculty and staff and Dental Faculty Associates, which provides dental care services performed by faculty dentists.

Other auxiliary enterprise revenues primarily represent revenues generated by intercollegiate athletics, parking, student unions, university press and student publications.

The University's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net assets are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, as defined by GASB, including state appropriations, state fiscal stabilization funds, federal Pell grants, gifts and investment income.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The most significant areas that require management estimates relate to self-insurance and benefits obligations.

Reclassifications: Certain prior year amounts have been reclassified to conform with current year presentations.

Note 2—Cash and Investments

Summary: The University maintains centralized management for substantially all of its cash and investments. With the exception of certain insurance reserves, charitable remainder trusts and other funds whose terms require separate management, the University invests its cash reserves and relatively short duration assets in the University Investment Pool ("UIP"). The University also collectively invests substantially all of the assets of its endowment funds (University Endowment Fund) together with a portion of its insurance and benefits reserves, charitable remainder trusts and gift annuity program in the Long Term Portfolio.

The UIP is invested together with the University's insurance and other benefits reserves in the Daily and Monthly Portfolios, which are principally invested in investment-grade money market securities, U.S. government and other fixed income securities and absolute return strategies. Balances in the UIP are primarily for operating expenses and capital projects. The funding for capital projects remains in current operating investments until amounts for specific capital projects are transferred for capital activities.

The longer investment horizon of the Long Term Portfolio allows for an equity-oriented strategy to achieve higher expected returns over time, and permits the use of less liquid alternative investments, providing for equity diversification beyond the stock markets. The Long Term Portfolio includes investments in domestic and non-U.S. stocks and bonds, commingled funds and limited partnerships consisting of venture capital, private equity, real estate, energy and absolute return strategies.

Authorizations: The University's investment policies are governed and authorized by University Bylaws and the Board of Regents. The approved asset allocation policy for the Long Term Portfolio sets a general target of 80 percent equities and 20 percent fixed income securities, within a permitted range of 65 to 90 percent for equities and 10 to 35 percent for fixed income securities. Since diversification is a fundamental risk management strategy, the Long Term Portfolio is broadly diversified within these general categories.

The endowment spending rule provides for distributions from the University Endowment Fund to the University entities that benefit from the endowment fund. Commencing with the quarter ending September 30, 2010, the annual distribution rate began to be reduced from 5 percent of the one-quarter lagged seven year moving average fair value of fund shares to 4.5 percent. Distributions are being managed toward the new rate by keeping quarter to quarter distributions per share unchanged and moving toward the 4.5 percent rate when increases in the value of fund shares would otherwise result in higher per share distributions. To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. Distributions are also made from the UIP to University entities based on the 90-day U.S. Treasury Bill rate. The University's costs to administer and grow the University Endowment Fund and UIP are funded by investment returns.

Cash and Cash Equivalents: Cash and cash equivalents, which totaled $316,534,000 and $194,645,000 at June 30, 2011 and 2010, respectively, represent short-term money market investments in mutual funds, overnight collective funds managed by the University's custodian or short-term highly liquid investments registered as securities and held by the University or its agents in the University's name. Of its cash and cash equivalents, the University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation ("FDIC") limits in the amount of $50,000 and $6,838,000 at June 30, 2011 and 2010, respectively. Under FDIC rules implemented during 2011, the University's noninterest-bearing transaction accounts have temporarily unlimited insurance coverage through December 31, 2012. The University does not require deposits to be collateralized or insured.

Investments: At June 30, 2011 and 2010, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows:

(in thousands)	**2011**	**2010**
Cash equivalents, noncurrent	$ 247,650	$ 122,474
Fixed income securities	1,435,082	1,372,232
Commingled funds	1,571,478	1,379,961
Equity securities	1,002,151	819,510
Nonmarketable alternative investments	4,941,887	4,024,853
Other investments	8,248	6,775
	$ 9,206,496	$ 7,725,805

The University's investment strategy, like that of most other institutions, incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts recorded in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forwards, futures and commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counterparty to perform according to the terms of the contract. The University's risk of loss in the event of a counterparty default is typically limited to the amounts recognized in the statement of net assets and is not represented by the contract or notional amounts of the instruments.

Fixed income securities have inherent financial risks, including credit risk and interest rate risk. Credit risk for fixed income securities is the risk that the issuer will not fulfill its obligations. Nationally recognized statistical rating organizations ("NSROs"), such as Moody's and Standard & Poor's, assign credit ratings to security issues and issuers that indicate a measure of potential credit risk to investors. Fixed income securities considered investment grade are those rated at least Baa by Moody's and BBB by Standard & Poor's. To manage credit risk, the University specifies minimum average and minimum absolute quality NSRO ratings for securities held pursuant to its management agreements.

The University minimizes concentration of credit risk, the risk of a large loss attributed to the magnitude of the investment in a single issuer of fixed income securities, by diversifying its fixed income issues and issuers and holding U.S. Treasury securities which are considered to have minimal credit risk. The University also manages this risk at the account level by limiting each fixed income manager's holding of any non-U.S. government issuer to 5 percent of the value of the investment account.

Notes to Consolidated Financial Statements

Note 2—Cash and Investments, continued

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of fixed income securities. Effective duration, a commonly used measure of interest rate risk, incorporates a security's yield, coupon, final maturity, call features and other embedded options into one number expressed in years that indicates how price-sensitive a security or portfolio of securities is to changes in interest rates. The effective duration of a security or portfolio indicates the approximate percentage change in fair value expected for a one percent change in interest rates. The longer the duration, the more sensitive the security or portfolio is to changes in interest rates. The weighted average effective duration of the University's fixed income securities was 5.0 years at June 30, 2011, compared to 5.1 years at June 30, 2010. The University manages the effective duration of its fixed income securities at the account level, where fixed income managers generally may not deviate from the duration of their respective benchmarks by more than 25 percent.

