University of Michigan

2009 Financial Report

Cover: The new Stephen M. Ross School of Business opened for classes in January 2009.

{ 2009 }

UNIVERSITY OF MICHIGAN
FINANCIAL REPORT

Cover photo: Phil Datillo

Donors to The Michigan Difference campaign supported 22 new building and facility projects, including the Wilpon Baseball and Softball Complex shown here.

{ Letter from the President }

MARY SUE COLEMAN

Not since the Great Depression has our mission as a public university been as important, or challenging, as it has been this past year. As the state and the nation face these times of economic uncertainty, we remain committed to maintaining and strengthening the University of Michigan's unique environment of teaching, research, and leadership.

Where other universities have been forced to close academic programs and suspend construction of new facilities, U-M has been able to move forward through careful planning and the diligent use and investment of resources.

As president, this economic climate has given me pause to appreciate more than ever the values and strengths of our university. My seven years at Michigan have been built upon a depth of experiences in higher education, including tenures at the universities of Texas, Kentucky, North Carolina, New Mexico, and Iowa. Like U-M, all are public universities; and three, like Michigan, are members of the Association of American Universities, with large and robust research enterprises.

Each of these institutions, with its unique merits, is outstanding. But with our breadth and depth, the University of Michigan stands alone. This university is in a different league with its national and international standing, its scholarly scope, and most of its 19 schools ranked among the very best. With our range of academic programs and our culture of interdisciplinary cooperation, the opportunities we offer our undergraduate and graduate students, as well as our faculty, are simply not available at other leading universities.

This is the essence of The Michigan Difference.

Preserving what is special about the University of Michigan has been at the forefront of our decision-making about the university's finances. Keeping the U-M strong during this tough economic time has been our highest priority. As a leading university, we are critical to the future well-being of thousands of young people. And we are critical to the rebirth of the state of Michigan as it deals with the refocusing of the auto industry and the development of a more entrepreneurial economy. In that sense, we represent a larger societal purpose that builds on our long-standing contributions in teaching and research.

The University of Michigan is moving forward because of the leadership of our Board of Regents and the diligence of our financial team. Morale is high: we are confounding people both here and nationally with our financial stability. This solidity, along with our ability to recruit and retain faculty and staff, as well as attract record numbers of students, is the foundation for our future.

Left: Scott C. Soderberg, U-M Photo Services; Above right: Martin Vloet, U-M Photo Services

Four activities underlie our continuing stability and strong performance.

First, we have aggressively focused on what the corporate world knows as market presence. We are seeing results in all aspects of our operations: strong admissions; steady growth in research funding, which we anticipate will continue and be augmented by federal stimulus dollars; contributions to economic development activities with genuine impact throughout our region; successful faculty hiring at a time when few universities are extending offers; and productive faculty, as evidenced by accomplishments such as membership in the national academies and appointments to prominent national leadership positions.

Second, we are generating funding at a time when revenue growth in most organizations is extremely challenging, if it occurs at all. Our research funding stands at record levels, with a notable increase in industry awards. In FY 2009, total research expenditures exceeded $1 billion for the first time, a milestone that highlights the university's role as an economic resource benefiting the entire state. Support from our donors has reached historic highs and continues, even with a downturn that surely is affecting their resources. We are offering more classes in spring and summer terms; treating more patients throughout our Health System; and seeing more students transfer from community colleges.

Third, we are deeply committed to controlling costs. We have asked people and programs across the institution to make sacrifices, and the savings are significant. Our efforts have included changes in employee benefits, such as health care and institutional retirement contributions for new employees; discontinuing operation of our public television station; being more deliberate in how we use and allocate space on campus; reducing energy usage; and asking our schools, colleges, and units to accept budget cuts.

And lastly, the university's cash and balance sheet management is the envy of higher education. We have an excellent bond rating that represents an external assessment of confidence in our market strength, financial position, and resource management. Our investment and spending rule strategy has been prudent and is sustaining us at a time when other universities are being forced to make drastic cuts.

The university's executive team and I are determined not merely to hold our own as an institution, but to advance among our peers on a global scale. We anticipate more budget challenges in the near future, but building on our strengths, we remain confident in the university's ability to lead the way forward.

As our society works through this financial crisis, there has been much discussion about the source of our nation's economic strengths and potential for growth. An educated, innovative workforce is critical to this future, and the University of Michigan—in Ann Arbor, Flint, and Dearborn—is on firm footing to prepare tomorrow's engineers, artists, lawyers, economists, scientists, and entrepreneurs.

This commitment is amplified by our collaboration with Michigan State University and Wayne State University as partners in the University Research Corridor. The URC is a testament to the power of research universities to develop intellectual capital that both stimulates the economy and improves our quality of life.

Higher education is the source of the people and ideas that are the driving force for our collective future as a region and nation. We must work together to protect, sustain, and grow the University of Michigan, because more than ever, our work matters—in teaching, research, health care, and in service to our state and the world.

Sincerely,

Mary Sue Coleman

Mary Sue Coleman | *President*

Report from the
{ Chief Financial Officer }

TIMOTHY P. SLOTTOW

I'm very pleased to report that the University of Michigan continues to be financially healthy, despite the difficult economic conditions facing the state and the nation. Our disciplined budget approach carefully balances the university's need to remain competitive with a challenging economic environment.

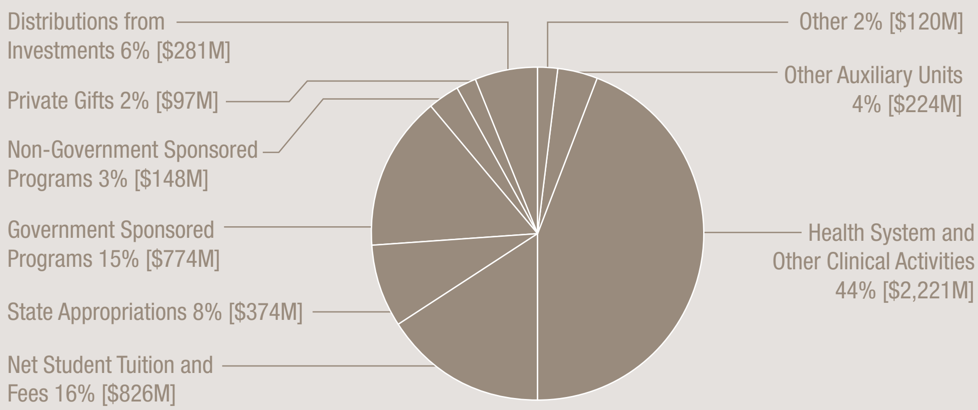
Our 34,000 faculty and staff share an unyielding focus on the university's core missions and are committed to finding innovative ways to control costs and manage resources more productively. As a result, we continue to have the resources to make strategic investments in the facilities, programs, and people that enable the institution to remain one of the best public research universities in the world.

Because of these collective efforts, the university continues to maintain the highest credit ratings from both Standard & Poor's (AAA) and Moody's Investor Services (Aaa). These ratings are important indicators of our strong financial health and outlook and are particularly encouraging in light of the tumultuous economy we've faced for several years. It is impressive that the university is one of only three public universities in the country to maintain these highest possible ratings.

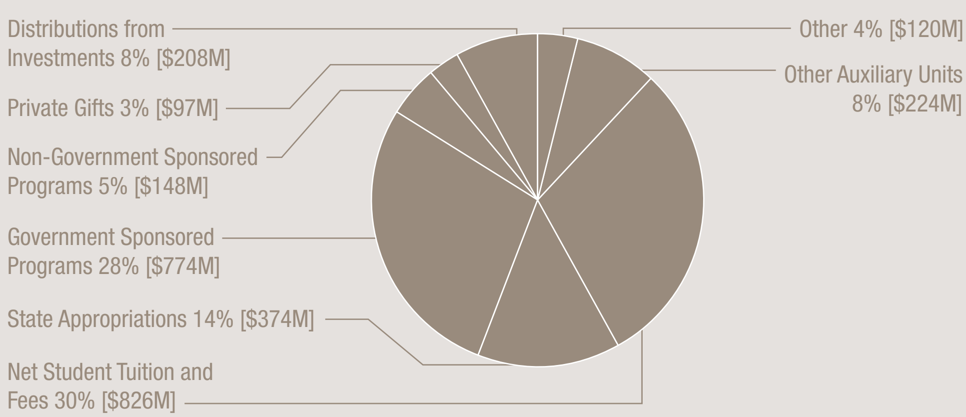
In summary, the university's total net assets (assets less liabilities) decreased by $2.1 billion in FY 2009 to $8.7 billion. This decrease is primarily the result of investment losses of $1.9 billion, mostly in the Long Term Portfolio, the investment pool for the university's endowment, which was impacted by the global financial crisis. The university's endowment spending rule, which is designed to insulate operations from volatility in the capital markets, cushioned the impact of the investment losses on the university's operating budget and there was no decrease in the endowment distributions to support the university's operations in FY 2009. At June 30, 2009, the endowment totaled $6.0 billion, down from $7.6 billion the year before. However, it is important to note that primarily due to generous new gifts from alumni and friends and transfers the size of the endowment decreased by only 21 percent despite net investment losses of 23 percent and a distribution of $244 million from the endowment to support operations. Despite the significant volatility of investment returns, the university's long-term diversified investment strategy continues to provide predictable support for university operations as well as endowment growth over time as demonstrated by our five- and ten-year average annual investment results of 7 percent and 9 percent, respectively.

John Schultz

OPERATING ACTIVITIES | *Total Revenue $5,065 Million*



OPERATING ACTIVITIES EXCLUDING HEALTH SYSTEM AND OTHER CLINICAL ACTIVITIES | *Total Revenue $2,771 Million*



The university's long-term investment strategy combined with aggressive cost containment, successful fund-raising, moderate tuition increases, and relentless protection and enhancement of the world-class quality of U-M's research, teaching, and clinical care will pave the way for our future. In the following sections, I will discuss the important contributors to the university's overall financial health to provide context to the accompanying financial statements.

REVENUE DIVERSIFICATION

Revenue diversification has long been an important strategy for the university to achieve financial stability in light 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 22 percent in the FY 2010 general fund budget. The current mix of revenue can be seen on the charts located on page 4, which show the FY 2009 operating revenue sources with and without the Health System and other clinical activities.

THE GENERAL FUND OPERATING BUDGET CHALLENGE

Although state appropriations have declined significantly since FY 2002, support from the state of Michigan remains an integral part of the university's strength. State appropriations have decreased $42 million, or 10 percent, from $416 million in FY 2002 to $374 million in FY 2009. In contrast, if appropriations had grown at the level of the Consumer Price Index, our state appropriations would have been $114 million higher in FY 2009. To put the state's current support in perspective, it is useful to consider that in a stable economic environment, it would take an additional endowment of approximately $7 billion to generate a revenue stream that would equal the current level of support.

Moving forward, our budget continues to be a challenge. We need to balance our commitment to academic excellence and access against our ongoing cost containment efforts and the need to invest in our future, all against the backdrop of the state's uncertain financial circumstances. In adopting the budget for FY 2010, we anticipated a state appropriation of $363 million, which reflects a 3 percent reduction from the amount we received in FY 2009. State appropriations for FY 2009 and FY 2010 are buffered by one-time federal stimulus support and we are planning for possible significant reductions in FY 2011 and FY 2012.

The university's deans, directors, faculty, and staff have been focused and diligent in reducing and reallocating $22 million in recurring general fund expenditures from the Ann Arbor campus budget for the coming year. This is in addition to the $135 million of recurring cost reductions achieved in the general fund over the previous six years.

By focusing on innovative solutions and through ingenuity and hard work, we have been able to limit tuition increases. The approved Ann Arbor campus budget for FY 2010 includes a relatively moderate increase in tuition rates of 5.6 percent for both resident and nonresident undergraduates and most graduate programs. This budget also includes $118 million in centrally funded financial aid, the largest investment in financial aid in the university's history. Within that, centrally awarded financial aid for undergraduates is increasing by nearly 12 percent, which will help preserve access for our most financially vulnerable undergraduate students. The approved Dearborn campus budget includes a 6.7 percent increase in undergraduate tuition, a 3 percent increase in graduate tuition, and a nearly 7 percent increase in institutional financial aid. At UM-Flint, the approved budget includes a 6.5 percent increase in undergraduate tuition, a 4.9 percent increase in graduate program tuition, and an 8.5 percent increase in institutional financial aid.

In FY 2010, many of our students will also see fewer loans and more grant aid in the form of more generous Pell Grants, increases in the American Opportunity Tax Credit, and more money for our work-study program. It is also noteworthy that the average rate of growth in our tuition during the past five years has been among the lowest of the public universities in the state of Michigan.

THE NORTH CAMPUS RESEARCH PROJECT

In June 2009, the university completed its purchase of the former Pfizer pharmaceutical research complex adjacent to the university's current North Campus. This acquisition of 174 acres and 30 buildings was funded primarily with Health System resources and provides a springboard for new discoveries, job creation, and educational opportunities—an important investment for the university's future. Known collectively as the North Campus Research Complex (NCRC), the nearly 2 million square feet of sophisticated laboratory facilities and administrative space acquired could expand the university's research capacity by 10 percent.

This strategic purchase will save the university both time and money over the long term compared with the cost of building new research facilities. The NCRC is particularly beneficial for the university's growing research activities in health, biomedical sciences, and other disciplines, which have been challenged in recent years by lack of research space. This investment also results in significant environmental benefits since the acquired buildings and their high-end research space will be preserved and utilized instead of demolished and transported to a landfill. The university will also use its multifaceted environmental programs to benefit the NCRC.

OTHER PHYSICAL PLANT IMPROVEMENTS, SUSTAINABILITY, AND PRODUCTIVITY

It is important that we continue investing in our future by carefully choosing which facilities should be renovated or replaced. The institution's facilities serve a wide range of needs, including everything from providing patient care to academic needs.

To support this effort, the university has invested an average of $396 million per year, over the past decade, for renovation and replacement of buildings and related infrastructure. FY 2009 was no exception as the university completed 286 projects across campus, an investment of $760 million. Many facilities to support the university's academic, research, patient care, and athletic functions have recently been completed or are currently under construction to meet the university's changing needs.

Two of the largest construction projects in university history are continuing with the North Quad Residential and Academic Complex, the university's first new residence hall on the Ann Arbor campus in 40 years, and replacement of the C.S. Mott Children's Hospital and Women's Hospital facility. In FY 2009, completed projects include the Alumni Memorial Hall Museum of Art addition and renovation, the new 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.

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. The renovation of Michigan Stadium, home to the football team since 1927, continues, with completion scheduled before the 2010 season begins. Construction is also continuing on the Al Glick Field House, a new indoor practice field for the football program, and a new 18,000-square-foot wrestling center is under construction.

The university is focused on improving usage of its instructional, research, and administrative space. Space utilization efforts include a change to centrally scheduled classrooms for all general fund buildings, targeted reporting on space and utility costs by building, and standards for office size and energy efficiency for all new and renovated buildings.

Planet Blue is a three-year, campus-wide effort to cut utility costs and increase recycling. The university spends more than $100 million a year on utilities and Planet Blue aims to cut those costs by 10 percent through a combined approach that includes energy-saving technologies, building upgrades, and engaging faculty, staff, and students in the program through an education and outreach program. Some of the energy-saving actions undertaken by the Planet Blue initiative include occupancy sensors for lighting, scheduling changes to heating and cooling systems, and modifications to water faucets in restrooms. Planet Blue is part of the campus-wide Energy and Environmental Initiative that was launched in 2007. The initiative's annual report is available online at *www.oseh.umich.edu/reporting.html.*

Our cost containment and productivity improvement efforts to date have been paying off, thanks in part to leveraging technology and streamlining administrative processes. Over the past five years, the university's general fund expenditure growth rate has been below the measure of inflation most appropriate for universities, the Higher Education Price Index (HEPI). The highest growth item during this time period among general fund expenditures has been scholarships and fellowships, reflecting our ongoing commitment to affordability and accessibility. And, the university's general fund expenditures per student credit hour (net of the scholarships and fellowships the university provides) grew at an annual rate of 2.1 percent between FY 2003 and FY 2008, when the HEPI grew at an annual rate of 4.3 percent and the U.S. Consumer Price Index (CPI) grew at an annual rate of 3.1 percent.

Refer to page 13 for more information about the university's increased productivity and strategic cost containment programs.

CONTROLLING HEALTH CARE COSTS

Organizations across the country continue to be challenged by escalating costs of employee and retiree benefits. Large employers report a lower rate of annual increase averaging about 8 percent over the past year, down from previous averages as high as 12 percent. Still, the cost growth is an ever-present challenge, with total university health care spending for employees and retirees reaching almost $283 million in FY 2009.

During the past fiscal year, the university drew upon the combined expertise of top clinical and health policy faculty and financial experts to design a new health benefits premium structure. Effective in January 2010, the new model will increase the overall contribution toward health care coverage made by employees, dependents, and retirees. A system of salary bands for active employees helps determine the contribution amount to lessen the impact on lower paid employees. Phased in over two years, these changes will provide a reduction in health care expenses of more than $31 million annually once fully implemented in 2011. 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. MHealthy offers a spectrum of programs designed to support healthy lifestyles. During FY 2009, MHealthy completed the first university-wide health risk assessment, with more than 17,500 faculty and staff completing an online health risk questionnaire and participating in a wellness screening at sites located on all U-M campuses and in the U-M Health System. This new data gives the university a rich opportunity to understand our greatest community health risks in ways never before possible, and to use the data to design targeted programs and interventions that invest in health improvement and thereby reduce the costs incurred by the university's health plans.

The university-managed prescription drug program continues to contribute to savings in the clinical realm, with a generic drug dispensing rate of just over 71 percent of prescriptions filled in FY 2009, up from 68 percent in the previous fiscal year and higher than the national average. 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.

THE ENDOWMENT

Our long-term diversified investment strategy is designed to maximize total return, while our spending rule policy is designed to protect and grow the endowment corpus in real terms and provide dependable support for operations. The financial market turmoil and large loss of wealth in global financial markets that followed the fall of Lehman Brothers in September 2008 exceeded any since the Great Depression. This resulted in broad-based losses across the university's public and private equity and equity-like investments, with large losses occurring in areas that had experienced the greatest gains in recent years, such as real estate, energy, and other alternative investments. Despite the losses in FY 2009, these assets remain the university's highest performing investments over longer time


Scott C. Soderberg, U-M Photo Services

North Campus Research Complex


Scott C. Soderberg, U-M Photo Services

MHealthy wellness screening

periods. Fixed income investments in the university's long-term pool performed in line with expectations and proved to be a stabilizing factor on the overall investment portfolio.

