UNIVERSITY OF MICHIGAN

FINANCIAL REPORT 2010

On the cover: The North Campus Research Complex (NCRC), which was acquired by the university from Pfizer in June 2009, includes 30 buildings with laboratories and administrative space. Situated on 174 acres, the NCRC will play a key role in the university's expanding research enterprise and provide greater opportunities for scientific collaboration among faculty, students, and industry partners. In FY 2010, some 300 university employees began working at the NCRC. Eventually, the facility is expected to be home to 3,000 faculty and staff.

Photo by Phil Dattilo

2010 FINANCIAL REPORT

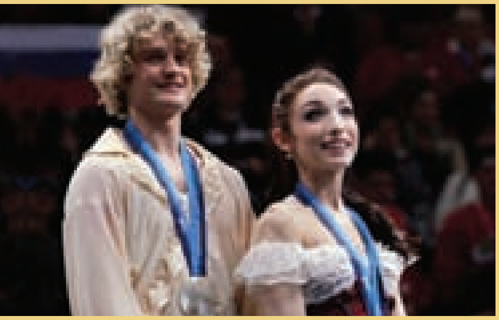
PRESIDENT BARACK OBAMA ADDRESSED ABOUT 8,500 GRADUATES AT U-M'S SPRING COMMENCEMENT ON MAY 1 IN MICHIGAN STADIUM.

Austin Thomason, U-M Photo Services

LETTER FROM THE PRESIDENT

Mary Sue Coleman


Martin Vloet, U-M Photo Services


Associated Press

OLYMPIC ICE DANCING SILVER MEDALISTS CHARLIE WHITE AND MERYL DAVIS.

A magnificent moment unfolded on the medal podium at the 2010 U.S. Figure Skating Championships.

In recognizing the best in ice dancing, judges placed gold medals around the necks of Meryl Davis and Charlie White; bronze medals were presented to skaters Emily Samuelson and Evan Bates.

In addition to gold and bronze, these four athletes represented two other beautiful colors: maize and blue. As University of Michigan undergraduates on the national stage, they were a point of pride for our campus and for alumni around the country.

All four skaters went on to compete in the 2010 Winter Olympics in Vancouver, with Meryl and Charlie capturing a silver medal for their spectacular performances and Emily and Evan catching judges' eyes for the 2014 games.

U-M students, faculty, and staff continually make headlines and draw accolades for their achievements. Reflecting on this past year, we have much to celebrate in the life of the university.

A Vibrant Campus

President Barack Obama honored the Class of 2010 with a commencement address at Michigan Stadium, where more than 80,000 graduates and guests gathered for the historic day. He was the third sitting American president to speak at a U-M commencement, and shared a message our graduates undoubtedly also heard in the classroom: understanding different viewpoints is invaluable.

Where President Obama closed our academic year, U.S. Chief Justice John Roberts opened the school year by joining us to celebrate the 150th anniversary of the Law School. This included breaking ground for a new academic building that will complement our iconic Law Quad.

This past year saw the opening of the U-M Confucius Institute, a key addition to our cultural offerings and a strong complement to the tremendous array of Chinese resources currently available on campus. We are particularly excited because of the 60 Confucius Institutes throughout the country, only ours focuses solely—and enthusiastically—on Chinese arts and culture.

We are providing insight of a different kind with the unveiling of the Brehm Tower at the Kellogg Eye Center. It is a remarkable facility for quality care and medical research, and gives new momentum in our work to find a cure for type I diabetes and its many debilitating effects, including blindness.

All of the many perspectives we provide played an important role in U-M earning continuing accreditation from The Higher Learning Commission of the North Central Association of Colleges and Schools. The accreditation process ensures that U-M meets certain standards, and demonstrates to the public—particularly students—the quality of our infrastructure in support of academic programs and other activities. U-M has been accredited for nearly 100 years.

Achieving Research Milestones

Pursuing cures and solutions continues to drive our faculty, who contributed to record levels of research this past year. Our research expenditures exceeded $1.1 billion, with our strongest partners being the National Institutes of Health (NIH), the National Science Foundation, and other federal agencies.

Our faculty were particularly successful in obtaining federal stimulus dollars to support their efforts. U-M proposals have led to more than $221 million in awards, making us a leading recipient nationally of American Recovery and Reinvestment Act (ARRA) funds.

One of the most impressive ARRA awards came to the Institute for Social Research (ISR), which secured $14.8 million from NIH for a major expansion of its facility. The expanded building will increase ISR's capacity for the large research programs it is known for, as well as strengthen coordination among researchers in various programs. The expansion also will create up to 200 temporary and permanent jobs.

Growing the economy

Research and economic growth go hand in hand with the evolving North Campus Research Complex (NCRC), which allows us to expand our life sciences enterprise and positions us for greater scientific collaboration among faculty, students, and industry partners.

Some 300 employees are now on site and we expect to have up to 3,000 faculty and staff in the NCRC over the next decade. In addition, we have identified the first two important technology anchors—biointerfaces and molecular, functional, and structural imaging—and made a commitment to unify U-M's health services research programs at NCRC.

The NCRC is one of the most visible facets of Michigan's University Research Corridor, our increasingly robust collaboration with Michigan State University and Wayne State University. Together, our three institutions are committed to transforming the Michigan economy through science and innovation.

Maintaining Financial Strength

The vibrancy and contributions of U-M arise from the work of bright, talented people across our campus. We also thrive as an institution because of a financial structure that is strong, strategic, and dynamic.

Building a budget, particularly in these turbulent economic times, is a challenging undertaking involving the contributions of many. This begins first and foremost with members of the Board of Regents, who are fully committed to a budget that ensures the continuing excellence and accessibility of the institution. They devote a great deal of time and experience to our process, and I am grateful for their counsel.

The deans of our schools and colleges have helped to identify millions of dollars in savings, while continuing to recruit exceptional faculty and develop innovative programs for our students.

On our Ann Arbor campus, we have cut or reallocated $135 million of recurring general fund expenses during FY 2003–2009, and we have made significant progress over the past year toward our goal of achieving an additional $100 million over the period FY 2010–2012. We have been aggressive in reducing our energy and water costs while significantly increasing use of our classrooms, laboratories, and offices. We are controlling health care costs by offering healthy lifestyle programs and incentives for employees, and by asking them to share more of the burden of premiums and co-pays.

In addition to using our assets wisely, we are grateful to the donors whose generosity provides an important margin of difference for students, faculty, and staff. This past year, donors gave more than $254 million to support U-M.

Most important, we have had the slowest annual growth in resident in-state tuition increases among Michigan universities in the past decade. That will continue in FY 2011, including a 1.5 percent increase for Ann Arbor campus in-state undergraduates—the smallest in 26 years.

For FY 2011, we have also increased our financial aid budget for these students by nearly 11 percent to keep a Michigan education accessible and affordable, and offered economic hardship grants to lower the burden of loans for qualified resident students. We have been mindful of the economic pressures facing many families and work to find ways to support them.

U-M is strong, stable, and growing because of the leadership of the Board of Regents and the involvement and support of many: deans, faculty and staff, alumni and donors, and Michigan taxpayers. Their contributions allow us to continue our commitment to exceptional teaching, research, and service, here in our state and throughout the world.

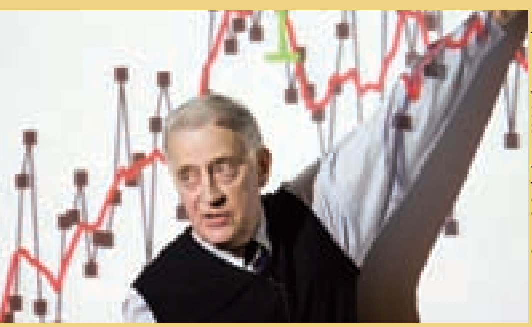
Sincerely,

Mary Sue Coleman
President

REPORT FROM THE CHIEF FINANCIAL OFFICER

Timothy P. Slottow

John Schultz



Scott C. Soderberg, U-M photo services

FACULTY AND STAFF ARE FOCUSED ON U-M'S CORE MISSIONS AND FINDING WAYS TO CONTROL COSTS AND MANAGE RESOURCES.

The University of Michigan remains financially healthy, despite the difficult economic conditions facing both the state and the nation. Our disciplined budget approach carefully balances the institution's need to remain competitive against a challenging economic environment.

Our 36,000 faculty and staff are focused on the university's core missions and are committed to finding innovative ways to control costs and manage resources more productively. Because of this commitment, 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.

The university, for example, 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 the institution's strong financial health and outlook. U-M is one of only three public universities in the country to maintain both of these highest possible ratings.

Over the years, our commitment to moderate tuition increases as well as aggressive cost containment strategies, successful fundraising efforts, and relentless protection and enhancement of the world-class quality of the university's research, teaching, and clinical care have combined with our long-term investment strategy to create a bright future for the university.

In summary, U-M's total net assets (assets less liabilities) increased by $698 million in FY 2010 to $9.4 billion. This increase is primarily due to net investment income, which totalled $796 million. 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

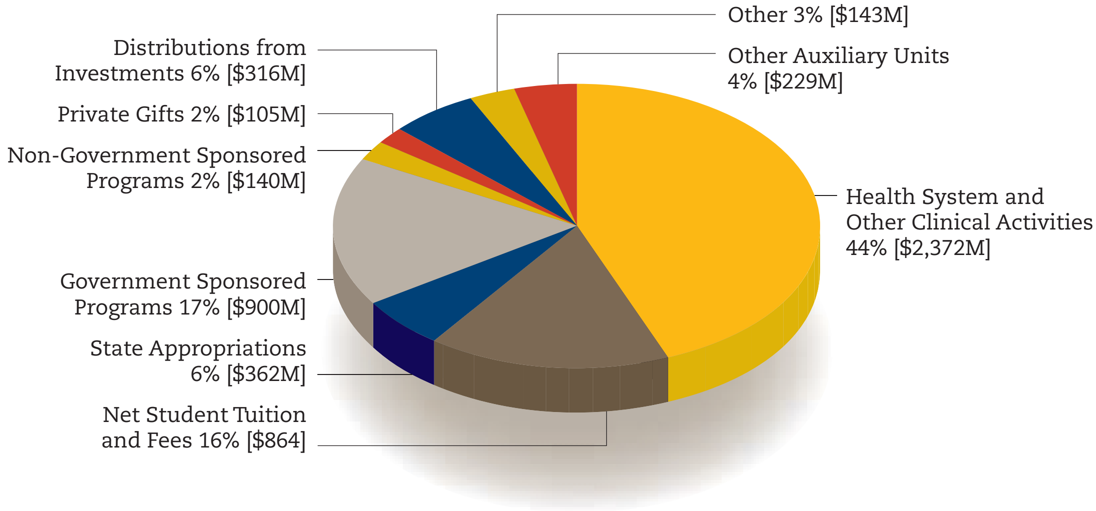
Revenue diversification has long been an important strategy for the university to achieve financial stability in light of unpredictable economic cycles. In the 1960s, for example, almost 80 percent of the university's general fund revenues came from state appropriations, compared to the projected 21 percent in the FY 2011 general fund budget. The current mix of revenue can be seen on the charts on the following page, which show the FY 2010 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 our strength. Base state appropriations have decreased $54 million, or 13 percent, from $416 million in FY 2002 to $362 million in FY 2010. In contrast, if appropriations had grown at the level of the Consumer Price Index, our state appropriations would have been $120 million higher in FY 2010. To put the state's current support in perspective, it is

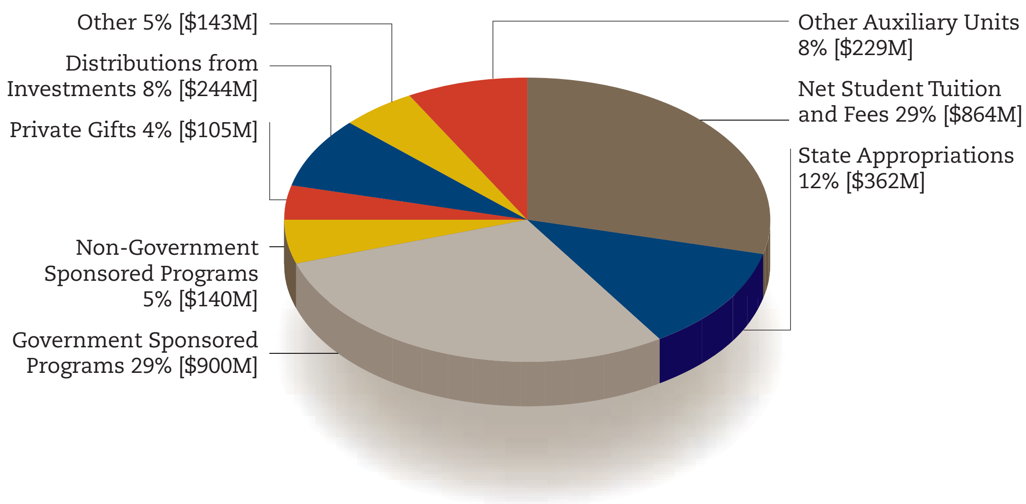
Operating Activities

Total Revenue $5,431 Million



Operating Activities Excluding Health System and Other Clinical Activities

Total Revenue $2,987 Million



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.

The general fund operating budget continues to balance our commitment to academic excellence and access with our ongoing cost containment efforts and the need to invest in our future, all against the backdrop of the state's uncertain financial circumstances. The FY 2011 budget takes our commitment to students and their families to a new level during a particularly difficult period. At the same time, it demonstrates an unwavering commitment to the quality of the institution, both inside and outside the classroom. By focusing on innovative solutions and through ingenuity and hard work, we have limited tuition increases and provided more financial aid.

In adopting the budget for FY 2011, we anticipated a total state appropriation of $361 million, which reflects a 3 percent reduction from the amount we received in FY 2010 and we are planning for possible significant reductions in FY 2012 and FY 2013.

A disciplined approach to long-term cost containment is a driving force behind our ability to invest in teaching and research. The university's deans, directors, faculty, and staff reduced and reallocated $135 million in recurring general fund expenditures from the Ann Arbor campus budget over the period FY 2003–2009. Further, we have made significant progress over the past year toward our goal of achieving an additional $100 million over the period FY 2010–2012.

The approved Ann Arbor campus budget for FY 2011 includes the lowest tuition increase in 26 years for resident undergraduates at 1.5 percent. The budget also includes moderate tuition rate increases of 3 percent for nonresident undergraduate students, and 2.8 percent for most graduate programs. Additionally, the Ann Arbor campus budget includes $126 million in centrally awarded 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 11 percent, which will help preserve access for our most financially vulnerable undergraduate students.

Over the last five years, Ann Arbor campus undergraduate tuition rates have increased on average by 5 percent while the annual increase in the budgeted amount for centrally awarded financial aid for undergraduates has averaged 10 percent.

The approved Dearborn campus budget includes a 3.9 percent increase in undergraduate tuition, a 2.9 percent increase in graduate tuition, and an 8.2 percent increase in institutional financial aid. At UM-Flint, the approved budget includes a 3.9 percent increase in undergraduate tuition, a 2.9 percent increase in graduate program tuition, and a 5.9 percent increase in institutional financial aid. At both UM-Dearborn and UM-Flint, the tuition increases for FY 2011 are the lowest in five years.

The FY 2011 budget is notable in that it was achieved during a period of unprecedented financial uncertainty. Multi-year budget planning, prudent management of resources, and our willingness to make tough decisions regarding priorities has enabled us to prepare for—and smooth out—the impact of the current tumultuous financial situation in the state and nation.

Growing Research

Research spending in FY 2010 grew 12 percent over the previous year to $1.1 billion, the second straight year the university has surpassed the billion dollar milestone. Research awards attained through the American Recovery and Reinvestment Act (ARRA) represented 5 percent of this increase, while the remaining 7 percent of the increase was attained through conventional funding sources. Thanks in part to ARRA research awards, federally funded research spending rose 15 percent over the previous fiscal year, accounting for 66 percent of total research expenditures.

One of the year's largest ARRA grants was a $19.5 million, five-year award from the Department of Energy to establish the Center for Solar and Thermal Energy Conversion in Complex Materials. Researchers at the center will study complex materials on the nanoscale, searching for new ways to convert sunlight and heat into electricity.

The North Campus Research Complex

Moving forward, the North Campus Research Complex (NCRC), which was acquired from Pfizer in June 2009, will play a strategic role in the university's critical expansion of its research enterprise. The NCRC has 30 buildings with nearly 2 million square feet of sophisticated laboratory facilities and administrative space situated on 174 acres. Beyond accelerating the institution's research efforts, it positions us for a future that will feature greater scientific collaboration among faculty, staff, students, and industry partners.

During FY 2010, we activated nine buildings on the complex property. With some 300 employees now on site, the first of an expected 3,000 faculty and staff are now working at the NCRC.

All of the groups chosen for the initial move are involved in supporting university research, whether by providing services to researchers or raising money to fund research. As more researchers move to the NCRC in coming months and years, they will benefit from having these research support functions close by.

We anticipate that the NCRC investment will provide a number of long-term benefits, including jobs, spin-offs, incubator space, and public–private partnerships. Rather than move too quickly, we are focused on deliberate, strategic growth to achieve our vision of a multi-faceted hub of research and innovation—one that helps transform our economy in Michigan and beyond.

This development is a once-in-a-life-time opportunity for the institution, and we are enthusiastic about the potential of research and innovation to deliver meaningful benefits to society. Over the next several years, thousands of current and new faculty, staff, and students will pursue ground-breaking research initiatives involving disciplines across campus and industry partnerships.

Other Physical Plant Improvements

The university's facilities serve a wide range of needs, from patient care to academics, and we are mindful of the importance of investing in our future by carefully choosing which facilities should be renovated or replaced.

To support this effort, the university has invested an average of $461 million per year, over the past decade, for renovation and replacement of buildings and related infrastructure. FY 2010 was no exception as the university completed 345 projects across campus, an investment of $617 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.

North Quad Residential and Academic Complex, one of the largest construction projects in university history, and the university's first new residence hall on the Ann Arbor campus in 40 years, will be home to 450 upper-level students in fall 2010. The new structure will serve as a hub for learning and collaboration and will also be home to the School of Information, and four academic units of LSA—Screen Arts and Cultures, Communication Studies, the Language Resource Center, and the Gayle Morris Sweetland Center for Writing.

The facility features 19 state-of-the-art classrooms and three labs, television/video production studios, faculty offices, a dining center, and abundant common areas shared and utilized by all of the building occupants. The Media Gateway provides individual and collaborative study alcoves and rooms equipped with display screens and workstations where students can connect with each other and the world. North Quad is a cornerstone of the university's Residential Life Initiative, a multi-year plan to revitalize and expand student residential halls and dining facilities.

Work is also continuing on another of the largest construction projects ever undertaken by the university—the replacement for the C.S. Mott Children's Hospital and the Women's Hospital, the latter of which will be known as the Von Voigtlander Women's Hospital. The new facility, which is slated to open in FY 2012, will total 1.1 million square feet and include nearly 350 beds. It is designed to bridge inpatient and outpatient services within the same medical disciplines to create a seamless approach to patient care.

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, was completed in FY 2010, in time for the start of the 2010–11 football season. Additionally, the Al Glick Field House, a new indoor practice field for the football program, and the Bahna Wrestling Center, a new 18,000-square-foot facility, were completed in FY 2010.