The composition of fixed income securities at June 30, 2011 and 2010, along with credit quality and effective duration measures, is summarized as follows:

2011

(in thousands)	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 96,076				$ 96,076	7.3
U.S. Treasury inflation protected	324,503				324,503	4.2
U.S. government agency	226,764				226,764	0.7
Mortgage backed		$ 27,941	$ 21,144		49,085	0.9
Asset backed		32,527	1,036		33,563	1.2
Corporate and other		677,307	17,525	$ 10,259	705,091	7.0
	$ 647,343	$ 737,775	$ 39,705	$ 10,259	$ 1,435,082	5.0

2010

(in thousands)	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 92,098				$ 92,098	8.7
U.S. Treasury inflation protected	309,926				309,926	3.7
U.S. government agency	178,941				178,941	0.6
Mortgage backed		$ 24,696	$ 19,930		44,626	1.8
Asset backed		40,857	3,676		44,533	2.9
Corporate and other		680,954	13,235	$ 7,919	702,108	6.8
	$ 580,965	$ 746,507	$ 36,841	$ 7,919	$ 1,372,232	5.1

Of the University's fixed income securities, 97 percent were rated investment grade or better at June 30, 2011 and 2010, with 52 percent and 48 percent of these securities rated AAA/Aaa or better at June 30, 2011 and 2010, respectively.

Commingled (pooled) funds include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures which are generally unrated and unregulated. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy. These investments are structured to limit the University's risk exposure to the amount of invested capital. The composition of commingled funds at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Absolute return	$ 764,844	$ 700,300
U.S. equities	101,890	77,588
Non-U.S./global equities	681,154	585,743
U.S. fixed income	15,123	8,607
Other	8,467	7,723
	$ 1,571,478	$ 1,379,961

Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Of the University's commingled funds at June 30, 2011 and 2010, approximately 76 percent and 80 percent are redeemable within one year, with 51 percent redeemable within 90 days for both years under normal market conditions. The remaining amounts are redeemable beyond one year, with redemption of certain funds dependent on disposition of the underlying assets.

Nonmarketable alternative investments consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. There is no active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner. The composition of these partnerships at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Private equity	$ 1,326,341	$ 1,085,145
Real estate	1,026,564	811,071
Absolute return	845,500	828,903
Energy	806,915	705,180
Venture capital	936,567	594,554
	$ 4,941,887	$ 4,024,853

The University's limited partnership investments are diversified in terms of manager selection and industry and geographic focus. At June 30, 2011 and 2010, no individual partnership investment represented 5 percent or more of total investments. The University's committed but unpaid obligation to these limited partnerships is further discussed in Note 13.

Absolute return strategies in the commingled funds and nonmarketable alternative investments classifications include long/short stock programs, merger arbitrage, intra-capital structure arbitrage and distressed debt investments. The goal of absolute return strategies is to provide, in aggregate, a return that is consistently positive and uncorrelated with the overall market.

The University participates in non-U.S. developed and emerging markets through commingled funds invested in non-U.S./global equities and absolute return strategies. Although substantially all of these funds are reported in U.S. dollars, both price changes of the underlying securities in local markets and changes to the value of local currencies relative to the U.S. dollar are embedded in the investment returns. In addition, a portion of the University's equity securities and nonmarketable alternative investments are denominated in foreign currencies, which must be settled in local (non-U.S.) currencies. Forward foreign currency contracts are typically used to manage the risk related to fluctuations in currency exchange rates between the time of purchase or sale and the actual settlement of foreign securities. Various investment managers acting for the University also use forward foreign exchange contracts in risk-based transactions to carry out their portfolio strategies.

Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. The value of the University's non-U.S. dollar holdings net of outstanding forward foreign exchange contracts at June 30, 2011 and 2010 totaled $1,224,168,000, or 13 percent of total investments and $906,342,000, or 12 percent of total investments, respectively, and is summarized as follows:

(in thousands)	2011	2010
Euros	$ 642,096	$ 419,172
British pounds sterling	175,837	125,487
Canadian dollar	104,274	28,938
Japanese yen	60,682	83,596
Other	241,279	249,149
	$ 1,224,168	$ 906,342

The University manages foreign exchange risk through the use of forward foreign currency contracts and manager agreements that provide minimum diversification and maximum exposure limits by country and currency.

The Daily and Monthly Portfolios held positions in bond futures at June 30, 2011 and 2010. Bond futures are used to adjust the duration of cash equivalents and the fixed income portion of the portfolios. To meet trading margin requirements, the University had U.S. government securities and cash with a fair value of $5,016,000 and $4,422,000 at June 30, 2011 and 2010, respectively, on deposit with its futures contract broker as collateral.

The Long Term Portfolio and the Monthly Portfolio participate in a short-term, fully collateralized, securities lending program administered by the University's master custodian. Together, the Portfolios had $103,600,000 and $115,500,000 in securities loans outstanding at June 30, 2011 and 2010, respectively. At loan inception, an approved borrower must deliver collateral of cash, securities or letters of credit to the University's lending agent equal to 102 percent of fair value for domestic securities and 105 percent for foreign securities. Collateral positions are monitored daily to ensure that borrowed securities are never less than 100 percent collateralized. At June 30, 2011, collateral of $107,900,000 (104 percent of securities on loan) includes invested cash of $100,600,000, University payables of $7,100,000 and U.S. government securities of $200,000, while at June 30, 2010, collateral of $119,800,000 (104 percent of securities on loan) includes invested cash of $103,500,000, University payables of $7,500,000 and U.S. government securities of $8,800,000. Cash collateral held by the University's lending agent, along with the offsetting liability to return the collateral at loan termination, are recorded in the statement of net assets. To conform with current year presentation, the 2010 statement of net assets has been revised to reflect the recording of these items. Neither the University nor its securities lending agent has the ability to pledge or sell securities received as collateral unless a borrower defaults; accordingly, noncash collateral is not recorded in the statement of net assets. Securities loans may be terminated upon notice by either the University or the borrower.