The Long Term Portfolio's -23 percent return in FY 2009 follows a 6 percent return in FY 2008 and a 26 percent return in FY 2007. The Long Term Portfolio's annualized five-year return of 7 percent was 2 percentage points above the custom market benchmark designed to capture the university's long-term diversified investment strategy and nearly 8 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 -2.2 percent over the same five year period.

INVESTMENT PERFORMANCE

	Return for twelve-month period ended June 30, 2009	Annualized three-year return	Annualized five-year return
Long Term Portfolio	-23.4%	0.8%	7.2%
U-M's Benchmark	-18.1%	-0.5%	5.1%
Equity/Fixed Income Index (80/20)	-21.5%	-4.7%	-0.3%

The table above shows the endowment's favorable investment performance relative to its benchmarks over longer time periods and its ability to support operations over the long term.

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 was extended by one quarter each subsequent quarter until it reached seven years at June 30, 2009. This change was enacted to further reduce distribution volatility, as well as to 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 $244 million in FY 2009, for a total of $1.0 billion over the past five years.

The payout from our nearly 7,000 separate endowment funds enables us to serve a diverse population, ranging from patients in our Health System to students. For example, approximately $1.5 billion, or 24 percent, of our $6.0 billion endowment is restricted for use by our Health System, where nearly 1.8 million patient visits take place each year. The portion of the endowment available for university operations supports the education of more than 57,000 students. About 19 percent of our total endowment, or $1.15 billion, has been set aside for student aid, with nearly 80 percent of our undergraduate students who are Michigan residents receiving some form of 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 the arts and sciences. 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, primarily for strategic capital investment, was 6.5 percent.

THE HEALTH SYSTEM

The Health System, which integrates the clinical operations of the Hospitals and Health Centers, Medical and Nursing Schools, and Michigan Health Corporation under the direction of the university's executive vice president for medical affairs, had a solid year financially despite the economic times, 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 13 years of positive financial margins, while also improving the quality and safety of the care we deliver to patients.

In FY 2009, the Hospitals and Health Centers achieved an operating margin of 1 percent ($18.5 million) on revenues of $1.8 billion. This smaller-than-expected margin reflects the strains of a difficult economy, an increase in patient care for those covered by government insurers, and a rise in uncompensated care provided to the uninsured and underinsured. That said, the continued achievement of a positive operating margin in this past year stands out from most other health care systems in the state and is a testament to the efforts of staff who work constantly to redesign operations for better efficiency and lower cost. The positive margin allows us to fund critical facilities and programs that will enhance patient care for a growing patient population, as well as research and education. These include the newly acquired North Campus Research Complex, the new 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 new Observation Unit and new inpatient beds in existing areas of the University Hospital, and advanced medical imaging equipment, continue to expand our capacity to serve patients and ensure their safety. As we look to the future, the North Campus Research Complex presents a transforming opportunity to expand and align biomedical research capabilities at the Medical School and other areas of the university, and to consolidate administrative functions that currently occupy leased space outside our campus environment.

With the Medical School now among the top 10 in the nation in research funding from the National Institutes of Health, the timing for this purchase could not be better. 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 2009, major gifts included a new $22 million gift from retail pioneer A. Alfred Taubman to further endow the institute he founded in FY 2008 with an original $22 million gift.

FINANCIAL CONTROLS

We are continuing our efforts to leverage best practices from the Sarbanes-Oxley Act through our annual financial stewardship and internal controls certification process, which is required for all deans and vice presidents at the institution. This year, we added cash handling and journal entry processes to the annual certification, which already includes other key risk areas such as information technology security, employment, purchasing card controls, and conflicts of interest. We are also providing a variety of tools and aids to units across campus such as web-based trend and exception reporting capabilities to help support management oversight. Beyond that, we developed written documentation templates to clearly define the key control points and procedures associated with our major financial-related processes.

CONCLUSION

It is, once again, satisfying to receive an unqualified opinion from the university's independent 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 encourage you to read Management's Discussion and Analysis, beginning on page 36. It provides the details of the university's financial strength, prudent financial policy, and most importantly, the capability 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

Lin Jones, U-M Photo Services

Report from the

{ Vice President for Development }

JERRY A. MAY

This has been an extraordinary fiscal year, beginning in a time of excitement as we approached the final months of The Michigan Difference campaign, and ending with significant economic challenges. In spite of the severe downturn, 115,370 donors made gifts totaling $265,787,374 this year.

Our enormously successful Michigan Difference campaign that began in FY 2000 with a goal of raising $2.5 billion ended December 31, 2008, receiving a record $3.2 billion from 372,931 donors, the most raised by a public university at the time. These donors transformed the U-M, supporting students, faculty, 22 buildings and facilities, programs, and research. Their gifts are already at work.

Due to the passion and foresight of donors BARBARA and FREDERICK ERB (BBA '47), PETER WEGE (HLLD '07), and DONALD GRAHAM (BSEIE '55, MSE '56, HDENG '09), sustainability is a focus of study and research university-wide. A new masters level program between the College of Engineering and the School of Natural Resources and Environment offers students an innovative course of study. These donor-supported initiatives fund a multi-disciplinary approach to the topic of sustainability.

The Life Sciences Institute, filled with more than 350 researchers, has taken a prominent place on campus. PAUL (AB '74) and SUSAN (BSN '74, PHD '82) MEISTER named the directorship to honor President Mary Sue Coleman, a scientist and a champion of the institute.

The Health System transformation encompasses facilities, programs, professorships, and research. The first of its kind, the Depression Center brings together comprehensive clinical care, research, and education within the RACHEL UPJOHN BUILDING. The new C.S. MOTT CHILDREN'S HOSPITAL AND WOMEN'S HOSPITAL will provide unparalleled care. D. DAN KAHN funded collaborative research into cardiovascular disease by physicians, scientists, and engineers working in biomedicine and bioengineering at U-M and Technion University, Israel. DELORES and WILLIAM BREHM (BS '50, MS '52) created a new center for type 1 diabetes research housed in the greatly expanded KELLOGG EYE CENTER. Research to battle disease received a powerful impetus with funding from A. ALFRED TAUBMAN (HLLD '91) for the TAUBMAN MEDICAL RESEARCH INSTITUTE and TAUBMAN SCHOLARS PROGRAM. All areas of the Health System will benefit from the 99 endowed professorships donors created, bringing the total number of professorships in the Health System to 163.

On Central Campus, for the first time GERALD R. FORD SCHOOL OF PUBLIC POLICY students and faculty are together in one building, JOAN AND SANFORD WEILL HALL—studying, meeting, and attending presentations by top public policy leaders. At the STEPHEN M. ROSS SCHOOL OF BUSINESS, a striking new building has made possible an entirely new way of teaching and learning. Interactive classrooms and meeting spaces have brought students and faculty together in a way that can only be described as revolutionary. And speaking of revolutionary, the Museum of Art with its MAXINE AND STUART FRANKEL AND THE FRANKEL FAMILY WING has taken a bold step by opening the facility to visitors in innovative ways. Multiple entrances encourage students to walk through and experience the greatly expanded exhibit spaces, and perhaps discover a piece of art they might not have otherwise seen.

Donors have transformed public spaces that the community as well as the university can enjoy. The MATTHAEI BOTANICAL GARDENS AND NICHOLS ARBORETUM created new exhibits and spaces for visitors of all ages. The Natural History Museum has a state-of-the-art planetarium projector. The WILLIAM E. UPJOHN EXHIBIT WING of the KELSEY MUSEUM OF ARCHAEOLOGY makes it possible to exhibit far more of their astounding collection and provide greater educational opportunities.

On North Campus, the CHARLES R. WALGREEN, JR. DRAMA CENTER provides performance, rehearsal, and meeting space, as well as office space for faculty members. STAMPS AUDITORIUM provides a beautiful central venue for classes, performances, and presentations. The College of Engineering's new facilities span disciplines from computer science to biomedical engineering to nanofabrication, providing classroom and research space, including space for research already benefiting the state's economy through new ventures.

The top campaign priority for UM-Flint was to increase the number of student scholarships. Donors created 94 new scholarships, which helped contribute to the 4,400 awards made to students during this time. In addition, donors supported faculty and student research, as well as travel, through 28 new funds.

On the Dearborn campus, 13,000 donors gave more than $45 million, 10 percent more than the original $40 million goal. One major campaign success had an impact far beyond the Dearborn campus into K-12 schools: The Center for Mathematics Education worked with Wayne County schools to implement a new mathematics program, "Algebra for All," that helps teachers improve their math teaching skills and students improve their algebra skills.

Every area of the University of Michigan has been touched by the success of the campaign, all of it made possible by private support from those who believe in this great university. Donors have made The Michigan Difference.

Jerry A. May | *Vice President for Development*

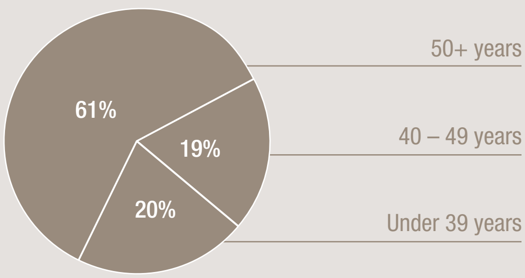
The Michigan Difference

{ Campaign Summary }

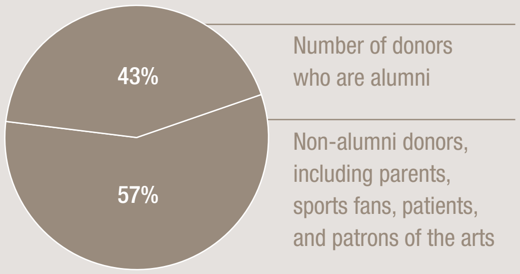
CAMPAIGN TOTALS

Programs/Research	$ 1,359,366,996
Faculty Support	$ 318,898,038
Buildings	$ 478,445,837
Student Support	$ 545,329,149
New Bequests	$ 498,693,083
Total Raised	**$ 3,200,733,103**
% of Campaign Goal	128%

BY AGE – PHILANTHROPY ACROSS GENERATIONS



SUPPORT: ALUMNI AND BEYOND



FIRST FACULTY AND STAFF CAMPAIGN

+ 16,898 faculty, staff, and retirees gave $165 million

+ 42% of all U-M retirees gave, contributing $84+ million

ENDOWMENTS

+ Donors gave $923 million for the endowment

+ 191 new endowed professorships, bringing the total number to 471

+ 2,045 endowed scholarship funds, doubling the number of endowed scholarship accounts to 4,530

+ Of the 6,972 endowed funds in the endowment, 65% are designated for student support

+ 257 new endowed research funds

DONOR CHALLENGES

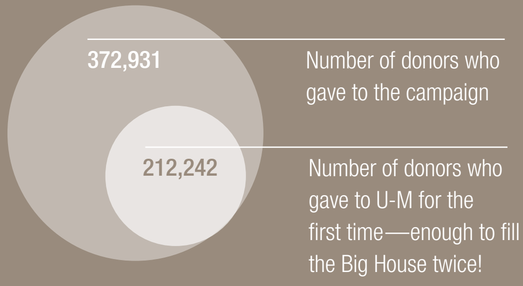
President Mary Sue Coleman's Donor Challenges focused on the highest priorities

Professorships: Donors created 21 new professorships
Gifts + pledges + match = $42 million

Undergraduate Need-Based Support:
Gifts + pledges + match = $72.6 million

Graduate and Professional Student Support:
Gifts + pledges + match = $60 million

In January 2009, President Coleman created the President's Challenge for Global Education to encourage funding for global study by Michigan students. To provide long-term funding, gifts of $25,000 and above creating an endowed fund will be matched $1 for every $2 given. The challenge continues until $10 million in private gifts is raised.



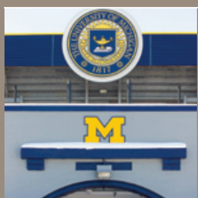
The Michigan Difference

{ Campaign Summary }

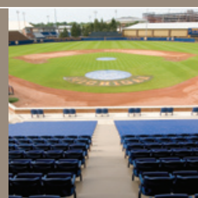
BUILDINGS AND FACILITIES

Donors funded 22 projects, of which 14 were completed as of June 30, 2009.

Athletic Campus


The J. Ira and Nicki Harris Family Football Locker Room


Junge Family Champions Center and Mortenson Family Plaza


Wilpon Baseball and Softball Complex

Stephen M. Ross Academic Center

Al Glick Field House, *under construction*

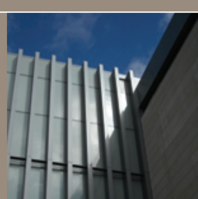
Michigan Wrestling Center, *under construction*

Michigan Stadium expansion, *under construction*

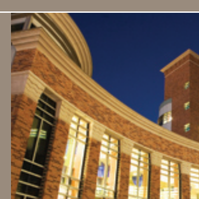
Basketball Player Development Center, *in design*

Central Campus


Stephen M. Ross School of Business Building


The Museum of Art and the Maxine and Stuart Frankel and the Frankel Family Wing


Joan and Sanford Weill Hall, Gerald R. Ford School of Public Policy

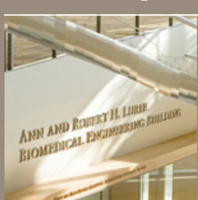

School of Public Health Crossroads and Research Tower

Stanford Lipsey Student Publications renovation

William E. Upjohn Exhibit Wing of the Kelsey Museum, *under construction*

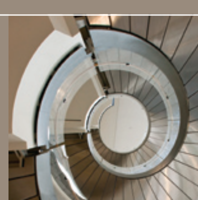
Law School Renovation and Expansion, *ground-breaking fall 2009*

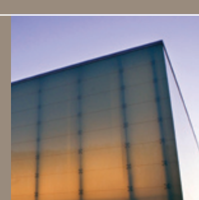
North Campus



Ann and Robert H. Lurie Biomedical Engineering Building


The Robert H. Lurie Nanofabrication Facility


Computer Science and Engineering Building


The Charles R. Walgreen, Jr. Drama Center and Arthur Miller Theatre

Medical Campus

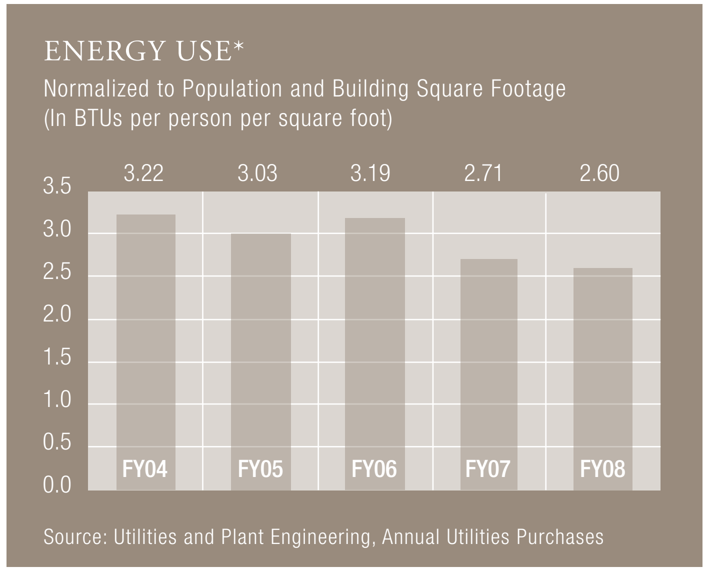

The Depression Center at the Rachel Upjohn Building

C.S. Mott Children's Hospital and Women's Hospital, *under construction*

The Kellogg Eye Center and the Brehm Tower, *under construction*

{ Cost Containment }

REDUCING EXPENSES TODAY TO FREE UP RESOURCES FOR TOMORROW



* Energy use calculations do not reflect inefficiencies related to off-campus production of electricity that was purchased for the Ann Arbor campus.

The University of Michigan has long been engaged in a disciplined program of strategic cost containment. These successful initiatives are central to U-M's ability to remain accessible to students from all economic backgrounds while maintaining the breadth and quality of the programs it offers. Sound financial management has helped U-M avoid the across-the-board cuts being made at other universities today.

In 2003, faced with steadily declining support from the state and rapidly rising costs in such areas as energy and health care, the university stepped up efforts to control costs. Over the next six years, U-M aggressively cut more than $135 million in recurring costs from the general fund budget—the budget that supports our core educational operation—and reallocated savings to the university's highest priorities.

Today, strategic cost containment is more necessary than ever, and U-M is ramping up efforts to meet this challenge.

STEPS TAKEN SINCE 2003

Energy efficiency

U-M has invested in large systems such as regional chillers and in energy-saving measures at the building level, including more efficient windows and laboratory fume hoods. It has also encouraged behavioral changes among community members by installing room occupancy sensors to shut off lights, low-flow faucets, and water-saving toilets.

As a result, despite growth in U-M's building square footage and the number of people who work, study, and live on the Ann Arbor campus, total energy use for buildings and transportation in FY 2008 decreased 7.5 percent from its record high in FY 2006.

Health insurance benefits strategies

Health benefits are a major cost driver for large employers, with annual costs increasing 8 percent to 10 percent nationally in recent years.

To address rising costs, U-M adopted new strategies for medical plan co-premium sharing that are more in line with peers. Reducing the U-M-paid portion of health insurance premiums saves the university an estimated $24 million annually.

U-M also encouraged employees to use generic prescription drugs rather than brand names, established a separate prescription drug plan for employees, and negotiated a new single pharmacy benefit manager contract.

Because of these steps, U-M's increase in general fund expenditures for health insurance benefits has been about half the national average, 5.1 percent annually since 2002.

Purchasing practices

A streamlined procurement system and more favorable rates with preferred vendors through its Strategic Supplier Program and university-wide contracts have resulted in millions of dollars in savings for computer equipment, food, materials, repairs, and supplies.

IT-enhanced innovations

Units across campus have leveraged technology to reduce costs and improve performance. Here are a few examples:

- Undergraduate Admissions saves nearly 300,000 pieces of paper annually with online enrollment applications.
- Students now are matched electronically with scholarship award criteria, and student grades are posted online, replacing more costly paper-based, staff-intensive systems.
- Many units use web-based technology to reduce print and mailing costs. For example, more than 80 percent of U-M employees who use direct deposit choose to forgo paper pay stubs, saving $340,000 in postage and $70,000 on pre-printed forms annually.

