



2013 FINANCIAL REPORT



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on the
COVER

Photos from top left, clockwise:

WILLIAM L. CLEMENTS LIBRARY

A major renovation of the William L. Clements Library will be funded in large part by a \$6 million donation from the Avenir Foundation.

SCHOOL OF MUSIC, THEATRE & DANCE

William and Dee Brehm's \$8 million gift will help renovate the school's main academic building.

GREAT LAKES

A \$4.5 million gift from the Fred A. and Barbara M. Erb Family Foundation, matched by funds from the university, created the U-M Water Center to protect and restore the world's largest group of freshwater lakes.

PENNY W. STAMPS SCHOOL OF ART & DESIGN


In recognition of Penny and Roe Stamps' \$32.5 million transformative gift, the school was named for her.

SAMUEL AND JEAN FRANKEL CARDIOVASCULAR CENTER

The center was named to recognize the generosity of the late Samuel and Jean Frankel whose family foundation made a gift of \$50 million to the center.

HELEN ZELL WRITER'S PROGRAM

Helen Zell's record \$50 million gift permanently funds the Master of Fine Arts in Creative Writing Program, now named for her.

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LETTER FROM THE PRESIDENT



MARY SUE COLEMAN

DEAR FRIENDS,

Excellence permeates the University of Michigan community. We set our sights high, because this is Michigan.

The teaching and research of Michigan faculty continually attract national honors. That includes being named 2012 Professor of the Year, an accolade for Professor Stephen DeBacker awarded by the Carnegie Foundation for the Advancement of Teaching and the Council for Advancement and Support of Education. Professor DeBacker is a Thurnau professor who directs the Mathematics Department's undergraduate program.

WITH 99 GRADUATE PROGRAMS RANKED IN THE TOP 10 NATIONALLY, WE HAVE THE INTELLECTUAL POWER TO BRING TO BEAR ON THE WORLD'S MOST CHALLENGING PROBLEMS, WHETHER THEY ARE IN SUSTAINABILITY, PUBLIC HEALTH, OR PUBLIC POLICY.

RESEARCH. Professor Yukiko Yamashita, a stem cell biologist with the Life Sciences Institute and the Department of Cell and Developmental Biology, attracted the attention of the W.M. Keck Foundation, which supports novel, high-risk research. The foundation awarded her a grant of \$500,000 for her work in studying how stem cells divide, which in turn can help explain how the human body develops. This is a remarkable award for Professor Yamashita, who two years ago was named a MacArthur Fellow.

GLOBAL. This past year the university was the recipient of the 2012 Simon Award, honoring our commitment to outstanding and innovative global engagement. This award, named for the late Senator Paul Simon and in acknowledgment of his strong advocacy of international learning, came at the same time the university was recognized for having the eighth-largest international student body in the country. And Michigan students once again led the nation in the prestigious Fulbright Awards that will allow them to study throughout the world.

ATHLETICS. Our student-athletes also drew national attention for their accomplishments. The men's gymnastics team and the men's swimming and diving team won NCAA championships, giving U-M 55 national titles.

THE PHILANTHROPY OF ALUMNI IS AN INVESTMENT NOT ONLY IN OUR INSTITUTION,
BUT ALSO IN THE STATE OF MICHIGAN.



nearly
42,000
applicants

The University of Michigan continues to be in demand among prospective students; with a record 41,885 applying to attend this fall.

IT'S BEEN A REMARKABLE YEAR.

Our academic foundation is exceptional. With 99 graduate programs ranked in the top 10 nationally, we have the intellectual power to bring to bear on the world's most challenging problems, whether they are in sustainability, public health, or public policy.

We have expanded the global reach of Michigan with new partnerships at several Brazilian universities and foundations. We share similar values with our higher education colleagues in Brazil, such as improving human health, protecting the environment, and holding open our doors to students of all backgrounds.

The university has numerous collaborations in Brazil, and we are particularly strong in the health sciences, in the humanities and Romance languages, and in sustainability. In leading a faculty delegation to Brazil last September, I saw the depth of this important work. International collaborations such as those in Brazil increase our understanding of the world and allow us to better prepare tomorrow's global citizens.