Note 3—Accounts Receivable

The composition of accounts receivable at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Patient care	$ 430,378	$ 436,818
Sponsored programs	80,997	82,464
State appropriations, educational and capital	65,796	65,875
Student accounts	22,858	21,626
Other	40,234	35,999
	640,263	642,782
Less provision for uncollectible accounts receivable	187,652	181,160
	$ 452,611	$ 461,622

Note 4—Notes and Pledges Receivable

The composition of notes and pledges receivable at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Notes:		
Federal student loan programs	$ 89,271	$ 94,432
University student loan funds	21,012	20,756
Other	542	734
	110,825	115,922
Less allowance for doubtfully collectible notes	3,100	2,800
Total notes receivable, net	107,725	113,122
Gift pledges outstanding:		
Capital	102,246	112,790
Operations	60,680	61,764
	162,926	174,554
Less:		
Allowance for doubtfully collectible pledges	9,643	6,925
Unamortized discount to present value	8,063	11,149
Total pledges receivable, net	145,220	156,480
Total notes and pledges receivable, net	252,945	269,602
Less current portion	58,586	57,960
	$ 194,359	$ 211,642

The principal repayment and interest rate terms of federal and university loans vary considerably. The allowance for doubtfully collectible notes only applies to University funded notes and the University portion of federal student loans, as the University is not obligated to fund the federal portion of uncollected student loans. Federal loan programs are funded principally with federal advances to the University under the Perkins and various health professions loan programs.

Payments on pledges receivable at June 30, 2011, are expected to be received in the following years ended June 30 (in thousands):

2012	$ 49,552
2013-2016	89,772
2017 and after	23,602
	$ 162,926

As discussed in Note 1, permanent endowment pledges do not meet eligibility requirements, as defined by GASB, until the related gift is received. Accordingly, permanent endowment pledges totaling approximately $59,374,000 and $68,580,000 at June 30, 2011 and 2010, respectively, are not recognized as assets in the accompanying financial statements. In addition, bequest intentions and other conditional promises are not recognized as assets until the specified conditions are met because of uncertainties with regard to their realizability and valuation.

Note 5—Capital Assets

Capital assets activity for the years ended June 30, 2011 and 2010 is summarized as follows:

2011

(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 93,964	$ 401		$ 94,365
Land improvements	102,274	4,961	$ 386	106,849
Infrastructure	213,772	3,819		217,591
Buildings	5,862,797	224,893	65,719	6,021,971
Construction in progress	545,595	279,312		824,907
Property held for future use	84,339	(30,516)		53,823
Equipment	1,623,287	128,267	122,840	1,628,714
Library materials	449,842	23,572		473,414
	8,975,870	634,709	188,945	9,421,634
Less accumulated depreciation	4,019,413	390,071	181,023	4,228,461
	$ 4,956,457	$ 244,638	$ 7,922	$ 5,193,173

2010

(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 89,217	$ 4,747		$ 93,964
Land improvements	97,743	4,857	$ 326	102,274
Infrastructure	200,271	13,501		213,772
Buildings	5,112,648	760,634	10,485	5,862,797
Construction in progress	786,480	(240,885)		545,595
Property held for future use	114,029	(29,690)		84,339
Equipment	1,509,299	160,590	46,602	1,623,287
Library materials	428,609	21,522	289	449,842
	8,338,296	695,276	57,702	8,975,870
Less accumulated depreciation	3,710,798	360,089	51,474	4,019,413
	$ 4,627,498	$ 335,187	$ 6,228	$ 4,956,457

The increase in construction in progress of $279,312,000 in 2011 represents the amount of capital expenditures for new projects of $562,924,000 net of capital assets placed in service of $283,612,000. The decrease in construction in progress of $240,885,000 in 2010 represents the amount of capital assets placed in service of $845,404,000 net of capital expenditures for new projects of $604,519,000. Interest of $17,599,000 and $5,640,000 was capitalized in 2011 and 2010, respectively.

Property held for future use represents the unoccupied portion of the North Campus Research Complex. The University acquired this property in June 2009 for $114,029,000, including liabilities assumed in the purchase. During 2011 and 2010, $30,516,000 and $29,690,000, respectively, of the acquired property was placed in service.

Note 6—Long-term Debt

Long-term debt at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Commercial Paper:		
Tax-exempt, variable rate (.20%)*	$ 85,450	$ 81,110
Taxable, variable rate (.22%)*	5,740	6,095
General Revenue Bonds:		
Series 2010A, taxable–Build America Bonds, 4.926% to 5.593% through 2040	163,110	163,110
Series 2010C, 2.00% to 5.00% through 2027	183,240	184,225
unamortized premium	15,997	17,635
Series 2010D, taxable–Build America Bonds, 1.051% to 5.333% through 2041	212,345	
Series 2010E, 5.00% through 2012	7,200	
unamortized premium	324	
Series 2009A, 2.00% to 5.00% through 2029	91,020	95,310
Series 2009B, variable rate (.23%)* through 2039	118,710	118,710
unamortized premium	7,189	7,668
Series 2009D, taxable–Build America Bonds, 5.155% to 6.172% through 2030	89,815	89,815
Series 2008A, variable rate (.03%)* through 2038	105,810	105,810
Series 2008B, variable rate (.03%)* to fixed via swap through 2026 and variable rate 2027 through 2028	111,865	115,205
Series 2005A, 5.00% through 2018	22,060	26,345
unamortized premium	1,054	1,472
unamortized loss on extinguishment	(118)	(175)
Series 2002, variable rate (.06%)* to fixed via swap through 2018 and variable rate 2019 through 2032	100,715	106,775
General Revenue Refunding Bonds:		
Series 2003, 3.50% to 5.00% through 2015	11,825	18,000
unamortized premium	310	614
unamortized loss on extinguishment	(51)	(106)
Hospital Revenue Bonds:		
Series 2007A, variable rate (.03%)* through 2038	26,195	26,195
Series 2007B, variable rate (.05%)* through 2038	44,310	44,310
Series 2005A, variable rate (.03%)* through 2036	69,315	69,315
Series 2005B, variable rate (.05%)* to fixed via swap through 2026	65,360	68,705
Hospital Revenue Refunding Bonds:		
Series 2002A, 5.00% to 5.25% through 2022	45,990	47,585
unamortized premium	405	672
unamortized loss on extinguishment	(1,482)	(1,755)
Series 1998A-2, variable rate (.03%)* to fixed via swap through 2025	44,670	44,670
Medical Service Plan Revenue Bonds:		
Series 1995A, variable rate (.04%)* through 2028	26,200	26,200
Series 1991, 7.05% capital appreciation through 2012	2,120	4,099
Medical Service Plan Revenue Refunding Bonds:		
Series 1998A-1, variable rate (.03%)* to fixed via swap through 2022	33,980	34,345
Housing Energy Conservation HUD Loan, 3.00% through 2021	1,792	1,943
	1,692,465	1,503,902
Less:		
Commercial paper and current portion of bonds payable	147,553	122,581
Long-term bonds payable subject to remarketing, net	274,895	384,550
	$ 1,270,017	$ 996,771

