UNIVERSITY OF MICHIGAN

Financial Report | 08

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LETTER FROM
THE PRESIDENT

MARY SUE COLEMAN

A unique and historic event took place on the University of Michigan's Central Campus last April. Thousands of graduating students, celebrating the successful completion of their bachelor's, master's, and doctoral degrees, converged for the first-ever commencement program to be held on the Diag. More than 165 years after the first Michigan students walked through the open pasture that would become the heart of our campus, the Class of 2008 secured its place in U-M history. *It was indeed a remarkable year.*

ADVANCING TEACHING AND RESEARCH

Recognizing that great universities like Michigan must transcend academic disciplines to be truly effective in addressing societal needs, Provost Teresa A. Sullivan and I launched an innovative hiring program for faculty specifically dedicated to interdisciplinary collaboration.

Over the next five years, we are committing $30 million in salaries and start-up costs to create 100 tenure-track faculty positions that will expand interdisciplinary work and increase faculty connections with undergraduates. These positions are being centrally funded and will complement the regular faculty hiring in the schools and colleges. In particular, we are encouraging cluster hiring, with groups of faculty focused on emerging areas of scholarship and creativity.

Our first round of competition attracted 39 proposals from across the University, resulting in the funding of 25 new positions. As an example of this program's potential, five proposed positions will be for a group of faculty who will enhance our work in developing new and more effective systems for storing renewable energy sources such as wind and sunlight. The College of Engineering, the School of Natural Resources and Environment, and the College of Literature, Science, and the Arts will collaborate on this venture to elevate U-M's impact in this field.

The University continued to expand its rich agenda of research activities, and in FY 2008 research expenditures totaled a record $876 million. While the federal government continues to be the largest supporter of our research, we were encouraged by an increase in funding from industry. We believe strongly that by partnering with industry, we can help transform the economy of our state and of the Midwest.

SUPPORTING THE ECONOMY

An exciting development that has important ramifications for area business and industry is the establishment of the University's Business Engagement Center. The center will act as a front door to our vast resources in technology, research, faculty expertise, and student talent—all tools that can support both new and established businesses.

Sharing space with the U-M Office of Technology Transfer, the Business Engagement Center is yet another facet of the University's commitment to helping diversify our state's economy.

That work includes the efforts of the University Research Corridor (URC), our collaboration with Michigan State University and Wayne State University. We are particularly excited about the URC's research and development work in alternative energy.

BEYOND ANN ARBOR

Of course, we are not limiting our work by geographic boundaries. As other nations emerge as economic powers, our society is growing more international, and so, too, must a student's education. There is so much to be learned from observing, from interacting, and from listening to people who live and work in cultures different than ours.

That is why I led a U-M delegation to Ghana and South Africa in February, when we met with university leaders in Accra, Capetown, and elsewhere to discuss stronger partnerships between their institutions and U-M faculty and students. With more than 120 U-M faculty already engaged in nations throughout the continent, the trip was an opportunity to strengthen our work in the areas of health sciences, open Internet access to educational resources, heritage studies, and social science research.

The trip also complemented the establishment of our African Studies Center, an academic home for faculty and students engaged in studies in and about Africa. The center is now one of 17 such centers in the U-M International Institute.

We also furthered our partnerships with educational leaders in China, where the University has been engaged for more than a century. In May we hosted the Michigan China Leadership Forum that attracted administrators from 18 Chinese universities. These officials spent two weeks at U-M, Michigan State, and Wayne State, learning about the principles and practices of higher education in a democratic society.

THE CHANGING CAMPUS

As one of the leading research universities in the nation, we are continually expanding and upgrading our facilities to ensure the best possible environment for faculty, students, and staff. This past year has been no exception.

We dedicated the Undergraduate Science Building, the final piece of our life sciences complex. In addition to housing state-of-the-art classrooms, the building brings together the Undergraduate Research Opportunities Program; Women in Science and Engineering; the Life Sciences, Values, and Society Program; and undergraduate and graduate neuroscience programs to create an exciting synergy in the sciences.

We also unveiled the College of Engineering's Lurie Nanofabrication Facility, designed to be used by both U-M students and faculty and researchers from around the country.

And we opened the doors of a beautifully renovated Observatory Lodge, the new home of the Division of Kinesiology, as well as Stamps Auditorium, which serves as a focal point for the disciplines that call North Campus home.

GUARANTEEING THE FUTURE

Key to so many U-M achievements has been philanthropy and the stability provided by our endowment. We are deeply grateful for the generosity and foresight of the many alumni and friends who have chosen to invest in the future of U-M over the years, and during The Michigan Difference campaign, which is now drawing to a close.

The University endowment is our fiscal foundation. It ensures educational access for thousands of students by providing scholarships and fellowships; last year, 80 percent of undergraduates from the state of Michigan received financial aid from the University.

The endowment also funds research activities in all 19 schools and colleges, as well as the important work of the U-M Health System, UM-Flint, and UM-Dearborn. And it supports faculty positions for hundreds of our scholars, allowing us to compete with other leading institutions for the brightest minds in the world.

Simply put, without our endowment, the University of Michigan would not be an institution known worldwide for extraordinary teaching, research, public service, and health care.

A strong and growing endowment such as ours guarantees—in perpetuity—our ability to carry out our mission, adapt to change, and grow to meet the needs of a society that has come to expect the best from our University.

Mary Sue Coleman

MARY SUE COLEMAN
PRESIDENT

REPORT FROM THE
CHIEF FINANCIAL OFFICER

The University of Michigan continues to be in excellent financial health, largely due to the University's 32,000 faculty and staff who remain keenly focused on the institution's core missions. Our committed and innovative faculty and staff continue to build on U-M's strong foundation and long tradition of excellence, even in the face of significant challenges.

TIMOTHY P. SLOTTOW

The University's disciplined and focused budget approach carefully balances our current and emerging operating needs with cost savings opportunities. This approach, combined with our diverse revenue streams, long-term investment strategy, positive operating margins at the Hospitals and Health Centers, and The Michigan Difference fundraising campaign, contribute to the University's strong financial position. As a result, the University continues to have the wherewithal to make key investments in the facilities, programs, and people necessary to maintain academic excellence and define what it means to be one of the world's best public research universities.

During FY 2008, the University implemented Governmental Accounting Standards Board (GASB) Statement No. 45, which requires recognition of the cost for postemployment benefits that will be paid in the future during employees' active years of service. In previous years, the University recognized costs for nearly all postemployment benefits as they were paid. Implementation of this statement resulted in an increase in the University's liabilities and a decrease in its net assets (assets less liabilities) of $1.4 billion. This impact, however, was offset by a $662 million growth in net assets before the implementation of GASB 45, which resulted from a variety of factors: positive investment income, which added $252 million to the endowment net of distributions for operations; generous grants, appropriations, and donations of $172 million for capital and endowment purposes; a positive margin at the Hospitals and Health Centers, resulting in a $22 million surplus for reinvestment in physical plant; as well as successful cost-containment activities and gifts for operations. Accordingly, in FY 2008 net assets decreased $742 million; however, the University's financial position remains strong with net assets totaling $10.8 billion at June 30, 2008.

I will discuss these and other important contributors to the University's overall financial health in the following sections to provide context to the accompanying financial statements.

REVENUE DIVERSIFICATION

Revenue diversification has long been an important strategy for U-M to achieve financial stability in the face of unpredictable economic cycles. In the 1960s, for example, almost 80 percent of the University's general fund revenues came from state appropriations, compared to the projected 24 percent in the FY 2009 general fund budget. The current mix of revenue can be seen on the charts on the following page, which show the FY 2008 operating revenue sources with and without the Health System and other clinical activities.

THE GENERAL FUND OPERATING BUDGET CHALLENGE

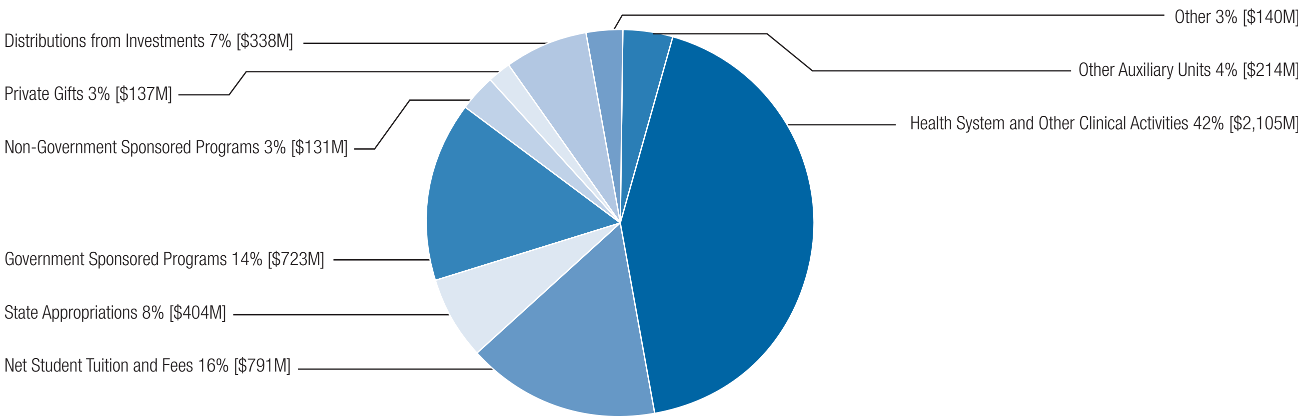
The last several years demonstrate a clear trend away from dependence on state appropriations, but support from the state of Michigan remains a cornerstone of the University's strength. To put it in perspective, it would take an additional endowment of approximately $7 billion to generate a revenue stream that would equal the current level of state support received by the University.

In FY 2008, the University received $370 million in base appropriations from the state, a 1 percent decrease from the prior year, as well as $34 million to restore a FY 2007 rescission. Since FY 2002, the University's base appropriations have decreased $46 million, or 11 percent. In contrast, if our state appropriations had grown at the level of the Consumer Price Index, our base appropriations would have been $106 million higher in FY 2008.

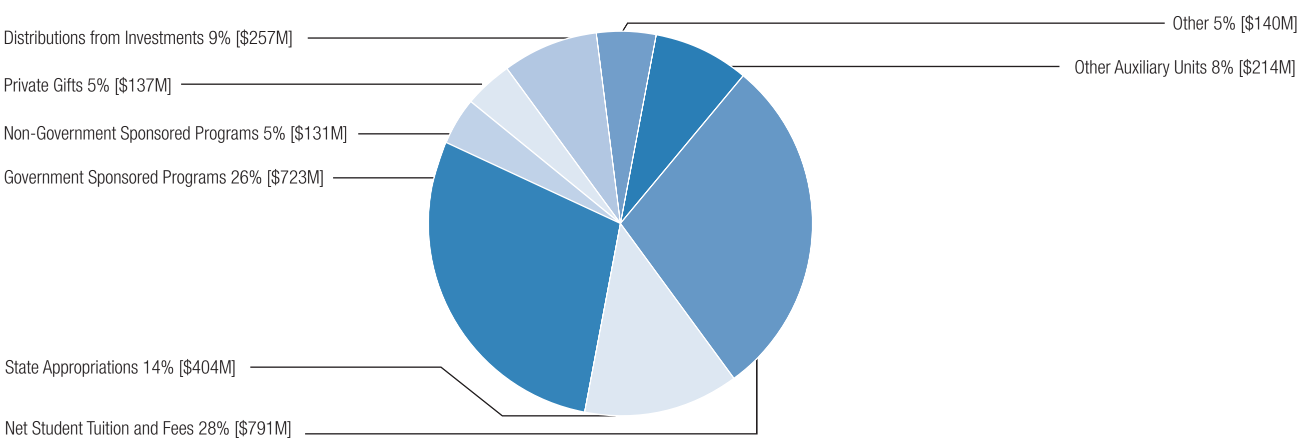
Looking ahead, our general fund operating budget continues to be a challenge for the institution. Our commitment to academic excellence and access combined with the state's uncertain financial circumstances requires a careful balance between cost containment and the need to invest in our future. In adopting the budget for FY 2009, we are anticipating a state appropriation of $374 million, an increase of 1 percent. Given the state's constrained financial circumstances, this planned increase shows support for higher education, for which we are very grateful. This increase in funding is a clear indication that the state recognizes the crucial role that higher education in general and, more specifically, research universities can play in transforming our economy. At the same time, however, this allocation will put our state appropriation at a level that is $42 million lower than the amount that was appropriated for FY 2002 and $114 million lower in inflation-adjusted dollars.

Through a combination of innovation, ingenuity, and hard work, we have been able to limit tuition increases. The approved Ann Arbor campus budget for FY 2009 includes a moderate increase in tuition rates of 5.6 percent for both resident and nonresident undergraduates and 5 percent for most graduate programs, along with an 11 percent increase in centrally awarded financial aid for undergraduates to preserve access for our most financially vulnerable students. The

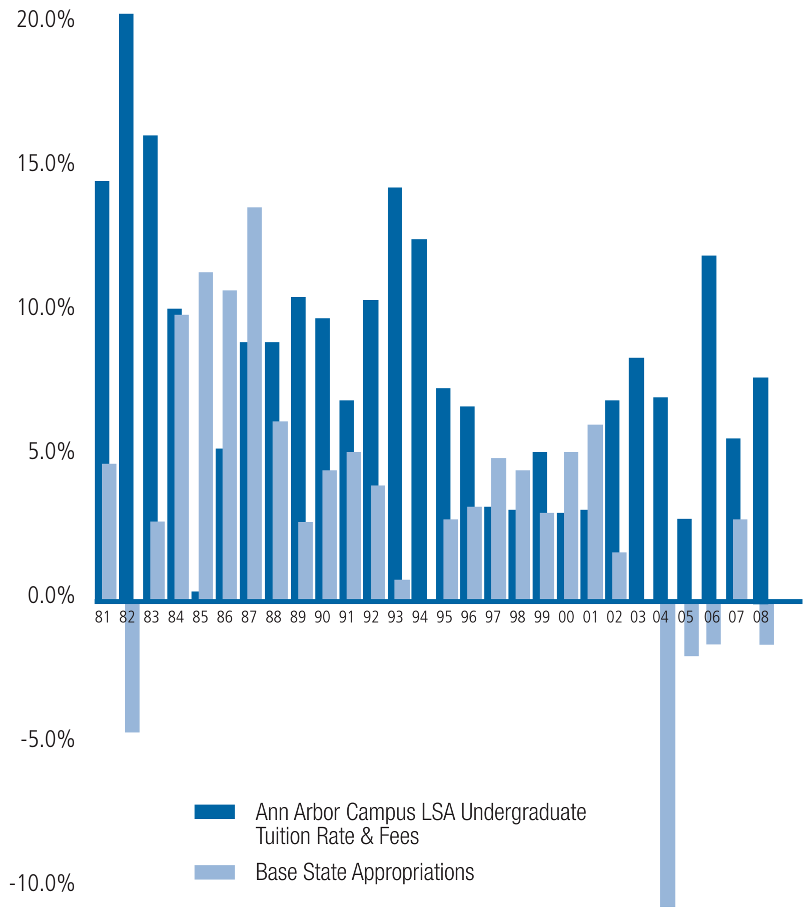
OPERATING ACTIVITIES
Total Revenue: $4,983 Million



OPERATING ACTIVITIES EXCLUDING HEALTH SYSTEM AND OTHER CLINICAL ACTIVITIES
Total Revenue: $2,797 Million



PERCENTAGE CHANGE IN UNDERGRADUATE TUITION RATE AND STATE APPROPRIATIONS



University's deans, directors, faculty, and staff have been focused and diligent in reducing $20 million in recurring general fund expenditures from the Ann Arbor campus budget for the coming year. This is in addition to the $117 million of recurring cost reductions achieved in the general fund over the previous five years.

The graph above shows the historic inverse relation between changes in state appropriation and changes in undergraduate tuition rates.

THE HEALTH SYSTEM

The Health System, which integrates the Hospitals and Health Centers, Medical School, and Michigan Health Corporation under the direction of Executive Vice President for Medical Affairs Dr. Robert Kelch, had another excellent year financially and continues to receive national recognition for its academic and clinical excellence. We take great pride in the fact that the Hospitals and Health Centers have experienced more than 12 years of solid financial results, while also improving the quality of the care we deliver to patients.

In FY 2008, the Hospitals and Health Centers achieved an operating margin of 1.3 percent ($22 million) on revenues of $1.7 billion. This somewhat smaller-than-expected margin reflects the strains of a difficult economy, decreased reimbursements from government insurers, and a trend of longer inpatient stays. That said, the continued achievement of a positive operating margin will allow us to fund critical facilities and programs that will enhance patient care for a growing patient population, as well as research and education. Among them: a new facility for the C. S. Mott Children's Hospital and Women's Hospital, which will open in 2012, and the expansion of the Kellogg Eye Center and Brehm Diabetes Center, which will open in 2010. Even within existing facilities, capital projects such as a $43 million investment in advanced medical imaging technology and renovated space, and a major information technology initiative that is bringing us close to becoming a truly paperless health care delivery system, continue to expand our capacity to serve patients and ensure their safety. As we look to the future, this year's purchase of a 32-acre parcel of land in Brighton, near our existing health center and other

U-M health facilities in Livingston County, will pave the way for further growth to serve patients where they live.

Philanthropy directed toward the Health System continues to be very strong, and supports our clinical, biomedical research, and medical education missions in many ways. In FY 2008, major gifts included $22 million from A. Alfred Taubman for a new medical research institute named after the retail pioneer, as well as many other generous donations of all sizes.

THE ENDOWMENT

The University realized meaningful growth in its endowment, primarily as a result of generous donations and strong investment performance. The University's long-term diversified investment strategy is designed to generate a level of return sufficient to provide dependable support for operations, while at the same time protect and grow the corpus in real terms.

This long-term strategy's 6 percent return in FY 2008 was strong relative to difficult financial markets and follows a 26 percent return in FY 2007. The Long Term Portfolio's annualized five-year return of 17 percent was 5 percentage points above the custom market benchmark designed to capture the University's long-term diversified investment strategy and nearly 10 percentage points over the undiversified benchmark consisting of major equity and fixed income indices in an 80/20 ratio. The return of the S&P 500 stock index was 7.6 percent over the same five year period.

The table above shows the endowment's investment performance and results of the long-term strategy, which has produced both extraordinary returns in the good years and limited the loss of capital in the more challenging years.

The University's endowment spending rule smoothes the impact of volatile capital markets by providing for annual distributions of 5 percent of the moving average fair value of the endowment. Effective July 1, 2006, the moving average period was extended from three years to four years, and it is being extended by one quarter each subsequent quarter until it reaches seven years. This change is expected to reduce distribution volatility, as well as better preserve and grow the endowment corpus over time. The spending rule, along with the growth of the endowment, allowed for distributions to support operations of $227 million in FY 2008, for a total of $950 million over the past five years.

The payout from our more than 6,500 separate endowment funds enables us to serve a diverse population, ranging from patients in our health system to students. For example, approximately $2 billion, or 26 percent, of our $7.6 billion endowment is restricted for use by our health system, which serves the needs of 1.6 million patients each year. The portion available for University operations supports the education of more than 57,000 students. About 20 percent of our total endowment, or $1.5 billion, has been set aside for student aid, with nearly 80 percent of our undergraduate students who are Michigan residents receiving some form of institutional financial aid, which includes grants, work-study, and loans. Endowment income also provides key support to the University's research efforts, which have made countless contributions to our global society in areas ranging from medicine and law to arts and science. The average effective annual spending rate from our endowment over the last 10 years, including spending rule payouts and withdrawals from funds functioning as endowment, was 6.5 percent.

INVESTMENT PERFORMANCE

	Return for twelve-month period ended June 30, 2008	Annualized three-year return	Annualized five-year return
Long Term Portfolio	6.4%	15.8%	17.5%
U-M's Benchmark	-1.0%	10.8%	12.4%
Equity/Fixed Income Index (80/20)	-8.0%	5.6%	7.6%

HEALTH BENEFITS | THE NATIONAL CHALLENGE

Organizations across the country continue to grapple with the escalating costs of employee and retiree benefits, with large employers reporting annual rates of increase as high as 12 percent. In FY 2008, the University spent $250 million on health care for employees and retirees. The continued escalation of costs is driven by factors including the development and adoption of new medical technologies, new pharmaceuticals with increasingly specialized uses, and the growing demand for medical care while the market for health professionals remains highly competitive.

CONTROLLING HEALTH CARE COSTS

A recent study by an actuarial firm showed U-M health plans perform with as much as 13 percent more financial efficiency than the average of other employer plans. The University's well-designed medical and prescription drug plans and the highly efficient U-M Health System have contributed to this positive result, and to our lower-than-average 8–10 percent rate of annual cost increase. Prevention, early intervention, and wellness also help to reduce the pressures on the health care system and promote overall control of costs. The University's health and wellness effort, known as MHealthy, addresses these important factors. With this year's finalization of a five-year strategic plan, MHealthy is working toward long-range goals to raise the baseline of health in our community. MHealthy offers a spectrum of programs designed to support healthy lifestyles by increasing physical activity, improving nutritional habits, supporting smoking cessation, and promoting ergonomics and workplace safety for injury reduction. More than 10,000 employees have participated in team physical activity challenges alone.

Other MHealthy voluntary programs represent bold efforts to directly utilize the expertise of U-M faculty. Focus on Diabetes, for example, tests the effect on patient compliance with important medication regimens when the potential cost barriers of drug co-pays are removed. Focus on Medicines allows individuals taking multiple prescription medications to receive drug safety counseling and a complete medication review by U-M clinical pharmacists to minimize the number of drugs necessary and reduce University and patient costs with increased use of generic medications.

The University's generic drug dispensing rate has increased to 68 percent of prescriptions filled, which is higher than the national average. A comparison of the previous two calendar years revealed a savings to the University and plan members of as much as $2.8 million in additional expense that would have been incurred had generic drugs not been utilized. Each 1 percent increase in the U-M rate of generic drug dispensing results in a savings of nearly $500,000 in reduced medication and co-pay costs.

HEALTH CARE PARTNERSHIPS

U-M Premier Care is the University's self-insured health plan, which is administered by Blue Care Network, a subsidiary of Blue Cross Blue Shield of Michigan (BCBSM). Launched in 2008, U-M Premier Care provides cost-effective managed care with access to all U-M Health System providers for more than 55,000 enrolled employees, retirees, and dependents. Our partnership with BCBSM extends beyond our health plan to the establishment of the Center for Healthcare Research and Transformation. This joint venture works to improve the quality of the state's health care system and improve the way patient care is delivered. Similarly, the University's Center for Value-Based Insurance Design is nationally known for its work in reducing barriers to health care access.

PHYSICAL PLANT, SUSTAINABILITY, AND COST CONTROLS

Even in the face of ongoing economic pressures from the state and escalating health care and energy costs, it is essential that we invest in our future through strategic facility renovation and replacement. The University's facilities play a critical role in meeting patient care needs; accommodating current technologies; and supporting growing academic, research, and clinical needs.

Over the last decade, the University has invested an average of $360 million per year for renovation and replacement of buildings and related infrastructure. FY 2008 was no exception as the University completed more than 327 projects across campus, an investment of more than $609 million. Many facilities to support the University's academic, research, and athletic functions have recently been completed or are currently under construction to meet the University's changing needs.