We are expanding our commitment to a sustainable world, thanks in part to the Fred A. and Barbara M. Erb Family Foundation's \$4.5 million commitment, along with a \$4.5 million university match, to the Great Lakes region. In establishing the U-M Water Center, we are focusing on four critical areas: reducing toxic contamination, fighting invasive species, protecting wildlife habitats, and promoting the health of the coastlines.

Building on the university's long history of freshwater research, we are taking ownership of and responsibility for regional sustainability challenges that affect us—close to home and where our expertise can have enormous impact.

The University of Michigan continues to be in demand among prospective students; nearly 42,000 applied to attend this fall. The incoming class of 6,000 will see exciting new projects unfolding on campus, thanks to generous alumni and the investments they provided this past year.

The philanthropy of alumni is an investment not only in our institution, but also in the state of Michigan. There is a powerful show of faith in our collective future. This support is increasingly critical to our growth and impact, and provides tremendous momentum as we approach our upcoming comprehensive campaign. That campaign will look to broaden the financial support we provide students, as well as extend our global reach and deepen the university's public service.

William and Dee Brehm made an \$8 million gift to the School of Music, Theatre & Dance to renovate the school's main academic building.

\$8
million



WE WILL ENTER OUR NEXT, HISTORIC CAMPAIGN WITH GREAT MOMENTUM BECAUSE OF THE FORESIGHT OF DONORS.

PENNY AND ROE STAMPS made a transformative gift of \$32.5 million to the School of Art & Design, which is now the Penny W. Stamps School of Art & Design.

HELEN ZELL made an astounding gift of \$50 million for creative writing at Michigan. Such a gift for poetry and fiction, at a time when many programs are struggling, truly sets our graduate program apart.

WILLIAM AND DEE BREHM made an \$8 million gift to the School of Music, Theatre & Dance to renovate the school's main academic building.

THE SAMUEL AND JEAN FRANKEL FOUNDATION committed \$50 million to the Samuel and Jean Frankel Cardiovascular Center and its innovative approaches to diagnosing and treating heart disease.

CHARLES MUNGER, the vice chair at Berkshire Hathaway, made a \$110 million gift for a revolutionary graduate student housing complex that will encourage collaboration among students in different disciplines, and includes \$10 million for financial aid.

The Munger gift is the largest in the history of the university through FY 2013. It will be used to design a graduate student community unlike anything here or in most of higher education. It will be on the Central Campus, across from West Quad, and will be named in honor of Charles Munger. We expect to open the doors in the fall of 2015.

As many of you may know I have told the Board of Regents I will retire as president when my contract ends on July 31, 2014. I am committed to working with the board members to ensure a smooth leadership transition.

Leading the University of Michigan is the most challenging and rewarding work of my career. It is a tremendous privilege and one that continually energizes me.

I am extremely proud of the work we have done, together, to make Michigan more vibrant, more accessible, and more global. It's much too soon for goodbyes. Instead, I look forward to working together, with you, to continue to advance the academic excellence of the University of Michigan.

Sincerely,

Mary Sue Coleman

Mary Sue Coleman

REPORT FROM THE CHIEF FINANCIAL OFFICER



TIMOTHY P. SLOTTOW

The University of Michigan continues to be financially healthy, due in large measure to our dedicated faculty and staff, who have a sharp focus on advancing the institution's core missions as well as pursuing new ideas to contain costs, maximize resources, and increase efficiencies. Their commitment to building on our strong foundation and tradition of excellence has provided the university with the resources to make strategic investments in the facilities, programs, and people that make U-M one of the best public research universities in the world.

THE UNIVERSITY, ONCE AGAIN, RECEIVED THE HIGHEST CREDIT RATINGS FROM BOTH STANDARD & POOR'S (AAA) AND MOODY'S INVESTOR SERVICES (Aaa). THESE RATINGS ARE CLEAR INDICATORS OF THE INSTITUTION'S STRONG FINANCIAL HEALTH AND OUTLOOK. U-M IS ONE OF ONLY THREE PUBLIC UNIVERSITIES IN THE COUNTRY TO MAINTAIN THESE RATINGS—THE HIGHEST POSSIBLE—FROM BOTH OF THESE AGENCIES.