*Denotes variable rate at June 30, 2011

The variable rate portions of bonds payable have remarketing features which allow bondholders to put debt back to the University. Accordingly, variable rate bonds payable are classified as current unless supported by long-term liquidity agreements, such as lines of credit or standby bond purchase agreements, which can refinance the debt on a long-term basis. The classification of the University's variable rate bonds payable at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	**2011**	**2010**
Variable rate bonds payable subject to remarketing	$ 747,130	$ 760,240
Less:		
Current principal maturities	14,725	13,110
Long-term liquidity agreements:		
Unsecured lines of credit	150,000	150,000
Standby bond purchase agreements	307,510	212,580
Long-term bonds payable subject to remarketing, net	$ 274,895	$ 384,550

The University's available line of credit and standby bond purchase agreements, which expire between August 2012 and July 2013, were entirely unused at June 30, 2011.

In connection with certain issues of variable rate debt, the University has entered into various floating-to-fixed interest rate swaps to convert all or a portion of the associated variable rate debt to synthetic fixed rates to protect against the potential of rising interest rates. The fair value, significant terms and other information about the University's interest rate swaps are discussed in Note 7.

Long-term debt activity, and the type of revenue it is supported by, for the year ended June 30, 2011, is summarized as follows:

(in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Commercial Paper:				
General revenues	$ 87,205	$ 85,450	$ 81,465	$ 91,190
Bonds and Notes:				
General revenues	1,050,413	219,997	27,990	1,242,420
Hospital revenues	299,697		4,934	294,763
Faculty Group Practice revenues	64,644	216	2,560	62,300
Student residences revenues	1,943		151	1,792
	$ 1,503,902	$ 305,663	$ 117,100	$ 1,692,465

The University maintains a combination of variable and fixed rate debt, with effective interest rates that averaged approximately 2.5 percent and 2.0 percent in 2011 and 2010, respectively, including the amortization of bond premiums and discounts and net of federal subsidies for interest on taxable Build America Bonds. The University utilizes commercial paper to provide interim financing for its capital improvement program. The Board of Regents has authorized the issuance of up to $200,000,000 in commercial paper backed by a general revenue pledge. Outstanding commercial paper debt is converted to long-term debt financing, as appropriate, within the normal course of business.

During 2011, the University issued $219,545,000 of General Revenue Bonds with a net original issue premium of $452,000. Total bond proceeds of $219,997,000 were utilized to provide $218,757,000 for capital projects and $1,240,000 for debt issuance costs. General Revenue Bonds issued in 2011 include $212,345,000 of fixed rate taxable Build America Bonds (Series 2010D) and $7,200,000 of fixed rate tax-exempt bonds (Series 2010E).

During 2010, General Revenue Bonds issued include $163,110,000 of fixed rate taxable Build America Bonds (Series 2010A) and $184,225,000 of fixed rate tax-exempt bonds (Series 2010C). Variable rate bonds refunded with proceeds from this debt issuance include $100,000,000 of Series 1995A Hospital Revenue Bonds, $23,925,000 of Series 2007A Hospital Revenue Bonds, $55,925,000 of Series 2007B Hospital Revenue Bonds and $21,400,000 of Series 1995A Medical Service Plan Revenue Bonds. In 2010, the University also refunded $46,070,000 of variable rate Series 2005B General Revenue Bonds, utilizing a portion of proceeds from the Series 2009A (fixed rate) and Series 2009B (variable rate) General Revenue Bonds issued in 2009, and extinguished $56,000,000 of variable rate Series 1992A Hospital Revenue Refunding Bonds.

Debt obligations are generally callable by the University and mature at various dates through fiscal 2041. Principal maturities and interest on debt obligations, based on scheduled bond maturities, for the next five years and in subsequent five-year periods are as follows:

(in thousands)	Principal	Interest*	Total
2012	$ 144,706	$ 39,852	$ 184,558
2013	61,896	38,122	100,018
2014	50,186	36,886	87,072
2015	51,381	35,871	87,252
2016	47,876	34,780	82,656
2017-2021	257,282	155,768	413,050
2022-2026	302,155	117,440	419,595
2027-2031	295,660	71,766	367,426
2032-2036	283,025	40,860	323,885
2037-2041	174,670	14,758	189,428
	1,668,837	$ 586,103	$ 2,254,940
Plus unamortized premiums, net	23,628		
	$ 1,692,465		

*Interest on variable rate debt is estimated based on rates in effect at June 30, 2011; amounts do not reflect federal subsidies to be received for Build America Bonds interest

If all variable rate bonds were put back to the University and existing unsecured lines of credit and standby bond purchase agreements were not extended upon their current expiration dates, the total principal payments due in 2012 would increase to $419,601,000, total principal payments due in 2013 would increase to $262,691,000 and total principal payments due in 2014 would increase to $270,871,000. Accordingly, principal payments due in subsequent years would be reduced to $32,161,000 in 2015; $27,811,000 in 2016; $153,297,000 in 2017 through 2021; $163,825,000 in 2022 through 2026; $158,235,000 in 2027 through 2031; $86,780,000 in 2032 through 2036; and $93,565,000 in 2037 through 2041. There would not be a significant impact on annual interest payments due to the low variable rate of interest on these bonds.