Controlling Health Care Costs

Organizations across the country continue to be challenged by escalating costs of employee and retiree benefits. This is an ever-present challenge, with total university health care spending for employees and retirees reaching almost $297 million in FY 2010.

In previous years, 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 that increased the overall contribution toward health care coverage made by employees, dependents, and retirees. Half of the changes became effective in January 2010, and the remainder will take effect in January 2011. These changes will provide a reduction in university health care expenses of more than $31 million annually. A system of salary bands for active employees helps determine the contribution amount to lessen the impact on lower-paid employees.

During FY 2010, we again called upon some of the university's national health care and health policy experts to form the Committee on Retiree Health Benefits to help us address the acceleration of benefits costs projected for current and future retirees and their dependents. The committee's work, now underway, will result in a long-term plan to keep the university's retiree benefits competitive with peer institutions while producing significant short- and long-term annual savings.

U-M HOSPITALS AND HEALTH CENTERS HAVE HAD 14 YEARS OF POSITIVE FINANCIAL MARGINS WHILE IMPROVING THE QUALITY OF CARE.

Scott C. Soderberg, U-M Photo Services

The university has also completed its first dependent benefits eligibility audit. About 20,000 U-M employees cover at least one dependent in university-sponsored health plans, and they were required to document the current eligibility of their dependent(s) in order to continue coverage. More than 400 ineligible or unsubstantiated dependents were removed from coverage during the audit process, which will provide an expected savings for the university of about $650,000 in the first year and a recurring savings in subsequent years.

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 well-being program, known as MHealthy, addresses these important factors. MHealthy offers a spectrum of programs designed to support healthy lifestyles, and uses health data to ensure that those programs are targeted to the greatest needs of faculty and staff.

MHealthy completed the second university-wide health risk assessment in FY 2010. This assessment provided measures of our community's health as compared to the first assessment completed in the previous year. The 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 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 Long Term Portfolio's 12 percent return in FY 2010 follows a -23 percent return in FY 2009 and a 6 percent return in FY 2008. The Long Term Portfolio's annualized five-year return of 6 percent was 1.7 percentage points above the custom market benchmark designed to capture the university's long-term diversified investment strategy and 5 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 -0.79 percent over the same five year period.

Investment Performance

	Return for twelve-month period ended June 30, 2010	Annualized three-year return	Annualized five-year return
Long Term Portfolio	12.3%	-3.0%	6.0%
U-M's Benchmark	10.2%	-3.5%	4.3%
Equity/Fixed Income Index (80/20)	12.3%	-6.8%	0.7%

The table above shows the endowment's favorable investment performance relative to its benchmarks. Utilizing a diversified investment strategy has limited the loss of capital in the more challenging years.

The university's endowment spending rule smoothes the impact of volatile capital markets by providing for annual distributions based on a percent of the moving average fair value of the endowment. The spending rule, along with the growth of the endowment, allowed for distributions to support operations of $255 million in FY 2010, for a total of $1.1 billion over the past five years.

The payout from our more than 7,100 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 $6.4 billion endowment is restricted for use by our Health System, where nearly 1.9 million patient visits take place each year. The portion of the endowment available for U-M operations supports the education of more than 58,000 students. About 20 percent of our total endowment, or $1.3 billion, has been set aside for student aid, with 70 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 5.8 percent.

The Health System

The Health System, which integrates the Hospitals and Health Centers, the Medical School, the clinical operations of the School of Nursing, and the Michigan Health Corporation under the direction of the university's executive vice president for medical affairs, had a stellar 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 14 years of positive financial margins, while also improving the quality and safety of the care we deliver to patients.

In FY 2010, the University of Michigan Hospitals and Health Centers (UMHHC) beat its own budget predictions by achieving an operating margin of 3.3 percent ($61 million) on revenues of $2 billion—surpassing the original target of 1.7 percent.

This year's success can be attributed to a combination of more patients, more efficiency, more teamwork, and more attention to every factor that affects the bottom line. More specifically, UMHHC saw 5 percent more patient activity, in terms of adjusted cases, and productivity improvements of 4 percent in FY 2010 when compared to the previous year. UMHHC, however, must perform even better in the new fiscal year in order to prepare for a future of health care reform.

Strong financial performance now will help the Health System prepare for the opening of the new C.S. Mott Children's and Von Voigtlander Women's Hospitals, scheduled for FY 2012, and major investments in clinical information systems and other clinical infrastructure.

The continuing struggles of the Michigan economy, which in turn have led to double-digit increases in the amount of charity care and uncompensated care that the Health System provides, also pose a significant challenge. UMHHC experienced a 17 percent rise in uncompensated care in just the past year, with increases in both the number of patients who qualify for charity care, and those who cannot pay bills for care they've already received. At the same time, a higher percentage of health system patients are covered by Medicare, Medicaid, and county health plans, which do not reimburse at the same rates as private insurers. In FY 2010, UMHHC was reimbursed $350 million less by these plans than it would have been if the same patients had been covered by private insurance.

Commitment to Sustainability

We take our responsibility to protect and preserve resources very seriously. In our educational programs, our goal is to inspire students to acquire the knowledge and insight that will empower them to address the many complexities of sustainability in their chosen careers. In our research programs, we are drawing on our multidisciplinary strengths to attack major sustainability problems at local-to-global scales. And in our operations, we aim to set the standard for excellence in achieving a green campus.

For the past several years, teams of Planet Blue energy and environmental specialists have been deployed throughout campus to improve energy efficiency within facilities while engaging building occupants to "think and act green." So far, in the first 35 buildings, energy utilization has been reduced by 11 percent for an annual savings of over $3 million.

In FY 2010, the university created a new Office of Campus Sustainability as well as a new position—Special Counsel to the President for Sustainability. The special counsel reports directly to President Coleman and is charged with coordinating existing efforts by students, faculty, and staff across the entire campus in education, research, and operations for maximum impact, and inspiring new initiatives.

U-M adopted LEED Silver certification as its standard for major new construction projects in FY 2010. LEED, which stands for Leadership in Energy and Environmental Design, is a standard created by the U.S. Green Building Council. This new policy builds upon an existing commitment to exceed by 30 percent a widely recognized energy efficiency standard, giving U-M one of the most rigorous construction standards among higher education institutions in the nation.

Financial Controls

FY 2010 was the sixth year that each unit on campus was required to complete an annual internal control review and certification of internal controls and for adding new areas for certification, including employee travel and expenses, human subject incentive payments, and donor stewardship.

Conclusion

It is, once again, satisfying to receive an unqualified opinion from the university's independent financial auditors. This opinion, which can be read 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.

Please read Management's Discussion and Analysis, beginning on page 36. It describes how the university's financial strength, prudent financial policy, and the institution-wide commitment to sustaining the highest level of excellence come together to ensure the university's mission is fulfilled in the years ahead.

Timothy P. Slottow
Executive Vice President
and Chief Financial Officer

STUDENTS, FACULTY, AND STAFF GATHER ON THE DIAG FOR ENERGY FEST.

Lisa Pappas, GESI

REPORT FROM THE VICE PRESIDENT FOR DEVELOPMENT

Jerry A. May

Steve Kuzma Photography

Scott C. Soderberg, U-M Photo Services

PENNY AND ROE STAMPS WITH FRESHMEN FROM THE STAMPS SCHOLARS PROGRAM.

This has been a most gratifying year. In spite of the turmoil in the economic sector, we have good news to report about the generosity of donors to the University of Michigan. More than 111,000 donors made gifts of cash and pledge payments totaling $254,086,812—only 3.6 percent fewer donors and 4.4 percent fewer dollars than last year. These are impressive figures.

Gifts from living individuals continue to be strong, up by approximately $5 million for a total of $154 million. Corporate giving is down by only 1 percent to $16.8 million this year.

Even as state support continued to decline, necessitating a rise in tuition, the university remained committed to providing increased financial aid to students to help them earn a Michigan degree. U-M maintains its aggressive approach to meeting the full, demonstrated financial need of all in-state undergraduates. In the past year, 70 percent of in-state undergraduates and 50 percent of out-of-state undergraduates received financial aid including scholarships, grants, loans, and work-study. Our Ann Arbor campus undergraduate students have been graduating with average debt of about $26,800. Our graduate students have been graduating with debt of about $42,000 for in-state students and $49,000 for out-of-state students. The goal is to have our students leave with fewer loans.

Our donors have responded to the need for increased financial aid, making gifts for undergraduate and graduate student support totaling more than $56 million. This current support has been augmented by the $60 million generated this fiscal year by the donor-supported endowed funds for scholarship and fellowship support. **Zelda M. Bartus** (BA ’39, CERT EDDUC ’39) left a $4.15 million bequest for need-based scholarship support for students in Civil and Environmental Engineering and Chemical Engineering to honor her husband, **Julius** (BSE CE ’36). Both received scholarships when they were students at the U-M, where they met. **Penny** (BSDES ’66) and **Roe Stamps** made a gift of $3 million to renew their Stamps Scholars program, which had already supported 72 students for four years. The new commitment will support an additional 72 students.

Even as donors provided funds to support students, others generously gave to advance areas throughout the university. A number of donors made record gifts. The **Ted and Jane Von Voigtlander Foundation** made a gift of $15 million, the largest gift ever to the Health System for women’s health, to

GWEN HAGGERTY AT THE NAMING CEREMONY FOR THE VON VOIGTLANDER WOMEN'S HOSPITAL.

Scott C. Soderberg, U-M Photo Services

support construction of the new women's hospital. The gift was made by **Gwen Haggerty,** president of the foundation, to honor the memory of her mother, **Jane,** and her adoptive father, **Ted.** In their honor, the new hospital was named the Von Voigtlander Women's Hospital. It will open in late 2011 as part of the building that will also house the new C.S. Mott Children's Hospital.

The Law School broke ground last fall on its new building aided by a record gift from **Robert** (JD '54) and **Ann** (BA '02) **Aikens** whose contribution of $10 million is the largest gift ever made to the Law School by a living donor. In recognition of their exceptional generosity, the Law School will name the new commons, located in the current Law Quad, the Robert B. Aikens Commons.

Ed Elliott (DCOB BBA '67) made a gift of $2 million to U-M Dearborn's College of Business, the largest gift to that campus from an alum. It endows a professorship in memory of his late wife, **Betty** (DCOB BBA '67) and provides discretionary funds for the dean.

Philanthropists, though, are not just those who make the largest gifts. We celebrate our alumni and friends who make gifts of all sizes to support Michigan. A new area on our website *www.giving.umich.edu,* called "Share Your Story," offers donors a place to tell why they give to the U-M and any other charitable organization. I urge you to go to the site, and I guarantee you will be inspired by the messages you read. They are from caring people who understand the value of helping others. I've included a few samples from the many stories posted there.

U-M Eye Center was there when I needed them in 1998. Dr. Elner was wonderful. I am now in remission from Graves Eye Disease, but I saw many others far worse off than I. This gift is for them.

When I graduated high school, the Regents-Alumni scholarship helped my parents in sending me to Michigan. I give what I can because others have helped me.

Scott C. Soderberg, U-M Photo Services

LAW SCHOOL GROUNDBREAKING CEREMONY

I have made a donation to the U-M every year since my graduation in 1970. I believe that the U-M is the greatest learning institution on earth, and will always support it.

Charitable giving fills the gaps, solves problems, answers prayers, meets needs that cannot be met in the public sphere.

I support education and health care because I feel strongly that both are critical to the well-being of people in general and society as a whole.

I have never supported U-M before. But, U-M has supported me by giving a future to my nephew, who at 3 just underwent a liver transplant and now has a bright and healthy outlook.

Philanthropy is infectious and contagious and makes me feel good.

These people and more than one hundred thousand others made the Michigan Difference.

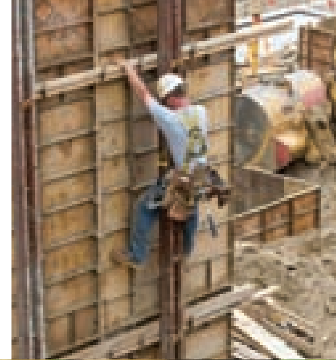
Thank You,

Jerry A. May

Vice President for Development

DEVELOPMENT HIGHLIGHTS

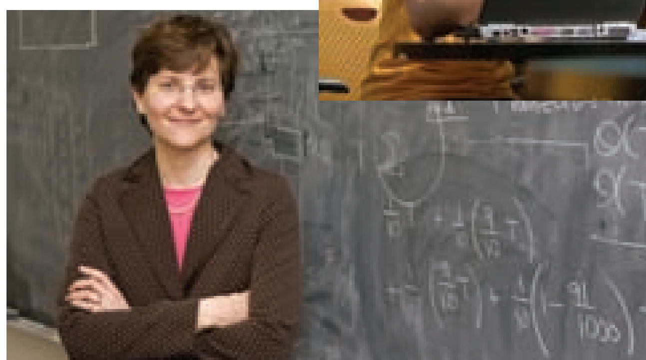
July 1, 2009–June 30, 2010



Student Support

$56,000,000+

Gifts for scholarships, fellowships, and dissertation support help students complete their degrees.



Research Support

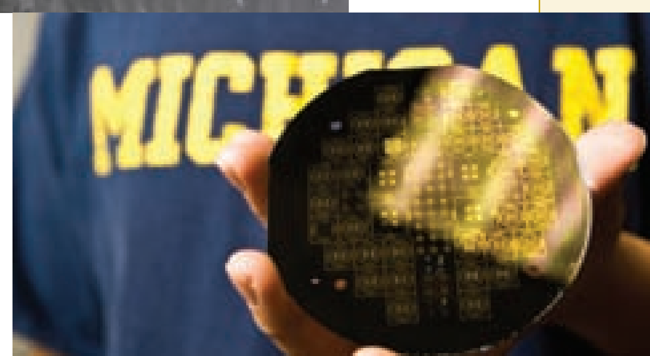
$56,000,000+

Gifts advance research done by faculty and research staff in every school, college, and unit of the university.

Faculty Support

$22,000,000+

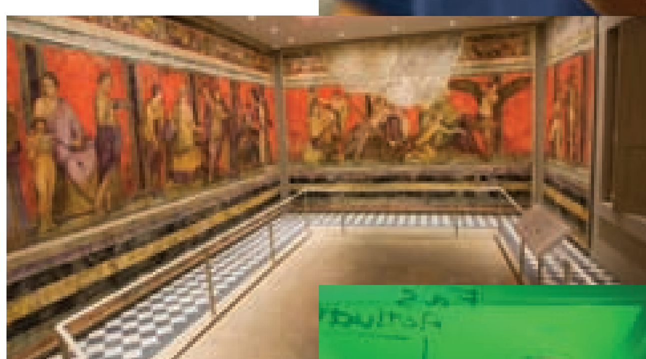
Gifts fund endowed professorships and visiting professorships, and help attract and keep the finest faculty members.



Facilities Support

$46,000,000+

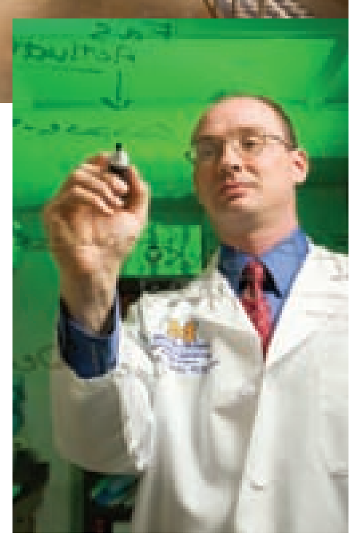
Gifts support construction, renovation, or endowed support for buildings.



Discretionary Support

$25,000,000+

Gifts given to be used at the discretion of a designated dean or unit head.



Endowment Support

$61,000,000+

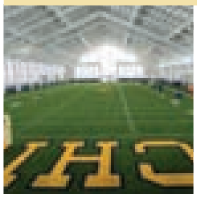
Gifts designated for any of the above areas of the university are invested in the endowment as directed by donors.

Marcia Ledford, Scott C. Soderberg, Paul Jaronski, Martin Vloet: U-M Photo Services

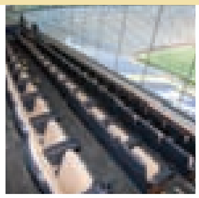
BUILDINGS AND FACILITIES

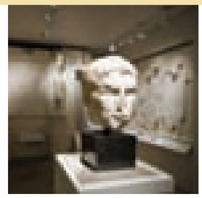
Donors provided significant support during The Michigan Difference campaign and afterwards to make 23 projects possible. Twenty campaign-related projects have been completed.

Completed in fiscal 2010


AL GLICK FIELD HOUSE

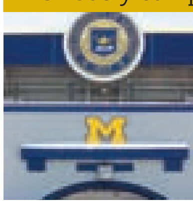

BAHNA WRESTLING CENTER

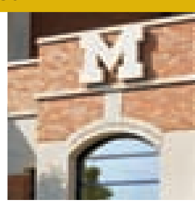

MICHIGAN STADIUM EXPANSION

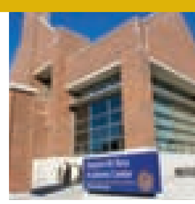

WILLIAM E. UPJOHN EXHIBIT WING OF THE KELSEY MUSEUM

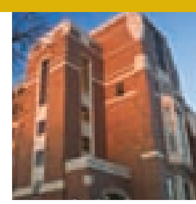

KELLOGG EYE CENTER AND BREHM TOWER

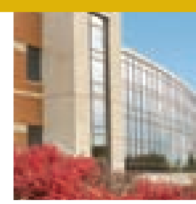
Previously completed


J. IRA AND NICKI HARRIS FAMILY FOOTBALL LOCKER ROOM

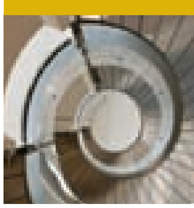

JUNGE FAMILY CHAMPIONS CENTER AND MORTENSON FAMILY PLAZA

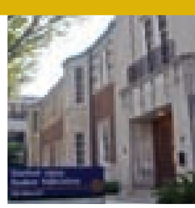

STEPHEN M. ROSS ACADEMIC CENTER

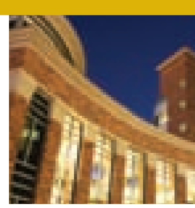

JOAN AND SANFORD WEILL HALL, GERALD R. FORD SCHOOL OF PUBLIC POLICY

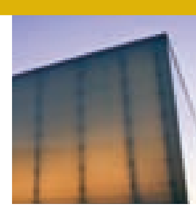

DEPRESSION CENTER AT THE RACHEL UPJOHN BUILDING

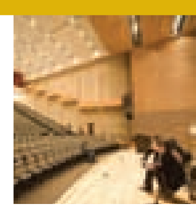

ANN AND ROBERT H. LURIE BIOMEDICAL ENGINEERING BUILDING

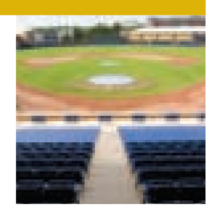

COMPUTER SCIENCE AND ENGINEERING BUILDING

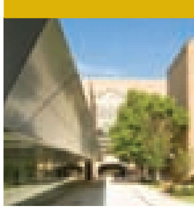

STANFORD LIPSEY STUDENT PUBLICATIONS BUILDING RENOVATION


SCHOOL OF PUBLIC HEALTH CROSSROADS AND RESEARCH TOWER

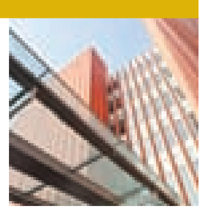

CHARLES R. WALGREEN, JR. DRAMA CENTER AND ARTHUR MILLER THEATRE


PENNY AND ROE STAMPS AUDITORIUM


WILPON BASEBALL AND SOFTBALL COMPLEX


ROBERT H. LURIE NANOFABRICATION FACILITY


MUSEUM OF ART AND THE MAXINE AND STUART FRANKEL AND THE FRANKEL FAMILY WING


STEPHEN M. ROSS SCHOOL OF BUSINESS

Under construction

LAW SCHOOL RENOVATION AND EXPANSION—GROUNDBREAKING SEPTEMBER 2009

PLAYER DEVELOPMENT CENTER FOR INTERCOLLEGIATE BASKETBALL—GROUNDBREAKING MAY 2010

C.S. MOTT CHILDREN'S HOSPITAL AND VON VOIGTLANDER WOMEN'S HOSPITAL

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

TUITION: SUPPORTING THE ACADEMIC ENTERPRISE

Tuition rates, and their growth over time, have been the subject of a great deal of national debate in recent years. At U-M, as at most other institutions of higher education, tuition revenue is a critical source of support for the academic enterprise, but it is not sufficient to cover the full costs of higher education.