In FY 2008, completed projects include renovations to Medical Science Units I and II, renovation and enhancement of the Wilpon Baseball and Softball Complex, and construction of the Charles R. Walgreen, Jr. Drama Center and Stamps Auditorium. Projects scheduled for completion in FY 2009 include a new home for the Stephen M. Ross School of Business, a new student housing facility for the Flint campus, and the comprehensive renovation of Mosher-Jordan Residence Hall, which also includes the new Hill Dining Center. In addition, two of the largest construction projects in University history are continuing with the North Quad Residential and Academic Complex and the C. S. Mott Children's Hospital and Women's Hospital, which was discussed earlier, along with other new or upgraded clinical facilities. Work also continues on the Alumni Memorial Hall Museum of Art addition and renovation. Many of these important projects were largely made possible through generous gifts from alumni and friends of the University.

The Athletic Department, through sound financial management and additional revenue sources such as those from the Big Ten Network and donor contributions, continues to make significant investments in its facilities. Beyond the renovated and enhanced facilities for baseball and softball mentioned earlier, Michigan Stadium, home to the football team since 1927, is undergoing a major renovation. Construction is also underway on a new indoor practice field.

An updated master plan for North Campus was developed in FY 2008. Currently, the existing North Campus buildings include seven million square feet of space that has been built over the past 50 years. The updated plan's themes include the creation of strong connections between North Campus and Central Campus, promoting campus vitality, optimizing development capacity, and respecting and incorporating environmental features. It, like former plans, also calls for making North Campus a more livable and accessible place that's easier and more convenient to get around. A variety of enhancements designed to enrich campus life are under consideration for North Campus, ranging from areas for the arts and performances to retail opportunities.

Planet Blue, which will be more broadly introduced to the University community in FY 2009, is a three-year, campus-wide effort to cut utility costs and increase recycling in approximately 90 large buildings on the Ann Arbor campus with an education and outreach campaign designed to engage the students, faculty, and staff in the program. The University spends more than $100 million a year on utilities and Planet Blue's goal is to cut those costs by 10 percent, through a combined approach that includes energy-saving technologies, building upgrades, and helping employees to change their behavior relative to energy consumption and conservation. In FY 2008, the University piloted Planet Blue in five buildings on the Ann Arbor campus, with very positive results. Many energy-saving actions already have been implemented in the pilot buildings while other recommendations are under review. Changes include everything from the installation of occupancy sensors for fume hoods to reducing operating hours for HVAC fans.

Planet Blue is part of the campus-wide Energy and Environmental Initiative that was launched in April 2007. Other components of this initiative include compilation and distribution of an annual report on consumption trends, research activities, and operations efforts, which can be read at http://www.oseh.umich.edu/Stewardship/reporting.html; increased efforts to purchase electricity produced from renewable sources; maintenance and expansion of alternative transportation options for students, staff, and faculty; strengthening procurement offerings to ensure that green products are prominently promoted; and revision of construction and renovation guidelines to improve energy efficiency.

FINANCIAL CONTROLS

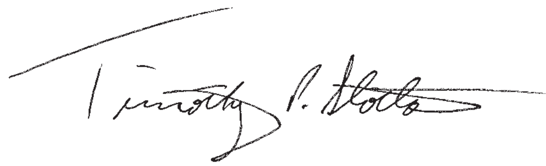
The University continues to work with units across campus to assess and strengthen internal controls, based on best practices from the Sarbanes-Oxley Act. We are identifying the key risks and control points related to our major financial processes. In addition, we are leveraging process improvement initiatives such as online journal entries and automated cash handling/depository procedures to improve internal controls and make our processes more effective and efficient. This year we have added purchasing card process controls to the annual certification required for deans and vice presidents, which includes, among other elements, our campus-wide IT Security Initiative and employment controls. In FY 2008, the University also launched a new training program for new and future budget administrators that promotes responsible stewardship of the institution's resources. Among the topics covered by the training are internal controls, financial analysis, and information management.

CONCLUSION

Thanks to the commitment and dedication of the University's 32,000 employees and their unyielding focus on sound financial stewardship, the institution maintains the highest credit ratings from both Standard & Poor's (AAA) and Moody's Investor Services (Aaa). This is particularly encouraging in light of the challenging state economy that we've faced for a number of years. These ratings are important indicators of the University's strong financial health and outlook. The University, in fact, is one of only three public universities in the country to maintain these highest possible ratings.

It is, once again, satisfying to receive an unqualified opinion from the University's external financial auditors. This opinion, found on page 35, signifies that the financial statements present fairly the financial position of the University. Included on page 34 is my certification of management's responsibility for the preparation, integrity, and fair presentation of the University's financial statements.

I hope you'll find the time to read Management's Discussion and Analysis, starting on page 36. It tells a story of financial strength, prudent financial policy, and perhaps most importantly, the ability and commitment to sustain the highest level of excellence in fulfilling the University's mission for many decades to come.



TIMOTHY P. SLOTTOW
EXECUTIVE VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER

REPORT FROM THE
VICE PRESIDENT FOR DEVELOPMENT

JERRY A. MAY

As we close this fiscal year, we begin the final months of The Michigan Difference campaign that will end on December 31, 2008. It has been a spectacular fundraising year in which President Coleman created another Donor Challenge, this one for graduate and professional students, and we successfully ended her Donor Challenge for Need-Based Undergraduate Support. These initiatives gave our donors opportunities to enlarge their gifts, resulting in more funds being available for our students now and in the future, since both challenges involved the endowment for at least part of the funds. The results were impressive.

This year more than 120,000 donors—including individuals, associations, corporations, and foundations—made cash gifts, pledge payments, and realized bequests totaling $342 million, surpassing last year's gifts by 14 percent. This figure does not include new pledges or bequest intentions. The President's Undergraduate Donor Challenge contributed $12 million in pledge payments. This amount will be matched dollar for dollar by the challenge, providing our undergraduates with $24 million in support.

The President's Graduate and Professional Student Donor Challenge, which continues until December 31, 2008, or until matching funds run out, contributed $20.5 million this fiscal year. These funds will generate a match of $10.25 million, $1 dollar for every $2 from a gift, for a total of $30.75 million for graduate and professional students.

While many individual donors took advantage of the president's challenges to increase their gifts, the University of Michigan Alumni Association Clubs looked on this as an excellent opportunity. Alumni Association Clubs have often raised funds for scholarships for local students. The undergraduate challenge gave them further incentive. The results were spectacular. This fiscal year the Grand Rapids Club gave $450,000, the Chicago Club $86,000, the Atlanta Club $25,000, and the Golden Gate, Orange County, and New York Clubs each gave more than $25,000.

We are excited to be able to put these funds to use immediately—helping undergraduates from all over the country afford a Michigan education.

Donors made gifts of $57 million toward the 22 Michigan Difference campaign construction projects. I am pleased to report that 16 of these buildings are fully funded and 13 have already been completed and are serving our students, faculty, and the community. Two opened this fiscal year.

The Robert H. Lurie Nanofabrication Facility is expected to change the high-tech landscape. Small and large companies had been using this facility, before its expansion, for research and development, contributing an estimated $500 million to the state's economy in terms of companies and jobs created from the research. The 57,000 square feet of added space and clean room for microsystems and nanotechnology is expected to increase that dollar figure significantly.

This year alone, 38 percent of the lab users were from outside the University, including 20 companies and 13 higher education institutions, such as Princeton, Cornell, The Ohio State University, Case Western Reserve, and Virginia Polytechnic Institute.

More than a dozen companies have been spun out of research performed in these labs during the last decade. Many of the created jobs remain in Michigan.

The Wilpon Baseball and Softball Complex and the Ray Fisher Stadium opened this spring, providing our student-athletes with a superb facility for practices and games, and creating a wonderful game day experience for our fans.

During the campaign, the Law School has reevaluated its plans for a building project and the addition of a Law School commons between Hutchins Hall and the Legal Research Building. Donors have stepped forward to support the plan and have already given $31 million toward the fundraising goal of $70 million. The campaign for this project will extend beyond the December 31, 2008, closing date for The Michigan Difference campaign. This project is pivotal to our ability to attract great students and faculty in the future.

Donors contributed $112 million to our endowment through the challenges, and through gifts for professorships, programs, and research. This is almost twice the $62 million donors gave for endowed funds in 1999.

The U-M endowment is made up of 6,500 separate funds, most of which were created by donors who stipulated what they could be used for, such as professorships, financial aid, or research. The University entered into a legal contract with these donors to spend the money exactly as they agreed, and to invest the money so it would be available in perpetuity.

Donors give to the endowment because they trust that the University, which is coming up on its 200th anniversary, will be here long into the future. And they want their gifts to continue making a difference in perpetuity.

A young doctor, Elizabeth Bates, who practiced medicine in New York state in 1898 had never visited the University of Michigan, but left the Medical School more than $100,000 in her will to create a professorship in diseases of women and children because the U-M admitted women to its Medical School. She created the first endowment for a named professorship at the University of Michigan. This was a colossal sum at a time when tuition was $12.50 a semester. Timothy R. B. Johnson, MD, is the seventh Bates Professor. Some of his predecessors served for more than 30 years. Dr. Johnson not only teaches U-M medical students—he is active in international teaching and training, particularly in Ghana, and is an honorary fellow of the West African College of Surgeons. A young woman from New York state who lived more than 100 years ago is thus affecting the training of U-M medical students and the health of the women and children in Ghana. Such is the power of endowments.

What difference does philanthropy make in the life of the University of Michigan? All the difference.

Jerry A. May

JERRY A. MAY
VICE PRESIDENT FOR DEVELOPMENT

CAMPAIGN UPDATE

The campaign ends December 31, 2008. All amounts are as of June 30, 2008.

NATIONAL CAMPAIGN LEADERSHIP CABINET

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Vail, CO

HONORARY CHAIR

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Palm Springs, CA

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John E. Riecker
Midland, MI

Joan Tisch
New York, NY

Mike Wallace
New York, NY

Helen and Sam Zell
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Palm Springs, CA

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Barrie Loeks
New York, NY

Waltraud Prechter
Detroit, MI

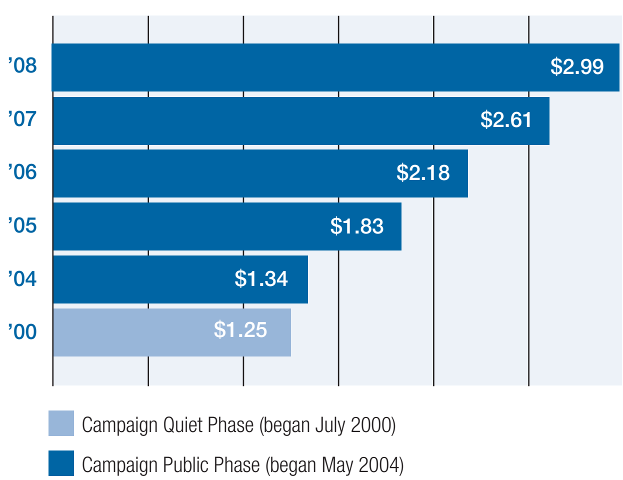
Joel Tauber
Detroit, MI

Marshall M. Weinberg
New York, NY

Robert Wood
Middlebury, CT

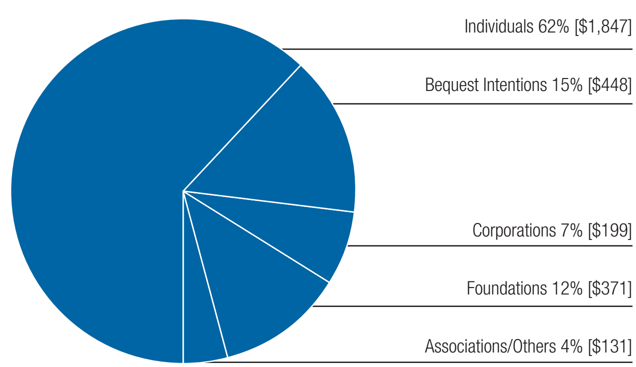
CAMPAIGN MILESTONES

Progress July 1, 2000 through June 30, 2008 (in billions)



SOURCE OF FUNDS

Progress through June 30, 2008 (in millions)



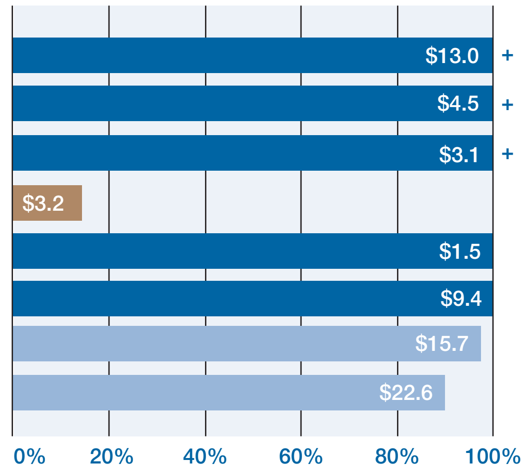
BUILDING GOALS

Total gifts from donors to percent of fundraising goal
Progress through June 30, 2008 (in millions)

Construction not begun | Construction in progress | Project completed

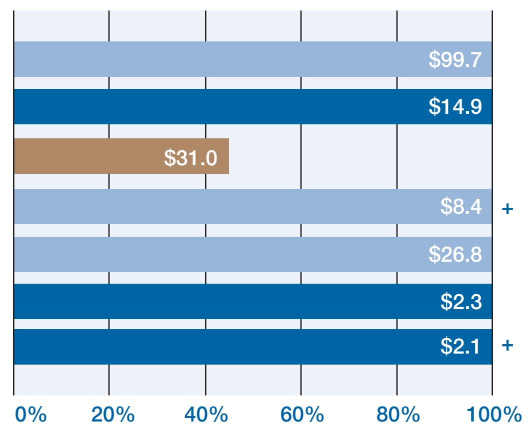
Athletic Campus

Stephen M. Ross Academic Center
J. Ira and Nicki Harris Family Football Locker Room
Junge Family Champions Center
Basketball Facility
Wilpon Baseball and Softball Complex: Softball Stadium
Wilpon Baseball and Softball Complex: Baseball Stadium
Indoor Field House
Football Stadium



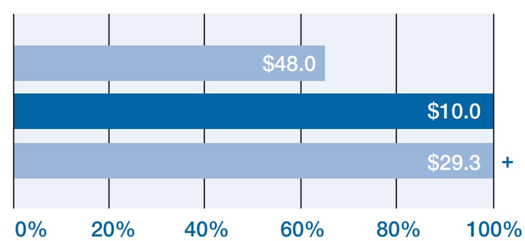
Central Campus

Stephen M. Ross School of Business
Joan and Sanford Weill Hall
Law School Building
Kelsey Museum: William E. Upjohn Exhibit Wing
Museum of Art: Maxine and Stuart Frankel and the Frankel Family Wing
Public Health Crossroads and Tower
Stanford Lipsey Student Publications Building



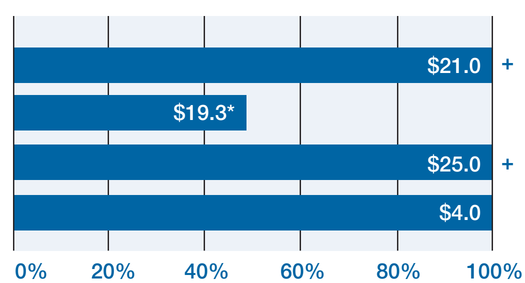
Medical Campus

C. S. Mott Children's Hospital and Women's Hospital
Depression Center: Rachel Upjohn Building
Kellogg Eye Center/Brehm Center for Diabetes Research



North Campus

Ann and Robert H. Lurie Biomedical Engineering Building
Computer Science and Engineering Building
Robert H. Lurie Nanofabrication Facility
Walgreen Drama Center/Stamps Auditorium



* remainder funded by College of Engineering resources
\+ exceeded goal

PURPOSE OF GIFT

Progress through June 30, 2008 (in millions)

	Goal	Progress
Faculty Support	$ 425	$ 307
Student Support	$ 400	$ 495
Programmatic*	$ 775	$ 1,284
Buildings	$ 500	$ 462
Total Cash and Pledges	**$ 2,100**	**$ 2,548**
New Bequests	$ 400	$ 448
Total–All Gifts	**$ 2,500**	**$ 2,996**

* Includes research and discovery

TYPE OF FUNDS

Progress through June 30, 2008 (in millions)

	Goal	Progress
Endowment	$ 800	$ 870
Expendable	$ 800	$ 1,216
Buildings	$ 500	$ 462
Total Cash and Pledges	**$ 2,100**	**$ 2,548**
New Bequests	$ 400	$ 448
Total–All Gifts	**$ 2,500**	**$ 2,996**

University of Michigan Alumni Association Clubs for Scholarship Funds

During the campaign, the Alumni Association, through 61 clubs and affiliates, has raised cash and pledges totaling $5.8 million. Of that, $2.9 million qualified for the President's Donor Challenge match for a total of $8.7 million for undergraduate, need-based student aid.

Our top clubs and affiliates are:

The U-M Club of Greater Detroit	$ 808,176
The U-M Club of Grand Rapids	$ 650,659
Alumnae Council	$ 513,856
The U-M Club of Greater Chicago	$ 317,977
The U-M Club of New York City	$ 308,006
The U-M Club of Greater Washington, DC	$ 259,966
The U-M Club of Fort Wayne	$ 186,926
The U-M Club of Orange County	$ 168,838
The U-M Club of Philadelphia	$ 150,625
The U-M Club of Greater Lansing	$ 118,297
The U-M Club of Greater Phoenix	$ 106,200
The U-M Club of San Diego	$ 81,968
The U-M Club of Toledo	$ 68,000
The U-M Club of Los Angeles	$ 57,881
The U-M Club of Grand Traverse	$ 55,389
The U-M Club of Seattle	$ 55,368

President's Donor Challenge for Endowed Professorships

$500,000 matched for every $1.5 million pledged
21 professorships
Begun: September 1, 2006 Ended: June 30, 2007
Amount raised: $31.5M + $10.5M match = **$42.0M**

President's Donor Challenge for Undergraduate Need-Based Financial Aid

$1 matched for every eligible $1 pledged
Begun: September 1, 2006 Ended: December 31, 2007
Amount raised: $37.8M + $34.8M match = **$72.6M**

President's Donor Challenge for Graduate and Professional Student Support

$1 matched for every $2 pledged
Begun: September 1, 2007
End: December 2008 or when matching funds are spent
Amount raised as of June 30, 2008: $32M + $16M match = **$48.0M**

Faculty, Staff, Retirees Campaign The Heart of the Michigan Difference

First time faculty/staff campaign
Number of faculty, staff, and retirees contributing: 16, 215
Amount raised as of June 30, 2008 = **$141.6M**

FUNDING A PUBLIC UNIVERSITY

THE ROLE OF ENDOWMENT

Top-tier universities such as the University of Michigan have an inherent focus on the future. As a major public educational and research institution, U-M develops the people and ideas that drive innovation and growth in virtually all aspects of our nation's economy.

ENDOWMENTS HAVE HELPED MAKE UNIVERSITIES AMONG THE LONGEST-LIVED INSTITUTIONS IN OUR SOCIETY, FAR OUTLASTING ALL BUT A VERY FEW CORPORATIONS.

U-M's finances are designed to focus on the future as well, enabling the University to fulfill its mission not just for today, but for generations to come. The cornerstone of a university's ability to achieve this long-term commitment is its endowment, a permanent fund that is carefully managed so that it will provide income to support core operating expenses in perpetuity.

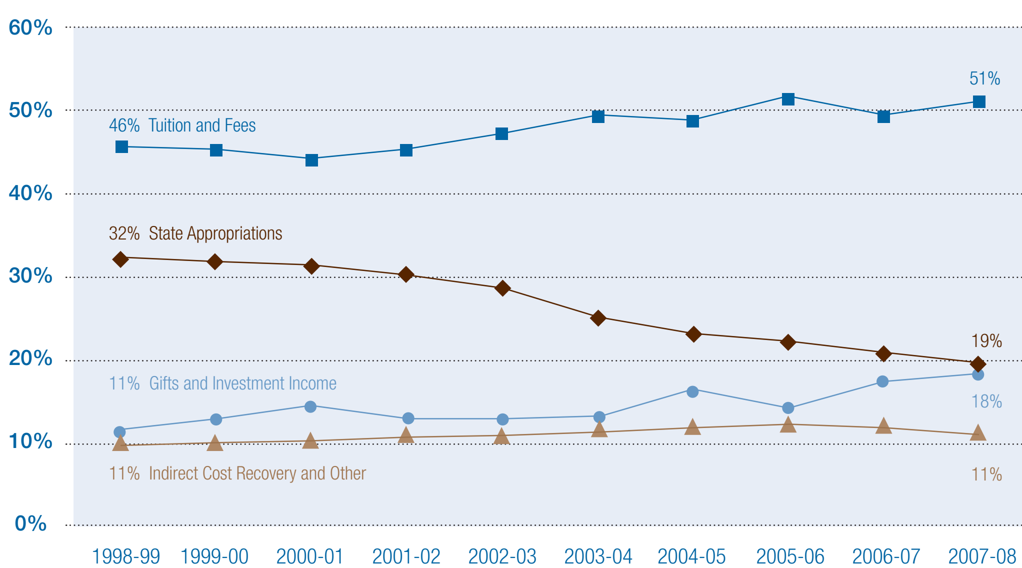
U-M receives revenue from a variety of sources to support its educational and research mission, including tuition and fees, state appropriations, gifts and investment income from the endowment, and grants associated mainly with research conducted under contract for government and industry. Income from the endowment is of growing importance, particularly as state support has declined steadily over the years.

Unlike charities, which generally distribute payouts from their endowments to support a changing portfolio of projects and activities for specified periods of time, universities use their endowment income to provide sustained support for such central operational needs as academic programs, faculty salaries, student aid, building maintenance and infrastructure, and strategic initiatives.

Endowment is built principally from gifts from alumni and friends who choose to invest in the mission of U-M. Donors make endowment contributions with the understanding that the principal will remain untouched so that it will provide ongoing benefit to students, faculty, and academic programs. A majority of these gifts are restricted by the donors to specific uses, such as scholarships, for example. And about 26 percent of the total endowment is restricted for use by the U-M Health System.

HISTORIC REVENUE SHARES FROM FOUR PRIMARY SOURCES*:

Tuition/Fees, State Appropriations, Gifts/Investment Income, and Indirect Cost Recovery/Other



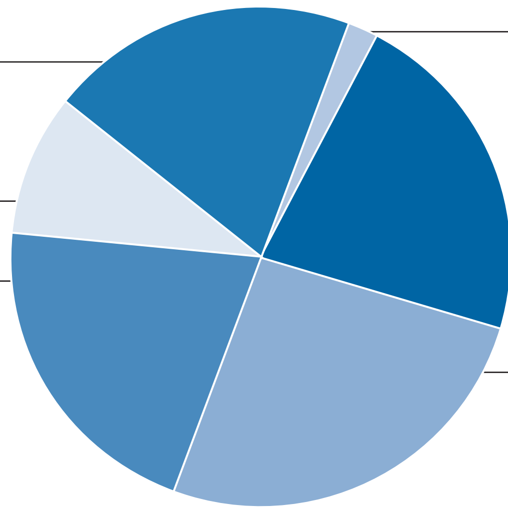
Over time, the decline in state appropriations has been offset by increases in tuition and fees, gifts, and investment income.