Increased staff productivity plus quality improvements

Units have consolidated job responsibilities and are working more productively while enhancing quality. The total number of general fund full-time equivalent employees has increased only 3 percent over the past six years while student enrollment has increased by more than 5 percent. U-M's volume of research expenditures has expanded by some 34 percent since FY 2003 to a record high of $1 billion in FY 2009.

Scott R. Galvin, Lin Jones, Scott C. Soderberg, Martin Vloet: U-M Photo Services; Philippe Badin; Tony Ding

In addition, between FY 2003 and FY 2008:

- General fund expenditures per student credit hour grew at a slower rate than the Consumer Price Index.
- Student credit hours per faculty/staff full-time equivalent increased 5.3 percent.
- U-M's six-year graduation rate increased from 85.2 percent to 88 percent.

More efficient use of space and facilities

In 2007, U-M launched a comprehensive Space Utilization Initiative to improve the use of classroom, research, and office space, thereby minimizing the expansion of facilities that are operated using tuition and taxpayer dollars (i.e., excluding facilities operated by the Health System, housing, and intercollegiate athletics, and the property formerly owned by Pfizer). The ultimate goal of the initiative is to contain general fund operating costs and reduce the environmental impact of campus facilities.

Prior to 2007, building space funded by the general fund had been increasing about 2 percent a year. Since the Space Utilization Initiative was launched, growth in new space has slowed to an average 0.5 percent per year, avoiding approximately $188 million in one-time capital costs and $7.5 million in recurring operating costs.

ADDITIONAL COST CONTAINMENT MEASURES

U-M units made $22 million in general fund budget reductions and reallocations for FY 2010. The largest savings resulted from eliminating 63 funded positions and some equipment replacement, eliminating lower priority activities, and introducing other operational efficiencies.

U-M plans to reduce or reallocate general fund expenditures by approximately $100 million during the next three years. Measures include:

- Additional restructuring of health care benefits so employees pay a larger share of their health care costs.
- Postponing employer retirement contributions until employees have worked at the university one year.
- Discontinuing the operation of U-M's public television station.
- Funding all new initiatives through reallocation.

ALTERNATE REVENUE SOURCES

U-M has tapped other revenue sources to support financial aid, some faculty salaries, and activities that otherwise would be paid for from the general fund. Here are a few examples:

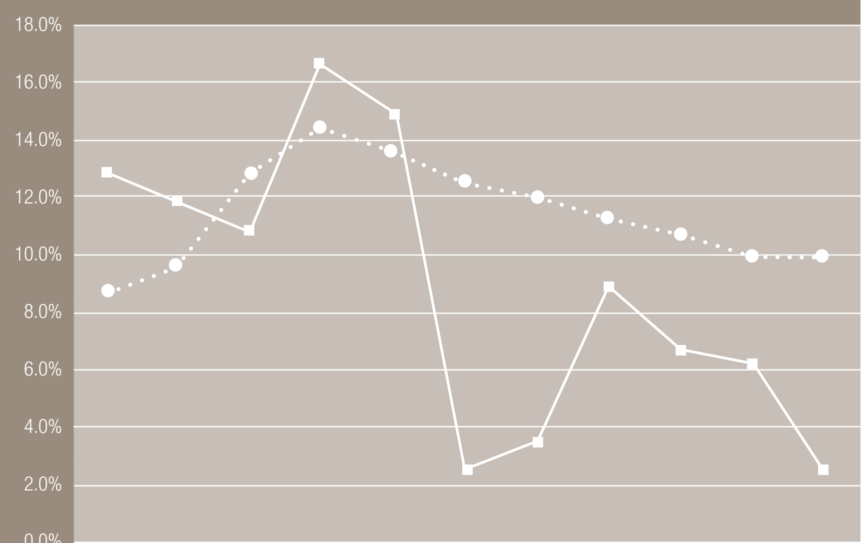
- More than $1 million of U-M's annual proceeds from the Big Ten Network contract is dedicated to need-based financial aid for undergraduates.
- Donors to the recent fundraising campaign contributed $545 million for student support, including 2,045 new endowed scholarships valued at $260 million, generating $13.2 million for students in FY 2009.
- U-M received $18.3 million in revenues from royalties and equities in FY 2009.

LOOKING AHEAD

U-M continues to identify and pursue opportunities to become more efficient and generate additional revenue, including the consolidation of information technology units, central scheduling of classrooms, and revised travel and hosting guidelines. Task forces are exploring the following:

- Expanding spring/summer instruction.
- Developing new non-traditional education programs.
- Ensuring U-M remains the school of choice for out-of-state students through effective marketing to outstanding potential applicants.
- Developing ideas for creative staffing and shared administrative services.
- Identifying best practices for centers and institutes.

U-M HEALTH RATE INCREASES VS. NATIONAL TREND



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
U-M Med +Rx Drug Rate	12.6%	11.9%	10.7%	16.4%	14.9%	2.5%	3.5%	8.9%	6.6%	6.1%	2.5%
Nat'l HMO + Rx Drug Trend	8.9%	9.9%	12.8%	14.4%	13.7%	12.4%	12.0%	11.3%	10.7%	10.0%	10.0%

{ New Appointments }

KATE DAVY, formerly dean of arts and sciences at Bentley University, was named provost and vice chancellor for academic affairs at UM-Dearborn effective, July 1, 2009. Before joining Bentley in 2002, Davy served as provost of Adelphi University, dean of the Peck School of the Arts at the University of Wisconsin-Milwaukee, associate dean at the University of California-Irvine, and dean at Alverno College.

Rachel Lindley, UM-Dearborn

BARBARA L. KORNBLAU, a professor of occupational therapy and public health at Nova Southeastern University, was named dean of the UM-Flint School of Health Professions and Studies, effective July 15, 2009. Kornblau's administrative experience includes president and board chair of the Occupational Therapy Association, board chair of the Arthritis Foundation Southeast Branch, Florida Chapter, and chief of occupational therapy at Baptist Hospital of Miami.

UM-Flint

LAURA LEIN, a poverty expert, was named dean of the U-M School of Social Work, effective January 1, 2009. Lein has conducted research on families in poverty, social welfare and childcare policies and programs, gender, race, and ethnicity. Lein worked for the Center for the Study of Public Policy in Cambridge, MA and was a faculty member at Wellesley College before going to the University of Texas at Austin in 1985, where she served as professor of social work and anthropology.

Scott R. Galvin, U-M Photo Services

ORA HIRSCH PESCOVITZ was appointed executive vice president for medical affairs and chief executive officer of the U-M Health System, effective May 11, 2009. Previously Pescovitz, a nationally recognized pediatric endocrinologist and researcher, served as executive associate dean for research affairs at Indiana University School of Medicine, president and CEO of Riley Hospital for Children in Indianapolis, and interim vice president for research administration at Indiana University.

Martin Vloet, U-M Photo Services

{ New Student Profile }

The 5,783 first-year students who enrolled in September 2008 came from 50 states and 72 countries. They were selected from a group of 29,814 well-qualified applicants.

ACADEMICS | 51% had 3.9 or higher GPAs | 30% had a perfect 4.0 high school GPA | 94% ranked in the top 10% of their graduating class | 52% had an ACT composite score between 30 and 36 | 2,059 students were members of a high school academic honor society

ACTIVITIES | 65% play a musical instrument | 43% were elected to at least one student government office | 31% had writing published or were editors of high school publications | close to three-quarters have participated in civics projects | 15% have started their own businesses | over a third have won city, regional, state, or national athletic awards

2008 FALL TERM ENROLLMENT

	Undergraduate	Graduate/Professional	Total
Ann Arbor	25,994	15,034	41,028
Dearborn	6,778	1,791	8,569
Flint	6,155	1,105	7,260
All Campuses	38,927	17,930	56,857

2007–08 DEGREES GRANTED

	Undergraduate	Graduate/Professional	Total
Ann Arbor	6,258	4,868	11,079
Dearborn	1,293	581	1,874
Flint	886	237	1,123
All Campuses	8,437	5,639	14,076

Chile, Torres del Paine National Park waterfall

The Michigan Difference

{ Leadership & Service }

GRAHAM SCHOLARS STUDY EFFECTS OF HYDROPOWER DEVELOPMENT IN PATAGONIA

Located in Argentina and Chile at the southernmost tip of South America, Patagonia has ice fields and glaciers in the south and mountains that rise into blue-gray mist in the east. Waterfalls thunder from cliffs into rivers so clean, people drink directly from them. This immense region is "pristine, immaculate," says U-M senior Matt Raubinger, and so ecologically diverse that there are penguins in the desert and flamingos in the ice fields.

Raubinger was one of 18 students who traveled there in April for 10 days as part of "Sustainable Energy Development in South America," a class co-taught by Steven Wright, the Arthur F. Thurnau Professor of Civil and Environmental Engineering in the College of Engineering, and Sara Adlerstein, research scientist and lecturer at the School of Natural Resources and Environment. This particular group studied proposals to build large new dams in the region. While the dams would generate hydropower for Chile, the social and environmental costs would be high.

The Graham Environmental Sustainability Institute funds the trips. The students, who come from various academic disciplines, must apply for the class and are admitted as "Graham Scholars." This course and others like it, says Adlerstein, will create "new professionals who are going to integrate information across different fields. That's the kind of people we need for the future."

{ Leadership & Service }

THE CHRONICLE of Higher Education named U-M one of the 2008 Great Colleges to Work For among institutions with 2,500 or more employees. The program addresses faculty–administration relations, compensation and benefits, and work/life balance.

UNDERGRADUATES HAVE a new and highly relevant major on their list of choices: informatics, the study of information and the ways people and social systems use it. The College of Literature, Science, and the Arts (LSA), the College of Engineering, and the School of Information spent nearly two years collaborating on development of the joint program.

DETROIT RENAISSANCE and *The Detroit News* honored the University Research Corridor and Congressman John Dingell for economic leadership when it named them the winners of their inaugural Renaissance Awards Program.

ACCORDING TO an independent 2008 report, University Research Corridor partners—Michigan State University, the University of Michigan, and Wayne State University—generated 69,285 jobs, educated more students than any of the nation's best comparable R&D clusters, and produced $13.3 billion in economic impact in 2007.

Scott R. Galvin, U-M Photo Services

THANKS TO A PARTNERSHIP between the School of Information and the United Way for Southeastern Michigan, the unemployed now have a new tool to help them get through difficult times. Neighbors4Neighbors, a project of the Keep Michigan Working Task Force, uses social computing technology to connect displaced workers with each other.

THE ANN ARBOR CAMPUS aims to cut utility costs by 10 percent over the next three years with an energy conservation program called Planet Blue, an education and outreach campaign that will target 90 large buildings. Planet Blue will combine energy-saving technologies and building upgrades with behavioral changes from building occupants.

IN FALL 2009, the School of Education began offering a master's concentration in philanthropy, advancement, and development. The 30-credit program teaches leadership skills for emerging professional opportunities in government relations, marketing, communications, alumni relations, and fund-raising.

THE SHAPIRO LIBRARY became the first university library to install the Espresso Book Machine, a state-of-the-art printer that will allow U-M to offer on-demand, bound reprints from its digitized collection of nearly 2 million books, as well as works from the Open Content Alliance and other digital sources. It was purchased with donations to U-M libraries.

THE CENTER FOR Health Communications Research at the Comprehensive Cancer Center has received a five-year, $8 million grant from the National Cancer Institute to study cancer communications issues. The grant designates U-M as one of five Centers of Excellence in Cancer Communications Research.

UM-DEARBORN and Oakwood Healthcare Inc. transformed a vacant Dearborn building into a state-of-the-art learning center for kids, families, and future teachers. The 38,000-square-foot facility will house UM-D's Early Childhood Education Center as well as Oakwood's Center for Exceptional Families. Oakwood purchased the former UAW/Ford property last year.

WITH 82 ALUMNI currently serving, U-M remains among the top five on the Peace Corps' top 25 list of large schools nationwide producing Corps volunteers. U-M has made the Top Schools list since the ranking system began in 2001, and also ranked fifth last year.

U-M IS COLLABORATING with seven universities to improve child welfare by offering training and resources through the new National Child Welfare Workforce Institute. The U.S. Children's Bureau awarded a five-year, $16.5 million grant to fund the institute.

IN NOVEMBER, President Mary Sue Coleman received a Humanitarian of the Year award from the Michigan Roundtable for Diversity and Inclusion for her work advocating the educational value of affirmative action and diverse perspectives in the classroom.

PRESIDENT OBAMA named Rosina M. Bierbaum, dean of the School of Natural Resources and Environment, to the President's Council of Advisors on Science and Technology. The council advises the president in areas where understanding of science, technology, and innovation is key to forming responsible and effective policy.

FOR THE FIRST TIME, the Medical School topped $300 million in awards from the National Institutes of Health, and reached the national top 10 among medical schools for NIH funding. The performance impacts not only medical care and research, but also the struggling regional economy.

Job Mainye

Chuck Hatt

ONLY 5 PERCENT of Africans have access to the Web, compared with 74 percent of North Americans. Thanks in part to an engineering student project called IMAGINE Africa, some residents of rural Kenya now have e-mail accounts and Internet access.

THE SCHOOL OF Natural Resources and Environment launched the Teaching and Inspiring Environmental Stewardship program in March. The initiative will help educators, students, and the public better understand sustainability and the benefits of building green.

THE INSTITUTE FOR Social Research is one of four institutions selected to carry out the largest study to date of suicide and mental health among military personnel. With $50 million in funding from the U.S. Army, the new study will also involve the National Institute of Mental Health and the U.S. Army.

U-M RECEIVED a $3 million grant from the Bill & Melinda Gates Foundation to work with Ghanaian health experts and authorities to strengthen human resources for health in Ghana. The Center for Global Health, School of Public Health, and Medical School will collaborate with two Ghanaian universities and the Ghanaian Ministry of Health.

FACED WITH THE toughest economic times since the Great Depression, U-M has earmarked $118 million in centrally awarded financial aid for fiscal 2010, including an 11.7 percent increase in financial aid for undergraduates. It is the largest investment in financial aid in U-M history.

A NEW WEBSITE that teaches English to Spanish-speaking immigrants attracted more than 500,000 visitors in its first three months. Funded by the U.S. Department of Education, *www.usalearns.org* is a collaboration between Project IDEAL at the Institute for Social Research and the Sacramento County Office of Education in California.

UM-FLINT WILL receive a grant from the U.S. Department of Health and Human Services to encourage participation in health training programs among students from families with low annual incomes or from environments otherwise lacking in preliminary training for health professions.

SIXTEEN WOMEN from the Middle East and North Africa with advanced degrees will spend eight weeks working in local research labs through an exchange program organized by UM-Dearborn's College of Engineering and Computer Science. The project is supported by a grant from the U.S. Department of State.

THE ANN ARBOR Languages Partnership, a new School of Education initiative, will provide Spanish language instruction to every third-grader in Ann Arbor public schools. U-M students will teach two sessions each week beginning fall 2009. The program will include fourth- and fifth-graders in 2010.

IN MAY, THE LIBRARY expanded its historic digitization partnership with Google. The amended agreement, based on Google's settlement with a broad class of authors and publishers, strengthens the library's preservation efforts and increases the public's access to books.

THE LIFE SCIENCES Institute launched the Innovation Partnership last year, a novel program that provides "gap funding" to help shepherd promising biomedical discoveries to the marketplace. As of March, donors pledged about $2 million toward the program's $10 million goal.

U-M ANNOUNCED in April that it would become a smoke-free campus as of July 1, 2011. The new policy will affect all grounds and buildings on the three campuses. The U-M medical campus has been smoke-free since 1999.

One of the finest university art museums in the country, UMMA's holdings represent 150 years of art collecting.

The Michigan Difference

{ Creativity & Innovation }

NEW MUSEUM CREATES A VIBRANT CROSSROADS FOR THE ARTS

Nearly 24,000 people streamed into the new University of Michigan Museum of Art (UMMA) to celebrate its reopening—an overwhelmingly positive public response that capped a nearly three-year expansion and restoration project. The opening-week festivities began on Tuesday, March 24 with a student preview and culminated on Sunday with a 24-hour community open house.

With the addition of the 53,000-square-foot Maxine and Stuart Frankel and the Frankel Family Wing and the restoration of historic Alumni Memorial Hall, UMMA ushers in a new era—a reimagining of the art museum as a new "town square" for the 21st century. Enhancements such as expanded open hours; meeting spaces for campus and community organizations; new programs in music, dance, film, and the spoken word; a new museum store; and new areas to relax all seek to place the arts at the center of public life.

The $41.9 million transformation features dramatic new galleries highlighting pieces drawn from the museum's collections of more than 18,000 works, soaring special exhibition spaces, and "open storage" displays. The majority of financing for expansion and restoration, which broke ground in the fall of 2006, was provided by private donors.

Lin Jones, U-M Photo Services

U-M SPINOFF COMPANY Lycera Corp. will receive $36 million of venture capital financing. The company develops small molecule drugs for treating autoimmune diseases. Gary Glick (below), Lycera founder and chief scientific officer, is the Werner E. Bachman Professor of Chemistry.

Peter Smith

A SENSOR BUILT by U-M engineers, technicians, and students enabled the first observations of Mercury's surface and atmospheric composition. The Fast Imaging Plasma Spectrometer is a soda can-sized instrument on board the MESSENGER spacecraft, which performed the first of three flybys in January.

FOUR DOCTORAL STUDENTS, winners of this year's Michigan Memorial Phoenix Energy Institute–Rackham Energy Fellowships, will receive two years of funding to pursue multi-disciplinary research in energy innovation. They are: Richard Chen, Steven Edmund, Bong Gi Kim, and Cameron Weimar.

WHEN U-M UNVEILED the Undergraduate Research Opportunity Program in 1989 it sponsored 14 projects. When the program celebrated its 20th anniversary in April, it boasted more than 1,000 students and 600 faculty researchers, making it one of the university's largest undergraduate research programs.

Scott R. Galvin, U-M Photo Services

U-M RESEARCHERS Ivan Maillard and Yi Zhang shared a $450,000 Innovation Award from the Damon Runyon Cancer Research Foundation. Maillard and Zhang will look for novel ways to make bone marrow transplants safer and more widely available. They were among four 2009 winners selected from 198 applicants.

U-M PHYSICISTS PLAYED a leading role in the discovery of a new particle, the Omega b baryon, which could help explain how matter was formed in the universe. The heavy particle is scarce today, but scientists believe it was abundant soon after the Big Bang.