In addition to tuition revenue, state support, private giving, endowment income, and federal and non-federal sponsored grants and contracts are all critical sources of support that enable the institution to fulfill its educational mission. The diversity of revenue sources is one of our strengths and a key part of our financial strategy, which aims both to ensure access to U-M for qualified students of all economic backgrounds and to continue to advance students' educational experience.

The primary financial support for the operation of the academic enterprise resides in the General Fund. Tuition revenue, the state appropriation, and indirect cost recovery from sponsored research are the principal revenue sources for the General Fund on the Ann Arbor campus. General Fund revenue is used to support teaching, financial aid, student services, libraries and museums, and administrative/operational activities.

The UMHHC and other auxiliary units, such as athletics and housing, are independent of the General Fund; these units have their own sources of revenue and do not receive tuition or state appropriation support. In addition, most construction on campus is funded from sources other than the General Fund.

Scott C. Soderberg, U-M Photo Services

Where the General Fund Money Goes

UM-ANN ARBOR FY 2010 GENERAL FUND BUDGET

65.6 cents of each dollar goes to academic activities

- Instruction
- Academic advising
- Libraries
- Museums

16.0 cents of each dollar goes to facilities and risk management

- Utilities
- Insurance
- Plant operations
- Public safety

10.3 cents of each dollar goes to administrative services

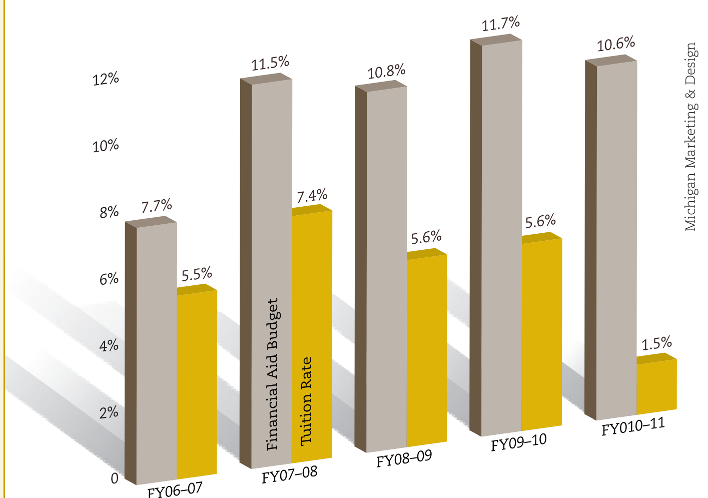
- Admissions
- Budgeting and accounting
- Central human resource services
- Central information technology
- Legal services

8.1 cents of each dollar is for centrally awarded financial aid

(U-M's schools and colleges also award financial aid.)

In FY 2010, tuition revenue constituted 65 percent of the Ann Arbor campus's General Fund budget while the state appropriation was 22 percent. As the state of Michigan has dealt with a troubled economy, state support to the university has decreased, both in real dollars and as a fraction of the General Fund.

On the cost side, institutions of higher education tend to see increases beyond the normal forces of inflation because teaching and research are more labor-intensive than most activities in the economy, and labor costs generally tend to rise faster than other prices. At the same time, U-M's volume of instruction and research activity continues to experience significant increases.



RESIDENT UNDERGRADUATE TUITION RATE INCREASES COMPARED TO CENTRAL FINANCIAL AID BUDGET INCREASES FOR THE ANN ARBOR CAMPUS.

These factors combined have challenged U-M to work especially hard to develop effective, long-term strategies to achieve its dual goals of ensuring access and maintaining an unwavering commitment to the quality of the institution both inside and outside the classroom.

The university has been particularly mindful of the issue of affordability and in recent years has held increases in cost of attendance to a minimum while investing significantly in financial aid. In particular, the Ann Arbor campus has consistently boosted financial aid for students with demonstrated need from year to year at a rate at least equal to, and often exceeding, the increase in tuition. Approximately 70 percent of resident undergraduate students and 50 percent of non-resident undergraduate students on the Ann Arbor campus receive some form of financial aid.

At the same time, U-M has invested in key academic priorities that enable it to remain one of the premier public universities. One recent example is an increase in the number of full-time faculty members, which will decrease average class size and enhance the student experience. Another is an investment in increased research opportunities for undergraduates.

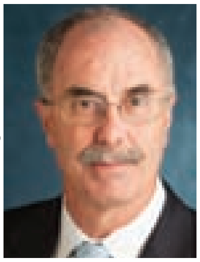
The University of Michigan's success at ensuring access while investing in excellence has been made possible by aggressive and successful cost-containment efforts, a philosophy of continual reallocation of funds toward highest-priority activities, and the diversity of our revenue sources. The generous philanthropy of U-M donors, combined with the active sponsored-research portfolio of our faculty, have diversified our funding sources and made it possible for the university to fulfill its mission.

Tuition revenue helps support the quality of teaching, the many and varied learning opportunities, and the respected scholarship that continue to make a University of Michigan education one of the best in the world.

Quick Facts

- Annual budgeting of the General Fund is directed by the provost, who serves as both the chief academic officer and the chief budget officer. This dual role ensures that budgetary decisions are directly aligned with U-M's academic mission. Final approval of budget and tuition rate recommendations rests with U-M's publicly elected Board of Regents.
- Tuition rates for undergraduate students vary by residency, school of enrollment, level of study, and number of credit hours enrolled.
- The increase in Ann Arbor campus resident undergraduate tuition for FY 2011 will be 1.5 percent—the lowest rate of increase in 26 years and lower than the rate of increase for resident students at most public universities.
- Cost containment efforts have resulted in the reduction or reallocation of $135 million of recurring Ann Arbor campus General Fund expenses over the period FY 2003–2009, and there has been significant progress made toward our goal of achieving an additional $100 million in reductions over the period FY 2010–2012. All new initiatives for the past two years have been funded through reallocation.

NEW APPOINTMENTS



Scott C. Soderberg, U-M Photo Services

Philip Hanlon, the Donald J. Lewis Professor of Mathematics and vice provost for academic and budgetary affairs at U-M, was selected as provost and executive vice president for academic affairs effective July 1, 2010. Hanlon, who came to U-M in 1986, served as the associate dean for planning and finance in LSA from 2001 to 2004, where he played a lead role in budgeting and academic planning.

Paul Jaronski, U-M Photo Services

Edward Silver, the William A. Brownwell Collegiate Professor of Education at UM-Ann Arbor, was named dean of the School of Education at UM-Dearborn. His three-year appointment began July 1, 2010. While in Ann Arbor, he also served as chair of the Educational Studies Program and as associate dean for academic affairs. Silver's area of specialization is mathematics education.

School of Information

Jeffrey K. MacKie-Mason, a founding faculty member of the School of Information (SI), became its new dean effective July 1, 2010. MacKie-Mason, the Arthur W. Burks Collegiate Professor of Information and Computer Science, also served as associate dean for academic affairs in SI. He is a professor in the Department of Economics and the Ford School of Public Policy as well.

Scott C. Soderberg, U-M Photo Services

Ronald Zernicke, director of the U-M Bone and Joint Injury Prevention & Rehabilitation Center, was appointed dean of the U-M School of Kinesiology, effective January 1, 2010. In addition to directing the center since 2007, Zernicke is a faculty member in the Department of Orthopaedic Surgery, the Department of Biomedical Engineering, and the School of Kinesiology.

NEW STUDENT PROFILE

The 6,079 first-year students who enrolled in September 2009 came from 50 states and almost 70 countries. They were selected from a group of 29,965 well-qualified applicants.

Academics

- 27% had a perfect 4.0 high school GPA
- 51% had 3.9 or higher GPA
- 94% ranked in the top 10% of their graduating class
- 30% had an ACT composite score between 30 and 36
- Approximately 1,200 students scored between 650 and 800 on the verbal portion of the SAT, and 1,800 students scored 650 or better on the math portion

Activities

- 65% play a musical instrument
- 43% were elected to at least one student government office
- 35% had writing published or were editors of high school publications
- More than half volunteered in community hospitals, clinics, or homes
- 10% have started their own businesses
- more than one third have won athletic awards

2009 Fall Term Enrollment

	Undergraduate	Graduate/Professional	Total
ANN ARBOR	26,208	15,466	41,674
DEARBORN	6,959	1,683	8,642
FLINT	6,581	1,192	7,773
ALL CAMPUSES	39,748	18,341	58,089

2009–10 Degrees Granted

	Undergraduate	Graduate/Professional	Total
ANN ARBOR	6,457	5,137	11,594
DEARBORN	1,264	533	1,797
FLINT	954	345	1,299
ALL CAMPUSES	8,675	6,015	14,690

THE GROWN IN DETROIT COOPERATIVE (SHOWN HERE AT EASTERN MARKET) SELLS PRODUCE FROM URBAN GARDENS, INCLUDING SID COMMUNITY PARTNER EARTHWORKS.

Ellie Van Houtte

LEADERSHIP & SERVICE

U-M students discover Detroit

Leeya Correll, SID

Ann Arbor is only a short trek from Detroit, but many students rarely visit. Even fewer spend any significant amount of time there. Things have been changing in recent years though as administration, faculty, and students have put renewed emphasis on strengthening ties between U-M and its nearest urban neighbor.

The university now boasts over 40 outreach programs that provide services in areas as diverse as public health, education, the arts, business development, literacy, social work, and family advocacy. Established in 2005, U-M's Detroit Center on Woodward Avenue helps coordinate the university's many Detroit-based programs and projects.

One of U-M's most recent outreach efforts is Semester in Detroit (SID). Now in its third year, the for-credit program allows undergraduates to engage fully with the city as they spend a semester living, working, and studying in Detroit.

SID students, who are housed in Wayne State University dorms, attend courses at the Detroit Center on history, urban planning, nonprofit administration, community development, and arts and culture. They also intern 16 hours per week with local community organizations. Past partners have included the Detroit Public Library, Alternatives for Girls, the Southwest Detroit Business Association, the Sugar Law Center, Focus Hope, and the Museum of Contemporary Art Detroit.

"Detroit is a city of many strengths and struggles, and there's also a whole lot going on that is creative," says Craig Regester, the program's associate director and a Detroit resident. "This makes spending a semester here a uniquely rich learning experience."

To learn more about SID, visit *www.semesterindetroit.com*.

Nick Tobier, SID

LEADERSHIP & SERVICE

- Despite rainy weather, a record-breaking 3,200 cars brought enough electronic waste to fill over 20 semis in the Pioneer High School parking lot. The U-M Office of Campus Sustainability and Ann Arbor Public Schools sponsored the fifth annual free e-waste recycling event, held April 25.

Scott C. Soderberg, U-M Photo Services

- U-M began making thousands of books that are no longer in copyright—including rare and one-of-a-kind titles—available to the public as reprints on demand under a new agreement with BookSurge, part of the Amazon.com group of companies.

- The Law School's new Detroit Center for Family Advocacy aims to reduce the number of children in public foster care by helping families better care for their children. The three-year pilot program will serve the Osborn neighborhood on Detroit's east side, an area with one of Wayne County's highest rates of child removal from families.

- Twenty-five teams of U-M business and engineering students vied for over $40,000 in scholarships as part of the Tauber Institute for Global Operations' annual *Spotlight!* competition, which focuses on innovative operations and manufacturing solutions to real-world challenges.

- According to a study conducted by Anderson Economic Group, University Research Corridor partners U-M, Michigan State University, and Wayne State University make a $14.5 billion impact on Michigan's economy and return $16 for every dollar the state invests.

- The U.S. Children's Bureau of Health and Human Services awarded a five-year, $5 million grant to the Law School to have it serve as the National Quality Improvement Center on the Representation of Children in the Child Welfare System.

- In October, the Latina/o Studies Program commemorated 25 years at U-M with a three-day symposium involving leading national researchers, students, and alumni.

- U-M Press is joining with HathiTrust Digital Library to open electronic content for free online access. U-M Press plans to have 1,000 or more titles available for full viewing by the end of this year.

- In October, U-M's Center for International & Comparative Studies announced a new multidisciplinary International Studies concentration designed to help students prepare for living and working in a global economy.

- The Stephen M. Ross School of Business is the best business school in the U.S. for integrating environmental, social, and ethical issues into its MBA program, according to the Aspen Institute's 2009–10 report *Beyond Grey Pinstripes*.

- U-M Business and Finance graduated its first Leadership Academy class in November. Created in 2009, the academy focuses on developing future senior leaders by providing mentoring, experiential learning, and developmental exercises to a select group of mid-level managers.

- In 1909, Michigan Visiting Nurses (MVN) began as a service to treat the "needy sick" from University Hospital. Now celebrating 100 years, MVN still provides home nursing care, but also offers therapeutic nursing and therapy services supported by home health aides, nutritionists, and medical social workers.

Scott R. Galvin, U-M Photo Services

Martin Vloet, U-M Photo Services

- Parking & Transportation Services is assessing ways to encourage and accommodate cyclists as part of a strategy to promote alternatives to bringing autos to campus. Covered bike racks, tax credits for cyclists, more bike lockers, and a campus parts and repair center will be studied.

- According to its 2009 Environmental Report, energy use at U-M has remained nearly constant over the last six years, despite a 9 percent increase in the campus population and an 11 percent increase in building area during that period.

- U-M is now metro Detroit's second-largest employer behind Ford Motor Co., according to the *Crain's Detroit Business 2010 Book of Lists*. A year ago, Crain's listed U-M fourth behind the Big Three automakers.

- In January, UM-Flint began allowing the transfer of credits for American Sign Language (ASL) classes taken at Mott Community College. Many states now recognize ASL as a foreign language, thus permitting schools and universities to accept it in fulfillment of foreign language requirements for hearing as well as deaf students.

- For the 10th year in a row, U-M has placed on the Peace Corps' top 25 list of large universities nationwide producing Peace Corps volunteers.

- In February, U-M launched the Global Michigan site *(globalportal.umich.edu)* to provide a single source of information about international opportunities across campus and offer a vehicle for U-M to engage with the global community.

- In March 1970, U-M held an "Environmental Teach-In" that drew over 15,000 participants and served as a model for the first national Earth Day on April 22, 1970. To celebrate its 40th anniversary and promote sustainability, U-M created an Earth Day site *(www.umich.edu/earthday)* and held dozens of events.

- U-M is home to the new statewide Michigan College Advising Corps, a unique approach to increasing the number of low-income, first-generation, and underrepresented students in higher education in Michigan.

- More than 2,000 students and 1,000 faculty and staff across the Ann Arbor campus participated in surveys and focus groups that will help U-M determine how best to move to a smoke-free campus.

- U-M will be Teach For America's local university partner when the organization returns to Detroit for the 2010–11 school year. One hundred Detroit corps members will enroll at U-M's School of Education to obtain their state teaching certification.

- U-M will pursue LEED Silver certification for major new construction projects. The new policy builds upon an earlier commitment to exceed by 30 percent an existing energy efficiency standard, giving U-M one of the most rigorous construction standards among higher education institutions in the nation.

- U-M engineering students traveled to Nicaragua for 10 days as part of a BLUElab project to turn bio-waste into clean cooking fuel for the developing world. Engineering's Multidisciplinary Design Program sponsored the trip.

- Robben Wright Fleming, the president of U-M who steered the university safely through the student unrest of the late 1960s and early 1970s, died January 11 in Ann Arbor. He was 93. Fleming served as president from 1968 to 1978 and as interim president in 1988.

- This year U-M hired 23 tenure-track junior faculty as part of a five-year, $30 million presidential initiative to increase multidisciplinary teaching and research. The program, which has approved 72 positions to date, will total 100 new positions when complete.

- U-M announced in March that it purchased renewable energy certificates from DTE Energy to support the production of renewable energy as part of its environmental and energy strategy.

ACTORS AND CREW FROM THE FILM TRUST PREPARE TO SHOOT A SCENE IN FRONT OF THE MICHIGAN UNION.

Jamie Isaler, U-M Film Office

CREATIVITY & INNOVATION

Lights, camera…Go Blue!

Lin Jones, U-M Photo Services

Since the state enacted one of the most aggressive film incentives in the country in 2008, filmmakers have been lining up to make movies in Michigan, including at the U-M. In the last three years, 16 feature films were shot in the greater Ann Arbor area, including nine on campus. Among them are *Conviction, Trust, Salvation Boulevard,* and *The Double*. The incentives offer up to a 42 percent tax credit to film companies spending at least $50,000 in the state.

Attracting film companies to the region has helped boost the local economy, says Lee Doyle, director of the U-M Film Office. According to the Michigan Film Office's latest annual report, seven films that completed shooting in and around Ann Arbor in 2009 reported expenditures of almost $46 million and generated over 2,000 jobs.

The incentive program has also created opportunities for U-M students and graduates. Instead of leaving for Los Angeles, about 80 percent of graduates pursuing a career in film or television are now staying in Michigan, says Jim Burnstein, the head of U-M's screenwriting program. "They love Michigan and want to be part of its rebirth."

One of those is Sultan Sharrief, whose film *Bilal's Stand* was accepted to the 2010 Sundance Film Festival. The project, which grew out of his work as a U-M student, tells the story of a Detroit high school student pursuing his dream of higher education. To help nurture and retain young talent such as Sharrief, U-M, Michigan State University, and Wayne State University recently formed the Michigan Creative Film Alliance to help build an infrastructure of skilled professionals who can support a self-sustaining film industry in the state.

To learn more about filming on the U-M campus, visit *www.vpcomm.umich.edu/film*.

Sultan Sharrief, EFEX Program

CREATIVITY & INNOVATION

- The world-reknowned Royal Shakespeare Company marked its fourth visit to U-M March 20–31. The collaboration, which focused exclusively on the play development process, included 16 actors and a nine-member creative team who developed three new works, including the reconstruction of a "lost" play credited to Shakespeare.

Scott C. Soderberg, U-M Photo Services

▼

- Inspiring students to pursue careers in automotive engineering was one of the goals behind a new technology exhibit that ran September 9–17 at the Duderstadt Gallery on North Campus. The GM/U-M Institute of Automotive Research and Education sponsored the event.

- U-M film students and recent graduates came from as far away as Los Angeles and New York to gather at the 2009 Traverse City Film Festival. The group presented two short films made for a Screen Arts and Cultures class.