* This represents revenues to support the Ann Arbor campus' educational mission.

USES OF ENDOWMENT

Total Endowment at June 30, 2008: $7,572M

The endowment supports core operating expenses of the University's primary missions in education, research, and patient care.



Today, the University of Michigan's endowment is a collection of 6,500 separate funds with a total value of $7.6 billion at June 30, 2008. Although it is the eighth largest university endowment in total value, based on the most recent survey data, it is just 116th overall on a per-student basis. Thus, one of U-M's top strategic goals is to continue to grow its endowment.

Prudent stewardship of this resource is critical to maximizing its impact. U-M manages these funds to strike a balance between generating a steady, predictable stream of annual support for current needs and preserving its purchasing power for the future in the face of inflation and inevitable fluctuations in financial markets.

U-M's endowment spending rule dictates that 5 percent of the market value of the funds is distributed each year, where the market value used to calculate the 5 percent spending rate is an average of the value over the last seven years. This approach allows U-M to stabilize distribution year over year through strong and weak markets.

Cutting costs is another key aspect of responsible fiscal management. In the last five years, the Ann Arbor campus has been able to trim more than $117 million from its annual educational operating costs. Further efforts under way to control costs include examining health care costs, boosting energy efficiency, using space more efficiently, improving procurement services, and leveraging technology.

As global competition intensifies and the pace of innovation quickens, universities will be an increasingly important resource to society. But rising costs, declining state funding, and volatile markets pose serious threats to the ability of U-M to remain affordable for all students, to attract top faculty, and to innovate.

A growing endowment is part of the solution. Central to the unique financial model of academia, this stable financial foundation has enabled U-M to educate generations of students, and to conduct the basic research that has laid the groundwork for countless innovations. U-M's endowment will play an even more critical role in maintaining and strengthening its ability to fulfill these responsibilities in years to come.

AT JUNE 30, 2007, U-M'S ENDOWMENT WAS THE EIGHTH LARGEST AMONG PUBLIC AND PRIVATE UNIVERSITIES, BUT IT RANKED ONLY 116TH ON A PER-STUDENT BASIS.

NEW APPOINTMENTS

RUTH PERSON was appointed chancellor of UM-Flint effective August 18, 2008. Person was chancellor of Indiana University Kokomo since 1999. She received her master's and doctoral degrees in library and information sciences from U-M, and also holds an MS in administration from George Washington University.

MONICA PONCE DE LEON was named dean of the A. Alfred Taubman College of Architecture + Urban Planning effective September 1, 2008. She holds a master's degree in urban design from the Harvard Graduate School of Design, where she had been a professor of architecture and director of the Digital Lab.

SUELLYN SCARNECCHIA, dean of the University of New Mexico Law School since 2003, became vice president and general counsel effective July 1, 2008. A Michigan Law alumna, Scarnecchia was a clinical professor of law and associate dean of the U-M Law School from 1987–2002, and special assistant to the U-M provost in 2002.

KIM SCHATZEL was appointed dean of the UM-Dearborn School of Management for a five-year term effective January 1, 2008. After a career in business, she earned her PhD in marketing from Michigan State University in 1999, and joined the UM-Dearborn faculty in 2000. Schatzel became associate dean in 2006, and had served as interim dean since 2007.

NEW STUDENT PROFILE

The 5,600 first-year students who enrolled in September 2007 came from all 50 states and 53 countries. They were selected from a group of over 26,000 well-qualified applicants.

ACADEMICS | 53% had a 3.9 or higher GPA | 28% had a perfect 4.0 high school GPA | 92% ranked in the top 10% of their graduating class | 40% had an ACT composite score between 30 and 36 | more than 4,000 students were members of a high school academic honor society

ACTIVITIES | 54% play a musical instrument | 28% were elected to at least one student government office | 20% had writing published or were editors of high school publications | 62% have participated in civics projects | 10% have started their own businesses | almost 25% have won all-city, regional, state, or national athletic awards

2007 FALL TERM ENROLLMENT

	Undergraduate	Graduate/Professional	Total
Ann Arbor	26,083	14,959	41,042
Dearborn	6,648	1,958	8,606
Flint	5,824	1,059	6,883
All Campuses	38,555	17,976	56,531

2006–07 DEGREES GRANTED

	Undergraduate	Graduate/Professional	Total
Ann Arbor	5,941	4,845	10,786
Dearborn	1,214	612	1,826
Flint	886	238	1,124
All Campuses	8,041	5,695	13,736

OFFICERS AND STAFF
AS OF JUNE 30, 2008

REGENTS OF THE UNIVERSITY OF MICHIGAN

Julia Donovan Darlow
Ann Arbor

Laurence B. Deitch
Bingham Farms

Olivia P. Maynard
Goodrich

Rebecca McGowan
Ann Arbor

Andrea Fischer Newman
Ann Arbor

Andrew C. Richner
Grosse Pointe Park

S. Martin Taylor
Grosse Pointe Farms

Katherine E. White
Ann Arbor

Mary Sue Coleman, *ex officio*

EXECUTIVE OFFICERS

Mary Sue Coleman
President

Sally J. Churchill
Vice President and Secretary of the University

Stephen R. Forrest
Vice President for Research

E. Royster Harper
Vice President for Student Affairs

Gloria Hage
Vice President and General Counsel (Interim)

Jack Kay
Chancellor, University of Michigan-Flint (Interim)

Robert Kelch
Executive Vice President for Medical Affairs

David R. Lampe
Vice President for Communications

Daniel Little
Chancellor, University of Michigan-Dearborn

Jerry A. May
Vice President for Development

Timothy P. Slottow
Executive Vice President and Chief Financial Officer

Teresa A. Sullivan
Provost and Executive Vice President for Academic Affairs

Cynthia H. Wilbanks
Vice President for Government Relations

DEANS OF THE SCHOOLS AND COLLEGES

ANN ARBOR

Architecture + Urban Planning
Douglas S. Kelbaugh

Art & Design
Bryan Rogers

Business Administration
Robert J. Dolan

Dentistry
Peter Polverini

Education
Deborah Loewenberg Ball

Engineering
David C. Munson

Graduate Studies
Janet A. Weiss

Information
Martha Pollack

Kinesiology (Division of)
Beverly D. Ulrich

Law School
Evan H. Caminker

Literature, Science, and the Arts
Terrence J. McDonald

Medical School
James O. Woolliscroft

Music, Theatre & Dance
Christopher Kendall

Natural Resources and Environment
Rosina M. Bierbaum

Nursing
Kathleen Potempa

Pharmacy
Frank J. Ascione

Public Health
Kenneth Warner

Public Policy
Susan M. Collins

Social Work
Paula Allen-Meares

DEARBORN

Arts, Sciences, and Letters
Kathryn Anderson-Levitt

Education
Paul N. Zionts

Engineering and Computer Science
Subrata Sengupta

Management
Kim Schatzel

FLINT

Arts and Sciences
Dale J. Trela

Education and Human Services
Susanne Chandler

Health Professions and Studies
Augustine O. Agho

Management
John A. Helmuth

BUSINESS AND FINANCIAL STAFF

Henry D. Baier
Associate Vice President for Facilities and Operations

L. Erik Lundberg, CFA
Chief Investment Officer

Margaret E. Norgren
Associate Vice President for Finance

Laura M. Patterson
Associate Vice President for Michigan Administrative Information Systems

Carol Senneff, CMA, CIA
Executive Director of University Audits

Cheryl L. Soper, CPA
Controller and Director of Financial Operations

Gregory J. Tewksbury, CTP
Treasurer

Laurita E. Thomas
Associate Vice President for Human Resources and Affirmative Action

FINANCIAL STAFF

Robert L. Barbret
Associate Director of Financial Operations for Sponsored Programs, Contract Administration, and Cost Reimbursement

Antony E. Burger
Director of Financial Analysis

Frederick G. Caryl
Assistant Director of Financial Operations for Invested, Designated, General, Plant, and Auxiliary Funds

Michele J. Everard, CFA
Director of University Investments

Russell R. Fleming, CPA
Financial Manager of Financial Operations for Financial Reporting and Transaction Services

Edward J. Jennings, CPA
Tax Manager

Deborah S. Mero
Director of the Core Process Unit for Financial/Physical Resources

Chip R. Simper
Assistant Director of Financial Operations for Student Loan Operations, Student Financial Operations, and Cashier's Office

Judith C. Smith
Director of Procurement, Logistics, and Business Services

John S. Sullivan, CFA
Financial Manager of Financial Operations for Investment Reconciliation

Joan Thowsen
Director of University Investments

Norel C. Tullier
Assistant Director of Financial Operations for Payroll

MICHIGAN MEANS
EXCELLENCE + ACHIEVEMENT

The University of Michigan's excellence is grounded in an outstanding community of students, faculty, and staff drawn from throughout Michigan, across the nation, and around the globe. We bring a wealth of perspectives drawn from a wide range of ideas, beliefs, ethnicities, and personal backgrounds that critically inform our understanding of a complex world. Ours is an environment that fosters achievement in everything we do—from academics, the arts, and athletics to research and teaching.

SOLAR CAR TEAM SHINES AGAIN | Innovation, collaboration, ingenuity, teamwork, and a competitive "drive" came together as the U-M Solar Car Team won the 2008 North American Solar Challenge. Team Continuum crossed the finish line in Alberta, Canada, on July 27, 2008, after more than 2,400 miles and 50 hours of racing over nine days in a competition that began in Plano, Texas. This is the fifth time U-M finished first in this competition. Continuum finished ten hours ahead of its nearest competitor.

The Michigan team's legacy of achievement is as old as solar car racing. U-M won the inaugural North American race in 1990 (then called the SunRayce) with its first car Sunrunner. The car called Maize and Blue finished first in 1993. M-Pulse won in 2001 as did Momentum in 2005.

With more than 100 members, Solar Car is one of the largest student organizations on the Ann Arbor campus. It includes students from the College of Engineering; the College of Literature, Science, and the Arts; the Stephen M. Ross School of Business; the School of Art & Design; and the School of Education. Working in collaborative teams with the assistance of faculty mentors, the group designs, finances, builds, and races a solar-powered vehicle in competitions around North America and the world.

Each educational discipline brings different expertise to the project–from raising and managing the team's project budget to designing, manufacturing, and testing the vehicle to operations, marketing, and public relations. The team raised more than $2.4 million from over 350 corporate and individual sponsors to fund the project.

MICHIGAN MEANS

EXCELLENCE + ACHIEVEMENT

Pursue excellence—should you stumble, let it be to a lofty mountain. – MAORI PROVERB

+ Research expenditures by U-M were $876 million in fiscal year 2008, a 6 percent increase over the previous year and an all-time high. The federal government provided 70 percent of the total. Investments by U-M, industry, foundations, and the state accounted for most of the rest.

+ U-M produced the highest number of 2007–08 Fulbright awards for American students, with 37 receiving grants. Yale University followed with 27 grantees. Two faculty members affiliated with U-M will teach and conduct research abroad with Fulbright Scholar grants. They are: Steven Wright, Arthur F. Thurnau Professor of Civil and Environmental Engineering, and Thomas O'Donnell, who taught at U-M from 2001–07.

+ The National Academy of Sciences named two U-M researchers to the prestigious Institute of Medicine in October 2007. They are: Dr. Theodore Lawrence, chairman of the Medical School radiation oncology department and Isadore Lampe Professor; and Antonia Villarruel, Nola J. Pender Collegiate Professor of Nursing, director of the School of Nursing Center for Health Promotion, and a professor in the school's division of risk reduction and health promotion.

+ For the 13th straight year, U-M Hospitals and Health Centers earned a place among the best hospitals in the nation, according to rankings compiled by *U.S. News & World Report.* U-M is 13th among the 19 on the honor roll, and fourth among public institution hospitals. No other Michigan hospitals made the honor roll.

+ Seven faculty members received 2008 Guggenheim Fellowships, the most this year by any university in the United States or Canada. They are: Geri Allen, associate professor of music, School of Music, Theatre & Dance: Sheldon Danziger, H. J. Meyer Distinguished University Professor of Public Policy, Gerald R. Ford School of Public Policy; Phoebe Gloeckner, assistant professor of art, School of Art & Design; David Halperin, W. H. Auden Collegiate Professor of the History and Theory of Sexuality, Department of English; Richard Primus, law professor, Law School; and Ashutosh Varshney, political science professor, Department of Political Science.

+ The National Academy of Sciences elected to its membership Conrad Kottak, the Julian H. Steward Collegiate Professor of Anthropology. Working in Brazil, Madagascar, and the United States, Kottak has researched how local cultures interact with national and global forces.

+ Five faculty members were elected to the American Academy of Arts and Sciences. They are: Elizabeth Anderson, Arthur F. Thurnau Professor and John Rawls Collegiate Professor of Philosophy and Women's Studies; L. Ross Chambers, Marvin Felheim Distinguished University Professor Emeritus of French and Comparative Literature; Susan Gelman, Frederick G. L. Huetwell Professor of Psychology; John Jackson, M. Kent Jennings Collegiate Professor in Political Science; and Margaret Jane Radin, a professor in the Law School.

+ At least eight U-M researchers contributed to the latest set of climate change reports issued by the U.N.-sponsored panel that shared the 2007 Nobel Peace Prize with former Vice President Al Gore. They include: Rosina Bierbaum, dean of the School of Natural Resources and Environment; Henry Pollack, emeritus professor of geological sciences; Joyce Penner, professor of atmospheric science; graduate students Minghuai Wang and Li Xu; Maria Carmen Lemos, associate professor, School of Natural Resources and Environment; and Detlef Sprinz, visiting professor of political science.

+ For the third year in a row, the U.S. Department of Health & Human Services awarded the Organ Donation Medal of Honor to the U-M Health System Transplant Center and its Gift of Life Michigan partners for achieving the national goal of converting at least 75 percent of eligible deaths into actual organ donors.

+ Members of the American Association for the Advancement of Science elected 10 U-M researchers as fellows in recognition of their efforts to advance scientific applications that are considered scientifically or socially distinguished. Founded in 1848, AAAS is the world's largest general scientific society, and publisher of the journal *Science.*

+ In 2007–08 varsity sports, the Wolverines captured Big Ten Championships in baseball, women's gymnastics, softball, men's swimming and diving, field hockey, and men's outdoor track and field; and NCAA regional championships in softball and men's tennis. In addition, the U-M hockey team won the Central Collegiate Hockey Association championship and women's water polo won both the Collegiate Water Polo Association's Western Division Championship and Eastern Championship titles. In varsity club sports, men's lacrosse won the Men's Collegiate Lacrosse Association national championship.

+ Advances in fuel-efficient engines and insights on quantum dot optoelectronic devices earned U-M College of Engineering professors Dennis Assanis and Pallab Bhattacharya election to the National Academy of Engineering, one of the highest honors in engineering.

+ Dr. James R. Baker Jr. was named the Distinguished University Innovator for 2008. Baker, a scientist in the Medical School and a successful entrepreneur, has conducted breakthrough research in nanotechnology materials and launched two start-up companies based on the results.

+ The Practice Greenhealth Environmental Excellence Awards recognized the U-M Health System for its variety of eco-friendly programs focusing on energy conservation, waste management, and environmental education.

+ Gus Rosania, an assistant professor of pharmaceutical sciences, received a Presidential Early Career Award for Scientists and Engineers from President Bush at a White House ceremony. The award is the highest honor the U.S. government bestows on early-career scientists and engineers.

+ The World Bank selected Rosina Bierbaum, dean of the School of Natural Resources and Environment, to co-author and co-direct its prestigious World Development Report 2010, which will focus on climate change and development.

+ Twenty-seven individuals with ties to U-M participated in the 2008 Summer Olympic Games in Beijing, China. The Wolverines represented nine countries across six sports, and included five medal winners.

+ U-M researchers disclosed 306 new inventions in FY 2008. Results also included 144 U.S. patent applications and 87 issued patents. Revenue at the Office of Technology Transfer rose to an all-time high of $25 million. The income—about half came from royalties—will fuel ongoing reinvestments in research, technology transfer, and industry-outreach activities.

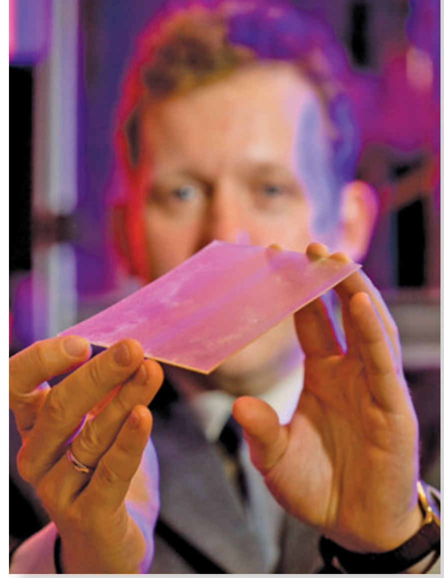
+ Six members of the U-M faculty were awarded Arthur F. Thurnau Professorships for outstanding contributions to undergraduate education. They are: James Cogswell Jr., professor of art in the School of Art & Design; Sherman Jackson, professor of Near Eastern studies in LSA; Robert Megginson, associate dean and professor of mathematics in LSA; Dana Muir, professor of business law in the Stephen M. Ross School of Business; Ann Marie Sastry, professor of mechanical engineering, biomedical engineering, and materials science and engineering in the College of Engineering (CoE); and Peter Washabaugh, associate professor of aerospace engineering, CoE.

+ The National Institutes of Health awarded U-M a five-year, $55 million Clinical and Translational Science Award as part of a national initiative to encourage and speed collaboration and interdisciplinary research for therapies that improve human health. It is the third-largest NIH award in U-M's history and the largest ever to the Medical School.

+ For the fifth year in a row, the Michigan Association of Broadcasters named Michigan Radio Public Broadcasting Station of the Year. It also received a National Edward R. Murrow Award for Best Radio News Documentary for the series "Ashes to Hope: Overcoming the Detroit Riots." Michigan Radio was the only television or radio station in the state of Michigan, public or commercial, to receive the award.

+ Erik Lundberg, chief investment officer for U-M, was a winner of *Institutional Investor's* 2007 Awards for Excellence in Investment Management in the endowments category.

MICHIGAN MEANS
CREATIVITY + INNOVATION



As one of the world's premier academic and research institutions, the University of Michigan must continually change to anticipate and meet the needs of an evolving global society. We must be prepared to follow paths that lead us in exciting new directions. Our interdisciplinary culture encourages the creativity and innovation that is essential to groundbreaking research, intellectual advancement, and artistic exploration—all hallmarks of the world-class university that is Michigan.

NORTH CAMPUS TRANSFORMATION CONTINUES WITH STAMPS DEDICATION | Behind the impressive list of donations and newly constructed buildings physically transforming UM-Ann Arbor's North Campus is the thought-provoking goal of elevating the role of and public discussion about the intrinsic value of the arts. The dedication of the Stamps Auditorium on March 27, 2008, offered a symbol of that new direction—as well as a bold display of the broad, multidisciplinary support for that goal.

A gathering of deans, dignitaries, and students celebrated what President Coleman calls "the emergence of North Campus as a destination, a nexus of cutting-edge collaboration." The 450-seat multipurpose facility adjacent to the Walgreen Drama Center provides a state-of-the-art stage for the visual and performing arts. The venue was named for Penny and Roe Stamps to recognize their significant generosity to the School of Art & Design and other units of U-M.

North Campus is home to the School of Art & Design; School of Music, Theatre & Dance; College of Engineering; Taubman College of Architecture + Urban Planning; and School of Information. In 2007 the North Campus deans launched Arts on Earth, a University-wide initiative that stimulates, explores, and celebrates the dynamic relationship between people and their arts worldwide. "Our hope is to create more of a community, where people work, study, and play closer together," explains David Munson, dean of the College of Engineering.

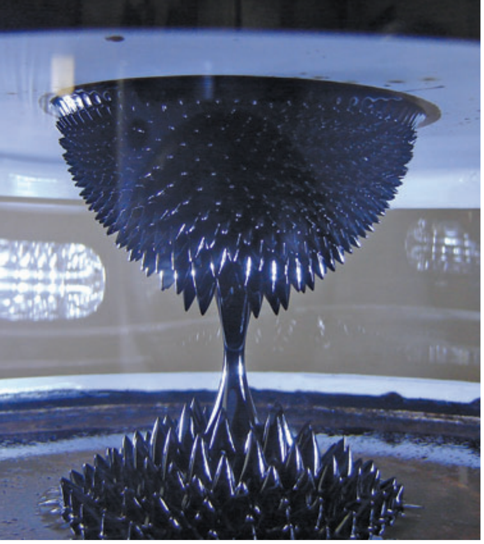
The initiative sponsors a range of compelling events that explore the interrelatedness among academic disciplines and support interdisciplinary collaborations involving the arts. "Developing students' creative talents—and creative thinking skills—is vital to preparing them for the emerging global culture," says Bryan Rogers, dean of the School of Art & Design. "Few educational institutions in the world conduct leading-edge scientific and medical research, and provide a nurturing environment for creative work."

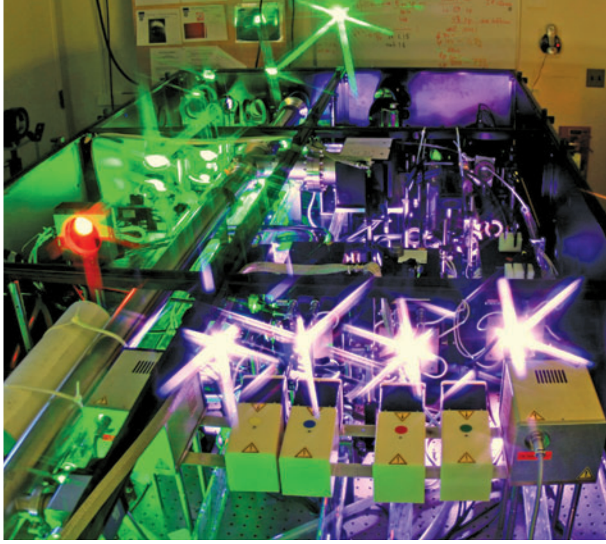
MICHIGAN MEANS

CREATIVITY + INNOVATION

Imagination is the beginning of creation. You imagine what you desire, you will what you imagine, and at last you create what you will. – GEORGE BERNARD SHAW

+ Construction at Michigan Stadium prompted U-M officials to move the 2008 spring commencement ceremony to the Central Campus Diag, for the first time in U-M's history. Workers brought in 30,000 folding chairs and 20 bleachers to transform the area into a graduation setting, trimming trees, laying down plastic flooring, and setting up a stage for the ceremony.
+ Linda Gregerson, the Frederick G. L. Huetwell Professor and professor of English at LSA, was one of four finalists in the 2007 National Book Awards for poetry. Gregerson is being recognized for her fourth collection of poems, *Magnetic North.*
+ An international study of 20,000 people, led by the U-M School of Public Health, found 7 new genes and confirmed 11 others that influence blood cholesterol levels. Finding new gene regions associated with cholesterol levels may help researchers develop better treatments for heart disease.
+ A market-based incentive program to reduce emissions from new cars and trucks would cut pollution as much as 33 percent and provide up to $2,500 in lifetime fuel savings for drivers, according to a new study by the U-M Transportation Research Institute.
+ "The Old Burying Ground," an evocative song cycle composed by Evan Chambers, chair of composition at the School of Music, Theatre & Dance, was performed at Carnegie Hall in New York in February 2008 by the University Symphony Orchestra under the direction of Kenneth Kiesler.
+ Nearly 430 Ross School of Business MBA students participated in "Innovation Boot Camp Day," a leadership-team building exercise inspired by TV's "Top Chef" cooking show and sponsored by The Food Network. The event, which took place in August 2007 on Palmer Field, emphasized creativity and innovation as key aspects of leadership.
+ A new $5 million, five-year grant from the National Institutes of Health will bring the U-M Medical School closer to developing an implantable artificial lung that can serve as a bridge to lung transplantation. The grant will fund collaborative research with the College of Engineering Department of Bioengineering and the U-M Health System.
+ By mimicking a brick-and-mortar molecular structure found in seashells, U-M engineering researchers have created a composite plastic that's as strong as steel but lighter and transparent. This "plastic steel" is made of layers of clay nanosheets and a water-soluble polymer that shares chemistry with white glue.
+ Kellogg Eye Center scientists have shown that a new metabolic imaging instrument can accurately detect eye disease at a very early stage. The noninvasive test takes less than six minutes. The device, patented through the Office of Technology Transfer, would be vision-saving because many severe eye diseases do not exhibit early warning signs.