Our disciplined budget approach carefully balances the university's requirement to be competitive against the challenging economic environment that we've faced for several years. With that in mind, our long-term strategy seeks to ensure that tuition increases are moderate and that we continue to develop and implement innovative cost containment strategies and successful fundraising efforts. At the same time, our 44,000 faculty and staff remain relentlessly committed to protecting and enhancing the world-class quality of the university's research, teaching, and clinical care. This approach, when combined with our long-term investment strategy, ensures a strong future for the university.

In FY 2013, the university's total net position (assets less liabilities) increased by \$730 million to \$11.5 billion. This increase primarily resulted from strong capital markets which added \$411 million to the endowment net of distributions for operations, and generous donations of \$200 million specifically for capital and endowment purposes, as well as successful cost containment activities and growing gifts for operations.

To provide context to the accompanying financial statements, I will review these contributors as well as provide updates on a number of university-wide efforts that are impacting the institution's overall financial health in the following sections.

REVENUE DIVERSIFICATION HAS LONG BEEN AN IMPORTANT STRATEGY FOR THE UNIVERSITY TO ACHIEVE FINANCIAL STABILITY.

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, nearly 80 percent of the university's general fund revenues came from state appropriations, compared to the projected 17 percent in the FY 2014 general fund budget. The current mix of revenue can be seen on the following page, which shows the FY 2013 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 over the last decade, support from the state of Michigan remains an integral part of our strength. Base state appropriations decreased from \$416 million in FY 2003 to \$316 million in FY 2013, a decrease of \$100 million, or 24 percent. By contrast, if appropriations had grown at the level of the Consumer Price Index for Detroit, our state appropriations would have been nearly \$200 million higher in FY 2013. In spite of this decline, state support for operations is still crucially important to us as it would take an additional endowment of approximately \$7 billion to generate an equivalent revenue stream.

In FY 2014, the university will receive a modest increase of 2 percent to our appropriation from the state of Michigan. We are grateful for this increase and the adopted budget remains focused on limiting the financial burden for students while maintaining an unwavering commitment to the quality of the university, both inside and outside the classroom.

Multi-year budget planning, prudent management of resources, and our willingness to make tough decisions regarding priorities have enabled us to prepare for—and smooth out—the impact of the tumultuous financial situation that has faced both the state and nation in recent years. This long-term plan and focus has enabled us to avoid the severe program cuts and double-digit tuition increases other universities around the country are experiencing.

The general fund operating budget continues to balance academic excellence and access with long-term cost containment efforts and the need to invest in the future. A disciplined approach to long-term cost containment is a driving force behind our ability to limit tuition increases,

provide more financial aid, and continue to invest in teaching and research. Over the past decade, the university's deans, directors, faculty, and staff reduced and reallocated nearly \$265 million in recurring general fund expenditures from the Ann Arbor campus budget. Moving forward, our plans call for reducing or reallocating an additional \$90 million in recurring costs by 2017. The FY 2014 budget includes \$24 million in reductions and reallocation in order to meet our financial and academic goals. We will continue to make every effort to protect the excellence of the educational experience as we make reductions.

The approved Ann Arbor campus budget for FY 2014 includes tuition rate increases of only 1.1 percent for resident undergraduates, which is the lowest increase in nearly 30 years. The budget for the Ann Arbor campus also includes tuition rate increases of 3.2 percent for non-resident undergraduate students, and 1.8 percent for most graduate programs. It also includes \$161 million in centrally awarded financial aid, which constitutes the largest investment in financial aid in the university's history. Within that, centrally awarded financial aid for undergraduates is increasing by 13.7 percent, which will help in our ongoing efforts to preserve access for our most financially vulnerable undergraduate students. This marks the eighth time in the past nine years that financial aid has increased by at least 10 percent.

For the fifth year in a row, there will be no increase in the cost to attend U-M for the typical Ann Arbor campus undergraduate resident student who has financial need. The FY 2014 financial aid investment is sufficient to cover the full increase in the cost of attendance (tuition and fees, housing, textbooks, and incidentals) with grant aid for these students, resulting in no increase in packaged loan burden. In addition, the loan burden in the 2014 financial aid package for these students is less than in 2009.