- U-M burn surgeon Mark Hemmila reported at a September conference that treating second-degree burns with a nanoemulsion lotion sharply curbs bacterial growth and reduces inflammation. The formulation was developed at U-M and is licensed to U-M spin-off NanoBio Corp.

- U-M launched a new website, *www.montage.umich.edu,* to promote appreciation of the power and relevance of the arts and creativity in people's lives. The multimedia site features university cultural news, faculty profiles, think pieces, and student stories.

- U-M Health System researchers will lead a $10.25 million, five-year effort to study nephrotic syndrome, a rare disease that causes kidney failure. The syndrome contributes to nearly 12 percent of cases of kidney failure at an annual cost of more than $3 billion.

- As part of an ongoing effort to improve the way it conducts business, U-M launched a benchmarking study at its Ann Arbor campus to examine a number of its administrative functions. The study collects data in key areas ranging from technology allocation to staff mixes using various survey tools and interviews.

- Tech Transfer launched the Michigan Venture Center to enhance U-M's venture creation capability, and plans a faculty start-up accelerator unit at the NCRC. U-M is among the nation's leaders in creating start-up ventures based on university technology.

- At this year's MPowered 1,000 Pitches entrepreneurship competition, students from across campus submitted 2,165 ideas for new products, businesses, or social ventures. Each of the nine winners received a $1,000 prize. Organizers believe it is the largest pitch contest in the world.

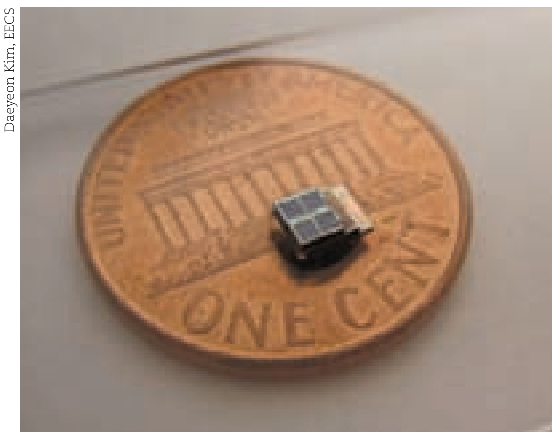
- Ann Arbor-based U-M spin-off HistoSonics Inc. secured $11 million in financing to develop a novel medical device that uses tightly focused ultrasound pulses to treat prostate disease. The five company founders and device co-inventors are all from U-M.

- Six engineering students at UM-Dearborn were among the first developers to adapt Ford Motor Co.'s new SYNC application programming interface for in-car voice-controlled smartphone mobile apps. The two resulting apps included SYNCcast, which lets users enjoy internet radio in the vehicle, and a navigation app called FollowMe.

- A 9-cubic millimeter sensor developed at U-M can operate nearly perpetually on solar power. The device, which is 1,000 times smaller than comparable commercial systems, could enable new biomedical devices and vastly improve current environmental sensor networks.

▲

Daeyeon Kim, EECS



- TechArb, a small-business incubator for student entrepreneurs, found a permanent home in November with the help of the College of Engineering's Center for Entrepreneurship and various private partners. TechArb's space in McKinley Towne Centre will be between internet giant Google and economic development group Ann Arbor SPARK.

- U-M faculty and staff authors who would like to publicize their books can do so through Books in Print, a new website (*www.ns.umich.edu/books*) hosted by the Office of the Vice President for Communications.

- U-M's multiyear IT strategy, NextGen Michigan, kicked off in February. The plan aims to develop a world-class IT infrastructure that will advance U-M's academic, clinical, and research programs while reducing costs.

- Research by a U-M team about potent muscle-building hormones called IGFs (insulin-like growth factors) could lead to new treatments for muscle-wasting diseases, ways to prevent muscle loss caused by aging, and potential new insights into cancer biology.

- Nine faculty members were honored on May 3 with the second annual Teaching Innovation Prize. Each of the five winning project teams, selected from a field of 58 entries, received $5,000. The prize is sponsored by the Office of the Provost, the Center for Research on Learning and Teaching, and the U-M Libraries.

- The Scribble, an electronic doodle pad that animates your drawings, won a toy design competition organized by the College of Engineering's Center for Entrepreneurship. The four-member student team from the School of Art & Design received a $2,500 prize. The idea for the device grew out of a focus group that asked third-graders what they wanted from Santa.

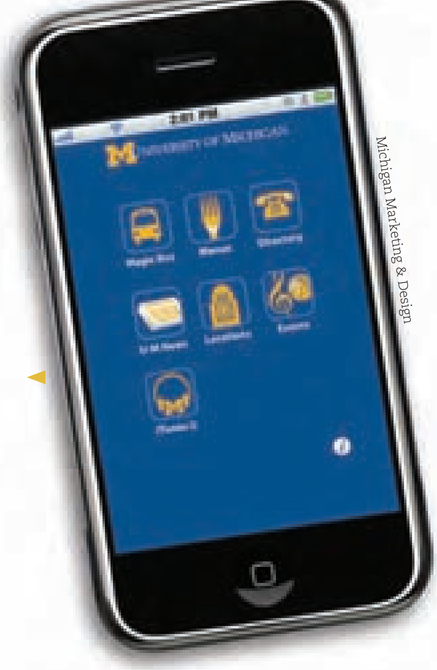
- A free iPhone app that provides access to news, events, and other university information, became available on *mobileapps.its.umich.edu*, a new website created to encourage and support mobile computing needs at U-M.

- *Crain's Detroit Business* and the Detroit Regional Chamber named U-M Nonprofit Employer of the Year. The award, presented for the first time, recognizes U-M's innovative Development Summer Internship Program.

- The School of Art & Design's ongoing video series, *PLAY,* received an Emmy Award in the arts and entertainment category. The award marks the fourth Emmy in three years for the series, which can be seen on cable television's Michigan Channel.

- Rare Egyptian mummy masks and a spectacular Tiffany chandelier were just some of the treasures on display during the 2009–10 theme year, "Meaningful Objects: Museums in the Academy." Sponsored by LSA, the theme year celebrated the contributions of U-M's 12 museums to local intellectual, cultural, and social life.

Lin Jones, U-M Photo Services



Michigan Marketing & Design

- A report released in May by The Science Coalition cited U-M spin-off companies Arbor Networks and Health Media, Inc. as examples of highly successful companies that trace their founding to breakthrough university research sponsored by a federal agency.

- Tonic, a digital media company, acquired the popular DoGood iPhone application developed last year by the U-M student-run company Mobil33t. The free app provides a daily virtuous deed suggestion for the close to 70,000 people who have downloaded it so far.

- U-M named Victor Strecher, a professor at the School of Public Health and the Medical School, Distinguished University Innovator for 2010. Strecher was the founder of HealthMedia Inc., which health care giant Johnson & Johnson acquired in 2008.

- In fiscal 2010, U-M researchers reported 290 new inventions. U-M Tech Transfer licensed 97 technologies, matching their all-time high, and added 10 new start-ups to the 93 ventures created in the last 10 years. Royalties increased 16 percent to $17.5 million while total revenues reached a record $39.8 million, largely due to a one-time revenue payment.

ACCORDING TO U-M'S MOST RECENT ENVIRONMENTAL REPORT, 57 PERCENT OF THE ANN ARBOR CAMPUS'S LAND IS DEDICATED TO NATURAL GREEN SPACE, WITH AN ADDITIONAL 24 PERCENT IN MAINTAINED GREEN SPACE.

Phil Dattilo

EXCELLENCE & ACHIEVEMENT

U-M Sustainability Initiative making an impact

Lisa Pappas, GESI

Launched by President Coleman last year, U-M's Sustainability Initiative is a campus-wide collaboration involving academics, research, and operations that is yielding impressive results and reinforcing the university's leadership position on this important global issue.

The Planet Blue Operations Team continues to reduce energy consumption in buildings by upgrading mechanical systems and educating building occupants. Their first 35 projects decreased overall energy use by about 11 percent and resulted in over $3 million in avoided utility costs.

The Office of Campus Sustainability and the Graham Environmental Sustainability Institute are co-leading an Integrated Assessment (IA) involving faculty, staff, and students to develop recommendations for improving operational sustainability on campus. With a focus on buildings, energy, transportation, land and water use, food, purchasing and recycling, and culture, the IA is harnessing the collective power of some of the university's best minds to help U-M meet the environmental challenges of tomorrow.

U-M offers students over 400 courses related to sustainability and more than 400 faculty are engaged in sustainability research and instruction. U-M is also making sustainability science a cornerstone of its research mission. Recent awards include $3 million for renewable energy, $4.4 million for climate adaptation science, and $5 million for research on the water–climate nexus. Going forward, U-M's collaborative research in sustainability will focus on three key areas—fresh water, climate, and livable communities.

Effectively tackling complex sustainability challenges requires innovation and broad-based collaboration. To that end, U-M will rely on the considerable talents of its students, faculty, staff, alumni, and external partners to make a "sustainable difference" in the world.

To learn more about U-M's Sustainability Initiative, visit *www.sustainability.umich.edu*.

Jim Erickson, U-M News Service

EXCELLENCE & ACHIEVEMENT

- U-M remains near the top in the *U.S. News & World Report's* annual rankings of the nation's best colleges and universities. Michigan was 27th on the 2010 undergraduate list. Among graduate programs, U-M maintained top-14 rankings in the magazine's 2010 edition of *America's Best Graduate Schools*.


Martin Vloet, U-M Photo Services

- Chinese dignitaries and U-M leaders came together at the Museum of Art on November 5 for the official opening of U-M's Confucius Institute. The institute aims to develop educational cooperation between the two countries and to promote Chinese arts and culture.

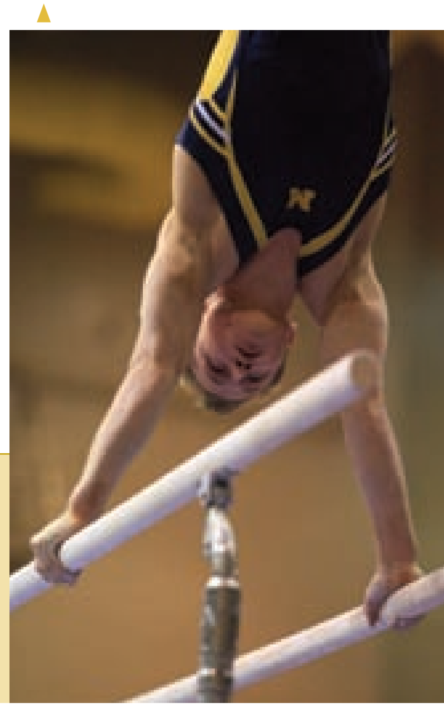
- U-M Photo Services photographer Martin Vloet was named 2009 Photographer of the Year by the University Photographers' Association of America.

- Electromagnetics researcher Anthony Grbic, an assistant professor of electrical engineering and computer science, was one of 100 recipients this year of a Presidential Early Career Award for Scientists and Engineers.

- In November the 20,000-square-foot William E. Upjohn Exhibit Wing of the Kelsey Museum of Archaeology opened to the public. The project was funded by an $8.5 million gift from the late Ed and Mary Meader of Kalamazoo.

- As of June 30, U-M received 495 grants totaling $221 million in American Recovery and Reinvestment Act funding, making U-M one of the largest beneficiaries of the $787 billion federal economic stimulus package.

- In athletics, men's gymnastics captured the NCAA championship while women's gymnastics won its fourth straight Big Ten title. Ice hockey took the CCHA Championship; softball clinched its seventh consecutive NCAA Regional and third straight Big Ten title; the Big Ten champion women's tennis team won its NCAA Regional; and the water polo team won the CWPA Eastern championships for the third straight season. Two varsity club teams—men's lacrosse and men's rowing—each claimed their third consecutive national titles.


Walt Middleton, U-M Photo Services

- For the second year, U-M made the *Chronicle of Higher Education*'s list of Great Colleges to Work For.

- Enrollment on the Ann Arbor campus hit an all-time high in fall 2009 with 41,674 students, including a freshman class of 6,079 students, a 5.1 percent increase from the previous year.

Martin Vloet, U-M Photo Services

- Seven U-M scholars and 28 students won Fulbright Fellowships for 2009–10. The Ann Arbor campus led the country in faculty winners along with Michigan State University and the University of Oregon. UM-Flint also produced a Fulbright Scholar.

- UM-Dearborn's accreditation with the Higher Learning Commission of the North Central Association of Colleges and Schools was expanded to include the campus's new doctorate in education degree program. The program began in fall 2009 with 18 students.

- Two faculty members were elected to the Institute of Medicine. They are: Arul Chinnaiyan, professor of pathology at the Medical School; and Ana Diez-Roux, professor of epidemiology at the School of Public Health.

- U-M topped all other U.S. universities for the amount of public interest measured by media coverage, internet traffic, and social media mentions, according to an independent national analysis released by the Global Language Monitor's newest Predictive Qualities Indicator survey.

- *Time* magazine named President Mary Sue Coleman one of the nation's 10 Best College Presidents, citing her leadership of the six-year $3.2 billion Michigan Difference campaign and her efforts to build a strong relationship with the city of Detroit.

- Brian Coppola, professor of chemistry, was selected as a 2009 U.S. Professor of the Year by the Carnegie Foundation for the Advancement of Teaching and the Council for Advancement and Support of Education.

- In June, U-M earned 10 more years of accreditation from The Higher Learning Commission of the North Central Association of Colleges and Schools.

- The U-M Board of Regents named four 2010 recipients of Distinguished University Professorships. They are: David Halperin, English language and literature; Yoram Koren, mechanical engineering; David Meyer, psychology; and Fawwaz Ulaby, electrical engineering and computer science.

- The UM-Flint Chamber Singers performed at a Black History Month observance at the Pentagon in Washington, DC on February 11 at a ceremony honoring the "Triple Nickel" 555th Parachute Infantry Battalion, an all-black unit that served during WWII.

Martin Vloet, U-M Photo Services

- For the 16th year in a row, *U.S. News & World Report* named U-M Hospitals and Health Centers one of "America's Best Hospitals." U-M placed 14th overall for the second consecutive year and was the only hospital in Michigan to make the national honor roll. The magazine also named C.S. Mott Children's Hospital as one of "America's Best Children's Hospitals."

- Five faculty members were honored with Arthur F. Thurnau Professorships for their outstanding contributions to undergraduate education. They are: Joel Blum, geological sciences, and ecology and evolutionary biology, LSA; Anne Ruggles Gere, education, School of Education, and English language and literature, LSA; Louis Loeb, philosophy, LSA; Robin Queen, linguistics, and Germanic languages and literatures, LSA; and Edward West, art, School of Art & Design.

- In addition to 14 Broadcast Excellence Awards, Michigan Public Radio won Broadcaster of the Year for the eighth time in nine years from the Michigan Association of Broadcasters.

- Perry Samson, professor of atmospheric, oceanic and space sciences, was chosen as a Michigan Distinguished Professor of the Year by the President's Council of State Universities.

- Valerie Lee, professor of education and faculty associate at the Institute for Social Research, was elected to the National Academy of Education; and Barry Rabe, professor of public policy in the Gerald R. Ford School of Public Policy, was inducted as a fellow of the National Academy of Public Administration.

- Six U-M professors were among 180 winners of Guggenheim Fellowships. They are: David Caron, French and women's studies; Holly Hughes, art and design, theatre and drama, and women's studies; Shinobu Kitayama, psychology; Tomoko Masuzawa, history and comparative literature; Elizabeth Sears, history of art; and Richard Tillinghast, a professor emeritus of English.

Alex Dowling, U-M Solar Car Team

- Finishing more than two hours ahead of its nearest competitor, the U-M Solar Car Team won the American Solar Challenge for a third consecutive North American title.

- U-M survey expert Robert Groves, Institute for Social Research Director James S. Jackson, and School of Public Health biostatistics Professor Roderick Little were named to the American Academy of Arts and Sciences.

THE NORTH QUAD DESIGN FOCUSED ON MAXIMIZING ENERGY EFFICIENCY AND INCORPORATES NUMEROUS ENERGY CONSERVATION MEASURES.

Ben Logan, U-M Alumni Association

MAJOR PROJECTS

North Quad blends academics and residential life

The last time U-M built a new residence, Bursley Hall in 1967, Lyndon Johnson was president and FM radio represented the cutting edge of electronic media. After its completion in May, the North Quadrangle Residential and Academic Complex (North Quad) opened as a home to 450 undergraduates as well as six media-related U-M schools, units, and programs. U-M's first new residence hall in more than four decades, North Quad also emerges as a hub for learning and collaboration.

Martin Vloet, U-M Photo Services

A cornerstone of President Mary Sue Coleman's Residential Life Initiative, North Quad combines residential and academic spaces to immerse its residents in a 24/7 learning environment, allowing a diverse group of students to connect with each other, with faculty, and with resources for intellectual and personal growth. The facility will feature high-tech classrooms and labs, faculty offices, a dining hall, and abundant common areas with wireless access and high-definition video monitors displaying everything from breaking news to works of art.

Located at the corner of State and Huron on the site of the old Frieze Building, the classic brick and stone exterior of North Quad blends easily into the U-M landscape. The project cost of $175 million was funded by University Housing, the Office of the Provost, LSA, and investment proceeds.

"The North Quad environment will combine state-of-the-art technology with tremendous opportunities for collaborative, hands-on learning," says LSA Dean Terrence J. McDonald. "The energetic exchange of ideas that it inspires will put Michigan squarely at the forefront of teaching for the 21st century."

To learn more about North Quad, visit *www.housing.umich.edu*.

Scott R. Galvin, U-M Photo Services

MAJOR PROJECTS

Projects in Planning

George Granger Brown Memorial Laboratories Mechanical Engineering Addition

Burton Memorial Tower Façade and Bell Tower Repairs

Crisler Arena Renovation

James and Anne Duderstadt Center Air Barrier and Mechanical System Repairs

Fuller Road Station

Carl A. Gerstacker Building Molecular Beam Epitaxy Laboratory Renovation

Golf Practice Facility

Institute for Social Research Addition

Alice Crocker Lloyd Renovation

Lorch Hall Building Envelope Repair

Michigan Memorial Phoenix Laboratory Addition and Second Floor Renovation

North Campus Chiller Plant Expansion

University of Michigan Hospitals and Health Centers Programs

- C.S. Mott Children's and Von Voigtlander Women's Hospitals Replacement Project Shell Space Completion Project
- Multiple Buildings Pneumatic Tube System Upgrade
- University Hospital Emergency Department Expansion

Projects in Progress

Administrative Services Building Substation Replacement | Work started April 2010 with an estimated completion date of December 2010. Financing is from investment proceeds.

Building Access Control Project | Work started December 2009 with an estimated completion date of June 2011. Financing is from investment proceeds.

Central Campus Transit Center | Work started April 2010 with an estimated completion date of December 2010. Financing is from federal transportation funds and federal American Recovery and Reinvestment Act of 2009 funds via the Ann Arbor Transportation Authority, with the university providing matching funds from Business and Finance, Parking, and utilities reserves.

Central Power Plant Water Treatment System Improvements | Work started May 2010 with an estimated completion date of March 2011. Financing is from utilities reserves.

Couzens Hall Renovation | Work started April 2010 with an estimated completion date of September 2011. Financing is from Housing and investment proceeds.

Engineering Programs Building Addition | Work started September 2009 with an estimated completion date of December 2010. Financing is from College of Engineering.