- The School of Art & Design exhibition "The Studio and The Lab" examined the boundaries between scientific discourse and artistic terrains. The piece shown above left by Michael Flynn, a lecturer in the School of Art & Design, explores creative uses for ferrofluid, which changes shape in response to fluctuations in magnetic fields.

- The federal Office of Research on Women's Health awarded a five-year, $6 million grant to the U-M Health System to study serious childbirth-related injuries that afflict millions of women. The unique multidisciplinary team includes gynecologists, engineers, nurses, and other researchers.

- Inspired by William Shakespeare's comedic characters, U-M drama students created an original work drawing on the clowns and fools of his plays. The production, entitled "Quick Comedians and Changeable Taffeta," was presented at the Kennedy Center Family Theatre in Washington, DC, in May 2008.

- A low-power microchip developed at U-M uses 30,000 times less power in sleep mode and 10 times less in active mode than comparable chips now on the market. The Phoenix Processor, which sets a low-power record, is intended for use in sensor-based devices such as medical implants, environment monitors, or surveillance equipment.

- Legendary American choreographer Paul Taylor selected the Department of Dance in the School of Music, Theatre & Dance for the first-ever Paul Taylor Summer Intensive. The arrangement with the famous and influential choreographer could become an annual offering and help elevate the department to the forefront of dance schools.

- U-M scientists have developed a lens-like device that focuses electromagnetic waves down to a point so small that it could allow a CD to hold up to 100 times more information than it now does. The breakthrough discovery holds promise for next-generation applications in data storage, non-contact sensing, imaging, and nanolithography.

- Media violence significantly increases the risk of aggressive behavior by the viewer in both the short and long term, according to a new study by the Institute for Social Research. The study concluded that only the negative public health effect of cigarette smoking on lung cancer outweighed that caused by exposure to violent electronic media.

- A new super laser made in a Department of Electrical Engineering and Computer Science lab produces a light ray of greater intensity than would be created by focusing all the sunlight shining toward Earth onto one grain of sand. In addition to medical uses, intense laser beams like these could help researchers explore new frontiers in science.

- Autism researchers at U-M were among scientists from three schools selected by the National Institutes of Health to share a five-year, $15.3 million grant to study the impact of intervening with toddlers. The research will determine if such efforts can reduce or even eliminate the language impairments and social deficits associated with the disorder.

- U-M scientists and their colleagues at the National Institute on Aging have produced the largest and most detailed worldwide study of human genetic variation. The new study produced genetic data nearly 100 times more detailed than previous worldwide assessments of human populations.

- In October 2007 Block M Records' annual "New Music on the Block" competition selected U-M students Rob Alexander, Dave Fienup, Alejandro Guerrero, and Jack Stratton as the winning entrants. Their original compositions were released on Block M Records and are available through iTunes Music Store.

- James Kibbie, professor of organ at the School of Music, Theatre & Dance, has completed the first phase of an ambitious three-year project to record the complete organ works of Johann Sebastian Bach. When finished, some 270 compositions totaling approximately 18 hours will be available as free Internet downloads.

- The Army awarded the College of Engineering a five-year, $10 million grant to develop a 6-inch robotic spy plane that gathers data from urban combat zones and transmits information back in real time. The grant establishes the Center for Objective Microelectronics and Biomimetic Advanced Technology, called COM-BAT for short.

MICHIGAN MEANS
LEADERSHIP + SERVICE

Our campus has grown and prospered this past year with new academic programs and stunning new teaching and research facilities. More importantly, we have reaffirmed our strong commitment to applying these resources and resulting new knowledge toward the betterment of society. As we prepare the young people of our communities to be future leaders, the University of Michigan has an unparalleled opportunity and responsibility to serve the public good and help address the many challenges facing the world.

U-M GLOBAL PARTNERSHIPS GROW | The University of Michigan has a long history of reaching out to the world in a spirit of service, academic cooperation, and cultural exchange. For example, U-M's relationship with China goes back to the mid 1850s, when a member of the Class of 1845 traveled to China as a missionary.

Today, U-M enjoys strong partnerships with Chinese institutions of higher education and continues to strengthen its leadership position in Chinese studies as well as in research and teaching exchanges with Chinese colleagues. In the first trip of its kind, a group of 30 graduate students from the U-M School of Public Health spent spring break this year working with the China Centers for Disease Control (CDC). It was the first time the China CDC hosted American students for practice-based deployments.

The relationship grew further when seven undergraduate chemistry students participated in a new research exchange program this summer with Peking University. Another initiative, the College of Engineering's Joint Institute Summer Program with Shanghai Jiao Tong University, offers students degree-granting programs from both institutions. In fact, U-M was the first non-Chinese academic institution approved to offer graduate engineering degrees to students in China.

A continent away, President Mary Sue Coleman led a U-M delegation to eight universities in South Africa and Ghana from February 22 to March 5, 2008, to broaden existing collaborations with several universities and forge new relationships. Coleman and the delegation discussed initiatives for U-M's newly established African Studies Center, and explored proposals that extend many longstanding projects undertaken by the more than 120 U-M faculty involved in scholarship related to Africa.

In conjunction with the establishment of the center, the U-M African Exchange Scholars Program will bring approximately 10 visiting faculty, students, and scholars from African universities to U-M each year. Exchange scholars will facilitate U-M initiatives with partners in Africa, and collaborate on research, scholarship, and teaching.

MICHIGAN MEANS
LEADERSHIP + SERVICE

How wonderful it is that nobody need wait a single moment before starting to improve the world.
– ANNE FRANK

+ The College of Engineering has established a new Center for Entrepreneurial Programs to help enhance the state's economy. Thomas Zurbuchen, professor in the Department of Atmospheric, Oceanic and Space Sciences and Aerospace Engineering, will direct the new center.

+ The U-M Library has put its millionth digitized book online (out of the 7.5 million volumes in its current holdings). Michigan's MBooks program makes these volumes available to readers around the world. The Michigan Digitization Project is a partnership with Google that involves the entire U-M collection.

+ DTE Energy Foundation pledged $1.5 million to the College of Engineering and the Michigan Memorial Phoenix Energy Institute to create the DTE Energy Professorship of Advanced Energy Research. The professorship supports research in alternative energy sources, energy storage/conversion, transportation, fuels, and sustainability.

+ After a 10-year partnership with the U.S. EPA ENERGY STAR buildings program, U-M has implemented more than 200 projects that save energy, prevent pollution, and lower operating costs. Over the last three fiscal years alone, U-M introduced 135 energy conservation measures at a capital cost of $6 million with $1.5 million in predicted annual operating savings.

+ The 14th Dalai Lama of Tibet delivered a special Peter M. Wege Lecture on Sustainability on April 20, 2008, at Crisler Arena. The Nobel Peace Prize winner and Buddhist leader's appearance coincided with Earth Day weekend and was free and open to the public.

+ The University Research Corridor's pool of engineering talent convinced Spanish aerospace company Grupo Aernnova to bring 600 new jobs to the state of Michigan for an aerospace engineering center. The College of Engineering's aerospace and mechanical engineering programs are ranked among the nation's five best.

+ U-M is drawing attention to the Detroit metro area's often-unrecognized visual arts. The School of Art & Design unveiled Work:Detroit, a gallery where U-M and Detroit area artists exhibit side by side. The gallery is located in the U-M Detroit Center, U-M's recruitment and community outreach arm in the city.

+ UM-Flint opened Genesee Early College, the state's first early college high school. The new high school alternative allows students to obtain a high school diploma and earn up to 60 college credits at the same time.

+ Total scholarships and fellowships provided to students aggregated $300 million in 2008, an increase of 16 percent over the past two years. Two new scholarship programs, the Michigan Tradition Award and the Michigan Experience Award, target underrepresented students.

+ The expanded Robert H. Lurie Nanofabrication Facility is expected to change the high-tech landscape in southeastern Michigan. During the past five years, the facility has contributed an estimated $500 million to the state's economy. Small and large companies as well as other universities utilize it for research and development.

+ Five of 11 U.S. Department of Energy research grants awarded in August 2007 to improve fuel efficiency of light-duty vehicle engines involved University Research Corridor members U-M, Michigan State University, and Wayne State University, and totaled $10 million.

+ U-M will invest $30 million over five years for 100 new tenure-track faculty members to expand interdisciplinary research and teaching, especially in the areas of alternative energy and environmental sustainability. In 2008, 25 positions were approved in data mining, energy storage, global change, global HIV/AIDS, microbial ecology, social science, and energy.

+ U-M honored Branch Rickey, the man who helped break the Major League Baseball color barrier by signing Jackie Robinson to a big-league contract, by establishing a collegiate professorship at the Law School, from which Rickey graduated in 1911. The professorship will be funded by the Judy and Fred Wilpon Family Foundation, Major League Baseball, the Zell Family Foundation, and others.

+ Football coach Lloyd Carr announced his retirement in November 2007 after 28 seasons, 13 as head coach. He compiled a career 122–40 record at U-M, leading the team to a national championship and five Big Ten titles. Carr, noted for his extensive charity work, will stay on with the Wolverines as associate athletic director.

+ A three-decade-long study of the behaviors, attitudes, and plans of young Americans has been awarded an additional $33 million grant from the National Institutes of Health. The Institute for Social Research's landmark "Monitoring the Future" study was extended for five years to survey 50,000 young people and follow up on select participants. The oldest respondents will turn 50 this year.

+ The University Research Corridor presidents released an independent analysis showing the state's three research universities helped create 69,285 Michigan jobs and produced $13.3 billion of net economic benefit in 2007.

+ Using revenue from a new Big Ten media contract, U-M added $1.6 million to M-PACT, a student financial aid program for Michigan residents created to increase grant aid and reduce loan amounts.

+ President Mary Sue Coleman joined women leaders from around the world to address the Women as Global Leaders Conference at Zayed University in Dubai, United Arab Emirates. The international conference brings together female students from 85 countries to learn lessons of leadership from outstanding women.

+ U-M officially opened the doors to its new Business Engagement Center. The center will provide one-stop shopping for businesses seeking talent, expertise, professional development for employees, and research partnerships. The center's goal is to make U-M more user friendly and accelerate the economic transformation of the region.

+ In 2007 U-M and Michigan State University (MSU) each produced 80 Peace Corps volunteers, tying for the top-five rank in the organization. The University of California, Berkeley, has produced the most Peace Corps volunteers since 1961 with 3,326, followed by the University of Wisconsin, the University of Washington, U-M, and MSU.

+ U-M received a record 29,105 applications from prospective freshmen for fall 2008 enrollment, an 8.6 percent increase over last year and the highest number in U-M history.

MAJOR PROJECTS

PROJECTS IN PLANNING

Art and Architecture Building Addition

Central Power Plant Replacement Steam Turbine

Central Power Plant Water Treatment System Improvements

East University Chiller Plant New Chiller

Engineering Programs Building First Floor Instructional Learning Center

Thomas Francis, Jr., Public Health Building Elevator Replacement

Flint-Kearsley Street Extension

W. K. Kellogg Institute and Dental Building Exterior Repairs

KMS Building Medical School Faculty Group Practice Billing Leasehold Improvements

Law School Academic Building and Hutchins Hall Student Commons Addition

Medical Science Unit II Microbiology and Immunology Departments Renovations

Michigan Wrestling Center

Molecular and Behavioral Neuroscience Institute Building First Level Laboratory Renovations

Earl V. Moore Building Infrastructure Improvements

North Campus Switch Station Transformer Upgrades

Thompson Street Parking Structure Addition

Towsley Center for Children Replacement Facility

University of Michigan Hospitals and Health Centers Programs

+ Briarwood 2 and 4 Renovations
+ Cardiovascular Center General Clinical Research Center Relocation
+ Cardiovascular Center Nuclear Cardiology Relocation
+ Data Center Project
+ C. S. Mott Children's Hospital Moderate Care Expansion
+ A. Alfred Taubman Health Care Center Second Level Clinic Entry Renovations
+ University Hospital Computed Tomography and Interventional Radiology Expansion
+ University Hospital High Dose Rate Radiation Suite

PROJECTS IN PROGRESS

300 NORTH INGALLS BUILDING GERIATRIC CENTER RELOCATION RENOVATIONS | Work started March 2008 with an estimated completion date of December 2008. Financing is from Medical School.

ALUMNI MEMORIAL HALL MUSEUM OF ART ADDITION | Work started November 2006 with an estimated completion date of December 2008. Financing is from gifts, Museum of Art, central administration, and investment proceeds.

VERA BAITS II MECHANICAL INFRASTRUCTURE RENEWAL | Work started May 2008 with an estimated completion date of September 2009. Financing is from University Housing.

CENTRAL CAMPUS AREA UTILITY TUNNEL REPLACEMENT 2008 | Work started March 2008 with an estimated completion date of March 2009. Financing is from utilities reserves.

CENTRAL CAMPUS RECREATION BUILDING AND MARGARET BELL POOL THIRD LEVEL RENOVATIONS FOR KINESIOLOGY | Work started January 2008 with an estimated completion date of September 2008. Financing is from Office of the Provost and Division of Kinesiology.

CENTRAL POWER PLANT STEAM TURBINES REPLACEMENT | Work started March 2005 with an estimated completion date of December 2008. Financing is from utilities reserves.

CENTRAL POWER PLANT 2.4KV SWITCHGEAR UPGRADE | Work started April 2008 with an estimated completion date of September 2009. Financing is from utilities reserves.

MARTHA COOK BUILDING ROOF REPLACEMENT | Work started February 2008 with an estimated completion date of September 2008. Financing is from University Housing.

WILLIAM W. COOK LEGAL RESEARCH LIBRARY AND HUTCHINS HALL LIGHTING IMPROVEMENTS | Work started February 2008 with an estimated completion date of March 2009. Financing is from Law School gifts and investment proceeds.

DAVID M. DENNISON BUILDING AUDITORIA RENOVATIONS | Work started May 2008 with an estimated completion date of September 2008. Financing is from College of LSA and general fund.

DENTAL BUILDING AND W. K. KELLOGG INSTITUTE ELEVATOR REPLACEMENT | Work started August 2007 with an estimated completion date of March 2009. Financing is from investment proceeds.

FLINT DAVID M. FRENCH HALL RENOVATIONS | Work started June 2007 with an estimated completion date of December 2008. Financing is from State Building Authority and UM-Flint.

FLINT STUDENT HOUSING FACILITY | Work started June 2007 with an estimated completion date of September 2008. Financing is from UM-Flint, gifts, and grants.

FORD NUCLEAR REACTOR DECOMMISSIONING | Work started December 2005 with an estimated completion date of November 2008. Financing is from investment proceeds.

HUTCHINS HALL 2008 EXTERIOR REPAIRS | Work started May 2008 with an estimated completion date of December 2008. Financing is from investment proceeds.

INDOOR PRACTICE FACILITY FOR INTERCOLLEGIATE FOOTBALL | Work started December 2007 with an estimated completion date of December 2009. Financing is from Athletic Department and gifts.

INTERCOLLEGIATE ATHLETICS SOCCER FIELDS | Work started July 2007 with an estimated completion date of September 2008. Financing is from Athletic Department.

INSTITUTE FOR SOCIAL RESEARCH HEATING, VENTILATION, AND AIR CONDITIONING UPGRADES | Work started January 2008 with an estimated completion date of September 2008. Financing is from investment proceeds.

CLARENCE COOK LITTLE SCIENCE BUILDING THIRD FLOOR GEOLOGY LABORATORY RENOVATION | Work started January 2008 with an estimated completion date of September 2008. Financing is from College of LSA.

MEDICAL SCIENCE UNIT I RENOVATIONS FOR RADIOLOGY AND NUCLEAR MEDICINE | Work started August 2007 with an estimated completion date of August 2008. Financing is from Medical School and general fund.

MICHIGAN MEMORIAL PHOENIX LABORATORY RENOVATION | Work started November 2007 with an estimated completion date of December 2008. Financing is from State Building Authority and investment proceeds.

MICHIGAN STADIUM RENOVATION AND EXPANSION | Work started July 2007 with an estimated completion date of December 2010. Financing is from Athletic Department and gifts.

MOSHER-JORDAN HALL RENOVATION AND HILL DINING CENTER | Work started August 2006 with an estimated completion date of September 2008. Financing is from University Housing and investment proceeds.

NEWBERRY HALL KELSEY MUSEUM ADDITION AND RENOVATION | Work started October 2006 with an estimated completion date of September 2008. Financing is from gifts, NEH grant, investment proceeds, and College of LSA.

NORTH QUAD RESIDENTIAL AND ACADEMIC COMPLEX | Work started December 2006 with an estimated completion date of September 2010. Financing is from University Housing, Office of the Provost, College of LSA, and investment proceeds.

STEPHEN M. ROSS SCHOOL OF BUSINESS FACILITIES ENHANCEMENT | Work started April 2006 with an estimated completion date of December 2008. Financing is from Ross School of Business and gifts.

SCHOOL OF NURSING BUILDING INTERIOR UPGRADES | Work started April 2008 with an estimated completion date of December 2008. Financing is from School of Nursing and investment proceeds.

SOUTH QUADRANGLE EIGHTH FLOOR ROOF REPLACEMENT | Work started April 2008 with an estimated completion date of September 2008. Financing is from University Housing.

MADELON LOUISA STOCKWELL HALL RENOVATION | Work started March 2008 with an estimated completion date of September 2009. Financing is from University Housing and investment proceeds.

STUDENT ACTIVITIES BUILDING RENOVATION | Work started March 2007 with an estimated completion date of December 2008. Financing is from State Building Authority and investment proceeds.

A. ALFRED TAUBMAN MEDICAL LIBRARY ELEVATOR REPLACEMENT | Work started October 2007 with an estimated completion date of June 2009. Financing is from investment proceeds.

UNIVERSITY OF MICHIGAN HOSPITALS AND HEALTH CENTERS PROGRAMS | Financing is from Hospitals and Health Centers.

+ CANCER CENTER DIGITAL BREAST IMAGING EXPANSION | Work started April 2008 with an estimated completion date of September 2008.
+ EAST MECHANICAL BUILDING AND SIMPSON CIRCLE PARKING STRUCTURE CHILLED WATER LOOP IMPROVEMENTS | Work started April 2008 with an estimated completion date of March 2009.
+ EYE CENTER EXPANSION | Work started January 2007 with an estimated completion date of March 2010. Financing is from Hospitals and Health Centers, Medical School, and gifts.
+ MEDICAL PROFESSIONAL BUILDING HEATING, VENTILATION, AND AIR CONDITIONING UNIT REPLACEMENT | Work started January 2008 with an estimated completion date of July 2008.
+ C. S. MOTT CHILDREN'S AND WOMEN'S HOSPITALS REPLACEMENT PROJECT | Work started February 2007 with an estimated completion date of June 2012. Financing is from Hospitals and Health Centers and gifts.
+ UNIVERSITY HOSPITAL AND MOTT CHILDREN'S HOSPITAL FOOD SERVICE EQUIPMENT REPLACEMENT AND GALLEY RENOVATION | Work started September 2005 with an estimated completion date of August 2008.
+ UNIVERSITY HOSPITAL MAGNETIC RESONANCE IMAGING EXPANSION | Work started January 2008 with an estimated completion date of December 2008.
+ UNIVERSITY HOSPITAL PROCESS CHILLED WATER SYSTEM EXPANSION | Work started December 2007 with an estimated completion date of July 2008.
+ UNIVERSITY HOSPITAL ROOF REPLACEMENT Work started August 2007 with an estimated completion date of December 2008.
+ UNIVERSITY HOSPITAL SURGICAL INTENSIVE CARE UNIT ROOM SEPARATION | Work started May 2008 with an estimated completion date of March 2009.

PROJECTS COMPLETED

ALUMNI FIELD RENOVATION | Completed April 2008. Financed by Athletic Department and gifts.

ANIMAL RESEARCH FACILITY THIRD FLOOR LABORATORY RENOVATIONS | Completed May 2008. Financed by a federal grant and Medical School.

BETSY BARBOUR HOUSE AND HELEN H. NEWBERRY RESIDENCE FIRE SUPPRESSION SYSTEM UPGRADES | Completed September 2007. Financed by University Housing and investment proceeds.

CENTRAL CAMPUS AREA UTILITY TUNNEL REPLACEMENT 2005 | Completed September 2007. Financed by utilities reserves.

CENTRAL CAMPUS AREA UTILITY TUNNEL REPLACEMENT 2006 | Completed January 2008. Financed by utilities reserves.

CENTRAL CAMPUS AREA UTILITY TUNNEL REPLACEMENT 2007 | Completed June 2008. Financed by utilities reserves.

CENTRAL CAMPUS RECREATION BUILDING, BELL POOL, AND DANCE BUILDING ROOF REPLACEMENT | Completed August 2007. Financed by investment proceeds.

CENTRAL POWER PLANT GAS DETECTION SYSTEM INSTALLATION | Completed September 2007. Financed by utilities reserves.

CENTRAL POWER PLANT LOW-PRESSURE STEAM HANDLING IMPROVEMENTS | Completed December 2007. Financed by utilities reserves.

DEARBORN HENRY FORD ESTATE FAIR LANE HEATING AND COOLING SYSTEM IMPROVEMENTS | Completed December 2007. Financed by UM-Dearborn and gifts.

DENTAL BUILDING AND W. K. KELLOGG INSTITUTE UPGRADE FIRE ALARM AND FIRE SUPPRESSION | Completed March 2008. Financed by investment proceeds.

ELECTRICAL ENGINEERING AND COMPUTER SCIENCE BUILDING RENOVATION | Completed June 2008. Financed by College of Engineering and gifts.

ROBERT H. LURIE NANOFABRICATION FACILITY | Completed December 2007. Financed by College of Engineering, gifts, and investment proceeds.