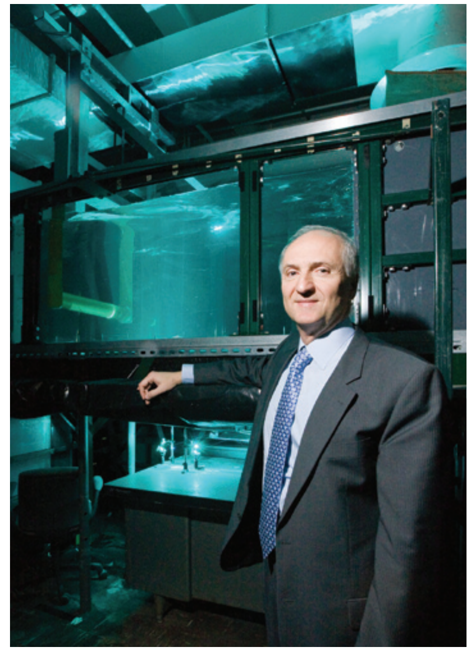
U-M SCIENTISTS USED two continuous wave lasers to create the building block of future quantum computing technology. Their research demonstrated that a quantum bit, or qubit, could be stabilized, thus achieving the fundamental step toward programming it.

IN SEPTEMBER, U-M scientists began a phase 1 clinical trial for the treatment of cancer-related pain. The technique, which uses a novel gene transfer vector injected into the skin, may hold promise for treating other types of chronic pain, including pain from nerve damage caused by diabetes.

A CONCRETE MATERIAL developed at U-M can heal itself when it cracks with just water and carbon dioxide. Test samples recovered their original strength after being subjected to a tensile strain that would catastrophically fracture traditional concrete.

U-M INTENSIFIED its efforts to help Michigan's economy with the creation of a new Innovation Economy website: *www.innovationeconomy.umich.edu.* The site raises the visibility of U-M's economic development activities, encourages tech transfer and entrepreneurial ventures, and gives potential business partners information about U-M resources.

Peter Smith



Scott R.Galvin, U-M Photo Services

MORE THAN 50 ALUMNI returned to Hill Auditorium on March 25 to perform in a sold-out concert celebrating the 25th anniversary of U-M's musical theatre program. The event featured distinguished graduates and current students performing selections from Broadway hits and past productions.

BY USING ULTRAFAST laser pulses to slice off pieces of chromosomes and observe how they behave, U-M biomedical engineers have gained pivotal insights into mitosis, the process of cell division. Their findings could help scientists better understand genetic diseases, aging, and cancer.

U-M AND GENERAL MOTORS announced in May the formation of the Institute of Automotive Research and Education, which will research clean and efficient vehicle technologies. Earlier in the year, GM and U-M established the Advanced Battery Coalition for Drivetrains, which will develop advanced batteries for electric vehicles.

ENGINEERING PROFESSOR Mark Burns' "lab on a chip" kit has been named one of *The Scientist* magazine's top 10 innovations of 2008. The 16-piece set cuts costs and production time from days to minutes, thus making the technology more readily available to the wider scientific community.

OVER 1,000 MEMBERS of the U-M community put forth ideas for new businesses, inventions, and nonprofit groups in a contest named after its goal: 1,000 Pitches. The student group MPowered Entrepreneurship and the College of Engineering's Center for Entrepreneurship organized the contest.

AMONG THE 13 NEW business startups U-M licensed last year are companies offering treatments and diagnostics for diseases. Others help produce next-generation vehicle batteries and semiconductor chips. Over the last five years, U-M helped launch 49 startups of which 70 percent are located in Michigan.

U-M RESEARCHERS HAVE a plan that could save up to 75 percent of the energy that power-hungry computer data centers consume. The approach includes PowerNap, a program to put idle servers to sleep, and RAILS, a high-efficiency power supply system.

U-M SCIENTISTS ARE using a $2 million grant from the National Science Foundation to explore plug-in hybrid electric vehicles that, when not in use, return excess electricity to the grid. The concept, called vehicle-to-grid integration, is part of a larger effort to improve transportation and electric power infrastructures.

ENGINEERING PROFESSOR Michael Bernitsas (above) has created a machine called VIVACE that can turn slow-moving water currents into a new, reliable, and affordable alternative energy source. A pilot device will be installed in the Detroit River in 2010.

TO HELP STUDENTS battle the increasing costs of textbooks, U-M has developed UBooks, an online tool aimed at making it easier for students to buy and sell used books. In addition, the system sends faculty selections automatically to local booksellers.

IN JUNE, THE Department of Dance presented "Dancing at 100," a series of performances and events in recognition of its century-long commitment to teaching and perpetuating the art of dance.

U-M ASTRONOMERS contributed to an international study that gives new insights into the workings of jets produced by supermassive black holes. The findings will help explain the physical processes going on in these remote objects, which have been very difficult to observe.

Refrigerators insulated with rice husk ash could have 20 percent more interior space while increasing efficiency by up to 50 percent.

The Michigan Difference

{ Excellence & Achievement }

U-M STUDENT TEAM TAKES TOP HONORS FOR DEVELOPMENT OF BIO-BASED INSULATION

On May 12, the Massachusetts Institute of Technology Clean Energy Prize announced that a U-M team beat out more than 100 student entries from 40 colleges and universities to win the $200,000 grand prize in the national energy business plan competition. It was the latest in a year of big wins for five students from the Ross School of Business and the School of Natural Resources and Environment and their business startup, Husk Insulation, Inc.

Husk's innovative and patented technology converts rice husks, an agricultural waste product, into cost-effective vacuum insulated panels that are thinner and up to 10 times more effective than conventional insulation. With applications in a variety of markets—including refrigeration, housing, and transportation—Husk answers the global demand for energy conservation by delivering a product solution that could reduce U.S. energy consumption by more than 57 billion kilowatt-hours.

In March, Husk placed second in the first U-M DTE Clean Energy Prize competition, and won second prize in the Cleantech Venture Challenge hosted by the Deming Center for Entrepreneurship at the University of Colorado at Boulder. In February, the group took the Pryor-Hale Award for best business plan at the Michigan Business Challenge and was also a winner of the Dow Sustainability Innovation Student Challenge. The enterprise was conceived by Ross 2009 graduates Erica Graham, Shally Madan, Siddharth Sinha, and Ian Dailey, and master's candidate Elizabeth Uhlhorn.

{ Excellence & Achievement }

THE 2008 WORLD University Rankings rated U-M one of the top 18 universities in the world and the top U.S. public university. The rankings are based on a survey of academics and recruiters, research, international orientation, the number of academic papers cited, and staff-to-student ratios.

MEDICAL AND DOCTORAL student Abdul El-Sayed was one of 32 Rhodes Scholars named nationwide in 2008. Sayed, who plans to become a neurosurgeon, earned his U-M bachelor's degree in biology and political science in 2007. Rhodes Scholarships provide all expenses for two or three years of study at the University of Oxford in England.

U-M ANNOUNCED in March the formation of the A. Alfred Taubman Medical Research Institute Consortium for Stem Cell Therapies. It is the first major embryonic stem cell program launched in Michigan since passage of a state constitutional amendment allowing for the creation of new stem cell lines using surplus embryos from fertility clinics.

AFTER TWO YEARS of construction, the new Hill Dining Center and renovated Mosher-Jordan Hall opened its doors in August. The projects are major achievements in U-M's Residential Life Initiative to revitalize and expand the student experience on campus, and to strengthen the living/learning connection at the university.

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Austin Thomason, U-M Photo Services

STEVEN WRIGHT, professor of civil and environmental engineering, was selected for the third annual Michigan Distinguished Professor of the Year award presented by the President's Council, State Universities of Michigan. Wright is one of three professors from Michigan's 15 public universities selected for the award.

AKKENEEL TALSMA, assistant professor at the School of Nursing, was one of 15 winners of the Robert Wood Johnson Foundation's inaugural Nurse Faculty Scholar award. The three-year, $350,000 grant will support Talsma's study of operating-room nurses.

THE NATIONAL INSTITUTES of Health awarded U-M $17 million to expand the Michigan portion of the National Children's Study, the largest and longest study yet conducted of the health and development of more than 100,000 children across the nation.

FOUR U-M STAFF received 2008–09 Fulbright Scholar grants. From Ann Arbor: Srinika Jayaratne, associate dean and professor, School of Social Work; Thomas Phillips, assistant director, Graduate Career Services, Gerald R. Ford School of Public Policy; Alan Henry Tkaczyk, research fellow, Departments of Mechanical Engineering and Biomedical Engineering. From Dearborn: Adnan Shaout, professor of electrical and computer engineering.

JOHN KIM, Life Sciences Institute faculty member and assistant professor in the Medical School's Department of Human Genetics, was named as one of 17 Pew Scholars in the Biomedical Sciences for 2009.

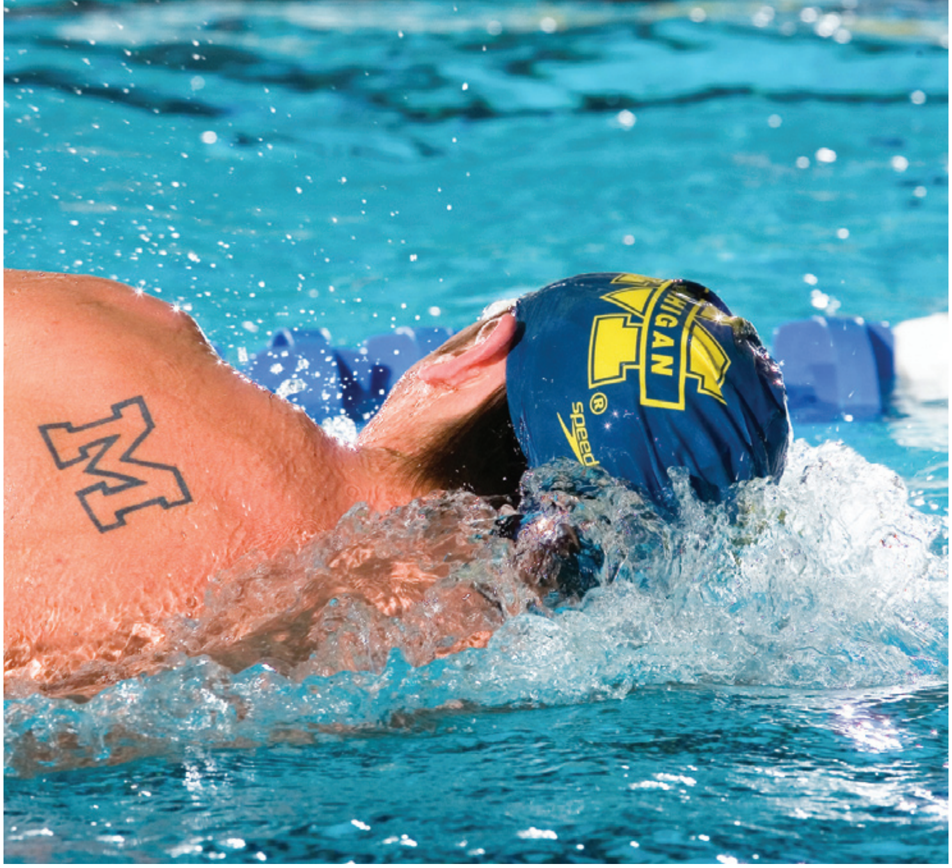
RONALD INGLEHART was named to the American Academy of Arts and Science. Inglehart, who joined U-M in 1966, directs the Institute for Social Research's World Values Surveys.

FIVE FACULTY MEMBERS were honored with Arthur F. Thurnau professorships for outstanding contributions to undergraduate education. Recipients retain their titles throughout their careers at U-M. They are: Charles Bright, professor of history, professor in and director of the Residential College, LSA; August Evrard, professor of physics and astronomy, LSA; Andrei Markovits, the Karl W. Deutsch Collegiate Professor of Comparative Politics and German Studies, professor of Germanic languages and literature, professor of political science and professor of sociology, LSA; James Walsh, the Gerald and Esther Carey Professor of Business Administration, and professor of organizational behavior, human resource management, corporate strategy, and international business at the Stephen M. Ross School of Business; Margaret Wooldridge, professor of mechanical engineering and aerospace engineering at the College of Engineering.

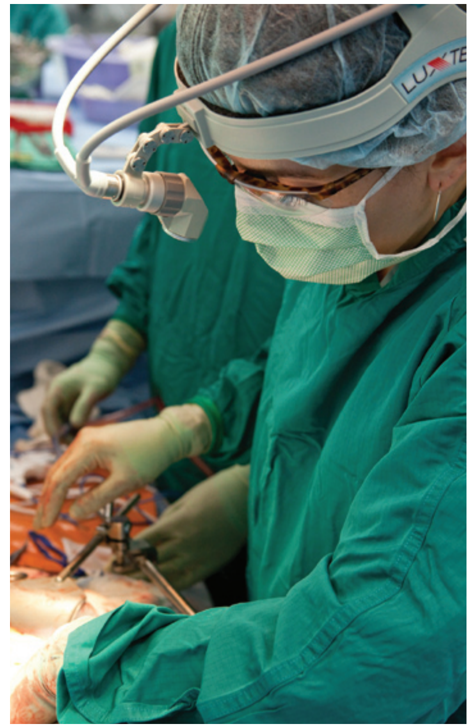
U-M ENGLISH PROFESSOR Ralph Williams was selected as the 2008 Carnegie Foundation for Advancement of Teaching Michigan Professor of the Year. Williams, an Arthur F. Thurnau Professor of English, retired after winter term 2009. He had been with U-M since 1970.

U-M WILL BE home to an Energy Frontier Research Center that will explore new materials to better convert solar energy to electricity. It is one of 46 centers across the nation and one of two in Michigan that will pursue advanced research on energy. The Department of Energy will fund the center for five years with about $19.5 million.

TWO PROFESSORS received a Presidential Early Career Award for Scientists and Engineers at a White House ceremony on December 19. Anna Michalak is an assistant professor in the College of Engineering. Max Shtein is an assistant professor in the College of Engineering and the School of Art & Design.



Scott R.Galvin, U-M Photo Services



Lin Jones, U-M Photo Services

IN 2008–09 VARSITY sports, the Wolverines captured Big Ten Championships in men's and women's gymnastics, softball, men's swimming and diving, and women's water polo. Women's water polo also won the Collegiate Water Polo Association's Eastern Championship title. In varsity club sports, men's lacrosse won the Men's Collegiate Lacrosse Association national championship and men's rowing swept the heavyweight eights at the American Collegiate Rowing Association Championships.

THREE PROFESSORS WERE elected as members of the National Academy of Sciences: David Meyer, director of the Psychology Department's Brain Cognition and Action Laboratory; Allan Gibbard, the Richard B. Brandt Distinguished University Professor of Philosophy; and Yu Xie, the Otis Dudley Duncan Distinguished University Professor of Sociology.

AMERICAN SCHOOL & UNIVERSITY magazine selected UM-Flint's $5.6 million renovation of David M. French Hall for "Outstanding Design" recognition.

AFTER 20 YEARS of construction, CERN's Large Hadron Collider—the world's largest—finally began its mission in the fall of 2008. More than 100 U-M researchers have worked on the historic multibillion-dollar project, which aims to answer lingering questions about the prevailing theory of particle physics. CERN (the European Organization for Nuclear Research) is located in Geneva, Switzerland.

FOR THE THIRD TIME in the past four years, U-M led the nation in the number of Fulbright recipients with 31 awardees. Harvard University followed with 29, Yale University with 26, Northwestern University and the University of California-Berkeley with 24, and the University of Chicago with 23.

TWO FACULTY MEMBERS received 2009 Guggenheim Fellowships. They are: Laura Kasischke, an associate professor in the Department of English and the Residential College, and Heidi Kumao, an associate professor in the School of Art & Design. This year's winners included 180 artists, scholars, and scientists selected from nearly 3,000 applicants.

U-M HOSPITALS AND Health Centers were again named among the nation's best, ranking 14th overall in the annual *U.S. News & World Report* honor roll of "America's Best Hospitals." Both the Consumers' Checkbook ranking, published by *AARP The Magazine,* and the Thomson/Reuters Top 100 Hospitals ranking, published in *Modern Healthcare,* also cited UMHHC for high-quality care. U-M was the only Michigan hospital to make the lists.

THE CHARLES R. WALGREEN, JR. Drama Center and Arthur Miller Theater received the Architecture Merit Award from the United States Institute for Theatre Technology, an association of professional designers and technicians in the performing arts.

THE SCIENCE AND Technology Foundation of Japan awarded David E. Kuhl, professor of radiology at the Medical School, the 2009 Japan Prize for technological integration of medical science and engineering. The prize is one of the world's most prestigious awards in science and technology.

The NCRC will provide opportunities for collaborations with industry in areas such as pharmaceuticals, biotech, energy, nanotechnology, and many other types of research activity.

{ Major Projects }

PURCHASE OF PFIZER FACILITY PAVES THE WAY FOR RESEARCH EXPANSION AND JOB CREATION

U-M completed its purchase of the former Pfizer pharmaceutical research center adjacent to North Campus on June 16, 2009. Acquisition of the 174-acre site, which is now considered part of North Campus, will save U-M both time and money over the long term compared with the cost of building new research facilities.

The 30-building facility, now known as the North Campus Research Complex (NCRC), will help launch new discoveries, create jobs, provide educational opportunities—and offers a wise investment for U-M's future. The purchase could expand research capacity by 10 percent and generate up to 3,000 high-quality new jobs in the next decade.

No state taxpayer or tuition dollars were used to finance this $114 million acquisition, which includes assumed liabilities of approximately $6 million. Funds for the acquisition came primarily from Health System reserves. Renovation and operating costs will be borne by the Health System and other university units whose researchers and staff will occupy the complex.

"This purchase is an investment in the future of the University of Michigan and of our state," said President Mary Sue Coleman. "These facilities will help attract more research funding to the area, allowing us not only to broaden our contributions as one of the nation's premier research universities, but also to strengthen the region's ability to stimulate new business."

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Austin Thomason, U-M Photo Services

PROJECTS IN PLANNING

Couzens Hall Renovation

Engineering Programs Building Addition

François-Xavier Bagnoud Building
Ultra-Low Vibration Laboratory

George Granger Brown Memorial Laboratories Mechanical Engineering Addition

Intercollegiate Soccer Stadium

Kresge Complex Demolition

Law School Academic Building and Hutchins Hall Law School Commons Addition

Molecular and Behavioral Neuroscience Institute Building First Level Laboratory Renovations

North Campus Research Complex

North Campus Switch Station Transformer Upgrades

Player Development Center for Intercollegiate Basketball

University Stores and Alexander G. Ruthven Museums Building Museum of Zoology Collection Relocation and Renovations

University of Michigan Hospitals and Health Centers Programs

+ C.S. Mott Children's Hospital and Women's Hospital Replacement Project Shell Space Completion Project

+ University Hospital Inpatient Adult Psychiatry Renovation

PROJECTS IN PROGRESS

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

CAMP DAVIS ROCKY MOUNTAIN FIELD STATION CABIN REPLACEMENT AND INFRASTRUCTURE IMPROVEMENT | Work started December 2008 with an estimated completion date of September 2009. Financing is from College of LSA.