The UM-Dearborn budget includes a 3.5 percent increase in resident undergraduate and graduate rates and a 10 percent increase in institutional financial aid. UM-Flint's budget includes a 3.5 percent increase in undergraduate tuition rates, a 3.0 percent increase in graduate program tuition, and a 5.5 percent increase in institutional financial aid.

THE HEALTH SYSTEM

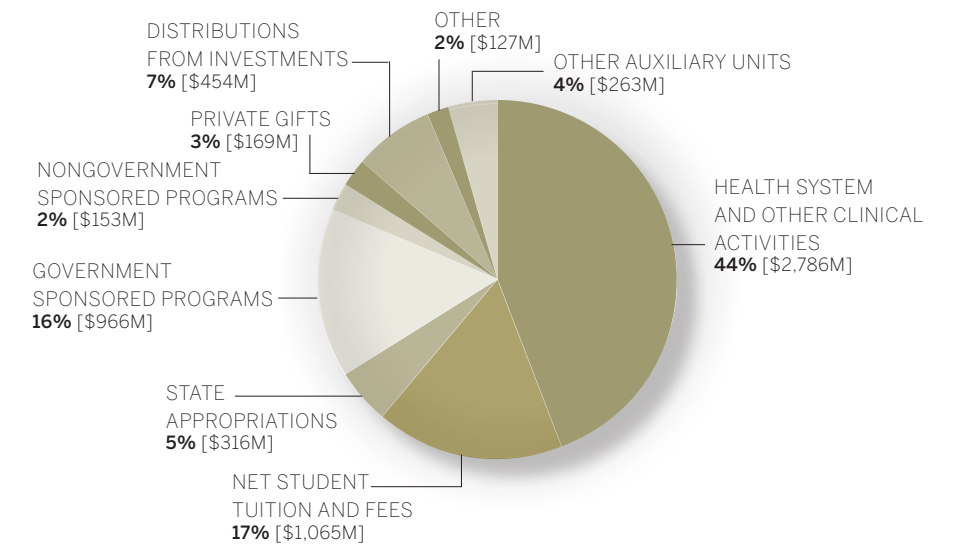
The U-M Health System—which integrates the Hospitals and Health Centers, Medical School, and Michigan Health Corporation under the direction of the university's executive vice president for medical

affairs—continues to receive national recognition for its academic and clinical excellence. During 2013, U-M was recognized as *U.S. News & World Report's* top hospital in the state of Michigan, and was included in Truven Health/Modern Healthcare's 100 Top Hospitals, the Leapfrog Group's Top Hospitals list and the top 10 hospitals for patient safety from UHC, a consortium of academic medical centers. These honors recognize the solid base of clinical excellence that will continue to fuel our health system's growth.

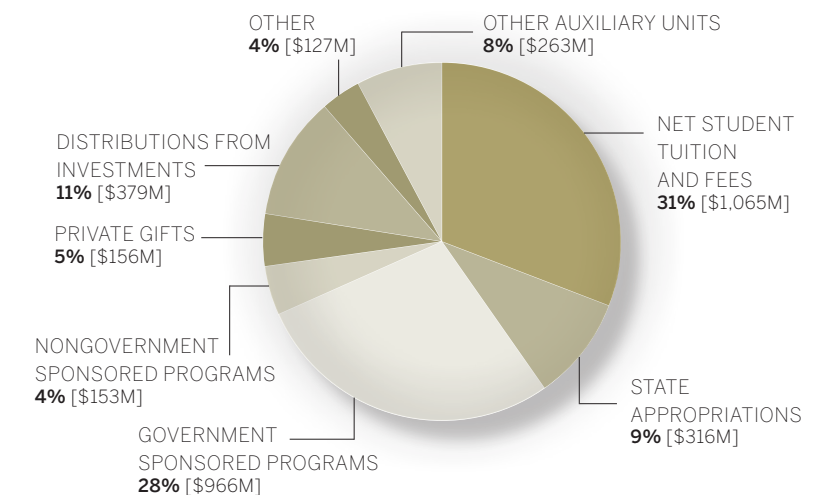
In FY 2013, the U-M Hospitals and Health Centers (UMHHC) achieved a break-even operating margin. This improvement from last year's operating loss of 0.5 percent was driven by factors such as a 3.5 percent increase in patient care activity, record-high patient satisfaction, and an 8 percent rise in revenues. UMHHC's operating performance this past year included the expected short-term impacts of strategic investments that will provide long-term benefits. Most notable this year were the activation of the comprehensive MiChart electronic health information system for U-M's 40 outpatient health centers and central billing, the depreciation and incremental staffing associated with the first full year of operating both the 1.1 million square foot facility for children's and women's care and the adult emergency department expansion. UMHHC also continued to make strategic investments in its facilities to improve capacity and access for patients, including renovation of inpatient areas in University Hospital, expanded clinics in the Taubman Center, and using portions of the new children's and women's facility for adult care.