EXTEND STEAM, CONDENSATE, AND CHILLED WATER TO NORTH QUAD SITE | Completed December 2007. Financed by utilities reserves.

RAY FISHER BASEBALL STADIUM RENOVATION | Completed March 2008. Financed by Athletic Department and gifts.

FLETCHER STREET PARKING STRUCTURE STRUCTURAL REPAIRS | Completed November 2007. Financed by parking resources.

HENRY S. FRIEZE BUILDING ASBESTOS ABATEMENT, DEMOLITION, AND SITE PREPARATION | Completed December 2007. Financed by University Housing, central administration, College of LSA, and investment proceeds.

MARIE DOROTHY HARTWIG ADMINISTRATION BUILDING RENOVATION | Completed August 2007. Financed by Athletic Department.

HARLAN HATCHER SOUTH GRADUATE LIBRARY AIR HANDLING IMPROVEMENTS | Completed December 2007. Financed by utilities reserves.

HEALTH SERVICE ROOF REPLACEMENT | Completed June 2008. Financed by investment proceeds.

INGALLS SUBSTATION TO WALL STREET UTILITY DUCT BANK | Completed April 2008. Financed by utilities reserves and Information Technology Central Services.

INTRAMURAL SPORTS BUILDING INSTALL FIRE SUPPRESSION SYSTEM | Completed September 2007. Financed by investment proceeds.

INTRAMURAL SPORTS BUILDING ROOF REPLACEMENT | Completed December 2007. Financed by investment proceeds.

EDWARD HENRY KRAUS BUILDING LABORATORY RENOVATION | Completed December 2007. Financed by College of LSA.

MARY B. MARKLEY HALL INFRASTRUCTURE UPDATES | Completed August 2007. Financed by University Housing and investment proceeds.

MATTHAEI BOTANICAL GARDENS EXHIBITION GREENHOUSE INFRASTRUCTURE RENEWAL | Completed January 2008. Financed by Matthaei Botanical Gardens, gifts, and investment proceeds.

MEDICAL SCIENCE UNIT I PATHOLOGY RESEARCH LABORATORY RENOVATIONS | Completed July 2007. Financed by Medical School.

MEDICAL SCIENCE UNIT I THIRD FLOOR RESEARCH LABORATORY RENOVATIONS | Completed May 2008. Financed by Medical School.

MEDICAL SCIENCE UNIT II THIRD FLOOR RESEARCH LABORATORY RENOVATIONS | Completed February 2008. Financed by Medical School.

MEDICAL SCIENCE UNITS I AND II RENOVATIONS | Completed March 2008. Financed by Medical School.

MICHIGAN MEMORIAL PHOENIX LABORATORY ASBESTOS ABATEMENT | Completed September 2007. Financed by investment proceeds.

MICHIGAN STADIUM 2007 CONCRETE REPAIRS | Completed August 2007. Financed by Athletic Department.

EARL V. MOORE BUILDING INTERIOR FINISH UPGRADES AND LIBRARY REMODELING | Completed September 2007. Financed by central administration and University Library.

NORTH CAMPUS RECREATION BUILDING ROOF REPLACEMENT | Completed September 2007. Financed by investment proceeds.

NORTH CAMPUS UNDERGROUND CHILLED WATER LINES EXTENSION | Completed August 2007. Financed by utilities reserves and investment proceeds.

OBSERVATORY LODGE RENOVATION | Completed October 2007. Financed by State Building Authority, Division of Kinesiology, and investment proceeds.

SCHOOL OF NURSING BUILDING RENOVATIONS IN THE CHILDREN'S CENTER | Completed August 2007. Financed by investment proceeds.

SCHOOL OF PUBLIC HEALTH BUILDING THIRD AND FOURTH FLOOR SHELL SPACE COMPLETION | Completed October 2007. Financed by School of Public Health.

SCHOOL OF PUBLIC HEALTH BUILDINGS RENOVATIONS | Completed December 2007. Financed by investment proceeds, School of Public Health, and gifts.

UNIVERSITY OF MICHIGAN HOSPITALS AND HEALTH CENTERS PROGRAMS | Financed by Hospitals and Health Centers.

+ BRIARWOOD BUILDING 9 DIGITAL RADIOGRAPHY RENOVATIONS | Completed September 2007.
+ BURLINGTON OFFICE BUILDING PAIN CLINIC RELOCATION LEASEHOLD IMPROVEMENTS | Completed May 2008.
+ CHILLED WATER LOOP REPLACEMENT PHASE I | Completed July 2007.
+ C. S. MOTT CHILDREN'S HOSPITAL INFANT SECURITY SYSTEM UPGRADE | Completed December 2007.
+ UNIVERSITY HOSPITAL EMERGENCY DEPARTMENT EXPANSION | Completed July 2007.
+ UNIVERSITY HOSPITAL INTENSIVE CARE UNIT BED EXPANSION | Completed March 2008.
+ UNIVERSITY HOSPITAL NEUROSURGERY INTENSIVE CARE UNIT BED EXPANSION | Completed June 2008.
+ UNIVERSITY HOSPITAL OPERATING ROOM RENOVATION | Completed March 2008.
+ UNIVERSITY HOSPITAL PHARMACY SERVICES RENOVATION | Completed July 2007.
+ UNIVERSITY HOSPITAL POSITRON EMISSION TOMOGRAPHY/ COMPUTED TOMOGRAPHY SCANNER REPLACEMENT | Completed April 2008.

+ UNIVERSITY HOSPITAL RADIATION ONCOLOGY COMPUTED TOMOGRAPHY SIMULATOR REPLACEMENT | Completed September 2007.
+ UNIVERSITY HOSPITAL RENOVATIONS FOR BLOOD BANK LABORATORY CLEAN ROOM | Completed December 2007.

CHARLES R. WALGREEN, JR. DRAMA CENTER AND STAMPS AUDITORIUM | Completed January 2008. Financed by gifts and investment proceeds.

Management Responsibility for Financial Statements

THE UNIVERSITY OF MICHIGAN
OFFICE OF THE EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

3014 FLEMING ADMINISTRATION BUILDING
ANN ARBOR, MICHIGAN 48109-1340
(734) 764-7272 FAX (734) 936-8730

September 9, 2008

The management of the University of Michigan (the "University") is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements. The financial statements, presented on pages 54 to 77, have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts based on judgments and estimates by management.

The consolidated financial statements have been audited by the independent accounting firm PricewaterhouseCoopers LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Regents. The University believes that all representations made to the independent auditors during their audit were valid and appropriate. PricewaterhouseCoopers' audit opinion is presented on page 35.

The University maintains a system of internal controls over financial reporting, which is designed to provide reasonable assurance to the University's management and Board of Regents regarding the preparation of reliable published financial statements. Such controls are maintained by the establishment and communication of accounting and financial policies and procedures, by the selection and training of qualified personnel, and by an internal audit program designed to identify internal control weakness in order to permit management to take appropriate corrective action on a timely basis. There are, however, inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention of controls.

The Board of Regents, through its Finance, Audit and Investment Committee, is responsible for engaging the independent auditors and meeting regularly with management, internal auditors, and the independent auditors to ensure that each is carrying out their responsibilities and to discuss auditing, internal control, and financial reporting matters. Both internal auditors and the independent auditors have full and free access to the Finance, Audit and Investment Committee.

Based on the above, I certify that the information contained in the accompanying financial statements fairly presents, in all material respects, the financial condition, changes in net assets and cash flows of the University.

Timothy P. Slottow
Executive Vice President and Chief Financial Officer

Report of Independent Auditors

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The Regents of the University of Michigan

In our opinion, the accompanying consolidated statement of net assets and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of the University of Michigan (the "University") at June 30, 2008 and 2007, and its consolidated revenues, expenses and changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the University adopted the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* as of July 1, 2007.

The Management's Discussion and Analysis ("MD&A") on pages 36 through 53 is not a required part of the financial statements but is supplementary information required by GASB. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

September 9, 2008

INTRODUCTION

The following discussion and analysis provides an overview of the financial position of the University of Michigan (the "University") at June 30, 2008 and 2007 and its activities for the three fiscal years ended June 30, 2008. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The University is a comprehensive public institution of higher learning with approximately 57,000 students and 6,600 faculty members on three campuses in southeast Michigan. The University offers a diverse range of degree programs from baccalaureate to post-doctoral levels through 19 schools, colleges and divisions, and contributes to the state and nation through related research and public service programs. The University, in total, employs more than 49,000 permanent and temporary staff. The University also maintains one of the largest health care complexes in the world through its Hospitals and Health Centers ("HHC"). HHC consists of three hospitals, 40 health centers and more than 120 outpatient clinics. HHC is an integral part of the University's Health System which also includes the University's Medical School; Michigan Health Corporation, a wholly-owned corporation created to pursue joint venture and managed care initiatives; and M-CARE, a wholly-owned health maintenance organization which was sold effective December 31, 2006.

The University consistently ranks among the nation's top universities by various measures of quality, both in general academic terms, and in terms of strength of offerings in specific academic disciplines and professional subjects. Excellence in research is another crucial element in the University's high ranking among educational institutions. Research is central to the University's mission and permeates its schools and colleges. In addition to the large volume of research conducted within the academic schools, colleges, and departments, the University has more than a dozen large-scale research institutes outside the academic units that conduct, in collaboration with those units, full-time research focused on long-term interdisciplinary matters. The University's Health System also has a tradition of excellence in teaching, advancement of medical science and patient care, consistently ranking among the best health care systems in the nation.

FINANCIAL HIGHLIGHTS

During fiscal 2008, the University implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions.* This Statement requires accrual-based measurement and recognition of the cost of postemployment benefits during the periods when employees render their services. Previously, the University recognized obligations for most postemployment benefits as they were paid. Implementation of this Statement resulted in an increase in liabilities and a decrease in net assets of $1.4 billion.

The University's financial position remains strong, with assets of $14.8 billion and liabilities of $4.0 billion at June 30, 2008, compared to assets of $13.8 billion and liabilities of $2.3 billion at June 30, 2007. Net assets, which represent the residual interest in the University's assets after liabilities are deducted, totaled $10.8 billion at June 30, 2008 as compared to $11.5 billion at June 30, 2007. Changes in net assets represent the University's results of operations and are summarized for the years ended June 30, 2008 and 2007 as follows:

(in millions)	2008	2007
Operating revenues and state educational appropriations	$ 4,508.6	$ 4,167.8
Total expenses before implementation of GASB Statement No. 45	4,756.4	4,464.2
	(247.8)	(296.4)
Net investment income	621.9	1,572.6
Gifts and other nonoperating revenues, net	287.6	336.8
Increase in net assets before implementation of GASB Statement No. 45	661.7	1,613.0
Implementation of GASB Statement No. 45, postemployment benefits:		
Obligations as of July 1, 2007	(1,306.9)	
Additional operating expenses for 2008	(97.3)	
(Decrease) increase in net assets	$ (742.5)	$ 1,613.0

Before the implementation of GASB Statement No. 45, net assets increased $662 million in fiscal 2008 and $1.6 billion in fiscal 2007, primarily due to net investment income which totaled $622 million and $1.6 billion in fiscal 2008 and 2007, respectively. The results of operations reflect the University's focus on maintaining its national standards academically, and in research and health care, while addressing declining base state appropriations and rising health care, regulatory, and facility costs in a competitive recruitment environment for faculty and health care professionals. Operating revenues and state educational appropriations increased 8 percent, or $341 million, while total expenses before implementation of GASB Statement No. 45 increased 7 percent, or $292 million. Gifts and other nonoperating revenues, which in fiscal 2007 include a $160 million gain on the sale of M-CARE, decreased 15 percent, to $288 million in fiscal 2008.

The University invests its financial assets to maximize total return with an appropriate level of risk. While the University's working capital is invested in relatively short duration assets, the University invests its endowment with a strategy that seeks to maximize total return over the long term. The success of this long-term investment strategy is evidenced by strong returns over sustained periods of time and the University's ability to limit losses in the face of challenging markets. In 2008, during a difficult year for public equities, the University's returns in nonmarketable limited partnerships and absolute return strategies aided by strong returns from its energy holdings and hedging strategies resulted in positive investment income.

SALE OF M-CARE

Formed by the University in 1986, M-CARE offered managed health care benefits to the employees of the University and other employers in Southeast Michigan. Completing the sale of M-CARE to Blue Cross Blue Shield of Michigan ("Blue Cross") and its subsidiary Blue Care Network in fiscal 2007 enabled the University to make a smooth transition with a non-profit, community-minded, quality-oriented partner, at a time when the health insurance industry is experiencing great turbulence, including the rapid growth of consumer driven health care plans and emerging technologies that require significant capital investment. This sale also enabled the University to better direct its resources toward its core mission of education, research and patient care.

In 2007, the University received proceeds from the sale net of expenses of $258 million and recognized a $160 million gain on the sale. In 2008, pursuant to the terms of the sales agreement, the sales price was reduced by $7 million based on certain changes in net assets. As part of the sale, Blue Cross also committed up to $10 million to launch a joint venture with the University. This venture will commission research and other projects aimed at improving the quality of health care in the state of Michigan, and transforming the way patient care is delivered in the state and beyond.

Subscription premiums revenue recognized by M-CARE from employers other than the University totaled approximately $197 million for the six months ended December 31, 2006, the effective date of the sale. University members enrolled in M-CARE at the time of the sale maintained the same coverage through December 31, 2007. Replacement health plans designed and funded by the University, similar to the M-CARE HMO and GradCare plans and administered by Blue Cross, were available to University employees for calendar 2008 in addition to the other health plan choices offered by the University.

USING THE FINANCIAL STATEMENTS

The University's financial report includes three financial statements: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. These financial statements are prepared in accordance with GASB principles, which establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis to focus on the University as a whole.

STATEMENT OF NET ASSETS

The statement of net assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The difference between total assets and total liabilities — net assets — is one indicator of the current financial condition of the University, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation. A comparison of the University's assets, liabilities and net assets at June 30, 2008 and 2007 is summarized as follows:

(in millions)	2008	2007
Current assets	$ 2,536	$ 2,418
Noncurrent assets:		
Endowment, life income and other investments	7,855	7,380
Capital assets, net	4,130	3,755
Other	250	263
Total assets	14,771	13,816
Current liabilities	1,058	879
Noncurrent liabilities	2,958	1,440
Total liabilities	4,016	2,319
Net assets	$ 10,755	$ 11,497

The University continues to maintain and protect its strong financial foundation. This financial health, as reflected in the statement of net assets at June 30, 2008 and 2007, results from the prudent utilization of financial resources including careful cost controls, preservation of endowment funds, conservative utilization of debt, and adherence to a long-range capital plan for the maintenance and replacement of the physical plant.

Current assets consist primarily of cash and cash equivalents, operating and capital investments, and accounts receivable. Total current assets increased $118 million, to $2.5 billion at June 30, 2008. Cash and cash equivalents and operating investments totaled $1.2 billion at June 30, 2008, which represents approximately three months of total expenses excluding depreciation.

Current liabilities consist primarily of accrued compensation, accounts payable, deferred revenue, commercial paper and the current portion of bonds payable. Total current liabilities increased $179 million, to $1.1 billion at June 30, 2008, primarily due to the timing of investment trade settlements and the 2008 implementation of GASB Statement No. 45, which includes a current portion of obligations for postemployment benefits.

ENDOWMENT, LIFE INCOME AND OTHER INVESTMENTS

The University's endowment, life income and other investments increased $475 million, to $7.9 billion at June 30, 2008. This increase primarily resulted from favorable investment performance and the receipt of new endowment funds through gifts and transfers, offset by endowment distributions to beneficiary units for operations. The composition of the University's endowment, life income and other investments at June 30, 2008 and 2007 is summarized as follows:

(in millions)	2008	2007
Endowment investments	$ 7,572	$ 7,090
Life income investments	118	120
Noncurrent portion of insurance and benefits obligations investments	165	170
	$ 7,855	$ 7,380

The University's endowment funds consist of both permanent endowments and funds functioning as endowment. Permanent endowments are those funds received from donors with the stipulation that the principal remain inviolate and be invested in perpetuity to produce income that is to be expended for the purposes specified by the donors. Funds functioning as endowment consist of amounts (restricted gifts or unrestricted funds) that have been allocated by the University for long-term investment purposes, but are not limited by donor stipulations requiring the University to preserve principal in perpetuity. Programs supported by endowment funds include scholarships, fellowships, professorships, research efforts, and other important programs and activities.

The University uses its endowment funds to support operations in a way that strikes a balance between generating a predictable stream of annual support for current needs and preserving the purchasing power of the endowment funds for future periods. The major portion of the endowment is maintained in the University Endowment Fund, a unitized pool which represents a collection of more than 6,500 separate (individual) funds, the majority of which are restricted for specific purposes. The University Endowment Fund is invested in the University's Long Term Portfolio, a single diversified investment pool. The University's endowment spending rate policy provides for an annual distribution of 5 percent of the one-quarter lagged, moving average fair value of University Endowment Fund assets, with distributions limited to 5.3 percent of current fair value.

Any capital gains or income generated above the endowment spending rate are reinvested so that in lean times funds will be available. Effective July 1, 2006, the moving average period was extended from three years to four years and it is being extended by one quarter each subsequent quarter until it reaches seven years. This change is expected to reduce distribution volatility, as well as better preserve and grow the endowment corpus over time. In addition, departments may also use withdrawals from funds functioning as endowment to support capital expenditures and operations.

Endowment spending rate distributions totaled $227 million, $205 million and $190 million and withdrawals from funds functioning as endowment totaled $20 million, $57 million and $46 million in 2008, 2007 and 2006, respectively. Total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 4.0 percent, 5.0 percent and 5.2 percent of the fair value of the University Endowment Fund for 2008, 2007 and 2006, respectively. Over the past ten years, total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 6.5 percent.

CAPITAL AND DEBT ACTIVITIES

One of the critical factors in continuing the quality of the University's academic, research and clinical programs is the development and renewal of capital assets. The University continues to implement its long-range plan to modernize its complement of older facilities, along with balanced investment in new construction.

Capital asset additions totaled $701 million in 2008, as compared to $611 million in 2007. Capital asset additions primarily represent replacement, renovation and new construction of academic, research, clinical and athletic facilities, as well as significant investments in equipment, including information technology. Current year capital asset additions were primarily funded with gifts and net assets designated for capital purposes of $413 million, as well as debt proceeds of $276 million and state capital appropriations of $12 million. Construction in progress, which totaled $647 million at June 30, 2008 and $349 million at June 30, 2007, includes important new facilities for patient care, research, instruction, athletics and student residential life.

Renovation and expansion projects completed in 2008 include the Solid State Electronics Laboratory, and the Observatory Lodge. The expansion and renovation of the Solid State Electronics Laboratory, which has been renamed the Michigan Nanofabrication Facility, provided a new clean room and support space as well as architectural, mechanical and electrical improvements. This facility is now one of the premier nanofabrication facilities in the world and supports important new energy initiatives, nanotechnology, microchip fabrication and other research initiatives. The renovation of the Observatory Lodge provided an additional 18,000 net square feet of classroom, office and research space for the Division of Kinesiology, as well as major upgrades and replacements of mechanical and electrical infrastructure, while maintaining the historical nature of the building.

Many significant facility enhancement projects continue for critical academic, patient care, research and residential life facilities. Construction continues on a new facility for the Stephen M. Ross School of Business which will support the School's distinct, team-based learning that bridges theory and practice. Classrooms, offices and other spaces will be arranged in a setting conducive to collaboration inside the School. Technology designed into the building will foster interaction with firms and organizations around the world. The University expects classes to begin in this new facility in January 2009.

A new facility for C.S. Mott Children's Hospital and Women's Hospital is being constructed to meet increasing patient demand and accommodate future research, education and clinical care innovations. The new state-of-the art facility will further enhance specialty services for newborns, children and pregnant women not offered anywhere else in Michigan, including programs for Level I pediatric trauma, pediatric liver transplant, and craniofacial anomalies as well as high-risk pregnancy and specialty gynecological services. With a clinic building of nine floors and an inpatient building of twelve floors, the new facility will be approximately 1.1 million gross square feet. After the new facility is completed in 2012, the existing C.S. Mott Children's Hospital and Women's Hospital will be used to benefit the entire Health System.

The University continues construction of a new state-of-the art eye center that will more than double capacity for eye care, research and education, as well as give scientists more space to search for a cure for Type 1 diabetes. The new facility, which includes eight floors for clinics, surgery and research, will serve the growing number of patients who need advanced eye care and access to the latest research discoveries. Large windows and a full wall of glass panels on the building's façade will allow natural light to fill the clinics and common space, of particular benefit to patients whose vision is impaired. Clinics will have space for patient education and comfortable waiting areas designed to aid patient flow. Research areas will feature open laboratories to encourage collaboration and provide flexibility as research projects grow. The new facility will also house the Brehm Center for Type 1 Diabetes Research and Analysis, which will provide opportunities for collaboration among diabetes and vision scientists, particularly on vision loss caused by diabetes. The new eye center, which is expected to open in 2010, will be adjacent to and connected to the current Kellogg Eye Center tower.

The University also continues construction of its first new student residence hall in more than 40 years. Combining sophisticated classroom and academic space with residence space for 460 students, the North Quad Residential and Academic Complex will provide classrooms, studios and offices for five information and communications-related university programs. The result will be an environment in which interactions among students and faculty flow from classrooms to hallways to faculty offices to living quarters. The living spaces, like the whole of the project, are designed to facilitate student learning, and student social and programmatic needs. The University expects this new facility to be completed in Summer 2010.

At June 30, 2008, the University was nearing completion of a comprehensive renewal and renovation of the Mosher-Jordan Hall, the University's first residence hall to undergo such a renovation. The project preserves the existing historic areas and details, while creating new community environments by reconfiguring current spaces and completing significant infrastructure upgrades. The project also includes a new, multi-level lobby and entrance to provide a single point of entry for residents and visitors, as well as centralized services for students in both houses of Mosher-Jordan. Infrastructure upgrades include new plumbing, elevators, heating, ventilation, fire detection and suppression systems, wired and wireless high-speed network access, renovated bath facilities, and accessibility improvements. Taking place along with this renovation is the creation of the Hill Dining Center which will enable the University to consolidate dining services for all of the Hill area residence halls. This innovative new dining center is attached to Mosher-Jordan on the rear of the building facing Palmer Field and will feature a marketplace style facility with seating for 700, as well as a food emporium on the top floor with café style seating for 70.

In July 2007, the University broke ground on the first Student Housing Facility on the Flint Campus. This facility will provide accommodations for 310 students and will consist of one, two and four bedroom units, which include handicap accessible units. All units will contain one or two bathrooms, a kitchen and living room. The first floor of the facility will also provide communal living and learning space for residents. Commencing with the Fall 2008 semester, this facility will enter service at full capacity.

The Museum of Art's historic home, Alumni Memorial Hall, is undergoing a transformative facility expansion and restoration. An addition will nearly double the Hall's size to address space needs and allow for future growth in collections and programming, while the renovation will address needed infrastructure improvements. The addition consists of three floors with a lower level and will provide space for galleries, collections, exhibitions, classrooms and administration. The University expects this project to be completed in early 2009.