CENTRAL CAMPUS AREA UTILITY TUNNEL AND PIPING REPLACEMENT 2009 | Work started April 2009 with an estimated completion date of December 2009. 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.

CENTRAL POWER PLANT REPLACEMENT STEAM TURBINE | Work started July 2008 with an estimated completion date of December 2009. Financing is from utilities reserves.

WILLIAM W. COOK LEGAL RESEARCH LIBRARY ELEVATOR REPLACEMENT | Work started February 2009 with an estimated completion date of June 2010. Financing is from investment proceeds.

EAST QUADRANGLE RESIDENTIAL COLLEGE AUDITORIUM RENEWAL | Work started April 2009 with an estimated completion date of December 2009. Financing is from College of LSA, gifts, and general fund.

EAST UNIVERSITY CHILLER PLANT NEW CHILLER | Work started August 2008 with an estimated completion date of September 2009. Financing is from investment proceeds.

ENVIRONMENTAL AND WATER RESOURCES ENGINEERING BUILDING RESEARCH LABORATORIES FOR CIVIL AND ENVIRONMENTAL ENGINEERING | Work started May 2009 with an estimated completion date of December 2009. Financing is from College of Engineering.

FORD NUCLEAR REACTOR DECOMMISSIONING | Work started December 2005 with an estimated completion date of July 2009. Financing is from investment proceeds.

THOMAS FRANCIS, JR., PUBLIC HEALTH BUILDING ELEVATOR REPLACEMENT | Work started September 2008 with an estimated completion date of March 2010. Financing is from general fund.

THOMAS FRANCIS, JR., PUBLIC HEALTH BUILDING INFRASTRUCTURE AND FINISHES RENEWAL | Work started April 2009 with an estimated completion date of December 2011. Financing is from School of Public Health and 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.

W. K. KELLOGG INSTITUTE AND DENTAL BUILDING EXTERIOR REPAIRS 2008 | Work started October 2008 with an estimated completion date of September 2009. Financing is from investment proceeds.

W.K. KELLOGG INSTITUTE AND DENTAL BUILDING INFORMATION TECHNOLOGY INFRASTRUCTURE UPGRADE | Work started February 2009 with an estimated completion date of September 2010. Financing is from investment proceeds.

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

MICHIGAN WRESTLING CENTER | Work started October 2008 with an estimated completion date of December 2009. Financing is from Athletic Department and gifts.

MODERN LANGUAGES BUILDING CHILLED WATER PLANT EXPANSION | Work started December 2008 with an estimated completion date of September 2009. Financing is from utilities reserves and general fund.

EARL V. MOORE BUILDING INFRASTRUCTURE IMPROVEMENTS | Work started February 2009 with an estimated completion date of December 2009. Financing is from investment proceeds and utilities reserves.

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.

ALEXANDER G. RUTHVEN MUSEUMS BUILDING ELEVATOR REPLACEMENT | Work started February 2009 with an estimated completion date of March 2010. Financing is from general fund.

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.

THOMPSON STREET PARKING STRUCTURE ADDITION | Work started April 2009 with an estimated completion date of December 2010. Financing is from Parking and investment proceeds.

TOWSLEY CENTER FOR CHILDREN REPLACEMENT FACILITY | Work started August 2008 with an estimated completion date of December 2009. Financing is from investment proceeds.

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

+ BRIARWOOD 2 AND 4 RENOVATIONS | Work started September 2008 with an estimated completion date of September 2009.

+ DATA CENTER PROJECT | Work started October 2008 with an estimated completion date of June 2010.

+ DOMINO'S FARMS LEASEHOLD IMPROVEMENTS FOR THE DIVISION OF METABOLISM, ENDOCRINOLOGY, AND DIABETES | Work started October 2008 with an estimated completion date of September 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.

+ C.S. MOTT CHILDREN'S HOSPITAL AND WOMEN'S HOSPITAL REPLACEMENT PROJECT | Work started February 2007 with an estimated completion date of June 2012. Financing is from Hospitals and Health Centers and gifts.

+ A. ALFRED TAUBMAN HEALTH CARE CENTER LEVEL B1 MEDICAL OBSERVATION UNIT | Work started December 2008 with an estimated completion date of September 2009.

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+ A. ALFRED TAUBMAN HEALTH CARE CENTER REGISTRATION AREA RENOVATIONS ON LEVELS 1–3 | Work started January 2009 with an estimated completion date of December 2010.

+ A. ALFRED TAUBMAN HEALTH CARE CENTER SECOND LEVEL CLINIC ENTRY RENOVATIONS | Work started August 2008 with an estimated completion date of December 2009.

+ UNIVERSITY HOSPITAL AIR HANDLING UPGRADES | Work started February 2009 with an estimated completion date of March 2010.

+ UNIVERSITY HOSPITAL COMPUTED TOMOGRAPHY AND INTERVENTIONAL RADIOLOGY EXPANSION | Work started June 2008 with an estimated completion date of July 2009.

+ UNIVERSITY HOSPITAL INPATIENT BED EXPANSION – UNIT 7A | Work started April 2009 with an estimated completion date of December 2009.

+ UNIVERSITY HOSPITAL MORGUE RENOVATION | Work started February 2009 with an estimated completion date of December 2009.

+ UNIVERSITY HOSPITAL POSITRON EMISSION TOMOGRAPHY/ COMPUTED TOMOGRAPHY SCANNER EXPANSION | Work started May 2009 with an estimated completion date of December 2009.

+ UNIVERSITY HOSPITAL PROCESS CHILLED WATER EXPANSION AND NEW COOLING TOWER | Work started May 2009 with an estimated completion date of June 2010.

PROJECTS COMPLETED

300 NORTH INGALLS BUILDING GERIATRIC CENTER RELOCATION RENOVATIONS | Completed September 2008. Financed by Medical School.

ALUMNI MEMORIAL HALL MUSEUM OF ART ADDITION | Completed November 2008. Financed by gifts, Museum of Art, central administration, and investment proceeds.

BUSINESS ADMINISTRATION EXECUTIVE DORMITORY AND SAM WYLY HALL GUEST ROOM AREA RENOVATIONS | Completed May 2009. Financed by Ross School of Business.

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

CENTRAL CAMPUS RECREATION BUILDING AND MARGARET BELL POOL THIRD LEVEL RENOVATIONS FOR KINESIOLOGY | Completed July 2008. Financed by Office of the Provost and Division of Kinesiology.

CENTRAL POWER PLANT STEAM TURBINES REPLACEMENT | Completed January 2009. Financed by utilities reserves.

CENTRAL POWER PLANT WATER TREATMENT SYSTEM IMPROVEMENTS | Completed March 2009. Financed by utilities reserves.

MARTHA COOK BUILDING ROOF REPLACEMENT | Completed September 2008. Financed by University Housing.

WILLIAM W. COOK LEGAL RESEARCH LIBRARY AND HUTCHINS HALL LIGHTING IMPROVEMENTS | Completed March 2009. Financed by Law School, gifts, and investment proceeds.

DAVID M. DENNISON BUILDING AUDITORIA RENOVATIONS | Completed September 2008. Financed by College of LSA and general fund.

DENTAL BUILDING AND W. K. KELLOGG INSTITUTE ELEVATOR REPLACEMENT | Completed April 2009. Financed by investment proceeds.

ENGINEERING PROGRAMS BUILDING FIRST FLOOR INSTRUCTIONAL LEARNING CENTER | Completed December 2008. Financed by College of Engineering.

FLINT- DAVID M. FRENCH HALL RENOVATIONS | Completed December 2008. Financed by State Building Authority and UM-Flint.

FLINT- KEARSLEY STREET EXTENSION | Completed December 2008. Financed by Charles Stewart Mott Foundation grant.

FLINT- STUDENT HOUSING FACILITY | Completed September 2008. Financed by UM-Flint, gifts, and grants.

HUTCHINS HALL 2008 EXTERIOR REPAIRS | Completed October 2008. Financed by investment proceeds.

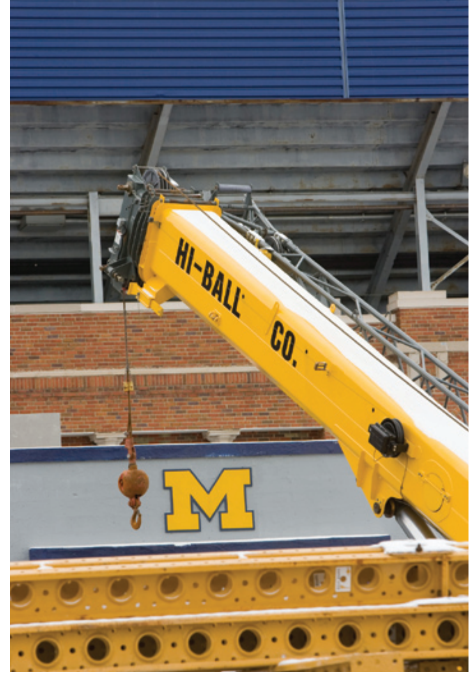
INSTITUTE FOR SOCIAL RESEARCH HEATING, VENTILATION, AND AIR CONDITIONING UPGRADES | Completed March 2009. Financed by investment proceeds.

INTERCOLLEGIATE ATHLETICS SOCCER FIELDS | Completed June 2009. Financed by Athletic Department.

W. K. KELLOGG EYE CENTER CHILLER REPLACEMENT | Completed April 2009. Financed by general fund.

KMS BUILDING MEDICAL SCHOOL FACULTY GROUP PRACTICE BILLING LEASEHOLD IMPROVEMENTS | Completed June 2009. Financed by Medical School.

Scott Soderberg, U-M Photo Services



Scott R.Galvin, U-M Photo Services

LIFE SCIENCES INSTITUTE BUILDING CRYO-ELECTRON MICROSCOPY SUITE | Completed March 2009. Financed by the Office of the Provost, Medical School, and the Life Sciences Institute.

CLARENCE COOK LITTLE SCIENCE BUILDING THIRD FLOOR GEOLOGY LABORATORY RENOVATION | Completed August 2008. Financed by College of LSA.

MEDICAL SCIENCE UNIT I RENOVATIONS FOR RADIOLOGY AND NUCLEAR MEDICINE | Completed December 2008. Financed by Medical School and general fund.

MICHIGAN MEMORIAL PHOENIX LABORATORY RENOVATION | Completed December 2008. Financed by State Building Authority and investment proceeds.

MOSHER-JORDAN HALL RENOVATION AND HILL DINING CENTER | Completed June 2008. Financed by University Housing and investment proceeds.

NEWBERRY HALL - KELSEY MUSEUM ADDITION AND RENOVATION | Completed October 2008. Financed by gifts, NEH grant, investment proceeds, and College of LSA.

STEPHEN M. ROSS SCHOOL OF BUSINESS FACILITIES ENHANCEMENT | Completed December 2008. Financed by Ross School of Business and gifts.

SCHOOL OF NURSING BUILDING INTERIOR UPGRADES | Completed September 2008. Financed by School of Nursing and investment proceeds.

SOUTH QUADRANGLE EIGHTH FLOOR ROOF REPLACEMENT | Completed July 2008. Financed by University Housing.

STUDENT ACTIVITIES BUILDING RENOVATION | Completed December 2008. Financed by State Building Authority and investment proceeds.

A. ALFRED TAUBMAN MEDICAL LIBRARY ELEVATOR REPLACEMENT | Completed June 2009. Financed by investment proceeds.

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

+ CANCER CENTER DIGITAL BREAST IMAGING EXPANSION | Completed August 2008.
+ CARDIOVASCULAR CENTER GENERAL CLINICAL RESEARCH CENTER RELOCATION | Completed December 2008.
+ CARDIOVASCULAR CENTER NUCLEAR CARDIOLOGY RELOCATION | Completed January 2009.
+ EAST MECHANICAL BUILDING AND SIMPSON CIRCLE PARKING STRUCTURE CHILLED WATER LOOP IMPROVEMENTS | Completed March 2009.
+ MEDICAL PROFESSIONAL BUILDING HEATING, VENTILATION, AND AIR CONDITIONING UNIT REPLACEMENT | Completed October 2008.
+ C.S. MOTT CHILDREN'S HOSPITAL MODERATE CARE EXPANSION | Completed December 2008.
+ UNIVERSITY HOSPITAL AND MOTT CHILDREN'S HOSPITAL FOOD SERVICE EQUIPMENT REPLACEMENT AND GALLEY RENOVATION | Completed August 2008.
+ UNIVERSITY HOSPITAL HIGH DOSE RATE RADIATION SUITE | Completed December 2008.
+ UNIVERSITY HOSPITAL MAGNETIC RESONANCE IMAGING EXPANSION | Completed March 2009.
+ UNIVERSITY HOSPITAL PROCESS CHILLED WATER SYSTEM EXPANSION | Completed November 2008.
+ UNIVERSITY HOSPITAL ROOF REPLACEMENT | Completed October 2008.
+ UNIVERSITY HOSPITAL SURGICAL INTENSIVE CARE UNIT ROOM SEPARATION | Completed November 2008.

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 8, 2009

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 52 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

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
PricewaterhouseCoopers Plaza
1900 St. Antoine Street
Detroit MI 48226-2263
Telephone (313) 394 6000
Facsimile (313) 394 6555

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, 2009 and 2008, and the changes in its financial position 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our 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 51 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 8, 2009

INTRODUCTION

The following discussion and analysis provides an overview of the financial position of the University of Michigan (the "University") at June 30, 2009 and 2008 and its activities for the three fiscal years ended June 30, 2009. 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 6,700 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 and colleges, and contributes to the state and nation through related research and public service programs. The University, in total, employs more than 48,000 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 and Michigan Health Corporation, a wholly-owned corporation created to pursue joint venture and managed care initiatives.

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

The University's financial position remains strong, with assets of $12.9 billion and liabilities of $4.2 billion at June 30, 2009, compared to assets of $14.8 billion and liabilities of $4.0 billion at June 30, 2008. Net assets, which represent the residual interest in the University's assets after liabilities are deducted, totaled $8.7 billion at June 30, 2009 as compared to $10.8 billion at June 30, 2008. Changes in net assets represent the University's results of operations and are summarized for the years ended June 30, 2009 and 2008 as follows:

(in millions)	2009	2008
Operating revenues and state educational appropriations	$ 4,687.3	$ 4,508.6
Total expenses	5,119.3	4,853.6
	(432.0)	(345.0)
Net investment (loss) income	(1,851.2)	621.9
Gifts and other nonoperating revenues, net	195.5	287.5
	(2,087.7)	564.4
Implementation of GASB Statement No. 45, postemployment benefits obligations as of July 1, 2007		(1,306.9)
Decrease in net assets	$ (2,087.7)	$ (742.5)

Net assets decreased $2.1 billion in fiscal 2009 primarily due to net investment losses. Net assets decreased $743 million in fiscal 2008, primarily due to the implementation of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, offset by net investment income.

Operating revenues and state educational appropriations increased 4 percent, or $179 million, while total expenses increased 5 percent, or $266 million. The results of operations reflect the University's focus on maintaining its national standards academically, and in research and health care, while addressing declining state appropriations and rising health care, regulatory, and facility costs in a competitive recruitment environment for faculty and health care professionals.

Net investment losses in 2009 were $1.9 billion compared to net investment income of $622 million in 2008. The University invests its financial assets in pools with distinct risk and liquidity characteristics based on its needs, with most of its financial assets invested in two such pools. The University's working capital is primarily invested in relatively short duration, liquid assets, while the University's endowment is invested in a long term strategy where a greater allocation to equity and equity-like investments left it more exposed to the effects of the global financial crisis in 2009. The impact of losses in the endowment was muted by the University's spending policy which seeks to insulate University operations from expected volatility in the capital markets and provide for a stable and predictable level of spending from the endowment.

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 indication of whether the overall financial condition has improved or worsened during the year. A comparison of the University's assets, liabilities and net assets at June 30, 2009 and 2008 is summarized as follows:

(in millions)	2009	2008
Current assets	$ 1,825	$ 2,536
Noncurrent assets:		
Endowment, life income and other investments	6,215	7,855
Capital assets, net	4,628	4,130
Other	241	250
Total assets	12,909	14,771
Current liabilities other than long-term bonds payable subject to remarketing, net	1,017	1,058
Long-term bonds payable subect to remarketing, net	652	707
Noncurrent liabilities	2,573	2,251
Total liabilities	4,242	4,016
Net assets	$ 8,667	$ 10,755

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, 2009 and 2008, 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 decreased $711 million, to $1.8 billion at June 30, 2009, primarily due to decreases in cash and investments. Cash, cash equivalents and operating investments totaled $704 million at June 30, 2009, which represents approximately two months of total expenses excluding depreciation.

Current liabilities other than long-term bonds payable subject to remarketing consist primarily of accounts payable, accrued compensation, deferred revenue, commercial paper and the current portion of bonds payable.

ENDOWMENT, LIFE INCOME AND OTHER INVESTMENTS

The University's endowment, life income and other investments decreased $1.6 billion, to $6.2 billion at June 30, 2009. This decrease primarily resulted from unrealized losses on investments and endowment distributions to beneficiary units for operations, offset by the receipt of new endowment funds through gifts and transfers. The composition of the University's endowment, life income and other investments at June 30, 2009 and 2008 is summarized as follows:

(in millions)	2009	2008
Endowment investments	$ 6,001	$ 7,572
Life income investments	89	118
Noncurrent portion of insurance and benefits obligations investments	125	165
	$ 6,215	$ 7,855

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 nearly 7,000 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, seven-year 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 for distribution. Effective July 1, 2006, the moving average period was extended from three to four years and was extended by one quarter each subsequent quarter until it reached seven years at June 30, 2009. This change was enacted to further reduce distribution volatility, as well as to 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 $244 million, $227 million and $205 million and withdrawals from funds functioning as endowment totaled $46 million, $20 million and $57 million in 2009, 2008 and 2007, respectively. Total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 5.9 percent, 4.0 percent and 5.0 percent of the fair value of the University Endowment Fund for 2009, 2008 and 2007, 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 $844 million in 2009, as compared to $701 million in 2008. 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 net assets and gifts designated for capital purposes of $592 million, as well as debt proceeds of $240 million and state capital appropriations of $12 million.