This is a time of tremendous change in healthcare, as the major provisions of the Patient Protection and Affordable Care Act begin to go into effect. Thanks to MiChart and other projects, the health system has earned more than \$12 million in federal incentive payments for making meaningful use of electronic health record technology. The impact of increased private insurance coverage and the potential for expanded Medicaid coverage is still to be seen, but should offset some of the rise in uncompensated care experienced in recent years. At the same time, the health system confronts the impacts of federal budget sequestration on reimbursement to hospitals and on biomedical research—as well as continued pressure from insurers and employers to hold healthcare cost growth down.

OPERATING ACTIVITIES
TOTAL REVENUE \$6,299 MILLION



OPERATING ACTIVITIES EXCLUDING HEALTH SYSTEM AND OTHER CLINICAL ACTIVITIES
TOTAL REVENUE \$3,425 MILLION



THE PAYOUT FROM APPROXIMATELY 7,800 SEPARATE ENDOWMENT FUNDS ENABLES US TO SERVE A DIVERSE POPULATION, RANGING FROM PATIENTS TO STUDENTS.

In the coming year, UMHC aims to achieve a positive operating margin, with a growth in revenues to \$2.5 billion and a plan to serve over 5 percent more patients. Recent partnerships and affiliations will allow the health system to bolster its capacity and market position. The Physicians Organization of Michigan Accountable Care Organization formed with eight other physician groups statewide and a part-ownership affiliation with MidMichigan Health both launched this year, as did a new jointly operated inpatient unit for older adults at Saint Joseph Mercy Hospital-Ann Arbor. In addition, Chelsea Community Hospital's unit for U-M patients was expanded in connection with a master affiliation agreement with Trinity Health Michigan signed in 2012. Work also continues on a new multi-specialty health center in Northville Township that will increase outpatient capacity in the crucial I-275 corridor.

GROWING RESEARCH

Total research spending in FY 2013 totaled \$1.3 billion, exceeding the billion-dollar milestone for the fifth straight year. The university is committed to maintaining the strength of its research enterprise while drawing on it to catalyze the transformation of the economy through technology transfer, encouraging entrepreneurship, and linking faculty and businesses to spur innovative research.

Over the last decade, total research expenditures have more than doubled even as the rate of increase of federal funding has eased off, showing the strength of U-M's competitive standing among its peer research universities and the diversity of research funding from non-federal sources. It is likely that federal support for research will be further constrained in coming years, and that competition for available funds will rise.

Efforts are underway to further diversify and strengthen the university's research portfolio by expanding support from industry as well as from federal agencies where research funding at the university has been growing, including the Department of Transportation, the Department of Energy, NASA, the Department of Defense, and the National Science Foundation. This year, for example, we launched the Michigan Mobility Transformation Center, a major new research partnership with government and industry to dramatically improve the safety, sustainability, and accessibility of the ways that people and goods move from place to place in our society. A key goal of the center is to build on the university's research strengths, its relationships with state and federal agencies, and its partnerships with industry worldwide to help position the region as a global center for a new era of mobility research, development, and manufacturing.

Transferring the fruits of the university's research to the marketplace remains a high priority. Over the last decade, we have launched an average of one new startup company based on U-M technology every five weeks. The Office of Technology Transfer's Venture Accelerator provides laboratory and office space as well as expertise and resources to help many of these new ventures get established in the marketplace.