In December 2007 the University began a comprehensive renovation and expansion of Michigan Stadium. The project will add 400,000 square-feet encompassed by two multi-story masonry structures on both the east and west sides of the stadium, leaving the end zones open. The structures include 83 suites and 3,000 club seats, and will provide space for additional restrooms, concessions, first-aid and security stations. Renovation to the stadium itself will result in improvements in the number and quality of restrooms and concession stands, wider aisles, handrails and additional entry and exit points for improved crowd circulation and safety; and additional dedicated seating for fans with impaired mobility. Construction will take place in the off-season so as not to interrupt the home football schedule and is expected to be completed before the 2010 football season.

The University takes its financial stewardship responsibility seriously and works hard to manage its financial resources effectively, including the prudent use of debt to finance capital projects. A strong debt rating is an important indicator of the University's success in this area. During 2008, Moody's Investors Service affirmed its highest credit rating (Aaa) for bonds backed by a broad revenue pledge based on the University's extremely strong credit fundamentals, including significant financial resources, strong market position and consistent operating performance derived from a well diversified revenue base. Standard & Poor's Ratings Services also affirmed its highest credit rating (AAA) based on the University's national reputation for excellence, strong financial performance, exceptional record of fundraising, and manageable debt burden and capital plan. Only two other public universities have received the highest credit ratings from both Moody's and Standard & Poor's.

Long-term debt activity for the year ended June 30, 2008, and the type of revenue it is supported by, is summarized as follows:

(in millions)	Beginning Balance	Additions	Reductions	Ending Balance
Commercial Paper:				
General revenues	$ 110	$ 170	$ 143	$ 137
Bonds and Notes:				
General revenues	255	224	20	459
Hospital revenues	581		29	552
Faculty Group Practice revenues	94	1	3	92
Student residences revenues	2			2
	$ 1,042	$ 395	$ 195	$ 1,242

The University maintains a combination of fixed and variable rate debt with effective interest rates that averaged 3.40 percent in fiscal 2008 and 4.04 percent in fiscal 2007. Consistent with the University's capital and debt financing plans, total outstanding debt increased $200 million, or 19 percent, to $1.2 billion at June 30, 2008, and interest expense increased 10 percent, to $34 million.

The University utilizes commercial paper, backed by a general revenue pledge, to provide interim financing for its capital improvement program. Outstanding commercial paper is converted to long-term debt financing, as appropriate, within the normal course of business. At June 30, 2008 and 2007, commercial paper totaled $137 million and $110 million, respectively, and is included in current liabilities. During fiscal 2008, the University issued $170 million of commercial paper to fund new construction projects and refund Hospital Revenue Refunding Bonds Series 1998A-1.

In March 2008, the University issued $224 million in variable rate general revenue bonds (Series 2008A and Series 2008B) to convert $73 million of commercial paper to long-term debt and provide $150 million for capital projects, including the Michigan Stadium Renovation and Expansion, North Quad Residential and Academic Complex, Stephen M. Ross School of Business Facilities Enhancement, and the Flint Student Housing Facility, as well as $475,000 for debt issuance costs. Of the total bond issue, $126 million is variable rate debt and $98 million is variable rate debt with a corresponding swap to fixed.

OBLIGATIONS FOR POSTEMPLOYMENT BENEFITS

The University implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions,* during fiscal 2008. This Statement requires accrual-based measurement and recognition of the cost of postemployment benefits during the periods when employees render their services. Previously, the University recognized obligations for most postemployment benefits as they were paid.

Implementation of this Statement resulted in an increase in liabilities and a decrease in net assets of $1.4 billion in fiscal 2008. Of this increase, $1.3 billion represents a one-time nonoperating expense to reflect the present value of the University's obligations for postemployment benefits as of July 1, 2007 and $97 million represents the additional fiscal 2008 operating expense for postemployment benefit obligations. In addition, a liability for insurance and benefit reserves for life insurance and open long-term disability claims, which totaled $88 million at June 30, 2007, is considered part of the obligations for postemployment benefits liability as defined by GASB Statement No. 45 and has been reclassified accordingly as part of the implementation of this statement.

Using current actuarial assumptions, and presuming a continuation of the current level of benefits, the University's liability for postemployment benefits obligations totaled $1.5 billion at June 30, 2008. Since a portion of retiree medical services will be provided by the University's Health System, this liability is net of the related margin and fixed costs of providing those services which totaled $221 million at June 30, 2008.

By implementing a series of health benefit initiatives over the past few years, the University has favorably impacted its liability for postemployment benefits obligations by $226 million. In accordance with GASB Statement No. 45, the University's liability for postemployment benefits obligations at June 30, 2008 does not reflect anticipated Medicare Part D prescription drug subsidies for future years of $179 million.

NET ASSETS

Net assets represent the residual interest in the University's assets after liabilities are deducted. The composition of the University's net assets at June 30, 2008 and 2007 is summarized as follows:

(in millions)	2008	2007
Invested in capital assets, net of related debt	$ 3,030	$ 2,864
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,071	960
Expendable:		
Net appreciation of permanent endowments	1,492	1,420
Funds functioning as endowment	1,561	1,492
Restricted for operations and other	680	693
Unrestricted	2,921	4,068
	$ 10,755	$ 11,497

Net assets invested in capital assets represent the University's capital assets net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets. The $166 million increase reflects the University's continued development and renewal of its capital assets in accordance with its long-range capital plan.

Restricted nonexpendable net assets represent the historical value (corpus) of gifts to the University's permanent endowment funds. The $111 million increase primarily represents new gifts. Restricted expendable net assets are subject to externally imposed stipulations governing their use. This category of net assets includes net appreciation of permanent endowments, funds functioning as endowment and net assets restricted for operations, facilities and student loan programs. Restricted expendable net assets totaled $3.7 billion at June 30, 2008, as compared to $3.6 billion at June 30, 2007.

Although unrestricted net assets are not subject to externally imposed stipulations, all of the University's unrestricted net assets have been designated for various academic and research programs and initiatives, as well as capital projects. At June 30, 2008, unrestricted net assets included funds functioning as endowment of $3.3 billion offset by unfunded obligations for postemployment benefits of $1.5 billion, which were recognized in fiscal 2008 pursuant to the implementation of GASB Statement No. 45. At June 30, 2007 unrestricted net assets included funds functioning as endowment of $3.1 billion.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

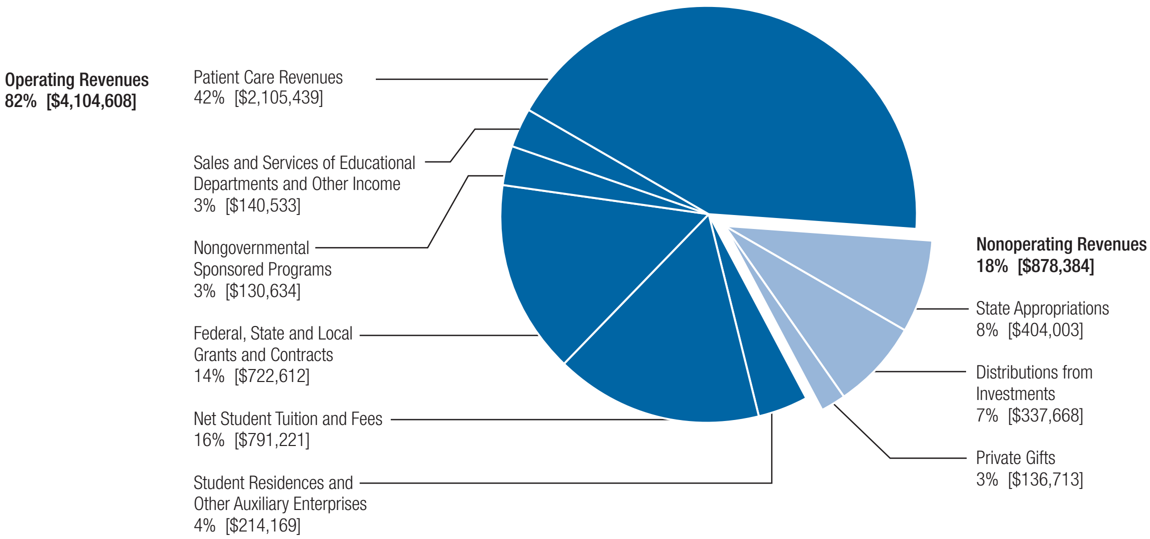
The statement of revenues, expenses and changes in net assets presents the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as either operating or nonoperating. A comparison of the University's revenues, expenses and changes in net assets for the three years ended June 30, 2008 is summarized as follows:

(in millions)	2008	2007	2006
Operating revenues:			
Student tuition and fees, net of scholarship allowances	$ 791.2	$ 718.7	$ 675.7
Sponsored programs	853.2	823.7	818.4
Patient care revenues and managed care premiums	2,105.4	1,983.6	1,990.5
Other	354.8	309.4	298.4
	4,104.6	3,835.4	3,783.0
Operating expenses	4,820.0	4,433.6	4,256.0
Operating loss	(715.4)	(598.2)	(473.0)
Nonoperating and other revenues (expenses):			
State educational appropriations	404.0	332.4	364.9
Private gifts	136.7	132.8	90.0
Net investment income	621.9	1,572.6	959.8
Interest expense	(33.6)	(30.6)	(27.1)
State capital appropriations	11.8	6.4	20.1
Endowment and capital gifts and grants	160.1	137.6	151.0
Other	(21.1)	60.0	(11.9)
Nonoperating and other revenues, net	1,279.8	2,211.2	1,546.8
Implementation of GASB Statement No. 45, postemployment benefits obligations as of July 1, 2007	(1,306.9)		
(Decrease) increase in net assets	(742.5)	1,613.0	1,073.8
Net assets, beginning of year	11,497.1	9,884.1	8,810.3
Net assets, end of year	$ 10,754.6	$ 11,497.1	$ 9,884.1

One of the University's greatest strengths is the diverse streams of revenue that supplement its student tuition and fees, including private support from individuals, foundations and corporations, along with government and other sponsored programs, state appropriations and investment income. The University continues to aggressively seek funding from all possible sources consistent with its mission in order to supplement student tuition and prudently manage the financial resources realized from these efforts to fund its operating activities.

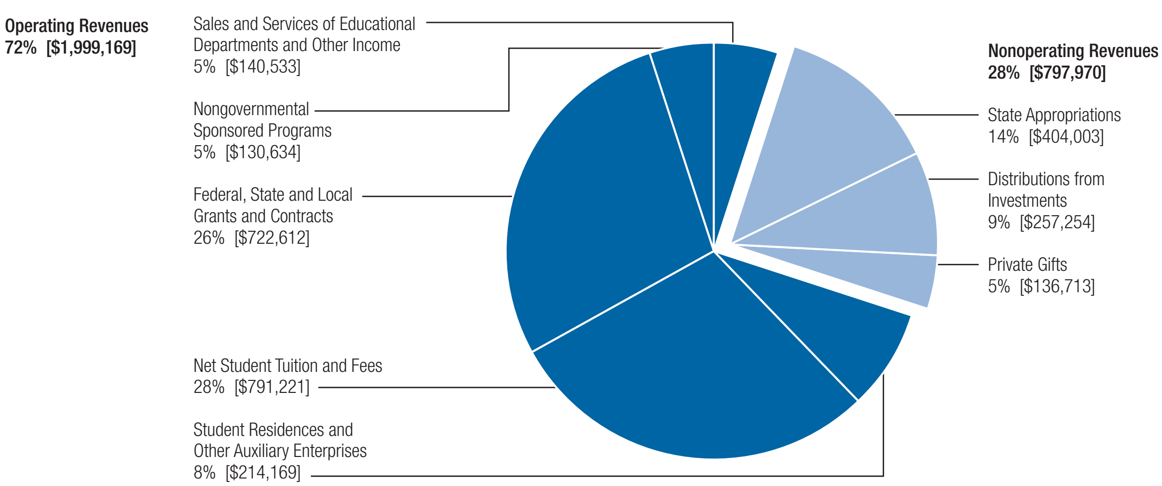
The following is a graphic illustration of revenues by source, both operating and nonoperating, which are used to fund the University's operating activities for the year ended June 30, 2008 (amounts are presented in thousands of dollars). Significant recurring sources of the University's revenues are considered nonoperating, as defined by GASB, such as state appropriations, private gifts and distributions from investments.

FISCAL YEAR 2008 REVENUES FOR OPERATING ACTIVITIES



The University measures its performance both for the University as a whole and for the University without its Health System and other similar activities. The exclusion of the Health System allows a clearer view of the operations of the schools and colleges, as well as the central administration. The following is a graphic illustration of University revenues by source, both operating and nonoperating, which are used to fund operating activities other than the Health System, for the year ended June 30, 2008 (amounts are presented in thousands of dollars).

FISCAL YEAR 2008 REVENUES FOR OPERATING ACTIVITIES EXCLUDING REVENUES FROM THE UNIVERSITY'S HEALTH SYSTEM



Tuition and state appropriations are the primary sources of funding for the University's academic programs. There is a direct relationship between the growth or reduction in state support and the University's ability to restrain tuition fee increases. Together, net student tuition and fees and base state appropriations increased 6 percent, or $70 million, to $1.2 billion in 2008, as compared to 5 percent, or $54 million, to $1.1 billion in 2007.

Downturns in state of Michigan tax revenues continue to put pressure on the state budget. For the three years ended June 30, 2008, state educational appropriations revenue consisted of the following components:

(in millions)	2008	2007	2006
Base appropriations	$ 370.1	$ 372.8	$ 362.0
Net restoration (rescission)	33.9	(40.4)	2.9
	$ 404.0	$ 332.4	$ 364.9

Due to ongoing pressures and volatility in the state budget, the University's base appropriations continue to be constrained and subject to mid-year rescission and restoration. Net revenues from state educational appropriations increased $39 million, or 11 percent, to $404 million in 2008 from 2006, while base state appropriations increased $8 million, or 2 percent, over the past two years. The $34 million net restoration in fiscal 2008 represents the return of part of a fiscal 2007 mid-year rescission. The $40 million mid-year rescission in fiscal 2007 consists of a reduction in base appropriations of $6 million and a deferral of $34 million until fiscal 2008. The net restoration in fiscal 2006 of $2.9 million represents the return of a fiscal 2005 net mid-year rescission.

To offset the constrained base state appropriations, net student tuition and fees revenue has increased 17 percent, or $116 million, over the past two years. For the three years ended June 30, 2008, net student tuition and fees revenue consisted of the following components:

(in millions)	2008	2007	2006
Student tuition and fees	$ 975.3	$ 891.6	$ 834.4
Scholarship allowances	(184.1)	(172.9)	(158.7)
	$ 791.2	$ 718.7	$ 675.7

In 2008, net student tuition and fees revenue increased 10 percent, or $73 million, to $791 million, which reflects a 9 percent, or $84 million, increase in gross tuition and fee revenues offset by a 6 percent, or $11 million, increase in scholarship allowances. Tuition rate increases in 2008 were 7.4 percent for all undergraduate students on the Ann Arbor campus, with a 7.9 percent tuition rate increase for the Dearborn campus, a 6.4 percent tuition rate increase for the Flint campus and a 5 percent increase for most graduate tuition rates. The University also experienced a modest growth in the number of students.

In 2007, net student tuition and fees revenue increased 6 percent, or $43 million, to $719 million, which reflects a 7 percent, or $57 million, increase in gross tuition and fee revenues offset by a 9 percent, or $14 million, increase in scholarship allowances. Tuition rate increases in 2007 averaged 5.8 percent for all undergraduate students on the Ann Arbor campus, with an 8 percent tuition rate increase for the Dearborn and Flint campuses and a 5 percent increase for most graduate tuition rates. The University also experienced a modest growth in the number of students.

Despite constrained base state appropriations, the University's tuition increases have been among the lowest in the state and in the Big Ten, which reflects a commitment to affordable higher education for Michigan families. At the same time, the University has also increased scholarship allowances, and scholarship and fellowship expenses, to benefit students in financial need.

While tuition and state appropriations fund a large percentage of University costs, private support is becoming increasingly essential to the University's academic distinction. Private gifts for other than capital and permanent endowment purposes totaled $137 million in 2008, as compared to $133 million in 2007 and $90 million in 2006.

The University receives revenues for sponsored programs from various government agencies and private sources, which normally provide for both direct and indirect costs to perform these sponsored activities. Revenues for sponsored programs increased 4 percent, or $35 million, to $853 million in 2008, from $818 million in 2006. A significant portion of the University's sponsored programs revenues relate to federal research and its growth is consistent with the national trend of stabilized federal research activity.

Patient care revenues and managed care premiums for the three years ended June 30, 2008 is summarized as follows:

(in millions)	2008	2007	2006
Patient care revenues	$ 2,105.4	$ 1,786.8	$ 1,585.4
Managed care premiums		196.8	405.1
	$ 2,105.4	$ 1,983.6	$ 1,990.5

The majority of these revenues relate to patient care services, which are principally generated within the University's hospitals and ambulatory care facilities under contractual arrangements with governmental payers and private insurers. Managed care premiums represent subscription revenue recognized by M-CARE from contracts associated with employers other than the University. Patient care revenues increased 18 percent, or $319 million, to $2.1 billion in 2008, as compared to an increase of 13 percent, or $201 million, to $1.8 billion in 2007. The increased revenues for both years primarily resulted from a growth in both outpatient and inpatient volume, as well as increased reimbursement rates from third party payers. The decrease in managed care premiums in 2008 and 2007 reflects the sale of M-CARE which was effective December 31, 2006.

Net investment income for the three years ended June 30, 2008 is summarized as follows:

(in millions)	2008	2007	2006
Interest and dividends, net	$ 236.5	$ 256.9	$ 214.3
Increase in fair value of investments	385.4	1,315.7	745.5
	$ 621.9	$ 1,572.6	$ 959.8

Net investment income totaled $622 million in 2008, as compared to $1.6 billion in 2007 and $960 million in 2006. Fiscal 2008 was a difficult year for public equities, but the University's returns in nonmarketable limited partnerships and absolute return strategies aided by strong returns from its energy holdings and hedging strategies resulted in positive investment income. Prior to 2008, net investment income was primarily the result of strong performance of the University's nonmarketable limited partnerships, non-U.S. dollar equities and absolute return strategies, which provided consistent positive returns during fiscal 2007 and 2006, combined with a meaningful increase in invested balances over the same time period. The University's endowment investment policies are designed to maximize long-term total return, while its income distribution policy is designed to preserve the value of the endowment and generate a predictable stream of spendable income.

With the Michigan Difference capital campaign nearing completion, gifts and grants for endowment and capital purposes continue to be a significant part of sustaining the University's excellence. Private gifts for permanent endowment purposes totaled $94 million in 2008, as compared to $73 million in 2007 and $86 million in 2006. Capital gifts and grants totaled $66 million in 2008, as compared to $65 million in 2007 and $65 million in 2006. Over the past three years, major capital gifts have been received in support of the University's wide-ranging building initiatives which include the Stephen M. Ross School of Business, Health System, Intercollegiate Athletics and College of Engineering capital projects.

Net other nonoperating revenues in 2007 include the $160 million gain on the sale of M-CARE, offset by the establishment of an $83 million liability for the University's faculty retirement furlough program. During 2007, the University recorded a liability for the program, of which $81 million was considered noncurrent. Faculty hired prior to January 1, 1984 who meet eligibility requirements are eligible for a terminal furlough year that may be taken as the last year preceding retirement or in partial installments over two or three years prior to the effective date of retirement.

In addition to revenue diversification, the University continues to make cost containment an ongoing priority. This is necessary as the University continues to face significant financial pressures, particularly in the areas of compensation and benefits, which represent 67 percent of total expenses, as well as in the areas of energy, technology and ongoing maintenance of facilities and infrastructure.

A comparative summary of the University's expenses for the three years ended June 30, 2008 is as follows:

(in millions)	2008		2007		2006	
Operating:						
Compensation and benefits	$ 3,234.2	67%	$ 2,961.9	66%	$ 2,757.9	64%
Supplies and services	1,167.6	24	1,103.9	25	1,150.2	27
Depreciation	319.4	6	284.1	6	264.0	6
Scholarships and fellowships	98.8	2	83.7	2	83.9	2
	4,820.0	99	4,433.6	99	4,256.0	99
Nonoperating:						
Interest	33.6	1	30.6	1	27.1	1
	$ 4,853.6	100%	$ 4,464.2	100%	$ 4,283.1	100%

The University is committed to recruiting and retaining outstanding faculty and staff and the compensation package is one way to successfully compete with peer institutions and nonacademic employers. The resources expended for compensation and benefits increased 9 percent, or $272 million, to $3.2 billion in 2008. Of this increase, compensation expense increased 7 percent, to $2.4 billion, and employee benefits increased 17 percent, to $807 million. For 2007, compensation increased 7 percent, to $2.3 billion, and employee benefits increased 11 percent, to $685 million.

The majority of the compensation expense increase occurred in the Health System, where nursing and other health professionals were added to support higher patient volume levels. Increases in wage rates also accounted for a significant portion of the expense growth, a reflection of the high demand for nurses and other health professionals and an industry-wide shortage of personnel in these fields. In addition, staffing levels were increased in many administrative and support areas, to further strengthen these areas and in response to the increasing regulatory burden borne by health systems.

In 2008, the Health System had a growth in compensation expense of 8 percent, which includes a growth in employees of 4 percent, while the rest of the University had a growth in compensation expense of 5 percent, which includes a growth in employees of 1 percent. In 2007, the Health System had a growth in compensation expense of 9 percent, which includes a growth in employees of 5 percent, while the rest of the University had a growth in compensation expense of 4 percent, with a minimal change in the number of employees.

Employee benefits expense grew at a higher rate than compensation over the past two years primarily because of the rising costs of health insurance and the implementation of GASB Statement No. 45 in fiscal 2008. Health care benefits are one of the most significant employee benefits and over the past several years, the University has implemented several initiatives to better control its rate of increase, encourage employees to choose the lowest cost insurance plan that meets their needs and share with employees a small portion of health insurance cost increases.

The University utilizes a single pharmacy benefit administrator to manage all pharmacy benefits with University oversight. The University also actively promotes and manages generic drug utilization and has achieved a 68 percent generic dispensing rate in 2008, as compared to 60 percent in 2007 and 57 percent in 2006. In January 2006, the University unbundled pharmacy benefit claim processing and mail order services and selected separate vendors for each service to achieve better discounts for retail and mail order pricing arrangements and additional rebates.

Compared to most employers, the University is in an unique position to utilize internal experts to advise and guide its health care and drug plans. For example, the University utilizes a Pharmacy Benefits Advisory Committee, which consists of internal experts such as Health System physicians, School of Pharmacy faculty and an on-staff pharmacist, to monitor the safety and effectiveness of covered medications as well as to optimize appropriate prescribing, dispensing and cost effective use of prescription drugs.

Current campus collaborations include several which are part of the Michigan Healthy Community initiative, a campus-wide effort to encourage healthier living through increased activity, attention to physical safety in the workplace, and other health and wellness efforts. The health and wellness programs offered by the University through this initiative have resulted in greater integration of evidence-based wellness programming into the University's benefit programs. For example, the MHealthy: Focus on Medicines program, which commenced in 2007, offers employees, retirees and dependents taking seven or more prescription medications a comprehensive medication review with a university pharmacist to optimize treatment and reduce drug interaction risks. The MHealthy: Focus on Diabetes, a two-year pilot program, launched in July 2006, reduces or eliminates co-pays for selected medications for employees and dependents who have diabetes to encourage the proper and sustained use of specific drugs that help people manage their diabetes and to help prevent or reduce the long-term complications of the disease.