Note 7—Derivative Instruments

Derivatives held by the University are recorded at fair value in the statement of net assets in accordance with GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. For hedging derivative instruments that are effective in significantly reducing an identified financial risk, as defined by the Statement, the corresponding change in fair value is deferred and included in the statement of net assets. For all other derivative instruments, changes in fair value are reported as net investment income (loss).

Derivative instruments held by the University at June 30, 2011 and 2010 are summarized as follows:

	2011		2010	
(in thousands)	Notional Amount	Fair Value	Notional Amount	Fair Value
Investment Derivative Instruments:				
Investment portfolios:				
Futures	$ 393,232	$ 54	$ 284,993	$ 3,058
Foreign currency forwards	772,286	2,085	368,749	(3,254)
Other	81,045	(198)	71,522	(744)
	$ 1,246,563	$ 1,941	$ 725,264	$ (940)
Floating-to-fixed interest rate swap on debt	$ 46,085	$ (2,468)	$ 52,145	$ (3,266)
Effective Cash Flow Hedges:				
Floating-to-fixed interest rate swaps on debt	$ 239,160	$ (28,612)	$ 246,210	$ (32,658)

The University utilizes bond futures in its investment portfolios to adjust the duration of cash equivalents and fixed income securities, while foreign currency forward contracts are utilized to settle securities and transactions denominated in foreign (non-U.S. dollar) currencies and manage foreign exchange risk. Other derivative instruments in the University's investment portfolios consist primarily of interest rate swaps, credit default swaps, total return swaps and forward security purchase or sale commitments and are used to carry out investment and portfolio strategies.

In connection with certain issues of variable rate debt, the University has entered into various floating-to-fixed interest rate swaps to convert all or a portion of the associated variable rate debt to synthetic fixed rates to protect against the potential of rising interest rates. The fair value represents the estimated amount that the University would pay to terminate the swap agreements at the statement of net assets date, taking into account current interest rates and creditworthiness of the underlying counterparty. The notional amount represents the underlying reference of the instrument and does not represent the amount of the University's settlement obligations.

In accordance with GASB Statement No. 53, an interest rate swap is considered an effective cash flow hedge if the swap payments received substantially offset the payments made on the associated debt and changes in fair value are deferred. An interest rate swap that is not considered an effective cash flow hedge, in accordance with the provisions of this Statement, is deemed to be an investment derivative instrument and changes in fair value are recorded as net investment income (loss).

At June 30, 2011 and 2010, the fair value of floating-to-fixed interest rate swaps associated with the University's variable rate debt is a liability of $31,080,000 and $35,924,000, respectively, and is included in the statement of net assets as part of noncurrent other liabilities. The majority of the University's interest rate swaps qualify as effective hedges as defined by GASB Statement No. 53. The corresponding deferred asset for the fair value of swaps deemed effective cash flow hedges totaled $28,612,000 and $32,658,000, at June 30, 2011 and 2010, respectively.

Note 7—Derivative Instruments, continued

The change in fair value of derivative instruments, which includes realized gains and losses on positions closed, for the years ended June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Investment Derivative Instruments:		
Investment portfolios:		
Futures	$ 12,026	$ 19,320
Foreign currency forwards	3,378	8,458
Other	762	(717)
	$ 16,166	$ 27,061
Floating-to-fixed interest rate swap on debt	$ 798	$ (927)
Effective Cash Flow Hedges:		
Floating-to-fixed interest rate swaps on debt	$ 4,046	$ (9,359)

The University's interest rate swaps, along with their associated variable rate debt and significant terms, are summarized below.

The floating-to-fixed interest rate swap associated with the Series 2008B General Revenue Bonds has a notional amount of $95,150,000 and $98,490,000 at June 30, 2011 and 2010, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective from April 1, 2008, the University makes payments based on a fixed rate of 3.105 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, until the swap terminates in April 2026. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2011 and 2010 and has a fair value of ($7,607,000) and ($9,187,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2005B Hospital Revenue Bonds has a notional amount of $65,360,000 and $68,705,000 at June 30, 2011 and 2010, respectively, tied to the outstanding balance of the bonds. Effective from December 1, 2005, the University makes payments based on a fixed rate of 3.229 percent and receives variable rate payments from the swap counterparty based on 68 percent of the One-Month USD LIBOR, until the bonds mature in December 2025. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2011 and 2010 and has a fair value of ($5,404,000) and ($6,539,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2002 General Revenue Bonds has a notional amount of $46,085,000 and $52,145,000 at June 30, 2011 and 2010, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective from June 1, 2007, the University makes payments based on a fixed rate of 3.5375 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, through April 1, 2009, and 63 percent of the Five-Year USD LIBOR Swap Rate for the balance of the term, through April 2018. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is not considered an effective hedge at June 30, 2011 and 2010 and has a fair value of ($2,468,000) and ($3,266,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 1998A-2 Hospital Revenue Refunding Bonds has a notional amount of $44,670,000 at June 30, 2011 and 2010 tied to the outstanding balance of the bonds. Effective from May 14, 1998, the University makes payments based on a fixed rate of 4.705 percent and receives variable rate payments from the swap counterparty based on the floating Securities Industry and Financial Markets Association (SIFMA) Municipal Index through the final maturity dates of the underlying bonds in December 2024. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2011 and 2010 and has a fair value of ($10,218,000) and ($11,088,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds has a notional amount of $33,980,000 and $34,345,000 at June 30, 2011 and 2010, respectively, tied to the outstanding balance of the bonds. Effective from May 14, 1998, the University makes payments based on a fixed rate of 4.685 percent and receives variable rate payments based on the floating Securities Industry and Financial Markets Association (SIFMA) Municipal Index through the final maturity dates of the underlying bonds in December 2021. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2011 and 2010 and has a fair value of ($5,383,000) and ($5,844,000), respectively.