In June 2009, the University completed the acquisition of the former Pfizer pharmaceutical research complex for approximately $114 million, which includes liabilities of approximately $6 million that were assumed as part of the purchase. This investment, which was funded primarily with Health System resources, provides a transformational opportunity for the University to develop and utilize the 30 buildings and 174 acres of land acquired. Known collectively as the North Campus Research Complex, these buildings with nearly 2 million square feet of sophisticated laboratory facilities and administrative space will provide much needed space for current research as well as help attract new projects and faculty to the University. This acquisition is classified as property held for future use at June 30, 2009 and committees with campus-wide representation are in the process of developing a strategy for the optimum utilization of this complex.

Construction in progress, which totaled $786 million at June 30, 2009 and $647 million at June 30, 2008, includes important new facilities for patient care, research, instruction, athletics and student residential life.

At June 30, 2009, construction continues on a new facility for C.S. Mott Children's Hospital and Women's Hospital 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 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.

Construction also continues on 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 connected to the current Kellogg Eye Center tower.

A comprehensive renovation and expansion of Michigan Stadium continues. 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. The expansion 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 approximately 3,000 club seats. Construction is taking place in the off-season so as not to interrupt the home football schedule and is expected to be completed before the 2010 season.

Construction of the first new student residence hall in more than 40 years on the Ann Arbor campus continues. The North Quad Residential and Academic Complex combines sophisticated classroom and academic space with residence space for 460 students. 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 academic space will provide classrooms, studios and offices for five information and communications-related university programs. The University expects this new facility to be completed in Summer 2010.

Renovation of the Stockwell Residence Hall serves to meet the contemporary and future needs of students, while preserving the building's historic character. Dining services, formerly located within the building, will be provided in the new Hill Dining Center freeing room to create meeting and community spaces for student interaction and living and learning activities. In addition, the building's infrastructure is being thoroughly upgraded, from high-speed network access to renovated bath facilities, accessibility improvements, and new plumbing, heating, cooling, ventilation, fire detection and fire suppression systems. This renovation will be completed in time for the Fall 2009 semester.

Renovation and expansion projects completed in 2009 include the Mosher-Jordan Residence Hall and Hill Dining Center, Flint Student Housing Facility, Stephen M. Ross School of Business and Alumni Memorial Hall Museum of Art.

The expansion and comprehensive renovation of the Mosher-Jordan Residence Hall provides a new dining center and preserves the existing historic areas and details, while creating new community environments by reconfiguring current spaces. A new, multi-level lobby and entrance were created to provide a single point of entry for residents and visitors, as well as centralized services for students in both houses of Mosher-Jordan. The infrastructure was upgraded to include new plumbing, elevators, heating, ventilation, fire detection and suppression systems, high-speed network access, renovated bath facilities and accessibility improvements.

The first student housing facility on the Flint Campus provides accommodations for approximately 300 students. The facility consists of one, two and four bedroom units, which include handicap accessible units. All units contain one or two bathrooms, a kitchen and living room. The first floor of the facility provides communal living and learning space for residents.

The new facility for the Stephen M. Ross School of Business encompasses 270,000 square feet that houses state-of-the-art classrooms, an auditorium and colloquiums, faculty offices, student service activities space, and a central gathering space providing seating areas and a food court.

The Museum of Art's historic home, Alumni Memorial Hall, underwent a transformative facility expansion and restoration. The expansion nearly doubled the Hall's size to address current space needs and allow for future growth in collections and programming, while the restoration addressed needed infrastructure improvements. The addition consists of three floors with a lower level and now provides space for galleries, collections, exhibitions, classrooms and administration.

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 May 2009, Moody's Investors Service, Inc. ("Moody's") 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 ("Standard & Poor's") also affirmed its highest credit rating (AAA) based on the University's national reputation for excellence, strong financial resources, positive 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, 2009, 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	$ 137	$ 21	$ 55	$ 103
Bonds and Notes:				
General revenues	459	315	21	753
Hospital revenues	552		12	540
Faculty Group Practice revenues	92		3	89
Student residences revenues	2			2
	$ 1,242	$ 336	$ 91	$ 1,487

The University maintains a combination of fixed and variable rate debt with effective interest rates that averaged 2.2 percent in 2009 and 3.4 percent in 2008. Consistent with the University's capital and debt financing plans, total outstanding debt increased $245 million, or 20 percent, to $1.5 billion at June 30, 2009, while interest expense decreased 25 percent, to $25 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, 2009 and 2008, commercial paper totaled $103 million and $137 million, respectively, and is included in current liabilities. During 2009, the University issued $21 million of commercial paper to fund new construction projects.

During 2009, the University issued $307 million in fixed and variable rate general revenue bonds (Series 2009A, Series 2009B and Series 2009D) with a net original issue premium of $8 million. Bond proceeds were used to convert $51 million of commercial paper to long-term debt and provide $218 million for capital projects including the C.S. Mott Children's and Women's Hospitals, Michigan Stadium Renovation and Expansion, and North Quad Residential and Academic Complex. Bond proceeds will also be used to refund $46 million of Series 2005B general revenue bonds in July 2009, which as a result are included in the current portion of bonds payable at June 30, 2009. Of the total bond issue, $119 million is variable rate debt, $98 million is fixed rate debt and $90 million is fixed rate taxable Build America Bonds.

The University's variable rate bonds are subject to remarketing and, in accordance with GASB Interpretation No. 1, are classified as current liabilities unless supported by long-term liquidity arrangements, such as lines of credit or standby bond purchase agreements, which could refinance the debt on a long-term basis. In the event that debt is put back to the University by the debt holder, management believes that it will be remarketed within a reasonable amount of time. The University's strong credit rating facilitates the remarketing of its debt. In addition, the University maintains three remarketing agents to achieve a wide distribution of its variable rate debt. In 2009, the University experienced the failed remarketing of $47 million of its variable rate bonds, which were subsequently remarketed within ten days.

OBLIGATIONS FOR POSTEMPLOYMENT BENEFITS

The University implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, during 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.

Using current actuarial assumptions, and presuming a continuation of the current level of benefits, the University's liability for postemployment benefits obligations totaled $1.56 billion and $1.49 billion at June 30, 2009 and 2008, respectively. 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 $199 million and $201 million at June 30, 2009 and 2008, respectively.

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 $215 million. In accordance with GASB Statement No. 45, the University's liability for postemployment benefits obligations at June 30, 2009 does not reflect anticipated Medicare Part D prescription drug subsidies for future years of $143 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, 2009 and 2008 is summarized as follows

(in millions)	2009	2008
Invested in capital assets, net of related debt	$ 3,276	$ 3,030
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,144	1,071
Expendable:		
Net appreciation of permanent endowments	808	1,492
Funds functioning as endowment	1,291	1,561
Restricted for operations and other	606	680
Unrestricted	1,542	2,921
	$ 8,667	$ 10,755

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 $246 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 $73 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 $2.7 billion at June 30, 2009, as compared to $3.7 billion at June 30, 2008. This decrease is primarily due to investment market conditions.

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, 2009 unrestricted net assets included funds functioning as endowment of $2.6 billion offset by unfunded obligations for postemployment benefits of $1.6 billion. 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.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

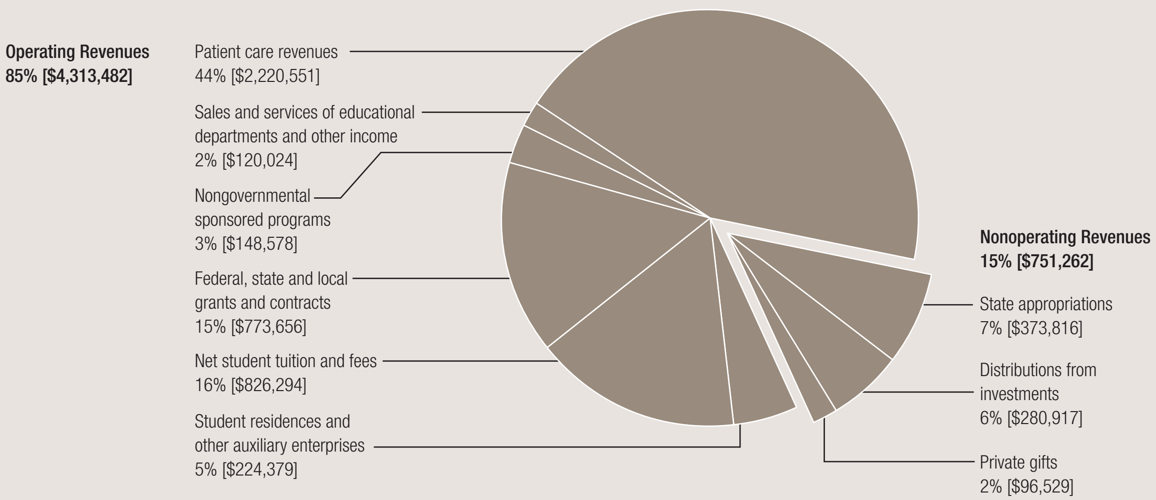
The statement of revenues, expenses and changes in net assets presents the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as either operating or nonoperating. A comparison of the University's revenues, expenses and changes in net assets for the three years ended June 30, 2009 is summarized as follows:

(in millions)	2009	2008	2007
Operating revenues:			
Student tuition and fees, net of scholarship allowances	$ 826.3	$ 791.2	$ 718.7
Sponsored programs	922.2	853.2	823.7
Patient care revenues and managed care premiums	2,220.6	2,105.4	1,983.6
Other	344.4	354.8	309.4
	4,313.5	4,104.6	3,835.4
Operating expenses	5,094.2	4,820.0	4,433.6
Operating loss	(780.7)	(715.4)	(598.2)
Nonoperating and other revenues (expenses):			
State educational appropriations	373.8	404.0	332.4
Private gifts for operating activities	96.5	136.7	132.8
Net investment (loss) income	(1,851.2)	621.9	1,572.6
Interest expense	(25.1)	(33.6)	(30.6)
State capital appropriations	12.2	11.8	6.4
Endowment and capital gifts and grants	88.4	160.1	137.6
Other	(1.6)	(21.1)	60.0
Nonoperating and other (expenses) revenues, net	(1,307.0)	1,279.8	2,211.2
Implementation of GASB Statement No. 45, postemployment benefits obligations as of July 1, 2007		(1,306.9)	
(Decrease) increase in net assets	(2,087.7)	(742.5)	1,613.0
Net assets, beginning of year	10,754.6	11,497.1	9,884.1
Net assets, end of year	$ 8,666.9	$ 10,754.6	$11,497.1

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.

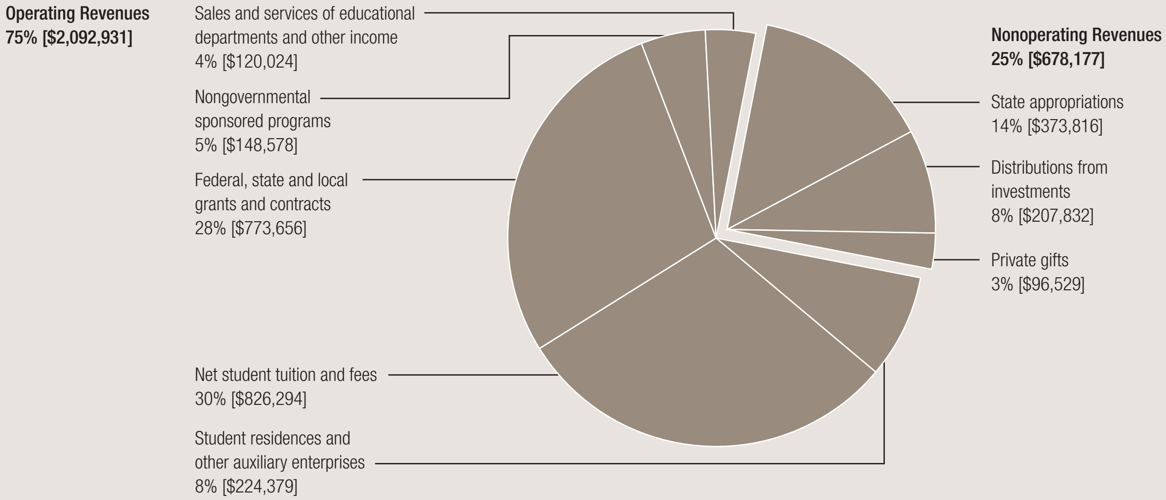
The following is a graphic illustration of revenues by source, both operating and nonoperating, which are used to fund the University's operating activities for the year ended June 30, 2009 (amounts are presented in thousands of dollars). Significant recurring sources of the University's revenues are considered nonoperating, as defined by GASB, such as state appropriations, private gifts and distributions from investments.

FISCAL YEAR 2009 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 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, 2009 (amounts are presented in thousands of dollars).

FISCAL YEAR 2009 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 3 percent, or $39 million, to $1.20 billion in 2009, as compared to 6 percent, or $70 million, to $1.16 billion in 2008.

Downturns in state of Michigan tax revenues continue to put pressure on the state budget. For the three years ended June 30, 2009, state educational appropriations revenue consisted of the following components:

(in millions)	2009	2008	2007
Base appropriations	$ 373.8	$ 370.1	$ 372.8
Net restoration (rescission)		33.9	(40.4)
	$ 373.8	$ 404.0	$ 332.4

Due to ongoing pressures and volatility in the state budget, the University's base appropriations continue to be constrained, and increased only $1 million or 0.3 percent, over the past two years. The $34 million net restoration in 2008 represents the return of part of a 2007 mid-year rescission. The $40 million mid-year rescission in 2007 consists of a reduction in base appropriations of $6 million and a deferral of $34 million until 2008.

To offset constrained base state appropriations, net student tuition and fees revenue has increased 15 percent, or $108 million, over the past two years. For the three years ended June 30, 2009, net student tuition and fees revenue consisted of the following components:

(in millions)	2009	2008	2007
Student tuition and fees	$ 1,029.2	$ 975.3	$ 891.6
Scholarship allowances	(202.9)	(184.1)	(172.9)
	$ 826.3	$ 791.2	$ 718.7

In 2009, net student tuition and fees revenue increased 4 percent, or $35 million, to $826 million, which reflects a 6 percent, or $54 million, increase in gross tuition and fee revenues offset by a 10 percent, or $19 million, increase in scholarship allowances. Tuition rate increases in 2009 were 5.6 percent for all undergraduate students on the Ann Arbor campus, with a 6.5 percent tuition rate increase for the Dearborn campus, a 5.9 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 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.

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 $97 million in 2009, as compared to $137 million in 2008 and $133 million in 2007.

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 8 percent, or $69 million, to $922 million in 2009, as compared to an increase of 4 percent, or $30 million, to $853 million in 2008. A significant portion of the University's sponsored programs revenues relate to federal research and its growth is consistent with the national trends of increasing activity after several years of stabilized federal research activity.

Patient care revenues and managed care premiums for the three years ended June 30, 2009 are summarized as follows:

(in millions)	2009	2008	2007
Patient care revenues	$ 2,220.6	$ 2,105.4	$ 1,786.8
Managed care premiums			196.8
	$ 2,220.6	$ 2,105.4	$ 1,983.6

Patient care revenues are principally generated within the University's hospitals and ambulatory care facilities under contractual arrangements with governmental payers and private insurers. Patient care revenues increased 5 percent, or $115 million, to $2.2 billion in 2009, as compared to an increase of 18 percent, or $319 million, to $2.1 billion in 2008. 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. Managed care premiums in 2007 represent subscription revenue recognized by M-CARE from contracts associated with employers other than the University. M-CARE was sold in December 2006.

Net investment loss totaled $1.9 billion in 2009, compared to net investment income of $622 million in 2008 and $1.6 billion in 2007. The financial market turmoil and wealth destruction that followed the fall of Lehman Brothers in September 2008 exceeded any since the Great Depression. This resulted in broad based losses across the University's public and private equity and equity-like investments, with the largest losses occurring in areas that had experienced the greatest gains in recent years, such as real estate, energy and other alternative investments. Despite the losses in 2009, these assets remain the University's highest performing investments over longer time periods. Fixed income investments in the University's working capital and long-term pools performed in line with expectations and proved to be a stabilizing factor on the University's overall investment portfolio.

It was also a difficult year for public equities in 2008, 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 2007, 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.

Private gifts for permanent endowment purposes totaled $60 million in 2009, as compared to $94 million in 2008 and $73 million in 2007. Capital gifts and grants totaled $28 million in 2009, as compared to $66 million in 2008 and $65 million in 2007. 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, Law School and College of Engineering.

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 66 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, 2009 is as follows (amounts in millions):

(in millions)	2009		2008		2007	
Operating:						
Compensation and benefits	$ 3,390.5	66%	$ 3,234.2	67%	$ 2,961.9	66%
Supplies and services	1,255.1	24	1,167.6	24	1,103.9	25
Depreciation	341.5	7	319.4	6	284.1	6
Scholarships and fellowships	107.1	2	98.8	2	83.7	2
	5,094.2	99	4,820.0	99	4,433.6	99
Nonoperating:						
Interest	25.1	1	33.6	1	30.6	1
	$ 5,119.3	100%	$ 4,853.6	100%	$ 4,464.2	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 5 percent, or $156 million, to $3.4 billion in 2009, as compared to a 9 percent increase, or $272 million, to $3.2 billion in 2008. Of this 2008 increase, $97 million represents additional operating expenses with the implementation of GASB Statement No. 45.

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 71 percent generic dispensing rate in 2009, as compared to 68 percent in 2008 and 60 percent in 2007. 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.

The University's MHealthy initiative is 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.

Over the past several years, MHealthy has offered a broad spectrum of programs designed to support healthy lifestyles. For example, the Focus on Medicines program 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 Focus on Diabetes program 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 manage their diabetes and to help prevent or reduce the long-term complications of the disease.

During 2009, MHealthy completed the first university-wide health risk assessment, with more than 17,500 faculty and staff completing an online health risk questionnaire and participating in a wellness screening at sites throughout the University. Data gathered from this assessment will be used to design programs to address the greatest areas of community health risk and thereby reduce the costs incurred by the University.

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 7 percent, or $88 million, to $1.3 billion in 2009, as compared to an increase of 6 percent, or $64 million, to $1.2 billion in 2008. The increases in 2009 and 2008 are primarily due to increases in patient activity experienced by the Health System, sponsored research activity and utilities.