These initiatives reflect the reality of the national landscape, while remaining true to the commitment we make to our employees for a robust benefits package.

Supplies and services expenses increased 6 percent, or $64 million, to $1.2 billion in 2008, as compared to a decrease of 4 percent, or $46 million, in 2007. The change in 2008 is primarily due to increased patient activity experienced by the Health System. The change in 2007 reflects the impact of the sale of M-CARE effective December 31, 2006. As the majority of its expenses were non-salary, the sale of M-CARE six months into fiscal 2007 had a meaningful effect on this category of expense. Excluding the impact from the sale of M-CARE, a 13 percent increase and a 7 percent increase would have been experienced in 2008 and 2007, respectively.

In addition to their natural (object) classification, it is also informative to review operating expenses by function. A comparative summary of the University's expenses by functional classification for the three years ended June 30, 2008 is as follows (amounts in millions):

	2008		2007		2006	
Operating:						
Instruction	$ 784.7	16%	$ 727.3	16%	$ 683.0	16%
Research	571.7	12	540.6	12	519.7	12
Public service	121.9	2	103.9	2	104.9	2
Institutional and academic support	448.7	9	378.7	9	380.5	9
Auxiliary enterprises:						
Patient and managed care	2,046.0	42	1,860.6	42	1,843.6	43
Other	179.6	4	198.5	4	127.7	3
Operations and maintenance of plant	249.2	5	256.3	6	248.7	6
Depreciation	319.4	7	284.0	6	264.0	6
Scholarships and fellowships	98.8	2	83.7	2	83.9	2
	4,820.0	99	4,433.6	99	4,256.0	99
Nonoperating:						
Interest	33.6	1	30.6	1	27.1	1
	$ 4,853.6	100%	$ 4,464.2	100%	$ 4,283.1	100%

Instruction and public service expenses increased 9 percent, or $75 million, to $907 million in 2008, as compared to a 5 percent, or $43 million, increase in 2007. These increases are consistent with the small level of growth in the related revenue sources, as well as the implementation of GASB Statement No. 45, which increased instruction and public service expenses by 2 percent in 2008.

To measure its total volume of research expenditures, the University considers research expenses, included in the above table, as well as research related facilities and administrative expenses, research initiative and start-up expenses, and research equipment purchases. These amounts aggregated $876 million in 2008, as compared to $823 million in 2007 and $797 million in 2006. This represents an increase of 10 percent, or $79 million, from 2006 to 2008, which includes the impact of the implementation of GASB Statement No. 45, which increased the total volume of research expenditures by 2 percent in 2008.

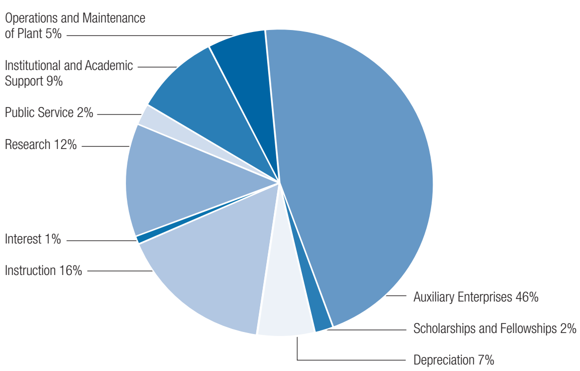
Patient and managed care expenses increased 10 percent, or $185 million, to $2.0 billion in 2008, as compared to a 1 percent, or $17 million increase in 2007. The increase in 2008 is a result of increased patient activity, including costs of medical supplies and pharmaceuticals, and the implementation of GASB Statement No. 45, offset by the sale of M-CARE effective December 31, 2006. Excluding the impact of the implementation of GASB Statement No. 45 in 2008 and the sale of M-CARE in 2007, a 13 percent increase and an 8 percent increase would have been experienced in 2008 and 2007, respectively.

Total scholarships and fellowships provided to students aggregated $300 million in 2008, as compared to $272 million in 2007 and $258 million in 2006, an increase of 16 percent over the past two years. Tuition, housing and fees revenues are reported net of aid applied to students' accounts, while amounts paid directly to students are reported as scholarship and fellowship expense. Scholarships and fellowships for the three years ended June 30, 2008 are summarized as follows:

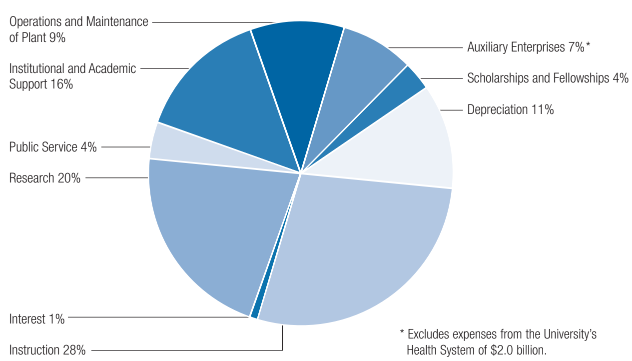
(in millions)	2008	2007	2006
Paid directly to students	$ 98.8	$ 83.7	$ 83.9
Applied to tuition and fees	184.1	172.9	158.7
Applied to University Housing	16.7	15.7	15.7
	$ 299.6	$ 272.3	$ 258.3

The following graphic illustrations present total expenses by function, with and without the University's Health System and other similar activities:

FISCAL YEAR 2008 EXPENSES BY FUNCTION



FISCAL YEAR 2008 EXPENSES BY FUNCTION EXCLUDING EXPENSES FROM THE UNIVERSITY'S HEALTH SYSTEM



* Excludes expenses from the University's Health System of $2.0 billion.

STATEMENT OF CASH FLOWS

The statement of cash flows provides additional information about the University's financial results by reporting the major sources and uses of cash. A comparative summary of the statement of cash flows for the years ended June 30, 2008 and 2007 is as follows:

(in millions)	2008	2007
Cash received from operations	$ 4,109.3	$ 3,835.9
Cash expended for operations	(4,391.7)	(4,114.1)
Net cash used in operating activities	(282.4)	(278.2)
Net cash provided by investing activities	189.6	16.9
Net cash used in capital and related financing activities	(478.6)	(407.6)
Net cash provided by noncapital financing activities	585.0	736.8
Net increase in cash and cash equivalents	13.6	67.9
Cash and cash equivalents, beginning of year	481.5	413.6
Cash and cash equivalents, end of year	$ 495.1	$ 481.5

Cash received from operations primarily consists of student tuition, sponsored program grants and contracts, and patient care revenues. Significant sources of cash provided by noncapital financing activities, as defined by GASB, include state appropriations and private gifts used to fund operating activities. In 2007, net cash from noncapital financing activities also includes proceeds from the sale of M-CARE. Cash and cash equivalents increased $14 million in 2008, as compared to an increase of $68 million in 2007.

ECONOMIC FACTORS THAT WILL AFFECT THE FUTURE

The University continues to successfully face significant financial challenges to its academic programs, stemming from the State's uncertain financial circumstances. Given the continuation of this difficult economic environment, it is especially impressive that the University maintains the highest credit ratings of Moody's (Aaa) and Standard & Poor's (AAA). Achieving and maintaining the highest credit ratings provides the University a high degree of flexibility in securing capital funds on the most competitive terms. This flexibility, along with ongoing efforts toward revenue diversification and cost containment, will enable the University to provide the necessary resources to support a level of excellence in service to students, patients, the research community, the state and the nation.

A crucial element to the University's future continues to be our strong relationship with the state of Michigan. Historically, there has been a direct relationship between the growth or reduction of state support and the University's ability to control tuition increases, as reduced growth in state appropriations generally necessitates increased tuition levels. Given the State's constrained financial circumstances, the anticipated one percent increase in educational appropriations in fiscal 2009 is an important indicator that the State recognizes the crucial role that higher education in general, and the State's research universities in particular, can play in transforming the State's economy. To support the University's commitment to both academic excellence and accessibility, the University's budget for fiscal 2009 includes a moderate increase in tuition rates along with an increased investment in financial aid for undergraduates.

Private gifts are an increasingly important supplement to the fundamental support provided by state appropriations and student tuition to maintain academic quality and support future initiatives. The University launched the public phase of a major fundraising campaign in May 2004, with the announcement of an ambitious goal of $2.5 billion. The campaign, titled "The Michigan Difference," will provide support for student scholarships and fellowships, endowed professorships, facilities, academic programs, research and other projects. Since launching the quiet phase of the campaign in 2000, the University has raised $2.6 billion in cash and pledges and $448 million in bequests, a total of $2.9 billion, or 120 percent of the goal, through June 30, 2008. The campaign will continue through December 2008.

The University continues to execute its long-range plan to modernize and expand its complement of older facilities while adding key new facilities for instruction, research, patient care, and residential life. This strategy addresses the University's growth and the continuing effects of technology on teaching and research methodologies. Authorized costs to complete construction and other projects totaled $1.1 billion at June 30, 2008. Funding for these projects is anticipated to include $975 million from gifts and net assets designated for capital purposes as well as future borrowings, $140 million from the utilization of unexpended debt proceeds and $16 million from the State Building Authority. While the State continues to support the University's systematic renewal of core academic facilities, economic pressures may also affect the State's future support.

The University will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to preserve endowment capital and insulate the University's operations from temporary market volatility.

While the University's Hospitals and Health Centers are also well positioned to maintain a strong financial position in the near term, ongoing constraints on revenue are expected due to fiscal pressures from employers and federal and state governments. Management believes that much of the payment pressure can be offset by growth in patient volume and continued efforts to contain certain costs.

As a labor-intensive organization, the University faces competitive pressures related to attracting and retaining faculty and staff. Moreover, consistent with the national landscape, the cost of the University's health benefits for its active employees and retirees has increased dramatically over the past several years, with the increasing cost of medical care and prescription drugs of particular concern. To address these challenges, the University has successfully taken and continues to take proactive steps to respond to the challenges of rising costs while protecting the quality of the overall benefit package.

While it is not possible to predict the ultimate results, management believes that the University's financial condition will remain strong.

Financial Statements

CONSOLIDATED STATEMENT OF NET ASSETS

(in thousands)	June 30, 2008	2007
Assets		
Current Assets:		
Cash and cash equivalents	$ 495,137	$ 481,488
Operating investments	686,218	693,851
Investments for capital activities	697,269	720,143
Investments for student loan activities	29,869	27,873
Investment trade settlements receivable	56,289	4,498
Accounts receivable, net	443,375	367,715
Current portion of notes and pledges receivable, net	73,832	62,385
Current portion of prepaid expenses and other assets	54,037	59,678
Total Current Assets	2,536,026	2,417,631
Noncurrent Assets:		
Endowment, life income and other investments	7,854,562	7,379,836
Notes and pledges receivable, net	233,572	247,148
Prepaid expenses and other assets	17,153	15,783
Capital assets, net	4,129,830	3,755,398
Total Noncurrent Assets	12,235,117	11,398,165
Total Assets	**$ 14,771,143**	**$ 13,815,796**
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable	$ 191,694	$ 204,649
Investment trade settlements payable	64,442	7,244
Accrued compensation and other	297,725	268,584
Deferred revenue	178,638	165,295
Current portion of insurance and benefits reserves	64,117	53,549
Current portion of obligations for postemployment benefits	60,792	8,493
Commercial paper and current portion of bonds payable	172,939	145,148
Deposits of affiliates and others	27,933	26,211
Total Current Liabilities	1,058,280	879,173
Noncurrent Liabilities:		
Accrued compensation	78,578	81,174
Insurance and benefits reserves	78,448	87,653
Obligations for postemployment benefits	1,431,021	79,194
Obligations under life income agreements	60,437	59,739
Government loan advances	86,567	85,940
Bonds payable	1,069,278	897,618
Deposits of affiliates and other	153,860	148,164
Total Noncurrent Liabilities	2,958,189	1,439,482
Total Liabilities	4,016,469	2,318,655
Net Assets:		
Invested in capital assets, net of related debt	3,030,110	2,864,340
Restricted:		
Nonexpendable	1,070,958	959,614
Expendable	3,733,022	3,605,213
Unrestricted	2,920,584	4,067,974
Total Net Assets	10,754,674	11,497,141
Total Liabilities and Net Assets	**$ 14,771,143**	**$ 13,815,796**

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

CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(in thousands)	Year Ended June 30, 2008	2007
Operating Revenues		
Student tuition and fees	$ 975,316	$ 891,634
Less scholarship allowances	184,095	172,952
Net student tuition and fees	791,221	718,682
Federal grants and contracts	712,963	695,289
State and local grants and contracts	9,649	12,937
Nongovernmental sponsored programs	130,634	115,498
Sales and services of educational departments	138,484	114,020
Auxiliary enterprises:		
Patient care revenues and managed care premiums	2,105,439	1,983,636
Student residence fees (net of scholarship allowances of $16,701,000 in 2008 and $15,690,000 in 2007)	74,759	70,255
Other revenues	139,410	123,151
Student loan interest income and fees	2,049	1,903
Total Operating Revenues	**4,104,608**	**3,835,371**
Operating Expenses		
Compensation and benefits	3,234,232	2,961,914
Supplies and services	1,167,616	1,103,928
Depreciation	319,351	284,048
Scholarships and fellowships	98,847	83,712
Total Operating Expenses	**4,820,046**	**4,433,602**
Operating loss	(715,438)	(598,231)
Nonoperating Revenues (Expenses)		
State educational appropriations	404,003	332,446
Private gifts for other than capital and endowment purposes	136,713	132,804
Net investment income	621,878	1,572,591
Interest expense	(33,644)	(30,606)
Total Nonoperating Revenues, Net	**1,128,950**	**2,007,235**
Income before other revenues (expenses)	413,512	1,409,004
Other Revenues (Expenses)		
State capital appropriations	11,796	6,413
Capital gifts and grants	66,372	64,870
Private gifts for permanent endowment purposes	93,777	72,686
Implementation of GASB Statement No. 45, postemployment benefits obligations as of July 1, 2007	(1,306,859)	
Other	(21,065)	60,023
Total Other (Expenses) Revenues, Net	**(1,155,979)**	**203,992**
(Decrease) increase in net assets	(742,467)	1,612,996
Net Assets, Beginning of Year	11,497,141	9,884,145
Net Assets, End of Year	**$ 10,754,674**	**$ 11,497,141**

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

Financial Statements

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	Year Ended June 30, 2008	2007
Cash Flows From Operating Activities		
Student tuition and fees	$ 798,616	$ 721,973
Federal, state and local grants and contracts	735,478	704,243
Nongovernmental sponsored programs	134,387	120,835
Sales and services of educational departments	275,134	243,343
Patient care revenues and managed care premiums	2,073,439	1,953,441
Student residence fees	75,412	71,082
Payments to employees	(2,413,442)	(2,188,845)
Payments for benefits	(681,369)	(652,446)
Payments to suppliers	(1,182,195)	(1,164,678)
Payments for scholarships and fellowships	(98,783)	(83,712)
Student loans issued	(15,866)	(24,346)
Student loans collected	14,700	19,040
Student loan interest and fees collected	2,049	1,903
Net Cash Used in Operating Activities	**(282,440)**	**(278,167)**
Cash Flows From Investing Activities		
Interest and dividends on investments, net	294,545	147,405
Proceeds from sales and maturities of investments	5,039,730	5,122,737
Purchases of investments	(5,252,622)	(5,165,786)
Net decrease (increase) in cash equivalents from noncurrent investments	100,741	(114,667)
Increase in deposits of affiliates and others, net	7,288	27,167
Net Cash Provided by Investing Activities	**189,682**	**16,856**
Cash Flows From Capital and Related Financing Activities		
State capital appropriations	1,773	8,419
Private gifts and other receipts	65,013	60,126
Proceeds from issuance of capital debt	393,770	202,370
Principal payments on capital debt	(193,644)	(77,304)
Interest payments on capital debt	(35,072)	(31,685)
Payments for bond refunding and related costs	(251)	(355)
Purchases of capital assets	(710,638)	(570,594)
Proceeds from sales of capital assets	483	1,424
Net Cash Used in Capital and Related Financing Activities	**(478,566)**	**(407,599)**
Cash Flows From Noncapital Financing Activities		
State educational appropriations	364,159	371,622
Private gifts and other receipts	217,599	102,700
Student direct lending receipts	253,462	219,787
Student direct lending disbursements	(255,765)	(220,480)
Amounts received for annuity and life income funds	15,029	12,340
Amounts paid to annuitants and life beneficiaries and related expenses	(6,992)	(6,699)
Proceeds, net of expenses, from sale of M-CARE	(2,519)	257,523
Net Cash Provided by Noncapital Financing Activities	**584,973**	**736,793**
Net increase in cash and cash equivalents	13,649	67,883
Cash and Cash Equivalents, Beginning of Year	481,488	413,605
Cash and Cash Equivalents, End of Year	**$ 495,137**	**$ 481,488**

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

CONSOLIDATED STATEMENT OF CASH FLOWS — CONTINUED

(in thousands)	Year Ended June 30, 2008	2007
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (715,438)	$ (598,231)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	319,351	284,048
Changes in assets and liabilities:		
Accounts receivable, net	(24,602)	(23,126)
Prepaid expenses and other assets	2,841	2,742
Accounts payable	(6,403)	(64,249)
Accrued compensation and other	26,991	99,703
Deferred revenue	13,343	(731)
Insurance and benefits reserves	4,210	(66,010)
Obligations for postemployment benefits	97,267	87,687
Net cash used in operating activities	$ (282,440)	$ (278,167)

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

Notes to Consolidated Financial Statements

JUNE 30, 2008 AND 2007

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 57,000 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), Veritas Insurance Corporation (a wholly-owned captive insurance company) and M-CARE (a wholly-owned health maintenance organization that was sold effective December 31, 2006). 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 the 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 Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities.* 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.

During fiscal 2008, the University implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* This statement requires accrual-based measurement and recognition of the cost of postemployment benefits during the periods when employees render their services. Previously, the University recorded obligations for most postemployment benefits as they were paid. Implementation of this Statement resulted in an increase in liabilities and a decrease in net assets of $1,491,813,000 in fiscal 2008. Of this increase, $1,306,859,000 represents a one-time nonoperating expense to reflect the present value of the University's obligations for postemployment benefits as of July 1, 2007 and $97,267,000 represents the additional fiscal 2008 operating expense for postemployment benefit obligations. In addition, insurance and benefit reserves for life insurance and open long-term disability claims, which totaled $87,687,000 at June 30, 2007, are considered postemployment benefits as defined by GASB Statement No. 45 and have been reclassified to the liability for postemployment benefit obligations as part of the implementation of this Statement.

The financial statements of all controlled organizations are included in the University's financial statements; affiliated organizations that are not controlled by 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 or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

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 Statement No. 35. 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 an original 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.

Investment trade settlements receivable and payable relate to investment transactions occurring on or before June 30, which settle after such date.

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, 2008 and 2007, as adjusted by cash receipts, cash disbursements, and securities distributions through June 30, 2008 and 2007. 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, 2008 and 2007. 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.

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. Endowment pledges do not meet eligibility requirements, as defined by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* 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 range from three to forty 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, net of related liabilities for the present value of estimated future payments due to beneficiaries.

For donor restricted endowments, the Uniform Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate an amount of realized and unrealized endowment appreciation as determined to be 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 $1,492,000,000 and $1,420,000,000 at June 30, 2008 and 2007, respectively, is available to meet spending rate distributions and 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. 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.

Managed care premiums relate to M-CARE, a wholly-owned health maintenance organization which was sold effective December 31, 2006.

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 Statement No. 35, including state appropriations, 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.

New Accounting Pronouncements: In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* effective for the University's fiscal year beginning July 1, 2008. This Statement establishes criteria to ascertain whether certain events result in a requirement for the University to estimate the components of any expected pollution remediation costs and determine whether these costs should be accrued as a liability or, if appropriate, capitalized.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* effective for the University's fiscal year beginning July 1, 2009. This Statement requires capitalization of identifiable intangible assets in the statement of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life.

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* effective for the University's fiscal year beginning July 1, 2009. This Statement requires derivative instruments to be reported at fair value. In addition, for derivative instruments that qualify as effective hedges, changes in fair value will be reported as deferrals in the statement of net assets, while changes in the fair value of derivative instruments that do not qualify as an effective hedge, including investment derivative instruments, will be reported as investment income. This Statement also requires additional disclosures about the University's derivative instruments.

The University is evaluating the effect that these Statements will have on its financial statements.

Notes to Consolidated Financial Statements

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. 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 University Investment Pool is invested together with the University's insurance and other benefit 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 University Investment Pool 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.

Distributions are made from the University Endowment Fund to the University entities that benefit from the endowment fund. The endowment spending rule provides for an annual distribution of 5 percent of the one-quarter lagged moving average fair value of fund units, limited to 5.3 percent of the current fair value to protect endowment principal in the event of a prolonged market downturn. Effective July 1, 2006, the moving average period was extended from three years to four years, and it is being extended by one quarter each subsequent quarter until it reaches seven years. Distributions are also made from the University Investment Pool 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 University Investment Pool are funded by investment income.

Cash and Cash Equivalents: Cash and cash equivalents, which totaled $495,137,000 and $481,488,000 at June 30, 2008 and 2007, respectively, represent short-term money market investments in 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. The University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation limits in the amount of $17,667,000 and $8,832,000 at June 30, 2008 and 2007, respectively. The University does not require deposits to be collateralized or insured.

Investments: At June 30, 2008 and 2007, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows:

(in thousands)	2008	2007
Cash equivalents, noncurrent	$ 239,043	$ 339,784
Fixed income securities	1,663,408	1,753,140
Commingled funds	2,075,546	2,123,446
Equity securities	1,171,267	1,531,815
Nonmarketable alternative investments	4,111,493	3,067,846
Other investments	7,161	5,672
	$ 9,267,918	$ 8,821,703

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 and Poor's, assign credit ratings to security issuers and issues 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 and 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 no 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.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair market 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 imbedded 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 4.7 years at June 30, 2008, compared to 4.1 years at June 30, 2007. The University manages the effective duration of its fixed income securities at the account level; fixed income managers generally may not deviate from the duration of their respective benchmarks by more than 25 percent.