Further progress was also made in realizing the potential of the North Campus Research Complex (NCRC), the property acquired from Pfizer in 2009. At the close of FY 2013, more than 2,000 faculty, staff, students, and private company employees were working at the NCRC in translational science initiatives and related research support facilities. In addition, the NCRC leases space to the VA Ann Arbor Healthcare System, two established private companies, and 17 faculty startup companies participating in U-M's Venture Accelerator.

10.2%

Annualized 10-year return of the university's Long Term Portfolio.



Total research spending in FY 2013 totaled \$1.3 billion, the fifth straight year the university has surpassed the billion-dollar milestone.

\$1.3 billion

THE ENDOWMENT

The university's 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 10.8 percent return in FY 2013 follows a -0.5 percent return in FY 2012 and a 24.3 percent return in FY 2011. The Long Term Portfolio's annualized 10-year return of 10.2 percent was 1.8 percentage points above the custom benchmark designed to capture the university's long-term diversified investment strategy and 4.4 percentage points over the university's blended passive index, which captures the performance of passive, investable asset class benchmarks representative of a large institutional investment pool. The return of the S&P 500 stock index was 7.3 percent over the same 10-year period.

The table below shows the Long Term Portfolio's favorable 10-year 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 smooths the impact of volatile capital markets by providing for annual distributions based on a percent of the moving average fair value of endowment shares. The spending rule, along with the growth of the endowment, allowed for distributions to support operations of \$276 million in FY 2013, for a total of \$1.3 billion over the past five years, and \$2.3 billion over the past 10 years.

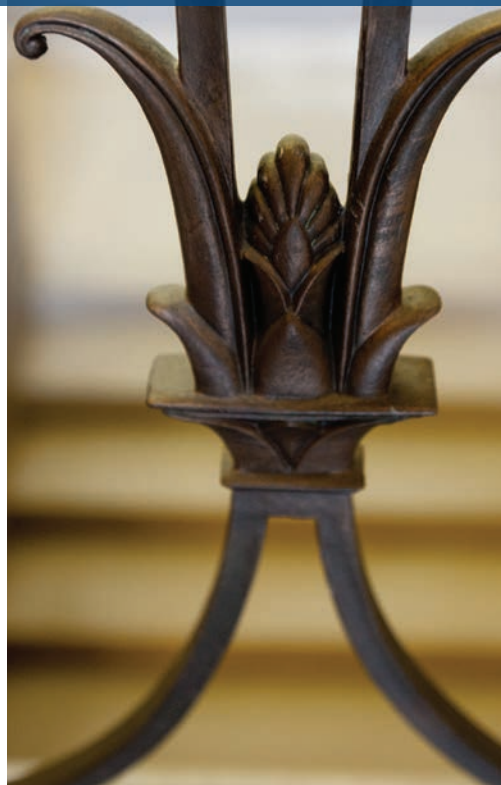
The payout from approximately 7,800 separate endowment funds enables us to serve a diverse population, ranging from patients in our health system to students. For example, approximately \$1.8 billion, or 22 percent, of our \$8.4 billion endowment is restricted for use by our health system, where more than 2 million patient visits take place each year.

The portion of the endowment available for U-M operations supports the education of approximately 61,000 students. About 20 percent of our total endowment, or \$1.7 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 to social sciences.

INVESTMENT PERFORMANCE

	RETURN FOR THE 12-MONTH PERIOD ENDED JUNE 30, 2013	ANNUALIZED 5-YEAR RETURN	ANNUALIZED 10-YEAR RETURN
Long Term Portfolio	10.8%	3.3%	10.2%
U-M's Benchmark	11.6%	4.4%	8.4%
Blended Passive Index	11.4%	3.9%	5.8%

FOR MORE THAN A DECADE, WE HAVE PURSUED A BROAD RANGE OF STRATEGIES TO ACHIEVE COST REDUCTIONS AND LONG-TERM EFFICIENCIES IN OUR OPERATIONAL AREAS.



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 5.1 percent.