Scott C. Soderberg, U-M Photo Services

C.S. MOTT CHILDREN'S AND VON VOIGTLANDER WOMEN'S HOSPITALS

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.

Intercollegiate Soccer Stadium | Work started October 2009 with an estimated completion date of September 2010. Financing is from Athletic Department and gifts.

Edward Henry Kraus Building Biology Laboratory Renovations | Work started February 2010 with an estimated completion date of December 2010. Financing is from College of LSA.

Kresge Complex Demolition | Work started February 2010 with an estimated completion date of March 2011. Financing is from Medical School.

Law School Academic Building and Hutchins Hall Law School Commons Addition | Work started June 2009 with an estimated completion date of June 2012. Financing is from gifts, investment proceeds, and Law School.

Player Development Center for Intercollegiate Basketball | Work started April 2010 with an estimated completion date of December 2011. Financing is from Athletic Department and gifts.

Thompson Street Parking Structure Addition | Work started April 2009 with an estimated completion date of December 2010. Financing is from Parking and investment proceeds.

University of Michigan Hospitals and Health Centers Programs | Financing is from Hospitals and Health Centers.

- C.S. Mott Children's and Von Voigtlander Women's Hospitals Replacement Project | Work started February 2007 with an estimated completion date of June 2012. Financing is from Hospitals and Health Centers and gifts.
- 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.
- University Hospital Central Sterile Supply Expansion | Work started January 2010 with an estimated completion date of March 2012.

U-M AEC

LAW SCHOOL ACADEMIC BUILDING AND HUTCHINS HALL LAW SCHOOL COMMONS ADDITION

- University Hospital Emergency Power System Improvements | Work started January 2010 with an estimated completion date of December 2010.
- University Hospital Inpatient Adult Psychiatry Renovation | Work started August 2009 with an estimated completion date of December 2010.

Varsity Drive Building and Alexander G. Ruthven Museums Building Museum of Zoology Collection Relocation and Renovations | Work started April 2010 with an estimated completion date of December 2012. Financing is from investment proceeds.

Wolverine Tower Renovations for Business and Finance | Work started April 2010 with an estimated completion date of December 2011. Financing is from Business and Finance.

U-M AEC

THE CENTRAL CAMPUS TRANSIT CENTER

Martin Vloet, U-M Photo Services

MADELON LOUISA STOCKWELL HALL RENOVATION

Projects Completed

Vera Baits II Mechanical Infrastructure Renewal | Completed August 2009. Financed by University Housing.

Bahna Wrestling Center | Completed December 2009. Financed by Athletic Department and gifts.

Camp Davis Rocky Mountain Field Station Cabin Replacement and Infrastructure Improvement | Completed August 2009. Financed by College of LSA.

Central Campus Area Utility Tunnel and Piping Replacement 2009 | Completed September 2009. Financed by utilities reserves.

Central Power Plant 2.4KV Switchgear Upgrade | Completed September 2009. Financed by utilities reserves.

Central Power Plant Replacement Steam Turbine | Completed March 2010. Financed by utilities reserves.

Chemistry Building and Willard H. Dow Laboratory Chiller Replacement | Completed June 2010. Financed by general fund.

William W. Cook Legal Research Library Elevator Replacement | Completed June 2010. Financed by investment proceeds.

East Quadrangle Residential College Auditorium Renewal | Completed August 2009. Financed by gifts, general fund, and College of LSA.

East University Chiller Plant New Chiller | Completed September 2009. Financed by investment proceeds.

Environmental and Water Resources Engineering Building Research Laboratories for Civil and Environmental Engineering | Completed December 2009. Financed by College of Engineering.

Ford Nuclear Reactor Decommissioning | Completed July 2009. Financed by investment proceeds.

Thomas Francis, Jr., Public Health Building Elevator Replacement | Completed February 2010. Financed by general fund.

Al Glick Field House | Completed September 2009. Financed by Athletic Department and gifts.

W.K. Kellogg Institute and Dental Building Exterior Repairs 2008 | Completed September 2009. Financed by investment proceeds.

W.K. Kellogg Institute and Dental Building Information Technology Infrastructure Upgrade | Completed May 2010. Financed by investment proceeds.

Clarence Cook Little Science Building Third and Fifth Floor Geology Laboratories and Offices | Completed June 2010. Financed by College of LSA.

Modern Languages Building Chilled Water Plant Expansion | Completed September 2009. Financed by utilities reserves and general fund.

Earl V. Moore Building Infrastructure Improvements | Completed December 2009. Financed by investment proceeds and utilities reserves.

North Campus Research Complex Buildings 100, 200, 300, and 400 Interior Renewal | Completed April 2010. Financed by the Medical School.

North Campus Switch Station Transformer Upgrades | Completed May 2010. Financed by utilities reserves.

North Quad Residential and Academic Complex | Completed May 2010. Financed by University Housing, Office of the Provost, College of LSA, and investment proceeds.

Alexander G. Ruthven Museums Building Elevator Replacement | Completed March 2010. Financed by general fund.

Scott R. Galvin, U-M Photo Services

▶ THE TOWSLEY CENTER FOR CHILDREN

BREHM TOWER ◀

Scott C. Soderberg, U-M Photo Services

Madelon Louisa Stockwell Hall Renovation | Completed August 2009. Financed by University Housing and investment proceeds.

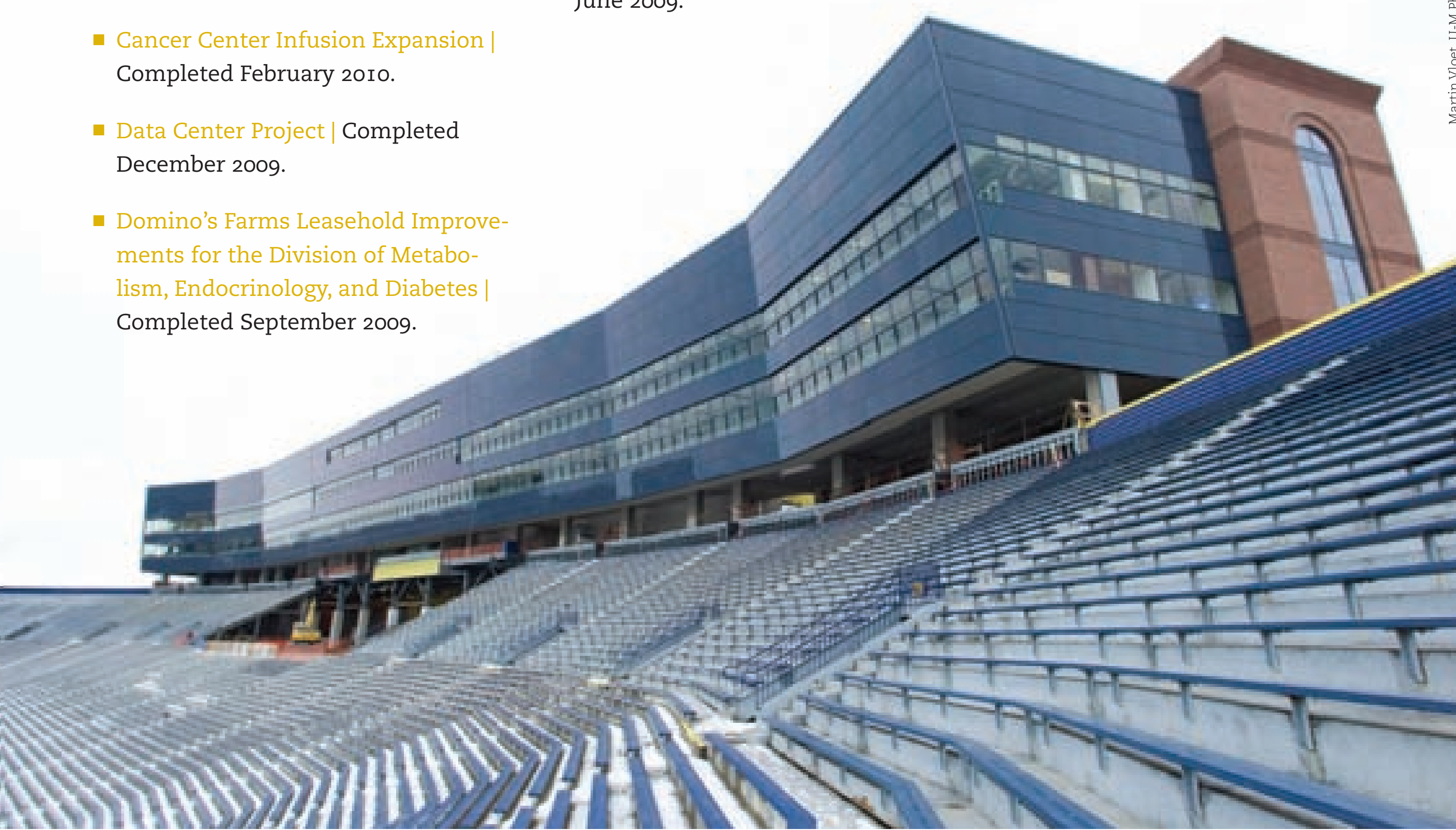
Towsley Center for Children Replacement Facility | Completed December 2009. Financed by investment proceeds.

Michigan Stadium Renovation and Expansion Project | Work started July 2007 with an estimated completion date of December 2010. Substantially complete June 2010. Financing is from Athletic Department and gifts.

University Of Michigan Hospitals and Health Centers Programs | Financed by Hospitals and Health Centers.

- Briarwood 2 and 4 Renovations | Completed October 2009.
- Cancer Center Infusion Expansion | Completed February 2010.
- Data Center Project | Completed December 2009.
- Domino's Farms Leasehold Improvements for the Division of Metabolism, Endocrinology, and Diabetes | Completed September 2009.
- East Ann Arbor Health and Geriatrics Center Renovations for New Infusion Suite | Completed June 2010.
- Eye Center Expansion | Completed February 2010. Financed by Hospitals and Health Centers, Medical School, and gifts.
- A. Alfred Taubman Health Care Center Level B1 Medical Observation Unit | Completed August 2009.
- A. Alfred Taubman Health Care Center Second Level Clinic Entry Renovations | Completed October 2009.
- University Hospital Air Handling Upgrades | Completed March 2010.
- University Hospital Computed Tomography and Interventional Radiology Expansion | Completed June 2009.
- University Hospital Inpatient Bed Expansion – Unit 7A | Completed December 2009.
- University Hospital Morgue Renovation | Completed August 2009.
- University Hospital Positron Emission Tomography/Computed Tomography Scanner Expansion | Completed October 2009.
- University Hospital Process Chilled Water Expansion and New Cooling Tower | Completed June 2010.

MICHIGAN STADIUM RENOVATION AND EXPANSION PROJECT



Martin Vloet, U-M Photo Services

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 10, 2010

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 53 to 81, 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, 2010 and 2009, 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. 53, *Accounting and Financial Reporting for Derivative Instruments,* as of July 1, 2009.

The Management's Discussion and Analysis ("MD&A") on pages 36 through 52 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 10, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Unaudited)*

Introduction

The following discussion and analysis provides an overview of the financial position of the University of Michigan (the "University") at June 30, 2010 and 2009 and its activities for the three fiscal years ended June 30, 2010. 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 58,000 students and 6,900 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 41,000 permanent employees and 11,000 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 $13.7 billion and liabilities of $4.3 billion at June 30, 2010, compared to assets of $12.9 billion and liabilities of $4.2 billion at June 30, 2009. Net assets, which represent the residual interest in the University's assets after liabilities are deducted, totalled $9.4 billion at June 30, 2010 as compared to $8.7 billion at June 30, 2009. Changes in net assets represent the University's results of operations and are summarized for the years ended June 30, 2010 and 2009 as follows:

(in millions)	2010	2009
Operating revenues and educational appropriations	$ 5,010.5	$ 4,687.3
Total operating and net interest expenses	5,306.8	5,119.3
	(296.3)	(432.0)
Net investment income (loss)	796.4	(1,851.9)
Gifts and other nonoperating revenues, net	198.3	195.5
Increase (decrease) in net assets	$ 698.4	$ (2,088.4)

Net assets increased $698 million in fiscal 2010, primarily due to net investment income which totalled $796 million. Net assets decreased $2.1 billion in fiscal 2009, primarily due to net investment losses which totalled $1.9 billion.

The results of operations reflect the University's focus on maintaining its national standards academically, and in research and health care, while addressing declining base state appropriations and rising health care, regulatory, and facility costs in a competitive recruitment environment for faculty and health care professionals. Operating revenues and educational appropriations increased 7 percent, or $323 million, due primarily to increases in federal grants and patient care revenues. Total operating and net interest expenses increased 4 percent, or $188 million, which reflects increases in patient care and sponsored research activities, offset by aggressive cost cutting and productivity gains.

Net investment income totalled $796 million in 2010, as compared to net investment losses of $1.9 billion in 2009. 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 endowment investment activities is 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.

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, 2010 and 2009 is summarized as follows:

(in millions)	2010	2009
Current assets	$ 1,685	$ 1,825
Noncurrent assets:		
Endowment, life income and other investments	6,807	6,215
Capital assets, net	4,956	4,627
Other	268	265
Total assets	13,716	12,932
Current liabilities	1,346	1,669
Noncurrent liabilities	3,007	2,598
Total liabilities	4,353	4,267
Net assets	$ 9,363	$ 8,665

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, 2010 and 2009, 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 $140 million, to $1.7 billion at June 30, 2010, primarily due to decreases in cash and investments. Cash, cash equivalents and operating investments totalled $767 million at June 30, 2010, which represents approximately two months of total expenses excluding depreciation.

Current liabilities consist primarily of accounts payable, accrued compensation, deferred revenue, commercial paper, the current portion of bonds payable and net long-term bonds payable subject to remarketing. Current liabilities decreased $323 million, to $1.3 billion at June 30, 2010, primarily due to a decrease in net long-term bonds payable subject to remarketing. The variable rate portion of bonds payable has remarketing features which allow bondholders to put debt back to the University and is, accordingly, classified as a current liability unless supported by long-term liquidity agreements which can refinance the debt on a long-term basis.

Endowment, Life Income and Other Investments

The University's endowment, life income and other investments increased $592 million, to $6.8 billion at June 30, 2010. This increase primarily resulted from unrealized gains on investments and the receipt of new endowment funds through gifts and transfers, offset by endowment distributions to beneficiary units for operations. The composition of the University's endowment, life income and other investments at June 30, 2010 and 2009 is summarized as follows:

(in millions)	2010	2009
Endowment investments	$ 6,564	$ 6,001
Life income investments	94	89
Noncurrent portion of insurance and benefits obligations investments	149	125
	$ 6,807	$ 6,215

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 approximately 7,100 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. In addition, departments may also use withdrawals from funds functioning as endowment to support capital expenditures and operations.

Endowment spending rate distributions totalled $255 million, $244 million and $227 million and withdrawals from funds functioning as endowment totalled $5 million, $46 million and $20 million in 2010, 2009 and 2008, respectively. Total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 5.1 percent, 5.9 percent and 4.0 percent of the current year average fair value of the University Endowment Fund for 2010, 2009 and 2008, respectively. Over the past ten years, total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 5.8 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 totalled $695 million in 2010, as compared to $844 million in 2009. Capital asset additions primarily represent replacement, renovation and new construction of academic, research, clinical, athletic and student residence 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 $521 million, as well as debt proceeds of $172 million and state capital appropriations of $2 million.

Construction in progress, which totalled $546 million at June 30, 2010 and $786 million at June 30, 2009, includes important new facilities for patient care, research, instruction, athletics and student residential life.

At June 30, 2010, construction continues on a new facility for C.S. Mott Children's Hospital and Von Voigtlander 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 fiscal 2012, the existing C.S. Mott Children's Hospital and Women's Hospital will be used to benefit the entire Health System.

Construction projects are also underway at the Law School. Legal education has changed considerably since Hutchins Hall, the main classroom and administrative building for the Law School, opened in 1933. Today's law students take a greater number of small classes, interact more with each other and with clients in supervised clinical settings, and draw heavily on technology. Located across Monroe Street and south of the Law Quad, a new four-story academic and administrative building is under construction to meet these needs, as well as provide more space for a student body which has more than doubled since the last time the Law School added classroom space. In addition, the new, two-level Robert B. Aikens Commons will occupy the currently unused grassy area between Hutchins Hall and the Legal Research Building. This structure will include a main floor café and a lower level designed to facilitate student meetings and study groups. This project also includes life safety upgrades to Hutchins Hall and the Cook Library. These projects are scheduled to be completed in fiscal 2012.

The renovation of Couzens Residence Hall serves to meet the contemporary and future needs of students, by thoroughly updating the building's infrastructure while preserving its traditional design. New and reorganized spaces within the facility will revitalize the old residence hall and create spaces for living-learning and academic initiatives, student interaction, and creation of community. The building's infrastructure will also be 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. In addition, energy conservation measures will be implemented to improve the energy performance of the overall building. This renovation, scheduled to be completed in Spring 2011, is part of the University's residential life initiatives and follows deep renovations to Mosher Jordan and Stockwell residence halls in previous years.

Expansion and renovation projects completed in 2010 include Brehm Tower, North Quad Residential and Academic Complex, Stockwell Residence Hall and Michigan Stadium.

Brehm Tower provides a new state-of-the art eye center that more than doubles capacity for eye care, research and education, as well as provides scientists more space to search for a cure for Type 1 diabetes. This new facility, which is connected to the current Kellogg Eye Center Tower includes eight floors for clinics, surgery and research, serving 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 allow natural light to fill the clinics and common space, of particular benefit to patients whose vision is impaired. The Tower's clinics have space for patient education and comfortable waiting areas designed to aid patient flow. Research areas feature open laboratories to encourage collaboration and provide flexibility as research projects grow. The new facility also houses the Brehm Center for Type 1 Diabetes Research and Analysis, which provides significant opportunities for collaboration among diabetes and vision scientists, particularly on vision loss caused by diabetes.

Construction of the first new student residence hall on the Ann Arbor campus in more than 40 years was completed this summer. The North Quad Residential and Academic Complex combines sophisticated classroom and academic space with residence space for 460 students. This results in 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, social and programmatic needs. The academic space will provide classrooms, studios and offices for five information and communications-related university programs.

The comprehensive renovation of Stockwell Residence Hall, which was completed in Fall 2009, meets the contemporary and future needs of students, while preserving the building's historic character. The building's infrastructure was 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. In addition, because dining services formerly located within the building are now provided in the new Hill Dining Center, space was available for the creation of meeting and community spaces for student interaction and living and learning activities.

A comprehensive renovation and expansion of Michigan Stadium was finished in time for the start of the 2010-11 football season. Renovation to the stadium itself resulted 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 added 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. These structures include 83 suites and approximately 3,000 club seats.

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 nearly 174 acres of land acquired. Known collectively as the North Campus Research Complex ("NCRC"), these buildings with nearly 2 million square feet of sophisticated laboratory facilities and administrative space will provide much needed space to help attract new research funding and faculty to the University.

During 2010, $30 million of the acquired NCRC property was placed in service, including administrative and utility buildings and a 300-space parking lot at the southern end of the property open to university commuters. The first phase of administrative building occupancy encompassed groups involved in supporting research and approximately 300 current employees were moved into four office buildings in the complex. These office-related functions were readily moved, primarily from leased space, into the NCRC with minimal improvements to the facilities. Other property in the complex, especially laboratories, has longer commissioning and activation timelines and will be the focus of occupancy efforts in 2011 and beyond. The unoccupied portion of the NCRC is classified as property held for future use and totalled $84 million at June 30, 2010. A small, dedicated NCRC staff is moving forward with implementation of the research growth plans developed in 2010, which will involve research groups from multiple schools and colleges across the university.