NOTE 2 | CASH AND INVESTMENTS — CONTINUED

The composition of fixed income securities at June 30, 2008 and 2007, along with credit quality and effective duration measures, is summarized as follows:

2008

(in thousands)	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 70,900				$ 70,900	3.6
U.S. Treasury Inflation Protected	489,523				489,523	4.4
U.S. Government agency	126,522				126,522	1.6
Mortgage backed		$ 123,464			123,464	2.7
Asset backed		56,035		$ 3	56,038	5.7
Corporate and other		773,542	$ 22,960	459	796,961	5.8
	$ 686,945	$ 953,041	$ 22,960	$ 462	$ 1,663,408	4.7

2007

(in thousands)	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 391,214				$ 391,214	9.7
U.S. Treasury Inflation Protected	370,881				370,881	4.1
U.S. Government agency	110,851				110,851	1.9
Mortgage backed		$ 211,656		$ 4,187	215,843	1.7
Asset backed		70,290		2,503	72,793	0.7
Corporate and other		449,099	$ 25,631	116,828	591,558	2.3
	$ 872,946	$ 731,045	$ 25,631	$ 123,518	$ 1,753,140	4.1

Of the University's fixed income securities, 99 percent and 91 percent were rated investment grade or better at June 30, 2008 and 2007, with 57 percent and 70 percent of these securities rated AAA/Aaa or better at June 30, 2008 and 2007, 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. The composition of commingled funds at June 30, 2008 and 2007 is summarized as follows:

(in thousands)	2008	2007
Absolute return	$ 1,177,265	$ 1,178,374
U.S. equities	152,614	115,207
Non-U.S./global equities	644,542	736,080
U.S. fixed income	79,782	81,542
Other	21,343	12,243
	$ 2,075,546	$ 2,123,446

Commingled funds have liquidity (redemption) provisions, which enable annual or more frequent withdrawals subject to notice requirements of up to 90 days. Certain commingled funds held in the Long Term Portfolio and the Daily and Monthly Portfolios 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.

Nonmarketable alternative investments consist of limited partnerships 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. The composition of these partnerships at June 30, 2008 and 2007 is summarized as follows:

(in thousands)	2008	2007
Private equity	$ 1,074,706	$ 836,956
Real estate	969,778	749,763
Absolute return	715,916	527,368
Energy	849,458	535,707
Venture capital	501,635	418,052
	$ 4,111,493	$ 3,067,846

While the University's limited partnership investments are diversified in terms of manager selection and industry and geographic focus, one energy partnership represented 6 percent, or $540,000,000, of total investments at June 30, 2008. The University's committed but unpaid obligation to these limited partnerships is further discussed in Note 12.

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. The University's investments also include securities 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 University's non-U.S. dollar holdings net of forward foreign exchange contracts amounted to $1,324,618,000, or 14 percent of total investments, at June 30, 2008, as compared to $1,271,515,000, or 14 percent of total investments, at June 30, 2007. The University manages foreign exchange risk through manager agreements that provide minimum diversification and maximum exposure limits by country and currency.

The Long Term Portfolio and the Daily and Monthly Portfolios hold positions in bond and stock index futures contracts. Bond futures are used to adjust the duration of cash equivalents and the fixed-income portion of the portfolios. Stock index futures are used to overlay cash equivalents and more closely align the portfolios' asset class exposures with asset allocation targets. To meet trading margin requirements, the University has deposited U.S. Government securities and cash with a fair value of $29,373,000 and $20,575,000 at June 30, 2008 and 2007, respectively, with its futures contract broker as collateral.

The Long Term Portfolio and the Daily and Monthly Portfolios, together, had fully collateralized short-term securities loans of $377,025,000 and $864,179,000 at June 30, 2008 and 2007, respectively, through a securities lending program administered by the University's master custodian. 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 for domestic securities and 105 percent for foreign securities. Collateral positions are monitored daily to insure that borrowed securities are never less than 100 percent collateralized. The fair value of the collateral totaled $393,361,000, or 104 percent of the fair value of the securities on loan, at June 30, 2008, as compared to $890,544,000, or 103 percent of the fair value of the securities on loan, at June 30, 2007. Neither the University nor its securities lending agent has the ability to pledge or sell collateral securities unless a borrower defaults. 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, 2008 and 2007 is summarized as follows:

(in thousands)	2008	2007
Patient care	$ 362,323	$ 310,432
Sponsored programs	66,800	75,959
State appropriations, educational and capital	78,326	28,460
Student accounts	18,383	20,145
Other	31,593	27,130
	557,425	462,126
Less provision for uncollectible accounts receivable	114,050	94,411
	$ 443,375	$ 367,715

NOTE 4 | NOTES AND PLEDGES RECEIVABLE

The composition of notes and pledges receivable at June 30, 2008 and 2007 is summarized as follows:

(in thousands)	2008	2007
Notes:		
Federal student loan programs	$ 99,464	$ 99,601
University student loan funds	18,837	17,041
Other	729	726
	119,030	117,368
Less allowance for doubtfully collectible notes	2,800	2,300
Total notes receivable, net	116,230	115,068
Gift pledges outstanding:		
Capital	137,270	148,910
Operations	77,570	72,561
	214,840	221,471
Less:		
Allowance for doubtfully collectible pledges	6,843	6,961
Unamortized discount to present value	16,823	20,045
Total pledges receivable, net	191,174	194,465
Total notes and pledges receivable, net	307,404	309,533
Less current portion	73,832	62,385
	$ 233,572	$ 247,148

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, 2008 are expected to be received in the following years ended June 30 (in thousands):

2009	$ 61,679
2010–2013	118,562
2014 and after	34,599
	$ 214,840

As discussed in Note 1, pledges for permanent endowment do not meet eligibility requirements, as defined by GASB Statement No. 33, until the related gift is received. Accordingly, permanent endowment pledges totaling approximately $105,467,000 and $96,360,000 at June 30, 2008 and 2007, 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.

Notes to Consolidated Financial Statements

NOTE 5 | CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2008 and 2007 is summarized as follows:

2008

(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 81,808	$ 7,085		$ 88,893
Land improvements	93,887	2,512		96,399
Infrastructure	164,091	21,072		185,163
Buildings	4,481,092	231,888	$ 10,036	4,702,944
Construction in progress	348,891	298,017		646,908
Equipment	1,345,544	120,039	51,268	1,414,315
Library materials	386,020	19,908		405,928
	6,901,333	700,521	61,304	7,540,550
Less accumulated depreciation	3,145,935	319,351	54,566	3,410,720
	$ 3,755,398	$ 381,170	$ 6,738	$ 4,129,830

2007

(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 81,278	$ 530		$ 81,808
Land improvements	91,452	2,435		93,887
Infrastructure	146,809	17,282		164,091
Buildings	3,957,478	547,580	$ 23,966	4,481,092
Construction in progress	557,036	(208,145)		348,891
Equipment	1,178,658	230,900	64,014	1,345,544
Library materials	365,894	20,126		386,020
	6,378,605	610,708	87,980	6,901,333
Less accumulated depreciation	2,925,164	284,048	63,277	3,145,935
	$ 3,453,441	$ 326,660	$ 24,703	$ 3,755,398

The increase in construction in progress of $298,017,000 in fiscal 2008 represents the amount of capital expenditures for new projects of $472,012,000 net of capital assets placed in service of $173,995,000. The decrease in construction in progress of $208,145,000 in fiscal 2007 represents the amount of capital assets placed in service of $560,193,000 net of capital expenditures for new projects of $352,048,000.

NOTE 6 | LONG-TERM DEBT

Long-term debt at June 30, 2008 and 2007 is summarized as follows:

(in thousands)	2008	2007
Commercial Paper:		
Tax-exempt, variable rate (1.58%)*	$ 129,825	$ 103,125
Taxable, variable rate (2.56%)*	6,760	7,075
General Revenue Bonds:		
Series 2008A, variable rate (1.60%)* through 2038	105,810	
Series 2008B, variable rate (1.50%)* to fixed via swap through 2026 and variable rate 2027 through 2028	118,335	
Series 2005A, 5.00% through 2018	34,315	37,745
unamortized premium	2,498	3,097
unamortized loss on extinguishment	(316)	(400)
Series 2005B, variable rate (1.45%)* through 2035	48,020	48,020
Series 2002, variable rate (1.40%)* to fixed via swap through 2018 and variable rate 2019 through 2032	119,900	130,090
General Revenue Refunding Bonds:		
Series 2003, 3.50% to 5.00% through 2015	29,395	34,660
unamortized premium	1,552	2,175
unamortized loss on extinguishment	(281)	(399)
Hospital Revenue Bonds:		
Series 2007A, variable rate (3.00%)* through 2038	50,120	50,120
Series 2007B, variable rate (1.45%)* through 2038	100,235	100,235
Series 2005A, variable rate (2.05%)* through 2036	69,315	69,315
Series 2005B, variable rate (1.40%)* to fixed via swap through 2026	75,065	78,085
Series 1995A, variable rate (1.40%)* through 2028	100,000	100,000
Hospital Revenue Refunding Bonds:		
Series 2002A, 5.00% to 5.25% through 2022	58,325	67,125
unamortized premium	1,279	1,747
unamortized loss on extinguishment	(2,342)	(2,700)
Series 1998A-1, 5.25% through 2011		16,540
unamortized premium		129
Series 1998A-2, variable rate (2.05%)* to fixed via swap through 2025	44,670	44,670
Series 1992A, variable rate (2.05%)* through 2020	56,000	56,000
Medical Service Plan Revenue Bonds:		
Series 1995A, variable rate (1.40%)* through 2028	48,800	49,300
Series 1991, 6.90% to 7.05% capital appreciation through 2012	7,674	9,290
Medical Service Plan Revenue Refunding Bonds:		
Series 1998A-1, variable rate (2.05%)* to fixed via swap through 2022	35,030	35,350
Housing Energy Conservation HUD Loan, 3.00% through 2021	2,233	2,372
Total long-term debt	1,242,217	1,042,766
Less current portion of long-term debt	172,939	145,148
	$ 1,069,278	$ 897,618

* Denotes rate at June 30, 2008

NOTE 6 | LONG-TERM DEBT — CONTINUED

Long-term debt activity, and the type of revenue it is supported by, for the year ended June 30, 2008 is summarized as follows:

(in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Commercial Paper:				
General revenues	$ 110,200	$ 169,625	$ 143,240	$ 136,585
Bonds and Notes:				
General revenues	254,988	224,145	19,905	459,228
Hospital revenues	581,266		28,599	552,667
Faculty Group Practice revenues	93,940	584	3,020	91,504
Student residences revenues	2,372		139	2,233
	$ 1,042,766	$ 394,354	$ 194,903	$ 1,242,217

The University maintains a combination of variable and fixed rate debt, with effective interest rates that averaged 3.40 percent in fiscal 2008 and 4.04 percent in fiscal 2007. 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 $150,000,000 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 fiscal 2008, the University issued $169,625,000 of commercial paper to fund new construction projects and refund Hospital Revenue Refunding Bonds Series 1998A-1. In March 2008, the University issued $224,145,000 of variable rate General Revenue Bonds. Bond proceeds were used to convert $73,200,000 of commercial paper to long-term debt and provide $150,470,000 for capital projects and $475,000 for debt issuance costs. Of the total bond issue, $105,810,000 (Series 2008A) is variable based on a daily rate mode and $118,335,000 (Series 2008B) is variable based on a weekly rate mode.

Debt obligations are generally callable by the University and mature at various dates through fiscal 2038. Principal maturities and interest on debt obligations for the next five years and in subsequent five-year periods are as follows:

(in thousands)	Principal	Interest*	Total
2009	$ 172,114	$ 21,959	$ 194,073
2010	27,452	21,024	48,476
2011	29,862	20,231	50,093
2012	43,438	19,133	62,571
2013	45,956	17,656	63,612
2014-2018	207,656	73,995	281,651
2019-2023	216,909	53,838	270,747
2024-2028	243,210	32,419	275,629
2029-2033	132,815	16,992	149,807
2034-2038	120,415	5,132	125,547
	1,239,827	$ 282,379	$ 1,522,206
Plus unamortized premiums, net	2,390		
	$ 1,242,217		

* Interest on variable rate debt is estimated based on rates in effect at June 30, 2008

In connection with the Series 2008B General Revenue Bonds, the University entered into a floating-to-fixed interest rate swap agreement with a notional value covering a portion of the principal amount outstanding, $98,490,000 at June 30, 2008, and decreasing as principal on the underlying bonds is repaid. The swap agreement converts the floating variable rate on these bonds to a fixed rate of 3.105 percent until the swap terminates in April 2026. The University makes fixed rate payments to the counterparty and receives a variable rate payment based on 68 percent of the One-Month USD LIBOR. The University has the option to terminate the swap upon five days written notice and payment of the fair market compensation for the value of the swap.

In connection with the issuance of the Series 2005B Hospital Revenue Bonds, the University entered into a floating-to-fixed interest rate swap agreement for a notional amount tied to the outstanding balance of the bonds. The swap agreement converts the floating variable rate on these bonds to a fixed rate of 3.229 percent commencing December 2005 through December 2025, the final maturity of the underlying bonds. The University makes fixed rate interest payments to the counterparty and receives a variable rate payment based on 68 percent of the One-Month USD LIBOR. The University has the option to terminate the swap upon five business days written notice and payment of the fair market compensation for the value of the swap.

In connection with the Series 2002 General Revenue Bonds, the University entered into a floating-to-fixed interest swap agreement with a notional value covering a portion of the principal amount outstanding, $58,215,000 at June 30, 2008 and 2007, and decreasing as principal on the underlying bonds is repaid. The swap agreement converts the floating variable rate on these bonds to a fixed rate of 3.5375 percent until the swap terminates in April 2018. The University makes fixed rate payments to the counterparty and receives a variable rate payment 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. The University has the option to terminate the swap upon five days written notice and payment of the fair market compensation for the value of the swap.

In connection with the issuance of the Series 1998A-2 Hospital Revenue Refunding Bonds and the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds, the University entered into floating-to-fixed interest rate swap agreements for notional amounts tied to the outstanding balance of the bonds. The swap agreements convert the floating variable rates on these Hospital and Medical Service Plan bonds to fixed rates of 4.705 percent and 4.685 percent, respectively through December 2024 and December 2021, the final maturity dates of the underlying bonds. The University makes fixed interest payments to the counterparty and receives a variable rate payment based on the floating Bond Market Association Municipal Swap Index. 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.

The estimated fair value of the interest rate swaps was a liability of $11,612,000 at June 30, 2008 and a liability of $871,000 at June 30, 2007. 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 counterparties. In accordance with governmental accounting standards, these amounts are not required to be included in the accompanying financial statements.

The University maintains unsecured lines of credit with three major commercial banks to support the liquidity requirements of variable rate debt. Available lines of credit, which totaled $650,000,000 at June 30, 2008 and $450,000,000 at June 30, 2007, were entirely unused during fiscal 2008 and 2007.

NOTE 7 | 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, 2008 and 2007 are summarized as follows:

(in thousands)	2008	2007
Balance, beginning of year	$ 141,202	$ 212,099
Claims incurred and changes in estimates	220,493	82,403
Claim payments	(219,130)	(153,300)
Balance, end of year	142,565	141,202
Less current portion	64,117	53,549
	$ 78,448	$ 87,653

NOTE 8 | 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 32,000 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 who 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.

During fiscal 2008, the University implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* This Statement requires accrual-based measurement and recognition of the cost of postemployment benefits during the periods when employees render their services. Previously, the University recognized obligations for most postemployment benefits as they were paid.

The University's annual other postemployment benefits ("OPEB") cost is actuarially determined in accordance with the parameters of GASB Statement No. 45. 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.

Changes in the total reported liability for postemployment benefits obligations for the year ended June 30, 2008 are summarized as follows:

(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 4,749	$ 82,938	$ 87,687
Annual OPEB cost:			
One-time amortization of total unfunded			
actuarially accrued liability at July 1, 2007	1,259,125	47,734	1,306,859
Recurring postemployment benefits expense	134,820	15,564	150,384
Payments of current premiums and claims	(38,519)	(14,598)	(53,117)
Balance, end of year	1,360,175	131,638	1,491,813
Less current portion	45,514	15,278	60,792
	$ 1,314,661	$ 116,360	$ 1,431,021

The OPEB balance at the beginning of the year, which totaled $87,687,000, represents a liability for open long-term disability claims and life insurance reserves, which were previously recorded at June 30, 2007 as a liability for insurance and benefit reserves. These reserves are considered postemployment benefits as defined by GASB Statement No. 45 and have been reclassified to obligations for postemployment benefits as part of the implementation of this statement.

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 $220,782,000 at June 30, 2008. In accordance with GASB Statement No. 45, obligations for postemployment benefits at June 30, 2008 do not reflect anticipated Medicare Part D prescription drug subsidies for future years, which would have reduced the accrued liability by $179,000,000.

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, 2008 as a percentage of covered payroll, of $2,311,422,000, was 65 percent.

In fiscal 2008, the University's annual OPEB cost represents the annual required contribution ("ARC"). The ARC 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. The University has chosen to amortize its initial unfunded actuarial accrued liability over one year, the minimum period allowed by GASB Statement No. 45.

At June 30, 2008, the University's OPEB liability was calculated using the projected unit credit method. Significant actuarial methods and assumptions used in the valuation are as follows:

	Retiree Health and Welfare	Long-term Disability
Discount Rate	6.4%	8.0%
Inflation Rate	3.0%	3.0%
Immediate/Ultimate Medical Trend Rate	11.7%/5.0%	11.7%/5.0%
Immediate/Ultimate Rx Trend Rate	8.5%/5.0%	8.5%/5.0%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2000 Projected to 2014	2005 SOA Life Waiver (Modified)

Notes to Consolidated Financial Statements

NOTE 9 | 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. Participants may elect to contribute additional amounts to the plan 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, 2008 are summarized as follows:

(in thousands)	2008	2007	2006
University contributions	$ 194,962	$ 183,145	$ 171,868
Employee contributions	$ 96,015	$ 90,252	$ 84,706
Payroll covered under plan	$ 2,311,422	$ 2,172,592	$ 2,001,670
Total payroll	$ 2,444,522	$ 2,292,929	$ 2,155,752

NOTE 10 | UNRESTRICTED NET ASSETS

Unrestricted net assets, as defined by GASB Statement No. 35, 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 or may otherwise be limited by contractual agreements with outside parties. All of the unrestricted net assets, which totaled $2,920,584,000 at June 30, 2008, have been designated for academic and research programs and initiatives, and capital programs.

NOTE 11 | FEDERAL DIRECT LENDING PROGRAM

The University distributed $255,765,000 and $220,480,000 for the years ended June 30, 2008 and 2007, 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 payable of $2,026,000 and $4,329,000 at June 30, 2008 and 2007, respectively, for DoED funding received in advance of distribution.

NOTE 12 | COMMITMENTS AND CONTINGENCIES

Authorized expenditures for construction and other projects unexpended as of June 30, 2008 were $1,131,102,000. Of these expenditures, approximately $15,590,000 will be funded by the State Building Authority, $140,107,000 will be funded using unexpended debt proceeds, and the remaining $975,405,000 will be funded by internal sources, gifts and future borrowings.

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, 2008, the University had committed, but not paid, a total of $3,334,023,000 in funding for these alternative investments. Outstanding commitments for such investments are anticipated to be paid in the following years ended June 30 (in thousands):

2009	$ 1,161,813
2010	729,805
2011	557,230
2012	334,799
2013	229,559
2014 and beyond	320,817
	$ 3,334,023

The University has entered into operating leases for space, which expire at various dates through fiscal 2018. Outstanding commitments for these leases are expected to be paid in the following years ended June 30 (in thousands):

2009	$ 37,332
2010	33,251
2011	28,672
2012	26,464
2013	22,963
2014–2018	67,651
	$ 216,333

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 13 | 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 Statement No. 35.

The University of Michigan Hospitals and Health Centers ("HHC") operates several 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 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.

Notes to Consolidated Financial Statements

NOTE 13 | SEGMENT INFORMATION — CONTINUED

Condensed financial information for HHC, before the elimination of certain intra-University transactions, as of and for the years ended June 30, 2008 and 2007 is as follows:

(in thousands)	2008	2007
Condensed Statement of Net Assets		
Assets:		
Current assets	$ 396,679	$ 304,711
Noncurrent assets	2,451,429	2,417,956
Total assets	$ 2,848,108	$ 2,722,667
Liabilities:		
Current liabilities	$ 161,462	$ 150,501
Noncurrent liabilities	808,195	576,017
Total liabilities	969,657	726,518
Net assets:		
Invested in capital assets, net of related debt	538,854	533,475
Restricted	73,181	69,436
Unrestricted	1,266,416	1,393,238
Total net assets	1,878,451	1,996,149
Total liabilities and net assets	$ 2,848,108	$ 2,722,667
Condensed Statement of Revenues, Expenses and Changes in Net Assets		
Operating revenues	$ 1,719,135	$ 1,561,198
Operating expenses other than depreciation expense	(1,561,044)	(1,400,029)
Depreciation expense	(122,363)	(99,476)
Operating income	35,728	61,693
Nonoperating revenues, net	97,308	239,145
Income before other revenues (expenses) and transfers	133,036	300,838
Other (expenses) revenues, net	(259,342)	5,780
Net (expenses) revenues before transfers	(126,306)	306,618
Transfers from (to) other University units, net	8,608	(74,608)
(Decrease) increase in net assets	(117,698)	232,010
Net assets, beginning of year	1,996,149	1,764,139
Net assets, end of year	$ 1,878,451	$ 1,996,149
Condensed Statement of Cash Flows		
Net cash flows provided by operating activities	$ 188,136	$ 149,799
Net cash flows provided by (used in) investing activities	92,117	(328)
Net cash flows used in capital and related financing activities	(211,183)	(104,588)
Net cash flows provided by (used in) noncapital financing activities	5,561	(70,205)
Net increase (decrease) in cash and cash equivalents	74,631	(25,322)
Cash and cash equivalents, beginning of year	82,381	107,703
Cash and cash equivalents, end of year	$ 157,012	$ 82,381

NOTE 14 | OPERATING EXPENSES BY FUNCTION

Operating expenses by functional classification for the years ended June 30, 2008 and 2007 are summarized as follows:

2008

(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 676,273	$ 108,472			$ 784,745
Research	397,464	174,188			571,652
Public service	85,931	35,949			121,880
Academic support	166,489	37,148			203,637
Student services	62,365	16,343			78,708
Institutional support	124,370	41,955			166,325
Operations and maintenance of plant	40,584	208,661			249,245
Auxiliary enterprises	1,680,756	544,900			2,225,656
Depreciation			$ 319,351		319,351
Scholarships and fellowships				$ 98,847	98,847
	$ 3,234,232	$ 1,167,616	$ 319,351	$ 98,847	$ 4,820,046

2007

(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 631,262	$ 96,082			$ 727,344
Research	376,184	164,421			540,605
Public service	73,985	29,934			103,919
Academic support	146,090	28,438			174,528
Student services	56,114	14,865			70,979
Institutional support	111,011	22,218			133,229
Operations and maintenance of plant	37,231	219,020			256,251
Auxiliary enterprises	1,530,037	528,950			2,058,987
Depreciation			$ 284,048		284,048
Scholarships and fellowships				$ 83,712	83,712
	$ 2,961,914	$ 1,103,928	$ 284,048	$ 83,712	$ 4,433,602

NOTE 15 | SALE OF M-CARE

The University sold M-CARE, its wholly-owned health maintenance organization, to Blue Cross Blue Shield of Michigan effective December 31, 2006. Proceeds from the sale, net of expenses, totaled $257,523,000 and the University recognized a gain on the sale of $159,743,000 in fiscal 2007, which is included in other revenues in the statement of revenues, expenses and changes in net assets. In fiscal 2008, based on certain changes in net assets pursuant to the terms of the sales agreement, the sales price was reduced by $6,500,000, of which $4,500,000 is included in accrued liabilities at June 30, 2008. Subscription premiums revenue recognized by M-CARE from employers other than the University totaled approximately $196,800,000 for the six months ended December 31, 2006.

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