PHYSICAL PLANT IMPROVEMENTS

The university's facilities serve a wide range of needs, from research efforts, patient care and student residences to academics, athletics, and the arts. Over the past decade, the university has invested an average of \$530 million per year for renovation and replacement of buildings and related infrastructure. In FY 2013, the university completed nearly 350 projects across campus. The university's ever-changing academic, research, patient care, and athletic functions are supported by a wide variety of facilities that were recently completed or are presently under construction. Refer to pages 38-41 for a summary of major capital projects in planning, in progress, and completed during FY 2013.

CONTROLLING BENEFIT COSTS AND IMPROVING HEALTH

The university remains sharply focused on the cost of employee and retiree health benefits. This is an ever-present challenge for organizations across the country. Drawing on the combined expertise of top clinical and health policy faculty and financial experts, the university has made adjustments to its health benefits premium structure and eligibility requirements according to a multi-year plan. In doing so, the university closely monitors key benchmarks to ensure that it remains competitive with local and national labor markets. As key facets of national healthcare reform are implemented, the university is also closely tracking cost and coverage implications.

For the university, total healthcare spending for more than 96,000 employees, retirees, and dependents was approximately \$354 million in FY 2013. Changes to the healthcare premium structure that began in FY 2004 are now generating cash savings of more than \$63 million annually. Changes to retirement eligibility rules and the amounts of university contributions toward healthcare for future retirees began to take effect on January 1, 2013. These changes are projected to yield recurring annual cash outlay savings of more than \$9 million by the year 2020 and \$165 million by 2040, helping to preserve vital funding for the university's core missions and creating greater opportunity to control the rate of future tuition increases.

MHealthy, the university's health and well-being program, works in conjunction with benefit programs and initiatives to curb the rate of increase through prevention, early intervention, and health improvement. An evaluation of overall program effectiveness during MHealthy's first three years showed decreases in the number of benefit-eligible individuals who were at high or moderate risk, and a 4.1 percent increase in the number of people who are now at low risk. Over the past four years, more than 33,000 of the university's employees have participated in a health risk questionnaire, allowing them to learn more about their health risks and take action to improve them through follow-up programs and services. MHealthy also has begun to provide special targeted health improvement programs to high-risk job families.

\$530
million

Ten-year annualized investment in renovations and replacement of buildings.

COMPREHENSIVE COST CONTAINMENT EFFORTS

For more than a decade, we have pursued a broad range of strategies to achieve cost reductions and long-term efficiencies in our operational areas. For instance, we have chosen to self-insure in certain areas, including health benefits and risk management, so as to achieve the full financial benefit of risk-reduction programs and investment opportunities with insurance reserves. In the area of health benefits, we have further worked to align benefit offerings with the market and to ensure appropriate levels of cost sharing with employees. Additionally, we have taken an aggressive approach to controlling energy consumption through the installation of new campus systems, retrofitting existing facilities to achieve efficiencies, and advanced energy purchases.

The university regularly scrutinizes vendor contracts to ensure they remain highly competitive in changing marketplaces. A new third party Pharmacy Benefit Manager was selected to administer the university's Prescription Drug Program, a change that took effect early this fiscal year and will save approximately \$13 million over 39 months. Likewise, competitive vendor selection resulted in a change in the mail order pharmacy serving the university's plan members for estimated annual savings of \$840,000, commencing in calendar year 2012, and fee reductions negotiated for health plan administrative services will reduce annual costs by another \$2.7 million per year.

We have recently focused on strategic sourcing initiatives to consolidate the university's spend with high-quality vendors to maximize pricing discounts. The university saved more than \$16 million in FY 2013 from our first wave of strategic sourcing, which included six commodities ranging from computers and peripherals to furniture and office supplies. Our second wave of strategic sourcing efforts are underway and we expect to achieve another \$6 million in annual savings from seven additional commodities, which include audio visual equipment, food supplies, and information technology temporary staffing.

Information technology rationalization projects will provide a shared technology infrastructure, improve service, and reduce costs. The first phase is underway, with a focus on improving shared foundational services including email, storage, security, server virtualization, and desktop support. During 2013, we completed a move to a common email, calendaring, and collaboration suite for most of the Ann Arbor

campus and launched services to consolidate and enhance desktop support, campus networking, and cloud computing capabilities.