Using rates in effect at June 30, 2011, the projected cash flows for the floating-to-fixed interest rate swaps deemed effective hedges in accordance with the provisions of GASB Statement No. 53, along with the debt service requirements of the associated variable rate debt, are summarized as follows:

	Variable Rate Bonds		Swap	Total
(in thousands)	Principal	Interest	Payments, Net	Payments
2012	$ 9,045	$ 89	$ 8,293	$ 17,427
2013	11,680	84	7,931	19,695
2014	12,155	80	7,544	19,779
2015	12,665	76	7,130	19,871
2016	13,195	71	6,708	19,974
2017-2021	70,845	280	26,489	97,614
2022-2026	109,575	119	9,389	119,083
	$ 239,160	$ 799	$ 73,484	$ 313,443

By using derivative financial instruments to hedge exposures to changes in interest rates, the University is exposed to termination risk and basis risk. There is termination risk with floating-to-fixed interest rate swaps because the University or swap counterparty may terminate a swap if the other party fails to perform under the terms of the contract or its credit rating falls below investment grade. Termination risk is the risk that the associated variable rate debt no longer carries a synthetic fixed rate and if at the time of termination a swap has a negative fair value, the University is liable to the counterparty for payment equal to the swap's fair value. The University is also exposed to basis risk because some of the variable payments paid to the University by the counterparties are based on a percentage of LIBOR. Basis risk is the risk that changes in the relationship between SIFMA and LIBOR may impact the synthetic fixed rate of the variable rate debt. The University is not exposed to credit risk because the swaps have negative fair values.

The University is required to post collateral for certain floating-to-fixed interest rate swaps if the fair value of the swap reaches a minimum threshold. Based on the University's current credit ratings, the thresholds are $26,000,000 for the swap associated with the Series 1998A-2 Hospital Revenue Refunding Bonds, $27,000,000 for the swap associated with the Series 2005B Hospital Revenue Bonds and $7,000,000 for the swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds. There are no collateral requirements for the other two swaps. During 2011, the University was required to post collateral of $1,061,000 for less than 90 days for the interest rate swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds.

Note 8—Self-Insurance

The University is self-insured for medical malpractice, workers' compensation, directors and officers' liability, property damage, auto liability and general liability through Veritas Insurance Corporation, a wholly-owned captive insurance company. The University is also self-insured for various employee benefits through internally maintained funds.

Claims and expenses are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported and the future costs of handling claims. These liabilities are generally based on actuarial valuations and are reported at present value, discounted at a rate of 6 percent.

Changes in the total reported liability for insurance and benefits obligations for the years ended June 30, 2011 and 2010 are summarized as follows:

(in thousands)	2011	2010
Balance, beginning of year	$ 155,272	$ 153,045
Claims incurred and changes in estimates	427,272	396,414
Claim payments	(416,668)	(394,187)
Balance, end of year	165,876	155,272
Less current portion	72,539	66,103
	$ 93,337	$ 89,169

Note 9—Postemployment Benefits

The University provides retiree health and welfare benefits, primarily medical, prescription drug, dental and life insurance coverage, to eligible retirees and their eligible dependents. Substantially all of the approximately 35,000 full-time permanent University employees may become eligible for these benefits if they reach retirement age while working for the University. For employees retiring on or after January 1, 1987, contributions toward health and welfare benefits are shared between the University and the retiree and can vary based on date of hire, date of retirement, age and coverage elections.

The University also provides income replacement benefits, retirement savings contributions and health and life insurance benefits to substantially all permanent University employees that are enrolled in a University sponsored long-term disability plan and qualify, based on disability status while working for the University, to receive basic or expanded long-term disability benefits. Contributions toward the expanded long-term disability plan are shared between the University and employees and vary based on years of service, annual base salary and coverage elections. Contributions toward the basic long-term disability plan are paid entirely by the University.

These postemployment benefits are provided through single-employer plans administered by the University. The Executive Vice Presidents of the University have the authority to establish and amend benefit provisions of the plans.

The University's annual postemployment benefits expense is actuarially determined in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Projections of benefits are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided and announced future changes at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

The University implemented GASB Statement No. 45 in 2008 and elected to amortize its initial unfunded actuarial accrued liability over one year, the minimum period allowed by the Statement. The University also elected to amortize subsequent changes in actuarial assumptions, plan design and experience gains and losses over a ten year closed period. Therefore, the liability for net postemployment benefits obligations recorded in the statement of financial condition will differ from the actuarial accrued liability by the unamortized portion of changes in actuarial assumptions, plan design and experience gains and losses. At June 30, 2011, the recorded liability for net postemployment benefits obligations and the actuarial accrued liability totaled $1,636,652,000 and $1,183,036,000, respectively.

