Notes to Consolidated Financial Statements

JUNE 30, 2009 AND 2008

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 and variable rate 2027 through 2028	116,800	118,335
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