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 December 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.

The University maintains a combination of fixed and variable rate debt, which totalled $1.5 billion at June 30, 2010. Long-term debt activity for the year ended June 30, 2010, 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	$ 102	$ 8	$ 23	$ 87
Bonds and Notes:				
General revenues	754	365	69	1,050
Hospital revenues	540		240	300
Faculty Group Practice revenues	89		24	65
Student residences revenues	2			2
	$ 1,487	$ 373	$ 356	$ 1,504

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, 2010 and 2009, commercial paper totalled $87 million and $102 million, respectively, and is included in current liabilities.

Consistent with capital and debt financing plans, the University issued fixed rate general revenue bonds in 2010 to refund variable rate debt supported by specific lines of revenue and support capital projects. Total bond proceeds of $365 million, which included a net original issue premium of $18 million, were utilized to refund variable rate hospital and medical service plan revenue supported bonds of

$201 million as well as provide $164 million for capital projects and debt issuance costs. In addition, the University refunded $46 million of variable rate Series 2005B General Revenue Bonds in 2010, utilizing a portion of proceeds from the Series 2009A (fixed rate) and Series 2009B (variable rate) General Revenue Bonds issued in 2009, and extinguished $56 million of variable rate Series 1992A Hospital Revenue Refunding Bonds.

The University continues to increase its mix of fixed rate bonds relative to variable rate demand bonds. While fixed rate bonds typically have a higher effective rate of interest as compared to variable rate demand bonds, they are subject to less volatility from liquidity and interest rate perspectives. The University's fixed and variable rate debt as of June 30, 2010 and 2009 is summarized as follows:

(in millions)	2010	2009
Variable rate:		
Commercial paper	$ 87	$ 102
Demand bonds	760	1,075
Fixed rate bonds	657	310
	$ 1,504	$ 1,487

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.

Interest expense net of federal subsidies received for interest on taxable Build America Bonds and interest capitalized during construction increased 6 percent, to $27 million in 2010. The University maintains a combination of variable and fixed rate debt, with effective interest rates that averaged approximately 2 percent in 2010 and 2009, including the amortization of bond premiums and discounts and net of federal subsidies for interest on taxable Build America Bonds.

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 obligations for postemployment benefits totalled $1.61 billion and $1.56 billion at June 30, 2010 and 2009, 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 totalled $199 million and $201 million at June 30, 2010 and 2009, respectively.

By implementing a series of health benefit initiatives over the past few years, the University has favorably impacted its obligations for postemployment benefits by $281 million. In accordance with GASB Statement No. 45, the University's obligations for postemployment benefits at June 30, 2010 do not reflect anticipated Medicare Part D prescription drug subsidies for future years of $179 million.

Net Assets

Net assets represent the residual interest in the University's assets after liabilities are deducted. The composition of the University's net assets at June 30, 2010 and 2009 is summarized as follows:

(in millions)	2010	2009
Invested in capital assets, net of related debt	$ 3,503	$ 3,276
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,214	1,144
Expendable:		
Net appreciation of permanent endowments	924	808
Funds functioning as endowment	1,447	1,291
Restricted for operations and other	439	606
Unrestricted	1,836	1,540
	$ 9,363	$ 8,665

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 $227 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 $70 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 totalled $2.8 billion at June 30, 2010, as compared to $2.7 billion at June 30, 2009.

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. Unrestricted net assets at June 30, 2010 and 2009 totalled $1.8 billion and $1.5 billion, respectively. At June 30, 2010, unrestricted net assets included funds functioning as endowment of $2.9 billion offset by unfunded obligations for postemployment benefits of $1.6 billion. 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. Unrestricted net assets at June 20, 2010 and 2009 also included other net resources of $500 million.

Statement of Revenues, Expenses and Changes in Net Assets

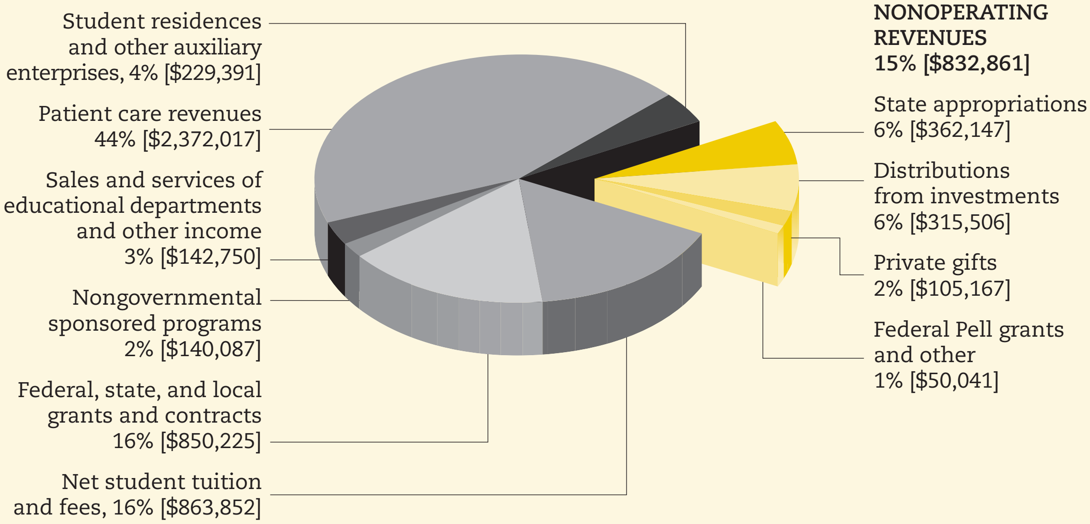
The statement of revenues, expenses and changes in net assets presents the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as either operating or nonoperating. A comparison of the University's revenues, expenses and changes in net assets for the three years ended June 30, 2010 is summarized as follows:

(in millions)	2010	2009	2008
Operating revenues:			
Student tuition and fees, net of scholarship allowances	$ 863.9	$ 826.3	$ 791.2
Sponsored programs	990.3	897.3	832.5
Patient care revenues	2,372.0	2,220.6	2,105.4
Other	372.2	344.4	354.8
	4,598.4	4,288.6	4,083.9
Operating expenses	5,280.1	5,094.2	4,820.0
Operating loss	(681.7)	(805.6)	(736.1)
Nonoperating and other revenues (expenses):			
State educational appropriations	362.1	373.8	404.0
State fiscal stabilization funds	10.1		
Federal Pell grants	39.9	24.9	20.7
Private gifts for operating activities	105.2	96.5	136.7
Net investment income (loss)	796.4	(1,851.9)	620.2
Interest expense	(30.0)	(25.1)	(33.6)
Federal subsidies for interest on Build America Bonds	3.3		
State capital appropriations	2.0	12.2	11.8
Endowment and capital gifts and grants	88.7	88.4	160.1
Other	2.4	(1.6)	(21.0)
Nonoperating and other revenues (expenses), net	1,380.1	(1,282.8)	1,298.9
Implementation of GASB Statement No. 45, postemployment benefits obligations as of July 1, 2007			(1,306.9)
Increase (decrease) in net assets	698.4	(2,088.4)	(744.1)
Net assets, beginning of year	8,664.6	10,753.0	11,497.1
Net assets, end of year	$ 9,363.0	$ 8,664.6	$ 10,753.0

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.

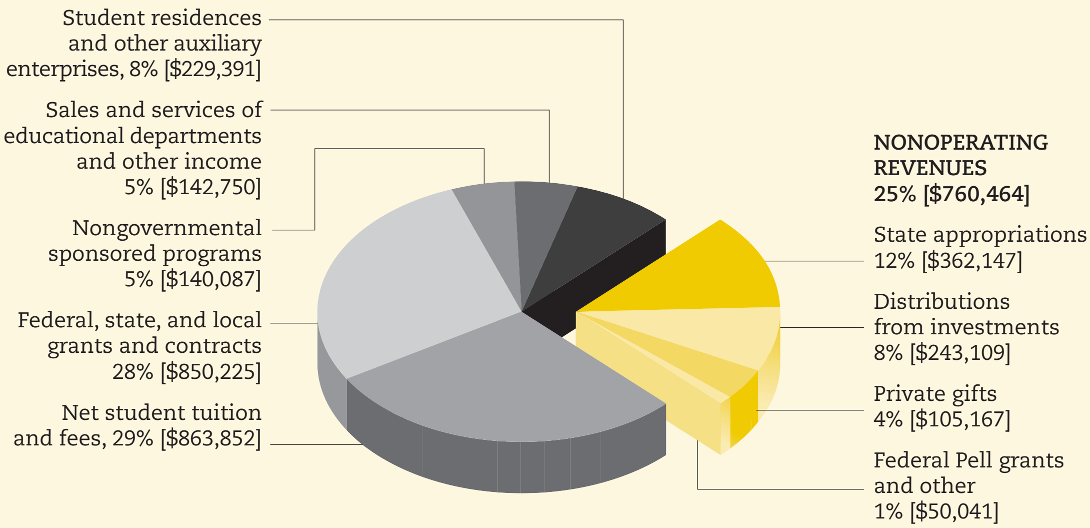
The following is a graphic illustration of revenues by source, both operating and nonoperating, which are used to fund the University's operating activities for the year ended June 30, 2010 (amounts are presented in thousands of dollars). Significant recurring sources of the University's revenues are considered nonoperating, as defined by GASB, such as state appropriations, distributions from investments, private gifts, and federal Pell grants.

Fiscal Year 2010 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, 2010 (amounts are presented in thousands of dollars).

Fiscal Year 2010 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 2 percent, or $26 million, to $1.23 billion in 2010, as compared to 3 percent, or $39 million, to $1.20 billion in 2009.

Downturns in state of Michigan tax revenues continue to put pressure on the state budget. For the three years ended June 30, 2010, state educational appropriations revenue consisted of the following components:

(in millions)	2010	2009	2008
Base appropriations	$ 362.1	$ 373.8	$ 370.1
Net restoration			33.9
	$ 362.1	$ 373.8	$ 404.0

Due to ongoing pressures and volatility in the state budget, the University's base appropriations continue to be constrained, decreasing $8 million or 2 percent, over the past two years. The $34 million net restoration in 2008 represents the return of part of a 2007 mid-year rescission, which totalled $40 million.

To maintain academic excellence and offset constrained base state appropriations, net student tuition and fees revenue increased 9 percent, or $73 million, over the past two years. For the three years ended June 30, 2010, net student tuition and fees revenue consisted of the following components:

(in millions)	2010	2009	2008
Student tuition and fees	$ 1,097.5	$ 1,029.2	$ 975.3
Scholarship allowances	(233.6)	(202.9)	(184.1)
	$ 863.9	$ 826.3	$ 791.2

In 2010, net student tuition and fees revenue increased 5 percent, or $38 million, to $864 million, which reflects a 7 percent, or $68 million, increase in gross tuition and fee revenues offset by a 15 percent, or $31 million increase in scholarship allowances. Tuition rate increases in 2010 were 5.6 percent for all undergraduate and most graduate students on the Ann Arbor campus, with a 6.7 percent tuition rate increase for all undergraduates and 3.1 percent increase for most graduate students on the Dearborn campus, and a 6.5 percent tuition rate increase for most undergraduate students on the Flint campus. The University also experienced a modest growth in the number of students on all three campuses.

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.

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.

In 2010, the University received $10 million from the State Fiscal Stabilization Fund program, a one-time appropriation under the American Recovery and Reinvestment Act of 2009. The U. S. Department of Education awarded state governors funds in exchange for a commitment to advance essential education reforms to benefit students from early learning through post-secondary education, including college. These funds were also awarded to help stabilize state and local government budgets in order to minimize and avoid reductions in education and other essential public services. The University used its $10 million allocation in 2010 to provide financial aid to resident students.

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 totalled $105 million in 2010, as compared to $97 million in 2009 and $137 million in 2008.

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 12 percent, or $108 million, to $1.0 billion in 2010, as compared to an increase of 8 percent, or $69 million, to $922 million in 2009. 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. The increase in federal support for sponsored programs in 2010 was especially fueled by federal stimulus funds from the American Recovery and Reinvestment Act of 2009. Revenues earned from federal stimulus funds for sponsored programs totalled $60 million in 2010, with $58 million specifically for research.

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 7 percent, or $151 million, to $2.4 billion in 2010, as compared to an increase of 5 percent, or $115 million, to $2.2 billion in 2009. 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.

Net investment income totalled $796 million in 2010, compared to net investment loss of $1.9 billion in 2009 and net investment income of $622 million in 2008. Financial markets rebounded strongly in 2010 from the losses in the prior year, with most asset classes experiencing double digit positive returns. The real estate segment of the University's investment portfolio, however, continued to experience losses in 2010. Real estate investments represented 11 percent and 12 percent of the University's total investments at June 30, 2010 and 2009, respectively.

In 2009, the financial market turmoil that followed the banking crisis in 2008 resulted in broad 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.

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 totalled $60 million in 2010, as compared to $61 million in 2009 and $94 million in 2008. Capital gifts and grants totalled $29 million in 2010, as compared to $28 million in 2009 and $66 million in 2008. 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, 2010 is as follows (amounts in millions):

	2010		2009		2008	
Operating:						
Compensation and benefits	$ 3,529.3	66%	$ 3,390.5	66%	$ 3,234.2	67%
Supplies and services	1,276.9	24	1,255.1	24	1,167.6	24
Depreciation	360.1	7	341.5	7	319.4	6
Scholarships and fellowships	113.8	2	107.1	2	98.8	2
	5,280.1	99	5,094.2	99	4,820.0	99
Nonoperating:						
Interest, net	26.7	1	25.1	1	33.6	1
	$ 5,306.8	100%	$ 5,119.3	100%	$ 4,853.6	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 non-academic employers. The resources expended for compensation and benefits increased 4 percent, or $139 million, to $3.5 billion in 2010, as compared to a 5 percent, or $156 million increase, to $3.4 billion in 2009.

Health care benefits are one of the most significant employee benefits. Over the past several years, the University has implemented initiatives to better control its rate of increase, encourage employees to choose the lowest cost insurance plan that meets their needs and share a larger portion of health insurance cost increases with employees.

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 including 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 also actively promotes and manages generic drug utilization and has achieved a 72 percent generic dispensing rate in 2010, as compared to 71 percent in 2009 and 68 percent in 2008.

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. During 2010, MHealthy completed the second university-wide health risk assessment, with more than 15,000 faculty and staff completing an online health risk questionnaire. 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.

Effective January 1, 2010, after careful review by the University's nationally recognized health policy faculty and financial experts, the University commenced a new health benefits cost sharing program which is being phased in over two years. 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 from 100 percent 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 are 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.

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 2 percent, or $22 million, to $1.3 billion in 2010, as compared to an increase of 7 percent, or $88 million, to $1.3 billion in 2009. The increases in 2010 and 2009 are primarily due to increases in patient care and sponsored research activities offset by aggressive cost cutting and productivity gains.

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, 2010 is as follows (amounts in millions):

	2010		2009		2008	
Operating:						
Instruction	$ 858.6	16%	$ 820.3	16%	$ 784.7	16%
Research	671.5	13	622.6	12	571.7	12
Public service	135.8	2	126.5	2	121.9	2
Institutional and academic support	485.0	9	485.2	10	448.7	9
Auxiliary enterprises:						
Patient care	2,244.0	42	2,164.5	42	2,046.0	42
Other	145.3	3	148.6	3	179.6	4
Operations and maintenance of plant	266.0	5	277.9	5	249.2	5
Depreciation	360.1	7	341.5	7	319.4	7
Scholarships and fellowships	113.8	2	107.1	2	98.8	2
	5,280.1	99	5,094.2	99	4,820.0	99
Nonoperating:						
Interest, net	26.7	1	25.1	1	33.6	1
	$ 5,306.8	100%	$ 5,119.3	100%	$ 4,853.6	100%

Instruction and public service expenses increased 5 percent, or $48 million, to $994 million in 2010, as compared to 4 percent, or $40 million, to $947 million in 2009. These increases are consistent with the modest level of growth in the related revenue sources.

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 $1.139 billion in 2010, as compared to $1.017 billion in 2009 and $929 million in 2008. This represents an increase of 23 percent, or $210 million, from 2008 to 2010. This increase includes the impact of stimulus funds from the American Recovery and Reinvestment Act of 2009, which increased the total volume of research expenditures by 5 percent in 2010.

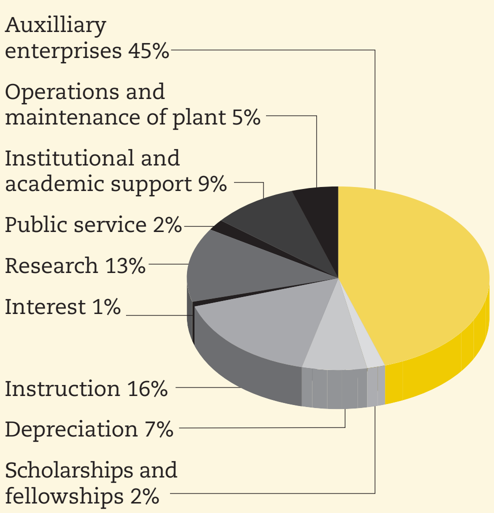
Patient care expenses increased 4 percent, or $80 million, to $2.2 billion in 2010, as compared to a 6 percent, or $119 million increase, to $2.2 billion in 2009. The increases in 2010 and 2009 are the result of increased patient activity, including costs of medical supplies and pharmaceuticals.

Total scholarships and fellowships provided to students aggregated $365 million in 2010, as compared to $327 million in 2009 and $300 million in 2008, an increase of 22 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, 2010 are summarized as follows:

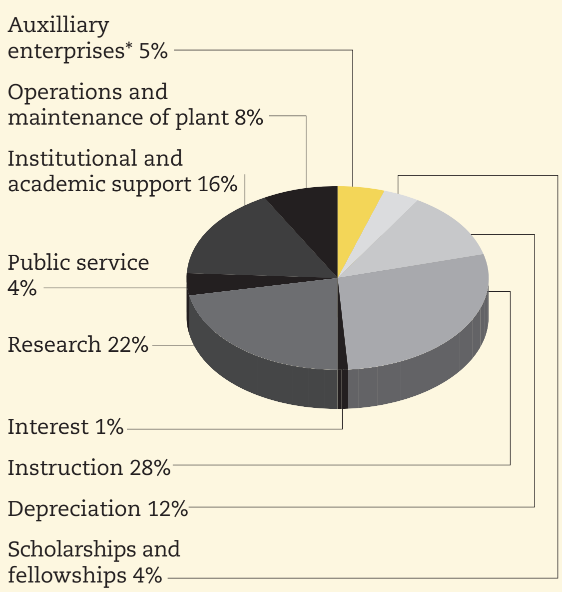
(in millions)	2010	2009	2008
Paid directly to students	$ 113.8	$ 107.1	$ 98.8
Applied to tuition and fees	233.6	202.9	184.1
Applied to University Housing	17.4	16.5	16.7
	$ 364.8	$ 326.5	$ 299.6

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

Fiscal Year 2010 Expenses by Function



Fiscal Year 2010 Expenses by Function Excluding Expenses from the University's Health System



*Excludes expenses from the University's Health System of $2.4 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, 2010 and 2009 is as follows:

(in millions)	2010	2009
Cash received from operations	$ 4,584.1	$ 4,310.3
Cash expended for operations	(4,881.0)	(4,699.3)
Net cash used in operating activities	(296.9)	(389.0)
Net cash provided by investing activities	212.0	256.1
Net cash used in capital and related financing activities	(658.7)	(575.0)
Net cash provided by noncapital financing activities	579.8	571.2
Net decrease in cash and cash equivalents	(163.8)	(136.7)
Cash and cash equivalents, beginning of year	358.4	495.1
Cash and cash equivalents, end of year	$ 194.6	$ 358.4

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, state fiscal stabilization funds, federal Pell grants and private gifts used to fund operating activities. Cash and cash equivalents decreased $164 million and $137 million in 2010 and 2009 respectively, primarily due to planned capital additions.