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, 2009 is as follows (amounts in millions):

	2009		2008		2007	
Operating:						
Instruction	$ 820.3	16%	$ 784.7	16%	$ 727.3	16%
Research	622.6	12	571.7	12	540.6	12
Public service	126.5	2	121.9	2	103.9	2
Institutional and academic support	485.2	10	448.7	9	378.7	9
Auxiliary enterprises:						
Patient and managed care	2,164.5	42	2,046.0	42	1,860.6	42
Other	148.6	3	179.6	4	198.5	4
Operations and maintenance of plant	277.9	5	249.2	5	256.3	6
Depreciation	341.5	7	319.4	7	284.0	6
Scholarships and fellowships	107.1	2	98.8	2	83.7	2
	5,094.2	99	4,820.0	99	4,433.6	99
Nonoperating:						
Interest	25.1	1	33.6	1	30.6	1
	$ 5,119.3	100%	$ 4,853.6	100%	$ 4,464.2	100%

Instruction and public service expenses increased 4 percent, or $40 million, to $947 million in 2009, as compared to 9 percent, or $75 million, to $907 million in 2008. 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 $1.017 billion in 2009, as compared to $929 million in 2008 and $881 million in 2007. This represents an increase of 15 percent, or $136 million, from 2007 to 2009, 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.

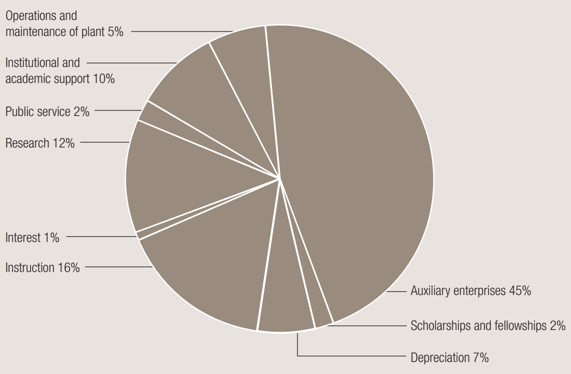
Patient and managed care expenses increased 6 percent, or $119 million, to $2.2 billion in 2009, as compared to a 10 percent, or $185 million increase in 2008. The increases in 2009 and 2008 are the result of increased patient activity, including costs of medical supplies and pharmaceuticals. The increase in 2008 as compared to 2007 also reflects the implementation of GASB Statement No. 45, offset by the sale of M-CARE effective December 31, 2006.

Total scholarships and fellowships provided to students aggregated $327 million in 2009, as compared to $300 million in 2008 and $272 million in 2007, an increase of 20 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, 2009 are summarized as follows:

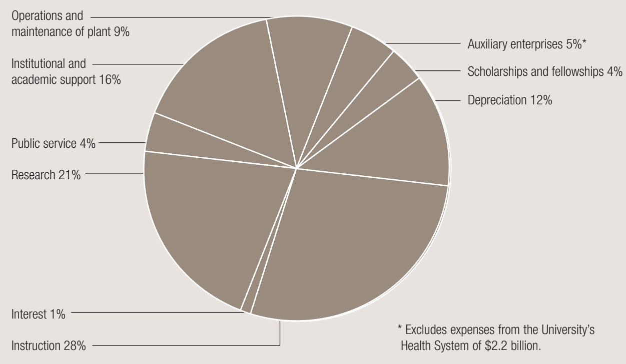
(in millions)	2009	2008	2007
Paid directly to students	$ 107.1	$ 98.8	$ 83.7
Applied to tuition and fees	202.9	184.1	172.9
Applied to University Housing	16.5	16.7	15.7
	$ 326.5	$ 299.6	$ 272.3

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

FISCAL YEAR 2009 EXPENSES BY FUNCTION



FISCAL YEAR 2009 EXPENSES BY FUNCTION EXCLUDING EXPENSES FROM THE UNIVERSITY'S HEALTH SYSTEM



* Excludes expenses from the University's Health System of $2.2 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, 2009 and 2008 is as follows:

(in millions)	2009	2008
Cash received from operations	$ 4,335.2	$ 4,109.3
Cash expended for operations	(4,699.3)	(4,391.7)
Net cash used in operating activities	(364.1)	(282.4)
Net cash provided by investing activities	256.1	189.6
Net cash used in capital and related financing activities	(575.0)	(478.6)
Net cash provided by noncapital financing activities	546.3	585.0
Net (decrease) increase in cash and cash equivalents	(136.7)	13.6
Cash and cash equivalents, beginning of year	495.1	481.5
Cash and cash equivalents, end of year	$ 358.4	$ 495.1

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. Cash and cash equivalents decreased $137 million in 2009, as compared to an increase of $14 million in 2008.

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. In adopting the the budget for 2010, the University anticipated a 3 percent decrease in state educational appropriations. To support the University's commitment to both academic excellence and accessibility, the University's budget for 2010 includes a moderate increase in tuition rates along with an increased investment in financial aid for undergraduates. Based on state revenue forecasts, the University is also preparing for further declines in state support for higher education in 2011 and beyond.

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 $1.17 billion at June 30, 2009. Funding for these projects is anticipated to include $1.04 billion from gifts and net assets designated for capital purposes as well as future borrowings, $126 million from the utilization of unexpended debt proceeds and $4 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 is developing a strategy for the optimum utilization of the newly acquired North Campus Research Complex, which is classified as property held for future use at June 30, 2009. This investment is expected to result in significant economic benefits for both the University and the surrounding region by making strategic use of University resources, and strengthening Michigan's life sciences industry. When fully developed this complex could enable the University to create up to 3,000 new faculty and staff positions over the next ten years.

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 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 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 will continue to take proactive steps to respond to the challenges of rising costs while protecting the quality of the overall benefit package.

After careful review by top clinical and health policy faculty and financial experts, the University announced a new health benefits cost sharing program which will be phased in over two years, commencing January 1, 2010. Once fully implemented, the University's overall contribution toward the health care of employees, retirees and dependents will be 70 percent of the total cost of premiums, co-pays and deductibles. Down from the current 80 percent overall contribution, the new target is more in line with average contributions of peer universities and health systems. The percentage applied to each individual depends on the plan choice and whether dependents are covered. Under the new structure, contribution amounts will be based on salary bands which are designed to lessen the impact on lower paid employees and retirees. In addition, the University's health premium contribution for part-time employees working between 20 and 31 hours per week will be reduced to 80 percent of the contribution made for full-time staff in the lowest salary band. Once fully implemented in 2011, these changes are expected to reduce the University's annual health care expenses by approximately $31 million. Beginning January 1, 2010, newly hired faculty and staff will also be subject to a one year waiting period before receiving the University's ten percent retirement savings plan contribution. This change is expected to result in annual savings of $11 million.

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, 2009	2008
Assets		
Current Assets:		
Cash and cash equivalents	$ 358,373	$ 495,137
Operating investments	345,207	686,218
Investments for capital activities	541,577	697,269
Investments for student loan activities	31,483	29,869
Investment trade settlements receivable	128	56,289
Accounts receivable, net	434,798	443,375
Current portion of notes and pledges receivable, net	64,055	73,832
Current portion of prepaid expenses and other assets	49,401	54,037
Total Current Assets	1,825,022	2,536,026
Noncurrent Assets:		
Endowment, life income and other investments	6,215,286	7,854,562
Notes and pledges receivable, net	219,823	233,572
Prepaid expenses and other assets	21,425	17,153
Capital assets, net	4,627,498	4,129,830
Total Noncurrent Assets	11,084,032	12,235,117
Total Assets	**$ 12,909,054**	**$ 14,771,143**
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable	$ 184,595	$ 191,694
Investment trade settlements payable	5,658	64,442
Accrued compensation and other	305,563	297,725
Deferred revenue	187,519	178,638
Current portion of insurance and benefits reserves	67,133	64,117
Current portion of obligations for postemployment benefits	58,401	60,792
Commercial paper and current portion of bonds payable	178,690	172,939
Long-term bonds payable subject to remarketing, net	652,285	706,870
Deposits of affiliates and others	29,705	27,933
Total Current Liabilities	1,669,549	1,765,150
Noncurrent Liabilities:		
Accrued compensation	76,924	78,578
Insurance and benefits reserves	85,912	78,448
Obligations for postemployment benefits	1,504,569	1,431,021
Obligations under life income agreements	47,843	60,437
Government loan advances	87,548	86,567
Bonds payable	656,341	362,408
Deposits of affiliates and other	113,393	153,860
Total Noncurrent Liabilities	2,572,530	2,251,319
Total Liabilities	4,242,079	4,016,469
Net Assets:		
Invested in capital assets, net of related debt	3,275,855	3,030,110
Restricted:		
Nonexpendable	1,143,668	1,070,958
Expendable	2,705,369	3,733,022
Unrestricted	1,542,083	2,920,584
Total Net Assets	8,666,975	10,754,674
Total Liabilities and Net Assets	**$ 12,909,054**	**$ 14,771,143**

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, 2009	2008
Operating Revenues		
Student tuition and fees	$ 1,029,240	$ 975,316
Less scholarship allowances	202,946	184,095
Net student tuition and fees	826,294	791,221
Federal grants and contracts	766,416	712,963
State and local grants and contracts	7,240	9,649
Nongovernmental sponsored programs	148,578	130,634
Sales and services of educational departments	117,690	138,484
Auxiliary enterprises:		
Patient care revenues	2,220,551	2,105,439
Student residence fees (net of scholarship allowances of $16,542,000 in 2009 and $16,701,000 in 2008)	81,391	74,759
Other revenues	142,988	139,410
Student loan interest income and fees	2,334	2,049
Total Operating Revenues	**4,313,482**	**4,104,608**
Operating Expenses		
Compensation and benefits	3,390,470	3,234,232
Supplies and services	1,255,078	1,167,616
Depreciation	341,462	319,351
Scholarships and fellowships	107,127	98,847
Total Operating Expenses	**5,094,137**	**4,820,046**
Operating loss	(780,655)	(715,438)
Nonoperating Revenues (Expenses)		
State educational appropriations	373,816	404,003
Private gifts for other than capital and endowment purposes	96,529	136,713
Net investment (loss) income	(1,851,234)	621,878
Interest expense	(25,136)	(33,644)
Total Nonoperating Revenues (Expenses), Net	**(1,406,025)**	**1,128,950**
(Loss) income before other revenues (expenses)	(2,186,680)	413,512
Other Revenues (Expenses)		
State capital appropriations	12,244	11,796
Capital gifts and grants	27,791	66,372
Private gifts for permanent endowment purposes	60,602	93,777
Implementation of GASB Statement No. 45, postemployment benefits obligations as of July 1, 2007		(1,306,859)
Other	(1,656)	(21,065)
Total Other Revenues (Expenses), Net	**98,981**	**(1,155,979)**
Decrease in net assets	(2,087,699)	(742,467)
Net Assets, Beginning of Year	10,754,674	11,497,141
Net Assets, End of Year	**$ 8,666,975**	**$ 10,754,674**

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, 2009	2008
Cash Flows From Operating Activities		
Student tuition and fees	$ 826,536	$ 798,616
Federal, state and local grants and contracts	774,376	735,478
Nongovernmental sponsored programs	147,246	134,387
Sales and services of educational departments	260,275	275,134
Patient care revenues	2,228,907	2,073,439
Student residence fees	81,203	75,412
Payments to employees	(2,578,312)	(2,413,442)
Payments for benefits	(739,668)	(681,369)
Payments to suppliers	(1,258,755)	(1,182,195)
Payments for scholarships and fellowships	(107,081)	(98,783)
Student loans issued	(15,488)	(15,866)
Student loans collected	14,319	14,700
Student loan interest and fees collected	2,334	2,049
Net Cash Used in Operating Activities	**(364,108)**	**(282,440)**
Cash Flows From Investing Activities		
Interest and dividends on investments, net	84,634	294,545
Proceeds from sales and maturities of investments	4,635,466	5,039,730
Purchases of investments	(4,535,346)	(5,252,622)
Net decrease in cash equivalents from noncurrent investments	57,479	100,741
Net increase in deposits of affiliates and others	13,852	7,288
Net Cash Provided by Investing Activities	**256,085**	**189,682**
Cash Flows From Capital and Related Financing Activities		
State capital appropriations	22,379	1,773
Private gifts and other receipts	39,527	65,013
Proceeds from issuance of capital debt	336,440	393,770
Principal payments on capital debt	(90,893)	(193,644)
Interest payments on capital debt	(27,908)	(35,072)
Payments for bond refunding and related costs	(277)	(251)
Purchases of capital assets	(855,834)	(710,638)
Proceeds from sales of capital assets	1,501	483
Net Cash Used in Capital and Related Financing Activities	**(575,065)**	**(478,566)**
Cash Flows From Noncapital Financing Activities		
State educational appropriations	373,143	364,159
Private gifts and other receipts	173,729	217,599
Student direct lending receipts	299,404	253,462
Student direct lending disbursements	(298,857)	(255,765)
Amounts received for annuity and life income funds	5,034	15,029
Amounts paid to annuitants and life beneficiaries and related expenses	(6,129)	(6,992)
Other		(2,519)
Net Cash Provided by Noncapital Financing Activities	**546,324**	**584,973**
Net (decrease) increase in cash and cash equivalents	(136,764)	13,649
Cash and Cash Equivalents, Beginning of Year	495,137	481,488
Cash and Cash Equivalents, End of Year	**$ 358,373**	**$ 495,137**

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

(in thousands)	Year Ended June 30, 2009	2008
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (780,655)	$ (715,438)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	341,462	319,351
Changes in assets and liabilities:		
Accounts receivable, net	(2,655)	(24,602)
Prepaid expenses and other assets	(4,920)	2,841
Accounts payable	(1,075)	(6,403)
Accrued compensation and other	(1,302)	26,991
Deferred revenue	8,881	13,343
Insurance and benefits reserves	4,999	4,210
Obligations for postemployment benefits	71,157	97,267
Net cash used in operating activities	$ (364,108)	$ (282,440)

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

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) and Veritas Insurance Corporation (a wholly-owned captive insurance company). While the University is a political subdivision of the state of Michigan, it is not a component unit of the State in accordance with the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*. The University is classified as a state instrumentality under Internal Revenue Code Section 115, and is also classified as a charitable organization under Internal Revenue Code Section 501(c)(3), and is therefore exempt from federal income taxes. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, as prescribed by 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. 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 2009, the University implemented GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. 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. Implementation of this Statement did not have a material impact on net assets.

During 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.

The University elected to amortize its initial unfunded actuarial accrued liability of $1,306,859,000 over one year, the minimum period allowed by the Statement. This amount is recorded as a one-time nonoperating expense in 2008 and represents the present value of the University's obligations for postemployment benefits as of July 1, 2007.

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. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

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

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

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, 2009 and 2008, as adjusted by cash receipts, cash disbursements, and securities distributions through June 30, 2009 and 2008. 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, 2009 and 2008. 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.

NOTE 1 | ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES | *continued*

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

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

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

Capital assets are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided on a straight-line basis over the estimated useful lives of the respective assets, which range from four 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 $808,000,000 and $1,492,000,000 at June 30, 2009 and 2008, 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.

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

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

Revision: The statement of net assets as of June 30, 2008 has been revised to reflect a debt classification adjustment that was not recorded in the previously issued financial statements due to immateriality. The University has historically presented debt with remarketing features as noncurrent liabilities based on scheduled maturities. In connection with the preparation of the June 30, 2009 financial statements, the University determined that pursuant to GASB Interpretation No. 1, long-term debt subject to remarketing arrangements should be shown as a current liability unless the debtor has entered into a take-out agreement or has available lines of credit sufficient to refinance that debt on a long-term basis. The following table summarizes the effect on the statement of net assets for the correction of this immaterial error:

(in thousands)	As originally reported	Adjustments	As adjusted
Long-term bonds payable to subject to remarketing, net	$ –	$ 706,870	$ 706,870
Bonds payable	$ 1,069,278	$ (706,870)	$ 362,408

New Accounting Pronouncements: 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.

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 was extended by one quarter each subsequent quarter until it reached seven years at June 30, 2009. 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 returns.

Cash and Cash Equivalents: Cash and cash equivalents, which totaled $358,373,000 and $495,137,000 at June 30, 2009 and 2008, respectively, represent short-term money market investments in mutual funds, overnight collective funds managed by the University's custodian or short-term highly liquid investments registered as securities and held by the University or its agents in the University's name. The University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation limits in the amount of $10,788,000 and $17,667,000 at June 30, 2009 and 2008, respectively. The University does not require deposits to be collateralized or insured.

Investments: At June 30, 2009 and 2008, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows:

(in thousands)	2009	2008
Cash equivalents, noncurrent	$ 181,564	$ 239,043
Fixed income securities	1,261,477	1,663,408
Commingled funds	1,399,681	2,050,114
Equity securities	781,719	1,171,267
Nonmarketable alternative investments	3,502,987	4,136,925
Other investments	6,125	7,161
	$ 7,133,553	$ 9,267,918

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

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

The University minimizes concentration of credit risk, the risk of a large loss attributed to the magnitude of the investment in a single issuer of fixed income securities, by diversifying its fixed income issues and issuers and holding U.S. Treasury securities which are considered to have 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 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 5.0 years at June 30, 2009, compared to 4.7 years at June 30, 2008. 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, 2009 and 2008, along with credit quality and effective duration measures, is summarized as follows:

2009

(in thousands)	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 67,363				$ 67,363	6.3
U.S. Treasury inflation protected	306,078				306,078	2.3
U.S. Government agency	88,632				88,632	1.3
Mortgage backed		$ 40,293	$ 9,979		50,272	1.5
Asset backed		54,384	3,296		57,680	4.6
Corporate and other		641,313	39,693	$ 10,446	691,452	6.8
	$ 462,073	$ 735,990	$ 52,968	$ 10,446	$ 1,261,477	5.0

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

Of the University's fixed income securities, 95 percent and 99 percent were rated investment grade or better at June 30, 2009 and 2008, with 44 percent and 57 percent of these securities rated AAA/Aaa or better at June 30, 2009 and 2008, respectively.

Commingled (pooled) funds include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and unregulated. Certain commingled funds, which are held in the Long Term 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. The composition of commingled funds at June 30, 2009 and 2008 is summarized as follows:

(in thousands)	2009	2008
Absolute return	$ 743,480	$ 1,177,265
U.S. equities	67,080	152,614
Non-U.S./global equities	525,366	644,542
U.S. fixed income	8,452	54,350
Other	55,303	21,343
	$ 1,399,681	$ 2,050,114

Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Of the University's commingled funds at June 30, 2009, approximately 80 percent are redeemable within one year, with 44 percent redeemable within 90 days. The remaining 20 percent of commingled funds are redeemable beyond one year, with redemption of certain funds dependent on disposition of the underlying assets.