Changes in the total reported liability for postemployment benefits obligations for the years ended June 30, 2011 and 2010 are summarized as follows:

2011

(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 1,468,563	$ 139,545	$ 1,608,108
Service cost	40,808	2,791	43,599
Amortization of assumption changes, plan changes, and actuarial losses	(63,307)	(405)	(63,712)
Interest cost	89,289	10,997	100,286
Payments of current premiums and claims	(36,958)	(14,671)	(51,629)
Balance, end of year	1,498,395	138,257	1,636,652
Less current portion	41,142	12,496	53,638
	$ 1,457,253	$ 125,761	$ 1,583,014

2010

(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 1,428,800	$ 134,170	$ 1,562,970
Service cost	43,340	6,196	49,536
Amortization of assumption changes, plan changes, and actuarial (gains) losses	(58,647)	2,448	(56,199)
Interest cost	91,443	10,734	102,177
Payments of current premiums and claims	(36,373)	(14,003)	(50,376)
Balance, end of year	1,468,563	139,545	1,608,108
Less current portion	36,958	14,671	51,629
	$ 1,431,605	$ 124,874	$ 1,556,479

Since a portion of retiree medical services will be provided by the University's Health System, the liability for postemployment benefit obligations is net of the related margin and fixed costs of providing those services which totaled $239,012,000 of actuarial accrued liability at June 30, 2011, and $198,665,000 at June 30, 2010. In accordance with GASB Statement No. 45, the University's liability for postemployment benefit obligations at June 30, 2011, is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods of approximately $139,000,000 on an actuarial accrued liability basis.

The annual required contribution represents a level of funding that an employer is projected to need in order to prefund its obligations for postemployment benefits over its employees' years of service and totals $102,158,000 and $114,552,000 at June 30, 2011 and 2010, respectively. The University has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently pays for postemployment benefits on a pay-as-you-go basis. The University's obligations for postemployment benefits at June 30, 2011, 2010 and 2009, as a percentage of covered payroll of $2,665,924,000, $2,551,273,000 and $2,456,343,000, was 61, 63 and 64 percent, respectively.

The University's liability for postemployment benefits obligations was calculated using the projected unit credit method. Significant actuarial methods and assumptions used in the valuation for years ended June 30, 2011 and 2010 are as follows:

2011

	Retiree Health and Welfare	Long-term Disability
Discount Rate	6.08%	7.88%
Inflation Rate	3.0%	3.0%
Immediate/Ultimate Medical Trend Rate	7.0%-7.5%/5.0%	7.0%/5.0%
Immediate/Ultimate Rx Trend Rate	7.0%/5.0%	7.0%/5.0%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2000 Generational	2005 SOA Life Waiver (Modified)

2010

	Retiree Health and Welfare	Long-term Disability
Discount Rate	6.4%	8.0%
Inflation Rate	3.0%	3.0%
Immediate/Ultimate Medical Trend Rate	9.0%-7.5%/5.0%	9.0%-7.5%/5.0%
Immediate/Ultimate Rx Trend Rate	7.5%/5.0%	7.5%/5.0%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2000 Projected to 2015	2005 SOA Life Waiver (Modified)

During fiscal 2011, the University announced changes to eligibility requirements for retiree health benefits and the related amount of the University's contributions. To assist current employees with the transition, changes will be phased in gradually over the eight-year period January 1, 2013, through January 1, 2021.

Note 10—Retirement Plan

The University has a defined contribution retirement plan for all qualified employees through the Teachers Insurance and Annuity Association - College Retirement Equities Fund ("TIAA-CREF") and Fidelity Management Trust Company ("FMTC") mutual funds. All regular and supplemental instructional and primary staff are eligible to participate in the plan based upon age and service requirements. Participants maintain individual contracts with TIAA-CREF, or accounts with FMTC, and are fully vested.

Eligible employees generally contribute 5 percent of their pay and the University generally contributes an amount equal to 10 percent of employees' pay to the plan. Effective January 1, 2010, the University contribution commences after an employee has completed one year of employment. Participants may elect to contribute additional amounts to the plans within specified limits that are not matched by University contributions. Contributions and covered payroll under the plan (excluding participants' additional contributions) for the three years ended June 30, 2011, are summarized as follows:

(in thousands)	2011	2010	2009
University contributions	$ 214,905	$ 215,905	$ 208,707
Employee contributions	$ 108,981	$ 106,389	$ 102,705
Payroll covered under plan	$ 2,665,924	$ 2,551,273	$ 2,456,343
Total payroll	$ 2,802,045	$ 2,698,219	$ 2,580,373

Note 11—Net Assets

The composition of net assets at June 30, 2011 and 2010 is summarized as follows:

(in thousands)	2011	2010
Invested in capital assets, net of related debt	$ 3,574,878	$ 3,502,716
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,279,058	1,213,962
Expendable:		
Net appreciation of permanent endowments	1,312,282	923,832
Funds functioning as endowment	1,652,381	1,447,176
Restricted for operations and other	502,569	439,008
Unrestricted	2,603,094	1,836,294
	$ 10,924,262	$ 9,362,988

Unrestricted net assets, as defined by GASB, are not subject to externally imposed stipulations; however, they are subject to internal restrictions. For example, unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents. All of the unrestricted net assets, which totaled $2,603,094,000 and $1,836,294,000 at June 30, 2011 and 2010, respectively, have been designated for academic and research programs and initiatives and capital programs.

Note 12—Federal Direct Lending Program

The University distributed $358,981,000 and $342,076,000 for the years ending June 30, 2011 and 2010, respectively, for student loans through the U.S. Department of Education ("DoED") federal direct lending program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements. The statement of net assets includes a receivable of $624,000 at June 30, 2011, for DoED funding received subsequent to distribution and a payable of $871,000 at June 30, 2010, for DoED funding received in advance of distribution.

Note 13—Commitments and Contingencies

Authorized expenditures for construction and other projects unexpended as of June 30, 2011, were $623,086,000. Of these expenditures, approximately $572,545,000 will be funded by internal sources, gifts, grants and future borrowings and the remaining $50,541,000 will be funded using unexpended debt proceeds.