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 noteworthy 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 a 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. The University's budget for 2011 achieves the lowest tuition rate increase for Ann Arbor campus resident undergraduates since 1984 of 1.5 percent through aggressive cost reduction, reallocation and willingness to make tough decisions regarding priorities. To support the University's commitment to both academic excellence and accessibility, the budget for 2011 also includes 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 2012 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 totalled $792 million at June 30, 2010. Funding for these projects is anticipated to include $766 million from gifts and net assets designated for capital purposes as well as future borrowings, $24 million from the utilization of unexpended debt proceeds and $2 million from the State Building Authority. Economic pressures are expected to affect the State's future support.

The University's investment in the North Campus Research Complex 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.

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.

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.

In July 2010, the Regents approved a change in the University's endowment spending rate policy. Commencing with the quarter ending September 30, 2010, the distribution rate will begin to be lowered from 5.0 percent to 4.5 percent to more effectively protect the purchasing power of the University's endowments and the distributions they provide. The distribution rate will continue to be based upon 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.

This change is a continuation of the university's prudent financial management strategy that has allowed us to weather the recent recession while avoiding drastic measures taken by many of our prestigious peer institutions, such as faculty hiring freezes, furloughs, program cuts or halting construction. To avoid negative impacts of this change on near-term budgets, the reduced distribution rate will be implemented gradually over a number of years. Distributions will be managed towards the 4.5 percent distribution rate by keeping quarter to quarter distributions per share unchanged and only moving toward the 4.5 percent when prior increases in share value otherwise would result in higher per share distributions. The length of the implementation period will depend on the actual investment returns and resulting changes in share values experienced during the implementation period.

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.

The University continues to utilize its nationally recognized health policy experts to guide future health plan strategies. A committee on retiree health benefits was formed in 2010 to help address the acceleration of health benefits costs for current and future retirees and their dependents. This committee's work, now underway, will result in a long-term plan to keep the University's retiree benefits competitive with peer institutions while producing a minimum of $7 million in savings to the University over the next ten years, and more than $80 million by 2040. In addition, a member engagement health plan design committee, also formed in 2010, will recommend changes in our health plan design for 2012 which will include incentives for our members to engage in health and well-being activities, and have positive effects on overall wellness and the University's health care cost trend.

Additionally, U.S. health care reform will influence university benefits planning. Now that health insurance reform legislation has been signed into law, new regulatory requirements will affect health plans, providers and employers alike, and the implementation of the changes will span several years into the future. University experts are diligently reviewing and assessing the short and long-term impacts on our health plans and our health system to develop clear strategies and options for the future that will ensure compliance over the next decade of regulatory change.

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, 2010	2009 (As Adjusted)
Assets		
Current Assets:		
Cash and cash equivalents	$ 194,645	$ 358,373
Operating investments	572,374	345,207
Investments for capital activities	305,386	541,577
Investments for student loan activities	41,033	31,483
Accounts receivable, net	461,622	434,798
Current portion of notes and pledges receivable, net	57,960	64,055
Current portion of prepaid expenses and other assets	52,468	49,529
Total Current Assets	1,685,488	1,825,022
Noncurrent Assets:		
Endowment, life income and other investments	6,807,012	6,215,286
Notes and pledges receivable, net	211,642	219,823
Prepaid expenses and other assets	55,158	44,724
Capital assets, net	4,956,457	4,627,498
Total Noncurrent Assets	12,030,269	11,107,331
Total Assets	**$ 13,715,757**	**$ 12,932,353**
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable	$ 173,923	$ 184,595
Accrued compensation and other	330,042	311,221
Deferred revenue	184,422	187,519
Current portion of insurance and benefits reserves	66,103	67,133
Current portion of obligations for postemployment benefits	51,629	58,401
Commercial paper and current portion of bonds payable	122,581	178,690
Long-term bonds payable subject to remarketing, net	384,550	652,285
Deposits of affiliates and others	32,656	29,705
Total Current Liabilities	1,345,906	1,669,549
Noncurrent Liabilities:		
Accrued compensation	71,610	76,924
Insurance and benefits reserves	89,169	85,912
Obligations for postemployment benefits	1,556,479	1,504,569
Obligations under life income agreements	49,245	47,843
Government loan advances	88,555	87,548
Bonds payable	996,771	656,341
Deposits of affiliates and other	155,034	139,030
Total Noncurrent Liabilities	3,006,863	2,598,167
Total Liabilities	4,352,769	4,267,716
Net Assets:		
Invested in capital assets, net of related debt	3,502,716	3,275,855
Restricted:		
Nonexpendable	1,213,962	1,143,668
Expendable	2,810,016	2,705,369
Unrestricted	1,836,294	1,539,745
Total Net Assets	9,362,988	8,664,637
Total Liabilities and Net Assets	**$ 13,715,757**	**$ 12,932,353**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

FINANCIAL STATEMENTS

Consolidated Statement of Revenues, Expenses, and Changes in Net Assets

(in thousands)	Year Ended June 30, 2010	2009 (As Adjusted)
Operating Revenues		
Student tuition and fees	$ 1,097,450	$ 1,029,240
Less scholarship allowances	233,598	202,946
Net student tuition and fees	863,852	826,294
Federal grants and contracts	844,026	741,487
State and local grants and contracts	6,199	7,240
Nongovernmental sponsored programs	140,087	148,578
Sales and services of educational departments	139,992	117,690
Auxiliary enterprises:		
Patient care revenues	2,372,017	2,220,551
Student residence fees (net of scholarship allowances of $17,441,000 in 2010 and $16,542,000 in 2009)	85,725	81,391
Other revenues	143,666	142,988
Student loan interest income and fees	2,758	2,334
Total Operating Revenues	**4,598,322**	**4,288,553**
Operating Expenses		
Compensation and benefits	3,529,271	3,390,470
Supplies and services	1,276,931	1,255,078
Depreciation	360,089	341,462
Scholarships and fellowships	113,753	107,127
Total Operating Expenses	**5,280,044**	**5,094,137**
Operating loss	(681,722)	(805,584)
Nonoperating Revenues (Expenses)		
State educational appropriations	362,147	373,816
State fiscal stabilization funds	10,136	
Federal Pell grants	39,905	24,929
Private gifts for other than capital and endowment purposes	105,167	96,529
Net investment income (loss)	796,399	(1,851,937)
Interest expense, net	(30,018)	(25,136)
Federal subsidies for Build America Bonds interest	3,303	
Total Nonoperating Revenues (Expenses), Net	**1,287,039**	**(1,381,799)**
Income (loss) before other revenues (expenses)	605,317	(2,187,383)
Other Revenues (Expenses)		
State capital appropriations	2,002	12,244
Capital gifts and grants	29,143	27,791
Private gifts for permanent endowment purposes	59,595	60,602
Other	2,294	(1,656)
Total Other Revenues, Net	**93,034**	**98,981**
Increase (decrease) in net assets	698,351	(2,088,402)
Net Assets, Beginning of Year	8,664,637	10,753,039
Net Assets, End of Year	**$ 9,362,988**	**$ 8,664,637**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

Consolidated Statement of Cash Flows

(in thousands)	Year Ended June 30, 2010	2009
Cash Flows From Operating Activities		
Student tuition and fees	$ 866,513	$ 826,536
Federal, state and local grants and contracts	838,436	749,499
Nongovernmental sponsored programs	134,956	147,246
Sales and services of educational departments and other	280,930	260,275
Patient care revenues	2,359,444	2,228,907
Student residence fees	85,768	81,203
Payments to employees	(2,678,274)	(2,578,312)
Payments for benefits	(800,175)	(739,668)
Payments to suppliers	(1,277,777)	(1,258,755)
Payments for scholarships and fellowships	(113,721)	(107,081)
Student loans issued	(11,016)	(15,488)
Student loans collected	15,280	14,319
Student loan interest and fees collected	2,758	2,334
Net Cash Used in Operating Activities	**(296,878)**	**(388,985)**
Cash Flows From Investing Activities		
Interest and dividends on investments, net	74,579	84,634
Proceeds from sales and maturities of investments	2,508,663	4,635,466
Purchases of investments	(2,438,641)	(4,535,346)
Net decrease in cash equivalents from noncurrent investments	59,090	57,479
Net increase in deposits of affiliates and others	8,328	13,852
Net Cash Provided by Investing Activities	**212,019**	**256,085**
Cash Flows From Capital and Related Financing Activities		
State capital appropriations	2,870	22,379
Private gifts and other receipts	39,488	39,527
Proceeds from issuance of capital debt	372,936	336,440
Principal payments on capital debt	(355,272)	(90,893)
Interest payments on capital debt	(27,361)	(27,908)
Federal subsidies for Build America Bonds interest	2,062	
Payments for bond refunding and related costs	(402)	(277)
Purchases of capital assets	(694,600)	(855,834)
Proceeds from sales of capital assets	1,594	1,501
Net Cash Used in Capital and Related Financing Activities	**(658,685)**	**(575,065)**
Cash Flows From Noncapital Financing Activities		
State educational appropriations	364,269	373,143
State fiscal stabilization funds	5,416	
Federal Pell grants	39,705	24,877
Private gifts and other receipts	171,379	173,729
Student direct lending receipts	343,778	299,404
Student direct lending disbursements	(342,076)	(298,857)
Amounts received for annuity and life income funds	3,630	5,034
Amounts paid to annuitants and life beneficiaries and related expenses	(6,285)	(6,129)
Net Cash Provided by Noncapital Financing Activities	**579,816**	**571,201**
Net decrease in cash and cash equivalents	(163,728)	(136,764)
Cash and Cash Equivalents, Beginning of Year	358,373	495,137
Cash and Cash Equivalents, End of Year	**$ 194,645**	**$ 358,373**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

Consolidated Statement of Cash Flows, continued

(in thousands)	Year Ended June 30, 2010	2009
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (681,722)	$ (805,584)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	360,089	341,462
Changes in assets and liabilities:		
Accounts receivable, net	(22,156)	(2,603)
Prepaid expenses and other assets	(1,882)	(4,920)
Accounts payable	(1,817)	(1,075)
Accrued compensation and other	6,342	(1,302)
Deferred revenue	(3,097)	8,881
Insurance and benefits reserves	2,227	4,999
Obligations for postemployment benefits	45,138	71,157
Net cash used in operating activities	$ (296,878)	$ (388,985)

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED FINANCIAL STATEMENTS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010 and 2009

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 58,000 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 2010, the University adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* which requires all derivative instruments within its scope to be reported at fair value in the statement of net assets. For hedging derivative instruments that are effective in significantly reducing an identified financial risk, as defined by the Statement, the corresponding change in fair value is deferred and included in the statement of net assets. For all other derivative instruments, changes in fair value are reported as net investment income (loss). GASB Statement No. 53 also requires additional disclosures about the University's derivative instruments.

The provisions of GASB Statement No. 53 have been applied to the years presented. The following table summarizes the effect of this implementation on the statements of net assets, revenues, expenses and changes in net assets as of June 30, 2009 and July 1, 2008 and for the year ended June 30, 2009:

(in thousands)	As Previously Reported	Implementation of GASB Statement No. 53	As Adjusted
June 30, 2009:			
Noncurrent assets:			
Prepaid expenses and other assets	$ 21,425	$ 23,299	$ 44,724
Noncurrent liabilities:			
Deposits of affiliates and other	$ 113,393	$ 25,637	$ 139,030
Net assets	$ 8,666,975	$ (2,338)	$ 8,664,637
July 1, 2008:			
Net assets	$ 10,754,674	$ (1,635)	$ 10,753,039
Year ended, June 30, 2009:			
Net investment income (loss)	$ (1,851,234)	$ (703)	$ (1,851,937)

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

Net assets are categorized as:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted:**
  Nonexpendable—Net assets subject to externally imposed stipulations that they be maintained permanently. Such net assets include the corpus portion (historical value) of gifts to the University's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

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

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

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

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

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

Investments in nonmarketable limited partnerships are generally carried at fair value provided by the management of the investment partnerships as of March 31, 2010 and 2009, as adjusted by cash receipts, cash disbursements, and securities distributions through June 30, 2010 and 2009, in order to provide an approximation of fair value at June 30. In addition, the carrying amount of these investments is adjusted for June 30 information from management of the investment partnerships when necessary to provide a reasonable estimate of fair value as of June 30, 2010 and 2009. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed and such differences could be material.

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

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

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

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

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

Capital assets are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided on a straight-line basis over the estimated useful lives of the respective assets, which primarily range from four to 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. The present value of estimated future payments due to life income beneficiaries is recorded as a liability.

For donor restricted endowments, the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate amounts for endowment spending rule distributions as is considered prudent. The University's policy is to retain net realized and unrealized appreciation with the endowment after spending rule distributions. Net appreciation of permanent endowment funds, which totalled $924,000,000 and $808,000,000 at June 30, 2010 and 2009, respectively, is recorded in restricted expendable net assets. The University's endowment spending rule is further discussed in Note 2.

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

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

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

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

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

Reclassifications: In accordance with the GASB *Comprehensive Implementation Guide,* federal Pell grant revenue, which totalled $24,929,000 in 2009, has been reclassified from operating revenues to nonoperating revenues within the statement of revenues, expenses and changes in net assets and from cash flows from operating activities to cash flows from noncapital financing activities within the statement of cash flows.

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 seven year 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. 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 totalled $194,645,000 and $358,373,000 at June 30, 2010 and 2009, respectively, represent short-term money market investments in mutual funds, overnight collective funds managed by the University's custodian or short-term highly liquid investments registered as securities and held by the University or its agents in the University's name. Of its cash and cash equivalents, the University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation limits in the amount of $6,838,000 and $10,788,000 at June 30, 2010 and 2009, respectively. The University does not require deposits to be collateralized or insured.

Investments: At June 30, 2010 and 2009, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows:

(in thousands)	2010	2009
Cash equivalents, noncurrent	$ 122,474	$ 181,564
Fixed income securities	1,372,232	1,261,477
Commingled funds	1,379,961	1,399,681
Equity securities	819,510	781,719
Nonmarketable alternative investments	4,024,853	3,502,987
Other investments	6,775	6,125
	$ 7,725,805	$ 7,133,553

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

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

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

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 5.1 years at June 30, 2010, compared to 5.0 years at June 30, 2009. The University manages the effective duration of its fixed income securities at the account level, where fixed income managers generally may not deviate from the duration of their respective benchmarks by more than 25 percent.

The composition of fixed income securities at June 30, 2010 and 2009, along with credit quality and effective duration measures, is summarized as follows:

2010

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

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

Of the University's fixed income securities, 97 percent and 95 percent were rated investment grade or better at June 30, 2010 and 2009, with 48 percent and 44 percent of these securities rated AAA/Aaa or better at June 30, 2010 and 2009, respectively.

Commingled (pooled) funds include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and unregulated. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy. These investments are structured to limit the University's risk exposure to the amount of invested capital. The composition of commingled funds at June 30, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Absolute return	$ 638,864	$ 743,480
U.S. equities	77,588	67,080
Non-U.S./global equities	585,743	525,366
U.S. fixed income	8,607	8,452
Other	69,159	55,303
	$ 1,379,961	$ 1,399,681

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, 2010 and 2009, approximately 80 percent are redeemable within one year, with 51 percent and 44 percent, respectively, redeemable within 90 days.

The remaining amounts are redeemable beyond one year, with redemption of certain funds dependent on disposition of the underlying assets.

Nonmarketable alternative investments consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. There is no active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner. The composition of these partnerships at June 30, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Private equity	$ 1,085,145	$ 849,529
Real estate	811,071	836,498
Absolute return	828,903	737,541
Energy	705,180	613,981
Venture capital	594,554	465,438
	$ 4,024,853	$ 3,502,987

The University's limited partnership investments are diversified in terms of manager selection and industry and geographic focus. At June 30, 2010 and 2009, no individual partnership investment represented 5 percent or more of total investments. The University's committed but unpaid obligation to these limited partnerships is further discussed in Note 13.

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

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

Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. The value of the University's non-U.S. dollar holdings net of outstanding forward foreign exchange contracts at June 30, 2010 and 2009 totalled $906,342,000, or 12 percent of total investments, and $793,952,000, or 11 percent of total investments, respectively, and is summarized as follows:

(in thousands)	2010	2009
Euros	$ 419,172	$ 329,417
British pounds sterling	125,487	126,282
Japanese yen	83,596	78,537
Other	278,087	259,356
	$ 906,342	$ 793,592

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

The Daily and Monthly Portfolios held positions in bond futures at June 30, 2010 and 2009. Bond futures are used to adjust the duration of cash equivalents and the fixed income portion of the portfolios. To meet trading margin requirements, the University had U.S. government securities and cash with a fair value of $4,422,000 and $3,889,000 at June 30, 2010 and 2009, respectively, on deposit with its futures contract broker as collateral.

The Long Term Portfolio and the Monthly Portfolio participate in a short-term, fully collateralized, securities lending program administered by the University's master custodian. Together, the Portfolios had $115,515,000 and $234,288,000 in securities loans outstanding at June 30, 2010, and 2009, respectively. Since the University does not possess or control the collateral and neither the University nor its lending agent has the ability to pledge or sell collateral unless the borrower defaults, the related collateral assets and liabilities are not recorded in the accompanying financial statements.

Note 3—Accounts Receivable

The composition of accounts receivable at June 30, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Patient care	$ 377,316	$ 355,395
Sponsored programs	82,464	72,001
State appropriations, educational and capital	65,875	68,865
Student accounts	21,626	21,118
Other	35,999	33,568
	583,280	550,947
Less provision for uncollectible accounts receivable	121,658	116,149
	$ 461,622	$ 434,798

Note 4—Notes and Pledges Receivable

The composition of notes and pledges receivable at June 30, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Notes:		
Federal student loan programs	$ 94,432	$ 99,710
University student loan funds	20,756	19,753
Other	734	761
	115,922	120,224
Less allowance for doubtfully collectible notes	2,800	2,800
Total notes receivable, net	113,122	117,424
Gift pledges outstanding:		
Capital	112,790	123,976
Operations	61,764	62,329
	174,554	186,305
Less:		
Allowance for doubtfully collectible pledges	6,925	7,114
Unamortized discount to present value	11,149	12,737
Total pledges receivable, net	156,480	166,454
Total notes and pledges receivable, net	269,602	283,878
Less current portion	57,960	64,055
	$ 211,642	$ 219,823

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, 2010 are expected to be received in the following years ended June 30 (in thousands):

2011	$ 50,398
2012-2015	97,789
2016 and after	26,367
	$ 174,554

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 $68,580,000 and $91,587,000 at June 30, 2010 and 2009, 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, 2010 and 2009 is summarized as follows:

2010

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

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

The decrease in construction in progress of $240,885,000 in 2010 represents the amount of capital assets placed in service of $845,404,000 net of capital expenditures for new projects of $604,519,000. 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. Interest of $5,640,000 and $1,370,000 was capitalized in 2010 and 2009, respectively.