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, 2009 and 2008 is summarized as follows:

(in thousands)	2009	2008
Private equity	$ 849,529	$ 1,074,706
Real estate	836,498	969,778
Absolute return	737,541	741,348
Energy	613,981	849,458
Venture capital	465,438	501,635
	$ 3,502,987	$ 4,136,925

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

NOTE 2 | CASH AND INVESTMENTS | *continued*

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 value of the University's non-U.S. dollar holdings net of forward foreign exchange contracts was $793,952,000, or 11 percent of total investments at June 30, 2009, compared to $1,324,618,000, or 14 percent of total investments at June 30, 2008. The University manages foreign exchange risk through manager agreements that provide minimum diversification and maximum exposure limits by country and currency.

The Daily and Monthly Portfolios held positions in bond futures at June 30, 2009 and 2008, while the Long Term Portfolio held positions in stock index futures at June 30, 2008. Bond futures are used to adjust the duration of cash equivalents and the fixed income portion of the portfolios. Stock index futures were 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 had U.S. Government securities and cash with a fair value of $3,889,000 and $29,373,000 at June 30, 2009 and 2008, respectively, on deposit with its futures contract broker as collateral.

The Long Term Portfolio and the Monthly Portfolio, together, had fully collateralized short-term securities loans of $234,288,000 and $377,025,000 at June 30, 2009 and 2008, 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 $241,092,000, or 103 percent of the fair value of the securities on loan, at June 30, 2009, as compared to $393,361,000, or 104 percent of the fair value of the securities on loan, at June 30, 2008. 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. Since the University does not control the securities lending collateral, the related assets and liabilities are not recorded in the accompanying financial statements.

NOTE 3 | ACCOUNTS RECEIVABLE

The composition of accounts receivable at June 30, 2009 and 2008 is summarized as follows:

(in thousands)	2009	2008
Patient care	$ 355,395	$ 362,323
Sponsored programs	72,001	66,800
State appropriations, educational and capital	68,865	78,326
Student accounts	21,118	18,383
Other	33,568	31,593
	550,947	557,425
Less provision for uncollectible accounts receivable	116,149	114,050
	$ 434,798	$ 443,375

NOTE 4 | NOTES AND PLEDGES RECEIVABLE

The composition of notes and pledges receivable at June 30, 2009 and 2008 is summarized as follows:

(in thousands)	2009	2008
Notes:		
Federal student loan programs	$ 99,710	$ 99,464
University student loan funds	19,753	18,837
Other	761	729
	120,224	119,030
Less allowance for doubtfully collectible notes	2,800	2,800
Total notes receivable, net	117,424	116,230
Gift pledges outstanding:		
Capital	123,976	137,270
Operations	62,329	77,570
	186,305	214,840
Less:		
Allowance for doubtfully collectible pledges	7,114	6,843
Unamortized discount to present value	12,737	16,823
Total pledges receivable, net	166,454	191,174
Total notes and pledges receivable, net	283,878	307,404
Less current portion	64,055	73,832
	$ 219,823	$ 233,572

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, 2009 are expected to be received in the following years ended June 30 (in thousands):

2010	$ 54,314
2011–2014	107,627
2015 and after	24,364
	$ 186,305

As discussed in Note 1, permanent endowment pledges do not meet eligibility requirements, as defined by GASB, until the related gift is received. Accordingly, permanent endowment pledges totaling approximately $91,587,000 and $105,467,000 at June 30, 2009 and 2008, respectively, are not recognized as assets in the accompanying financial statements. In addition, bequest intentions and other conditional promises are not recognized as assets until the specified conditions are met because of uncertainties with regard to their realizability and valuation.

NOTE 5 | CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2009 and 2008 is summarized as follows:

2009

(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 88,893	$ 324		$ 89,217
Land improvements	96,399	1,344		97,743
Infrastructure	185,163	15,108		200,271
Buildings	4,702,944	413,893	$ 4,189	5,112,648
Construction in progress	646,908	139,572		786,480
Property held for future use		114,029		114,029
Equipment	1,414,315	137,215	42,231	1,509,299
Library materials	405,928	22,681		428,609
	7,540,550	844,166	46,420	8,338,296
Less accumulated depreciation	3,410,720	341,462	41,384	3,710,798
	$ 4,129,830	$ 502,704	$ 5,036	$ 4,627,498

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

The increase in construction in progress of $139,572,000 in 2009 represents the amount of capital expenditures for new projects of $556,578,000 net of capital assets placed in service of $417,006,000. The increase in construction in progress of $298,017,000 in 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.

Property held for future use represents the North Campus Research Complex. The University acquired this property in June 2009 for approximately $114,000,000, including liabilities assumed in the purchase. Committees with campus-wide representation are in the process of developing a strategy for the optimum utilization of this complex, which includes 30 buildings and 174 acres of land adjacent to the University's North Campus.

NOTE 6 | LONG-TERM DEBT

Long-term debt at June 30, 2009 and 2008 is summarized as follows:

(in thousands)	2009	2008
Commercial Paper:		
Tax-exempt, variable rate (.34%)*	$ 96,070	$ 129,825
Taxable, variable rate (.35%)*	6,435	6,760
General Revenue Bonds:		
Series 2009A, 2.00% to 5.00% through 2029	98,555	
Series 2009B, variable rate (.28%)* through 2039	118,710	
unamortized premium	8,150	
Series 2009D, taxable – Build America Bonds,		
5.155% to 6.172% through 2030	89,815	
Series 2008A, variable rate (.19%)* through 2038	105,810	105,810
Series 2008B, variable rate (.17%)* to fixed via swap through 2026	116,800	118,335
and variable rate 2027 through 2028		
Series 2005A, 5.00% through 2018	30,430	34,315
unamortized premium	1,955	2,498
unamortized loss on extinguishment	(241)	(316)
Series 2005B, variable rate (.17%)* through 2009	46,070	48,020
Series 2002, variable rate (.25%)* to fixed via swap through 2018		
and variable rate 2019 through 2032	112,845	119,900
General Revenue Refunding Bonds:		
Series 2003, 3.50% to 5.00% through 2015	23,850	29,395
unamortized premium	1,031	1,552
unamortized loss on extinguishment	(184)	(281)
Hospital Revenue Bonds:		
Series 2007A, variable rate (.18%)* through 2038	50,120	50,120
Series 2007B, variable rate (.17%)* through 2038	100,235	100,235
Series 2005A, variable rate (.28%)* through 2036	69,315	69,315
Series 2005B, variable rate (.25%)* to fixed via swap through 2026	71,940	75,065
Series 1995A, variable rate (.20%)* through 2028	100,000	100,000
Hospital Revenue Refunding Bonds:		
Series 2002A, 5.00% to 5.25% through 2022	49,095	58,325
unamoritized premium	946	1,279
unamoritized loss on extinguishment	(2,036)	(2,342)
Series 1998A2, variable rate (.28%)* to fixed via swap through 2025	44,670	44,670
Series 1992A, variable rate (.28%)* through 2020	56,000	56,000
Medical Service Plan Revenue Bonds:		
Series 1995A, variable rate (.20%)* through 2028	48,200	48,800
Series 1991, 6.90% to 7.05% capital appreciation through 2012	5,945	7,674
Medical Service Plan Revenue Refunding Bonds:		
Series 1998A-1, variable rate (.28%)* to fixed via swap through 2022	34,695	35,030
Housing Energy Conservation HUD Loan, 3.00% through 2021	2,090	2,233
	1,487,316	1,242,217
Less:		
Commercial paper and current portion of bonds payable	178,690	172,939
Long-term bonds payable subject to remarketing, net	652,285	706,870
	$ 656,341	$ 362,408

* Denotes variable rate at June 30, 2009

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, 2009 is summarized as follows:

(in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Commercial Paper:				
General revenues	$ 136,585	$ 21,210	$ 55,290	$ 102,505
Bonds and Notes:				
General revenues	459,228	315,230	20,862	753,596
Hospital revenues	552,667		12,382	540,285
Faculty Group Practice revenues	91,504	471	3,135	88,840
Student residences revenues	2,233		143	2,090
	$ 1,242,217	$ 336,911	$ 91,812	$ 1,487,316

The University maintains a combination of variable and fixed rate debt, with effective interest rates that averaged 2.21 percent in 2009 and 3.40 percent in 2008. 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 2009, the University issued $307,080,000 of General Revenue Bonds with a net original issue premium of $8,150,000. Bond proceeds were used to convert $50,520,000 of commercial paper to long-term debt and provide $218,117,000 for capital projects and $523,000 for debt issuance costs. Bond proceeds will also be used to refund $46,070,000 of Series 2005B General Revenue Bonds in July 2009. The total bond issue includes $98,555,000 (Series 2009A) of fixed rate bonds, $118,710,000 (Series 2009B) of variable rate bonds based on a commercial paper rate mode and $89,815,000 (Series 2009D) of fixed rate taxable Build America Bonds.

Debt obligations are generally callable by the University and mature at various dates through fiscal 2039. 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
2010	$ 177,383	$ 16,733	$ 194,116
2011	32,185	16,234	48,419
2012	45,727	15,188	60,915
2013	51,051	13,819	64,870
2014	46,151	12,701	58,852
2015-2019	237,321	54,639	291,960
2020-2024	261,447	36,235	297,682
2025-2029	274,860	16,383	291,243
2030-2034	189,265	3,443	192,708
2035-2039	162,305	885	163,190
	1,477,695	$ 186,260	$ 1,663,955
Plus unamortized premiums, net	9,621		
	$ 1,487,316		

* Interest on variable rate debt is estimated based on rates in effect at June 30, 2009

The variable rate portion of bonds payable have remarketing features which allow bondholders to put debt back to the University. Accordingly, variable rate bonds payable are classified as current unless supported by long-term liquidity agreements, such as lines of credit or standby bond purchase agreements, which can refinance the debt on a long-term basis. The classification of the University's variable rate bonds payable at June 30, 2009 and 2008 is summarized as follows:

(in thousands)	2009	2008
Variable rate bonds payable subject to remarketing	$ 1,075,410	$ 971,300
Less:		
Current principal maturities	57,920	14,430
Long-term liquidity agreements:		
Unsecured lines of credit	250,000	250,000
Standby bond purchase agreement for Series 2008B		
General Revenue Bonds	115,205	
Long-term bonds payable subject to remarketing, net	$ 652,285	$ 706,870

The University also has a $200,000,000 line of credit to provide short-term liquidity for up to five days. The University's available lines of credit and standby bond purchase agreement were entirely unused at June 30, 2009.

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, 2009 and 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 business 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, 2009 and 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 3.5375 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 business 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, through December 2024 and December 2021, respectively, the final maturity dates of the underlying

NOTE 6 | LONG-TERM DEBT | *continued*

bonds. The University makes fixed interest payments to the counterparty and receives a variable rate payment based on the floating Securities Industry and Financial Markets Association (SIFMA) Municipal 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 $25,637,000 at June 30, 2009 and a liability of $11,612,000 at June 30, 2008. The fair value represents the estimated amount that the University would pay to terminate the swap agreements at the statement of net assets date, taking into account current interest rates and creditworthiness of the underlying counterparty. In accordance with governmental accounting standards, these amounts are not required to be included in the accompanying financial statements.

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, 2009 and 2008 are summarized as follows:

(in thousands)	2009	2008
Balance, beginning of year	$ 142,565	$ 141,202
Claims incurred and changes in estimates	360,002	220,493
Claim payments	(349,522)	(219,130)
Balance, end of year	153,045	142,565
Less current portion	67,133	64,117
	$ 85,912	$ 78,448

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 34,000 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 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 postemployment benefits expense 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.

The University elected to amortize its initial unfunded actuarial accrued liability over one year, the minimum period allowed by GASB Statement No. 45. The University also elected to amortize subsequent changes in actuarial assumptions, plan design, and experience gains and losses over a ten year closed period. Therefore, the net OPEB obligation recorded in the statement of financial condition will differ from the actuarial accrued liability by the unamortized portion of changes in actuarial assumptions, plan design, and experience gains and losses. At June 30, 2009, the net OPEB obligation and the actuarial accrued liability totaled $1,562,970,000 and $1,167,457,000, respectively.

Changes in the total reported liability for postemployment benefits obligations for the years ended June 30, 2009 and 2008 are summarized as follows:

2009			
(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 1,360,175	$ 131,638	$ 1,491,813
Annual required contribution:			
Service cost	49,749	5,439	55,188
Amortization of assumption changes and actuarial (gains) losses	(28,941)	328	(28,613)
Interest cost	87,051	10,531	97,582
Payments of current premiums and claims	(39,234)	(13,766)	(53,000)
Balance, end of year	1,428,800	134,170	1,562,970
Less current portion	42,287	16,114	58,401
	$ 1,386,513	$ 118,056	$ 1,504,569

2008			
(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 4,749	$ 82,938	$ 87,687
Annual required contribution:			
One-time amortization of total unfunded actuarially accrued liability at July 1, 2007	1,259,125	47,734	1,306,859
Service cost	55,200	5,110	60,310
Interest cost	79,620	10,454	90,074
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

NOTE 8 | POSTEMPLOYMENT BENEFITS | *continued*

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 $198,665,000 of actuarial accrued liability at June 30, 2009 and $201,294,000 at June 30, 2008. In accordance with GASB Statement No. 45, the University's liability for postemployment benefit obligations at June 30, 2009 is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods of $143,000,000 on an actuarial accrued liability basis.

The annual required contribution represents a level of funding that an employer is projected to need in order to prefund its obligations for postemployment benefits over its employees' years of service. 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, 2009 and 2008 as a percentage of covered payroll of $2,456,343,000 and $2,311,422,000, was 64 and 65 percent, respectively.

The University's liability for postemployment benefits obligations was calculated using the projected unit credit method. Significant actuarial methods and assumptions used in the valuation for years ended June 30, 2009 and 2008 are as follows:

2009

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

2008

	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)

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 plans within specified limits that are not matched by University contributions. Contributions and covered payroll under the plan (excluding participants' additional contributions) for the three years ended June 30, 2009 are summarized as follows:

(in thousands)	2009	2008	2007
University contributions	$ 208,707	$ 194,962	$ 183,145
Employee contributions	$ 102,705	$ 96,015	$ 90,252
Payroll covered under plan	$ 2,456,343	$ 2,311,422	$ 2,172,592
Total payroll	$ 2,580,373	$ 2,444,522	$ 2,292,929

NOTE 10 | UNRESTRICTED NET ASSETS

Unrestricted net assets, as defined by GASB, are not subject to externally imposed stipulations; however, they are subject to internal restrictions. For example, unrestricted net assets may be designated for specific purposes by action of management, the Board of Regents, or may otherwise be limited by contractual agreements with outside parties. All of the unrestricted net assets, which totaled $1,542,083,000 at June 30, 2009, have been designated for academic and research programs and initiatives, and capital programs.

NOTE 11 | FEDERAL DIRECT LENDING PROGRAM

The University distributed $298,857,000 and $255,765,000 for the years ended June 30, 2009 and 2008, 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 $2,573,000 and $2,026,000 at June 30, 2009 and 2008, 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, 2009 were $1,166,956,000. Of these expenditures, approximately $1,037,263,000 will be funded by internal sources, gifts and future borrowings, $126,053,000 will be funded using unexpended debt proceeds and the remaining $3,640,000 will be funded by the State Building Authority.

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, 2009, the University had committed, but not paid, a total of $2,758,820,000 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):

2010	$ 642,692
2011	730,900
2012	490,966
2013	251,546
2014	207,769
2015 and beyond	434,947
	$ 2,758,820

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

2010	$ 28,598
2011	22,845
2012	19,869
2013	15,203
2014	9,563
2015–2019	15,800
2020–2024	2,966
2025–2027	1,338
	$ 116,182

Operating lease expenses totaled $32,467,000 and $31,320,000 in 2009 and 2008, respectively.

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

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

NOTE 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.

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

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, 2009 and 2008 is as follows:

(in thousands)	2009	2008
Condensed Statement of Net Assets		
Assets:		
Current assets	$ 415,451	$ 396,679
Noncurrent assets	2,277,025	2,451,429
Total assets	$ 2,692,476	$ 2,848,108
Liabilities:		
Current liabilities	$ 415,106	$ 387,091
Noncurrent liabilities	740,061	582,566
Total liabilities	1,155,167	969,657
Net assets:		
Invested in capital assets, net of related debt	596,070	538,854
Restricted		
Nonexpendable	2,646	2,338
Expendable	70,262	70,843
Unrestricted	868,331	1,266,416
Total net assets	1,537,309	1,878,451
Total liabilities and net assets	$ 2,692,476	$ 2,848,108
Condensed Statement of Revenues, Expenses and Changes in Net Assets		
Operating revenues	$ 1,836,837	$ 1,743,251
Operating expenses other than depreciation expense	(1,691,520)	(1,584,504)
Depreciation expense	(129,974)	(122,363)
Operating income	15,343	36,384
Nonoperating expenses, net	(297,293)	(162,036)
Net expenses before transfers	(281,950)	(125,652)
Transfers (to) from other University units, net	(59,192)	7,954
Decrease in net assets	(341,142)	(117,698)
Net assets, beginning of year	1,878,451	1,996,149
Net assets, end of year	$ 1,537,309	$ 1,878,451
Condensed Statement of Cash Flows		
Net cash provided by operating activities	$ 175,354	$ 188,792
Net cash provided by investing activities	61,485	92,117
Net cash used in capital and related financing activities	(147,389)	(211,183)
Net cash (used in) provided by noncapital financing activities	(56,187)	4,905
Net increase in cash and cash equivalents	33,263	74,631
Cash and cash equivalents, beginning of year	157,012	82,381
Cash and cash equivalents, end of year	$ 190,275	$ 157,012

NOTE 14 | OPERATING EXPENSES BY FUNCTION

Operating expenses by functional classification for the years ended June 30, 2009 and 2008 are summarized as follows:

2009

(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 708,171	$ 112,082			$ 820,253
Research	427,564	195,079			622,643
Public service	86,682	39,782			126,464
Academic support	178,111	46,773			224,884
Student services	66,127	17,063			83,190
Institutional support	134,631	42,452			177,083
Operations and maintenance of plant	43,718	234,166			277,884
Auxiliary enterprises	1,745,466	567,681			2,313,147
Depreciation			$ 341,462		341,462
Scholarships and fellowships				$ 107,127	107,127
	$ 3,390,470	$ 1,255,078	$ 341,462	$ 107,127	$ 5,094,137

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

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