Under the terms of various limited partnership agreements approved by the Board of Regents or by University officers, the University is obligated to make periodic payments for advance commitments to venture capital, private equity, real estate, energy and absolute return strategies. As of June 30, 2011, the University had committed, but not paid, a total of $2,006,229,000 in funding for these alternative investments. Based on historical capital calls and discussions with those managing the limited partnerships, outstanding commitments for such investments are anticipated to be paid in the following years ended June 30 (in thousands):

2012	$ 493,411
2013	396,757
2014	351,120
2015	279,368
2016	209,539
2017 and beyond	276,034
	$ 2,006,229

These commitments are generally able to be called prior to an agreed commitment expiration date and therefore may occur earlier or later than estimated.

The University has entered into operating leases for space, which expire at various dates through 2027. Outstanding commitments for these leases are expected to be paid in the following years ended June 30 (in thousands):

2012	$ 30,849
2013	21,891
2014	12,795
2015	8,750
2016	5,975
2017-2021	7,228
2022-2026	2,801
2027	87
	$ 90,376

Operating lease expenses totaled $33,529,000 and $34,523,000 in 2011 and 2010, respectively.

Substantial amounts are received and expended by the University under federal and state programs and are subject to audit by cognizant governmental agencies. This funding relates to research, student aid, patient care and other programs. The University believes that any liabilities arising from such audits will not have a material effect on its financial position.

The University is a party to various pending legal actions and other claims in the normal course of business, and is of the opinion that the outcome thereof will not have a material adverse effect on its financial position.

Note 14—Segment Information

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds are outstanding. A segment has a specific identifiable revenue stream pledged in support of revenue bonds and has related expenses, gains and losses, assets and liabilities that are required by an external party to be accounted for separately. The University has one segment that meets the reporting requirements of GASB.

The University of Michigan Hospitals and Health Centers ("HHC") operates health care facilities and programs in southeastern Michigan, providing hospital care, ambulatory care and other health services. HHC serves as the principal teaching facility for the University of Michigan Medical School. The faculty of the Medical School provides substantially all physician services to HHC through its Faculty Group Practice.

HHC's outstanding debt, referred to as Hospital Revenue Bonds and Hospital Revenue Refunding Bonds, was issued pursuant to a Master Indenture Agreement, dated May 1, 1986. These bonds are solely payable from, and secured by, a pledge of hospital gross revenues, as defined in the Master Indenture. The University, as permitted by the Master Indenture, has further defined hospital gross revenues pledged to exclude revenues deemed to be associated with the Faculty Group Practice.

Condensed financial information for HHC, before the elimination of certain intra-University transactions, as of and for the years ended June 30, 2011 and 2010 is as follows:

Notes to Consolidated Financial Statements

Note 14—Segment Information, continued

(in thousands)	2011	2010
Condensed Statement of Net Assets		
Assets:		
Current assets	$ 357,509	$ 393,830
Noncurrent assets	2,793,939	2,455,854
Total assets	$ 3,151,448	$ 2,849,684
Liabilities:		
Current liabilities	$ 292,503	$ 281,385
Noncurrent liabilities	1,108,267	966,483
Total liabilities	1,400,770	1,247,868
Net assets:		
Invested in capital assets, net of related debt	702,096	670,052
Restricted:		
Nonexpendable	2,899	2,868
Expendable	100,672	92,463
Unrestricted	945,011	836,433
Total net assets	1,750,678	1,601,816
Total liabilities and net assets	$ 3,151,448	$ 2,849,684
Condensed Statement of Revenues, Expenses and Changes in Net Assets		
Operating revenues	$ 1,990,214	$ 1,912,425
Operating expenses other than depreciation expense	(1,793,016)	(1,716,696)
Depreciation expense	(144,238)	(135,887)
Operating income	52,960	59,842
Nonoperating revenues, net	198,307	105,238
Net income before transfers	251,267	165,080
Transfers to other University units, net	(102,405)	(100,573)
Increase in net assets	148,862	64,507
Net assets, beginning of year	1,601,816	1,537,309
Net assets, end of year	$ 1,750,678	$ 1,601,816
Condensed Statement of Cash Flows		
Net cash provided by operating activities	$ 201,706	$ 196,653
Net cash provided by investing activities	31,529	85,533
Net cash used in capital and related financing activities	(168,976)	(257,400)
Net cash used in noncapital financing activities	(99,263)	(59,246)
Net decrease in cash and cash equivalents	(35,004)	(34,460)
Cash and cash equivalents, beginning of year	155,815	190,275
Cash and cash equivalents, end of year	$ 120,811	$ 155,815

Note 15—Operating Expenses by Function

Operating expenses by functional classification for the years ended June 30, 2011 and 2010 are summarized as follows:

2011

(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 746,347	$ 106,790			$ 853,137
Research	486,677	246,847			733,524
Public service	86,891	44,597			131,488
Academic support	183,866	37,150			221,016
Student services	66,669	18,478			85,147
Institutional support	130,979	49,194			180,173
Operations and maintenance of plant	39,142	236,149			275,291
Auxiliary enterprises	1,893,194	560,446			2,453,640
Depreciation			$ 390,071		390,071
Scholarships and fellowships				$ 114,316	114,316
	$ 3,633,765	$ 1,299,651	$ 390,071	$ 114,316	$ 5,437,803

2010

(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 739,459	$ 111,102			$ 850,561
Research	463,421	216,079			679,500
Public service	96,469	39,295			135,764
Academic support	183,306	43,182			226,488
Student services	67,277	16,837			84,114
Institutional support	134,366	40,066			174,432
Operations and maintenance of plant	42,291	223,708			265,999
Auxiliary enterprises	1,802,682	525,415			2,328,097
Depreciation			$ 360,089		360,089
Scholarships and fellowships				$ 113,753	113,753
	$ 3,529,271	$ 1,215,684	$ 360,089	$ 113,753	$ 5,218,797