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

Note 6—Long-term Debt

Long-term debt at June 30, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Commercial Paper:		
Tax-exempt, variable rate (.30%)*	$ 81,110	$ 96,070
Taxable, variable rate (.35%)*	6,095	6,435
General Revenue Bonds:		
Series 2010A, taxable–Build America Bonds, 4.926% to 5.593% through 2040	163,110	
Series 2010C, 2.00% to 5.00% through 2027	184,225	
unamortized premium	17,635	
Series 2009A, 2.00% to 5.00% through 2029	95,310	98,555
Series 2009B, variable rate (.29%)* through 2039	118,710	118,710
unamortized premium	7,668	8,150
Series 2009D, taxable–Build America Bonds, 5.155% to 6.172% through 2030	89,815	89,815
Series 2008A, variable rate (.15%)* through 2038	105,810	105,810
Series 2008B, variable rate (.20%)* to fixed via swap through 2026 and variable rate 2027 through 2028	115,205	116,800
Series 2005A, 5.00% through 2018	26,345	30,430
unamortized premium	1,472	1,955
unamortized loss on extinguishment	(175)	(241)
Series 2005B, variable rate		46,070
Series 2002, variable rate (.28%)* to fixed via swap through 2018 and variable rate 2019 through 2032	106,775	112,845
General Revenue Refunding Bonds:		
Series 2003, 3.50% to 5.00% through 2015	18,000	23,850
unamortized premium	614	1,031
unamortized loss on extinguishment	(106)	(184)
Hospital Revenue Bonds:		
Series 2007A, variable rate (.14%)* through 2038	26,195	50,120
Series 2007B, variable rate (.26%)* through 2038	44,310	100,235
Series 2005A, variable rate (.15%)* through 2036	69,315	69,315
Series 2005B, variable rate (.28%)* to fixed via swap through 2026	68,705	71,940
Series 1995A, variable rate		100,000
Hospital Revenue Refunding Bonds:		
Series 2002A, 5.00% to 5.25% through 2022	47,585	49,095
unamortized premium	672	946
unamortized loss on extinguishment	(1,755)	(2,036)
Series 1998A-2, variable rate (.15%)* to fixed via swap through 2025	44,670	44,670
Series 1992A, variable rate		56,000
Medical Service Plan Revenue Bonds:		
Series 1995A, variable rate (.18%)* through 2028	26,200	48,200
Series 1991, 7.05% capital appreciation through 2012	4,099	5,945
Medical Service Plan Revenue Refunding Bonds:		
Series 1998A-1, variable rate (.15%)* to fixed via swap through 2022	34,345	34,695
Housing Energy Conservation HUD Loan, 3.00% through 2021	1,943	2,090
	1,503,902	1,487,316
Less:		
Commercial paper and current portion of bonds payable	122,581	178,690
Long-term bonds payable subject to remarketing, net	384,550	652,285
	$ 996,771	$ 656,341

*Denotes variable rate at June 30, 2010

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, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Variable rate bonds payable subject to remarketing	$ 760,240	$ 1,075,410
Less:		
Current principal maturities	13,110	57,920
Long-term liquidity agreements:		
Unsecured lines of credit	150,000	250,000
Standby bond purchase agreements	212,580	115,205
Long-term bonds payable subject to remarketing, net	$ 384,550	$ 652,285

The University also has a $150,000,000 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, 2010.

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

Long-term debt activity, and the type of revenue it is supported by, for the year ended June 30, 2010 is summarized as follows:

(in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Commercial Paper:				
General revenues	$ 102,505	$ 7,770	$ 23,070	$ 87,205
Bonds and Notes:				
General revenues	753,596	365,166	68,349	1,050,413
Hospital revenues	540,285		240,588	299,697
Faculty Group Practice revenues	88,840	349	24,545	64,644
Student residences revenues	2,090		147	1,943
	$ 1,487,316	$ 373,285	$ 356,699	$ 1,503,902

The University maintains a combination of variable and fixed rate debt, with effective interest rates that averaged approximately 2 percent in 2010 and 2009, including the amortization of bond premiums and discounts and net of federal subsidies for interest on taxable Build America Bonds. The University utilizes commercial paper to provide interim financing for its capital improvement program. The Board of Regents has authorized the issuance of up to $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 2010, the University issued $347,335,000 of General Revenue Bonds with a net original issue premium of $17,830,961. Total bond proceeds of $365,165,961 were utilized to refund variable rate hospital and medical service plan revenue supported bonds of $201,250,000 as well as provide $162,110,000 for capital projects and $1,805,961 for debt issuance costs.

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

Debt obligations are generally callable by the University and mature at various dates through fiscal 2040. Principal maturities and interest on debt obligations, based on scheduled bond maturities, for the next five years and in subsequent five-year periods are as follows:

(in thousands)	Principal	Interest*	Total
2011	$ 119,991	$ 32,323	$ 152,314
2012	46,100	31,306	77,406
2013	54,206	29,902	84,108
2014	42,441	28,714	71,155
2015	43,566	27,772	71,338
2016-2020	210,949	123,984	334,933
2021-2025	286,929	90,174	377,103
2026-2030	280,865	47,814	328,679
2031-2035	228,240	20,321	248,561
2036-2040	164,590	7,805	172,395
	1,477,877	$ 440,115	$ 1,917,992
Plus unamortized premiums, net	26,025		
	$ 1,503,902		

*Interest on variable rate debt is estimated based on rates in effect at June 30, 2010; amounts do not reflect federal subsidies to be received for Build America Bonds interest

If all variable rate bonds were put back to the University and existing unsecured lines of credit and standby bond purchase agreements were not extended upon their current expiration dates, the total principal payments due in 2011 would increase to $504,541,000 and the total principal payments due in 2012 would increase to $393,955,000. Accordingly, principal payments due in subsequent years would be reduced to $36,571,000 in 2013; $24,046,000 in 2014; $24,346,000 in 2015; $106,719,000 in 2016 through 2020; $151,614,000 in 2021 through 2025; $158,495,000 in 2026 through 2030; $35,260,000 in 2031 through 2035; and $42,330,000 in 2036 through 2040. There would not be a significant impact on annual interest payments due to the low variable rate of interest on these bonds.

Note 7—Derivative Instruments

During 2010, the University adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* which requires all derivative instruments within its scope to be reported at fair value in the statement of net assets. For hedging derivative instruments that are effective in significantly reducing an identified financial risk, as defined by the Statement, the corresponding change in fair value is deferred and included in the statement of net assets. For all other derivative instruments, changes in fair value are reported as net investment income (loss).

Derivative instruments held by the University at June 30, 2010 and 2009 are summarized as follows:

	2010		2009	
(in thousands)	Notional Amount	Fair Value	Notional Amount	Fair Value
Investment Derivative Instruments:				
Investment portfolios:				
Futures	$ 284,993	$ 3,058	$ 242,097	$ 614
Foreign currency forwards	368,749	(3,254)	396,487	16,486
Other	71,522	(744)	20,916	(575)
	$ 725,264	$ (940)	$ 659,500	$ 16,525
Floating-to-fixed interest rate swap on debt	$ 52,145	$ (3,266)	$ 58,215	$ (2,339)
Effective Cash Flow Hedges:				
Floating-to-fixed interest rate swaps on debt	$ 246,210	$ (32,658)	$ 249,795	$ (23,299)

The University utilizes bond futures in its investment portfolios to adjust the duration of cash equivalents and fixed income securities, while foreign currency forward contracts are utilized to settle securities and transactions denominated in foreign (non-US dollar) currencies and manage foreign exchange risk. Other investment derivative instruments in the University's investment portfolios consist primarily of interest rate swaps, credit default swaps and total return swaps used to carry out investment and portfolio strategies. Prior to implementation of GASB Statement No. 53, derivative instruments in the University's investment portfolios were reported as investments at fair value. Accordingly, implementation of this Statement did not impact the carrying value of derivative instruments in the University's investment portfolios

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

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

At June 30, 2010 and 2009, the fair value of floating-to-fixed interest rate swaps associated with the University's variable rate debt is a liability of $35,924,000 and $25,637,000, respectively, and is included in the statement of net assets as part of noncurrent other liabilities. The majority of the University's interest rate swaps qualify as effective hedges as defined by GASB Statement No. 53. The corresponding deferred asset for the fair value of swaps deemed effective cash flow hedges totalled $32,658,000 and $23,299,000, at June 30, 2010 and 2009, respectively. Prior to implementation of GASB Statement No. 53, interest rate swaps associated with the University's bonds payable were not recorded in the statement of net assets.

The change in fair value of derivative instruments, which includes realized gains and losses on positions closed, for the years ended June 30, 2010 and 2009 is summarized as follows:

(in thousands)	2010	2009
Investment Derivative Instruments:		
Investment portfolios:		
Futures	$ 19,320	$ 9,495
Foreign currency forwards	8,458	846
Other	(717)	(636)
	$ 27,061	$ 9,705
Floating-to-fixed interest rate swap on debt	$ (927)	$ (703)
Effective Cash Flow Hedges:		
Floating-to-fixed interest rate swaps on debt	$ (9,359)	$ (13,323)

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

The floating-to-fixed interest rate swap associated with the Series 2008B General Revenue Bonds has a notional amount of $98,490,000 at June 30, 2010 and 2009 covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective from April 1, 2008, the University makes payments based on a fixed rate of 3.105 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, until the swap terminates in April 2026. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2010 and 2009 and has a fair value of ($9,187,000) and ($5,321,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2005B Hospital Revenue Bonds has a notional amount of $68,705,000 and $71,940,000 at June 30, 2010 and 2009, respectively, tied to the outstanding balance of the bonds. Effective from December 1, 2005, the University makes payments based on a fixed rate of 3.229 percent and receives variable rate payments from the swap counterparty based on 68 percent of the One-Month USD LIBOR, until the bonds mature in December 2025. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2010 and 2009 and has a fair value of ($6,539,000) and ($4,073,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2002 General Revenue Bonds has a notional amount of $52,145,000 and $58,215,000 at June 30, 2010 and 2009, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective from June 1, 2007, the University makes payments based on a fixed rate of 3.5375 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, through April 1, 2009, and 63 percent of the Five-Year USD LIBOR Swap Rate for the balance of the term, through April 2018. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is not considered an effective edge at June 30, 2010 and 2009 and has a fair value of ($3,266,000) and ($2,339,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 1998A-2 Hospital Revenue Refunding Bonds has a notional amount of $44,670,000 at June 30, 2010 and 2009 tied to the outstanding balance of the bonds. Effective from May 14, 1998, the University makes payments based on a fixed rate of 4.705 percent and receives variable rate payments from the swap counterparty based on the floating Securities Industry and Financial Markets Association (SIFMA) Municipal Index through the final maturity dates of the underlying bonds in December 2024. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2010 and 2009 and has a fair value of ($11,088,000) and ($8,907,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds has a notional amount of $34,345,000 and $34,695,000 at June 30, 2010 and 2009, respectively, tied to the outstanding balance of the bonds. Effective from May 14, 1998, the University makes payments based on a fixed rate of 4.685 percent and receives variable rate payments based on the floating Securities Industry and Financial Markets Association (SIFMA) Municipal Index through the final maturity dates of the underlying bonds in December 2021. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2010 and 2009 and has a fair value of ($5,844,000) and ($4,998,000), respectively.

Using rates in effect at June 30, 2010, the projected cash flows for the floating-to-fixed interest rate swaps deemed effective hedges in accordance with the provisions of GASB Statement No. 53, along with the debt service requirements of the associated variable rate debt, are summarized as follows.

	Variable Rate Bonds		Swap	Total
(in thousands)	Principal	Interest	Payments, Net	Payments
2011	$ 7,050	$ 500	$ 8,238	$ 15,788
2012	9,045	483	8,010	17,538
2013	11,680	459	7,680	19,819
2014	12,155	435	7,292	19,882
2015	12,665	408	6,889	19,962
2016-2020	69,060	1,613	27,837	98,510
2021-2025	112,520	753	13,475	126,748
2026-2030	12,035	17	221	12,273
	$ 246,210	$ 4,668	$ 79,642	$ 330,520

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

The University is required to post collateral for certain floating-to-fixed interest rate swaps if the fair value of the swap reaches a minimum threshold. Based on the University's current credit ratings, the thresholds are $26,000,000 for the swap associated with the Series 1998A-2 Hospital Revenue Refunding Bonds, $27,000,000 for the swap associated with the Series 2005B Hospital Revenue Bonds and $7,000,000 for the swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds. There are no collateral requirements for the other two swaps. During 2009, on one occasion the University was required to post collateral of $1,156,000 for less than 30 days for the interest rate swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds.

Note 8—Self-Insurance

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

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

Changes in the total reported liability for insurance and benefits obligations for the years ended June 30, 2010 and 2009 are summarized as follows:

(in thousands)	2010	2009
Balance, beginning of year	$ 153,045	$ 142,565
Claims incurred and changes in estimates	396,414	360,002
Claim payments	(394,187)	(349,522)
Balance, end of year	155,272	153,045
Less current portion	66,103	67,133
	$ 89,169	$ 85,912

Note 9—Postemployment Benefits

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

The University also provides income replacement benefits, retirement savings contributions and health and life insurance benefits to substantially all permanent University employees 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.

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

In 2008, the year GASB Statement No. 45 was implemented, 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, 2010, the net OPEB obligation and the actuarial accrued liability totalled $1,608,108,000 and $1,278,617,000, respectively.

Changes in the total reported liability for postemployment benefits obligations for the years ended June 30, 2010 and 2009 are summarized as follows:

2010

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

2009

(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 1,360,175	$ 131,638	$ 1,491,813
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

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 totalled $198,655,000 of actuarial accrued liability at June 30, 2010 and $201,294,000 at June 30, 2009. In accordance with GASB Statement No. 45, the University's liability for postemployment benefit obligations at June 30, 2010 is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods of $178,822,000 on an actuarial accrued liability basis.

The annual required contribution represents a level of funding that an employer is projected to need in order to prefund its obligations for postemployment benefits over its employees' years of service and totals $114,522,000 and $141,206,000 at June 30, 2010 and 2009, respectively. The University has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently pays for postemployment benefits on a pay-as-you-go basis. The University's obligations for postemployment benefits at June 30, 2010, 2009 and 2008 as a percentage of covered payroll of $2,551,273,000, $2,456,343,000 and $2,311,422,000, was 63, 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, 2010 and 2009 are as follows:

2010

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

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%-8.0%/5.0%	9.0%-8.0%./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)

Note 10—Retirement Plan

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

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

(in thousands)	**2010**	**2009**	**2008**
University contributions	$ 215,905	$ 208,707	$ 194,962
Employee contributions	$ 106,389	$ 102,705	$ 96,015
Payroll covered under plan	$ 2,551,273	$ 2,456,343	$ 2,311,422
Total payroll	$ 2,698,219	$ 2,580,373	$ 2,444,522

Note 11—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. All of the unrestricted net assets, which totalled $1,836,294,000 at June 30, 2010, have been designated for academic and research programs and initiatives, and capital programs.

Note 12—Federal Direct Lending Program

The University distributed $342,076,000 and $298,857,000 for the years ending June 30, 2010 and 2009, 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 $871,000 and $2,573,000 at June 30, 2010 and 2009, respectively, for DoED funding received in advance of distribution.

Note 13—Commitments and Contingencies

Authorized expenditures for construction and other projects unexpended as of June 30, 2010 were $791,863,000. Of these expenditures, approximately $766,291,000 will be funded by internal sources, gifts and future borrowings, $24,136,000 will be funded using unexpended debt proceeds and the remaining $1,436,000 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, 2010, the University had committed, but not paid, a total of $2,214,711,000 in funding for these alternative investments. Based on historical capital calls and discussions with those managing the limited partnerships, outstanding commitments for such investments are anticipated to be paid in the following years ended June 30 (in thousands):

2011	$ 504,723
2012	602,030
2013	392,869
2014	197,361
2015	167,964
2016 and beyond	349,764
	$ 2,214,711

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

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

2011	$ 30,540
2012	25,784
2013	18,110
2014	10,423
2015	7,458
2016-2020	12,374
2021-2025	2,852
2026-2027	599
	$ 108,140

Operating lease expenses totalled $34,523,000 and $32,467,000 in 2010 and 2009, respectively.

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

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

Note 14—Segment Information

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

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

Condensed financial information for HHC, before the elimination of certain intra-University transactions, as of and for the years ended June 30, 2010 and 2009 is as follows:

(in thousands)	2010	2009
Condensed Statement of Net Assets		
Assets:		
Current assets	$ 393,830	$ 415,451
Noncurrent assets	2,455,854	2,290,005
Total assets	$ 2,849,684	$ 2,705,456
Liabilities:		
Current liabilities	$ 281,385	$ 415,106
Noncurrent liabilities	966,483	753,041
Total liabilities	1,247,868	1,168,147
Net assets:		
Invested in capital assets, net of related debt	670,052	609,050
Restricted:		
Nonexpendable	2,868	2,646
Expendable	92,463	70,262
Unrestricted	836,433	855,351
Total net assets	1,601,816	1,537,309
Total liabilities and net assets	$ 2,849,684	$ 2,705,456
Condensed Statement of Revenues, Expenses and Changes in Net Assets		
Operating revenues	$ 1,974,517	$ 1,836,837
Operating expenses other than depreciation expense	(1,778,788)	(1,691,520)
Depreciation expense	(135,887)	(129,974)
Operating income	59,842	15,343
Nonoperating revenues (expenses), net	105,238	(297,293)
Net income (expenses) before transfers	165,080	(281,950)
Transfers to other University units, net	(100,573)	(59,192)
Increase (decrease) in net assets	64,507	(341,142)
Net assets, beginning of year	1,537,309	1,878,451
Net assets, end of year	$ 1,601,816	$ 1,537,309
Condensed Statement of Cash Flows		
Net cash provided by operating activities	$ 196,653	$ 175,354
Net cash provided by investing activities	85,533	61,485
Net cash used in capital and related financing activities	(257,400)	(147,389)
Net cash used in noncapital financing activities	(59,246)	(56,187)
Net (decrease) increase in cash and cash equivalents	(34,460)	33,263
Cash and cash equivalents, beginning of year	190,275	157,012
Cash and cash equivalents, end of year	$ 155,815	$ 190,275

Note 15—Operating Expenses by Function

Operating expenses by functional classification for the years ended June 30, 2010 and 2009 are summarized as follows:

2010

(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 739,459	$ 119,120			$ 858,579
Research	463,421	208,061			671,482
Public service	96,469	39,295			135,764
Academic support	183,306	43,182			226,488
Student services	67,277	16,837			84,114
Institutional support	134,366	40,066			174,432
Operations and maintenance of plant	42,291	223,708			265,999
Auxiliary enterprises	1,802,682	586,662			2,389,344
Depreciation			$ 360,089		360,089
Scholarships and fellowships				$ 113,753	113,753
	$ 3,529,271	$ 1,276,931	$ 360,089	$ 113,753	$ 5,280,044

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

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as of June 30, 2010

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