Looking forward, we are planning for the implementation of a Shared Services Center for key finance and human resources administrative functions. Shared services models organize the service delivery of administrative functions to optimize scale economies and provide cost-effective, flexible, and reliable services. Our current scope is expected to generate significant annual savings across the university through managerial span of control adjustment, process standardization, and elimination of non-value added work.

CONCLUSION

It is satisfying to again receive an unqualified opinion from the university's independent financial auditors. This opinion, which appears on pages 43-44, signifies that the financial statements present fairly the financial position of the university. My certification of management's responsibility for the preparation, integrity, and fair presentation of the university's financial statements appears on page 42.

I encourage you to review Management's Discussion and Analysis, which begins on page 45. It describes how the university's financial strength, prudent financial policy, and the institution-wide commitment to maintaining the highest level of excellence are collectively ensuring the university's mission will be fulfilled in the coming years.

Timothy P. Slottow
Executive Vice President
and Chief Financial Officer

REPORT FROM THE VICE PRESIDENT FOR DEVELOPMENT



JERRY A. MAY

UNIVERSITY OF MICHIGAN DONORS SET RECORDS ACROSS ALL AREAS WITH THEIR GENEROSITY

—individual giving, numbers of donors, gifts of all sizes, and range of purposes. You made things happen in a way we never could have without you.

Approximately 129,000 donors made gifts to the university in FY 2013. That's enough donors to fill the Big House, Fisher Stadium, and Yost Arena!

THE RECORDS OUR DONORS HAVE BROKEN IN SO MANY AREAS ARE MOST SIGNIFICANT BECAUSE, ONCE AGAIN, THEY MAKE APPARENT HOW MUCH DONORS CONTRIBUTE TO THE SUCCESS OF THIS GREAT UNIVERSITY.

These donors made total gifts and pledge payments totaling a record \$357 million, an increase of 24 percent above FY 2012.

- 120,000 donors made gifts of \$25,000 or less, totaling \$74 million, a record total.
- Gifts from living individuals totaled \$250 million.
- Gifts from corporations remained even with last year at \$17 million.

Donors not only made records with the volume of their giving, but also made records with their individual giving.

THE REGENTS APPROVED THE NAMING OF THE PENNY W. STAMPS SCHOOL OF ART & DESIGN IN HONOR OF THE STAMPS' VISION.



CHARLES T. MUNGER (HLLD LAW '10), who made a generous gift last year to renovate the Lawyers Club, made what was at the time, the largest single donation in U-M's history, \$110 million. While his previous gift dramatically improves the lives of law school students, his new gift will transform the lives of thousands of graduate students by creating a state-of-the-art residence designed to foster a "community of scholars" where graduate students from multiple disciplines will live and exchange ideas. The gift will create an eight story facility on Central Campus that will house more than 600 occupants in apartments with three to six bedrooms, large kitchens and living areas. The facility will also feature gathering spaces, study areas, and common areas. The gift includes \$10 million for fellowships to help create a residential society that encourages scholarship and interaction between many fields of study. Munger, who studied mathematics at U-M in the 1940s, is vice chair of Berkshire Hathaway.

\$110
million

Munger's new gift will transform the lives of thousands of graduate students by creating a state-of-the-art residence designed to foster a "community of scholars."

PENNY W. (BSDES '66, TEACHCERT '66) AND E. ROE STAMPS made history this year when they added to their already generous support of the university by making a commitment of \$32.5 million from the Stamps Family Charitable Foundation in support of the School of Art & Design, Penny's alma mater. This makes the Miami-based couple the most generous donors in the history of the school and among the most charitable benefactors nationwide to an art and design school. In recognition of the Stamps' vision and in gratitude for their support, the Regents approved the naming of the Penny W. Stamps School of Art & Design. Penny and Roe Stamps have provided broad support to the school through such programs as the Roman J. Witt Residency Program and the Roman J. Witt Visitors Program, named for Penny's father, their Stamps Creative Work Scholarship, their creation of the Work Ann Arbor gallery, and the Penny W. Stamps Distinguished Visiting Artists Program, including the wildly popular Penny W. Stamps Distinguished Speaker Series that brings creative thinkers to campus each week during the academic year. In addition, each year the Stamps provide support for about 72 undergraduate students across campus, and support similar Stamps Scholars programs at 28 universities.

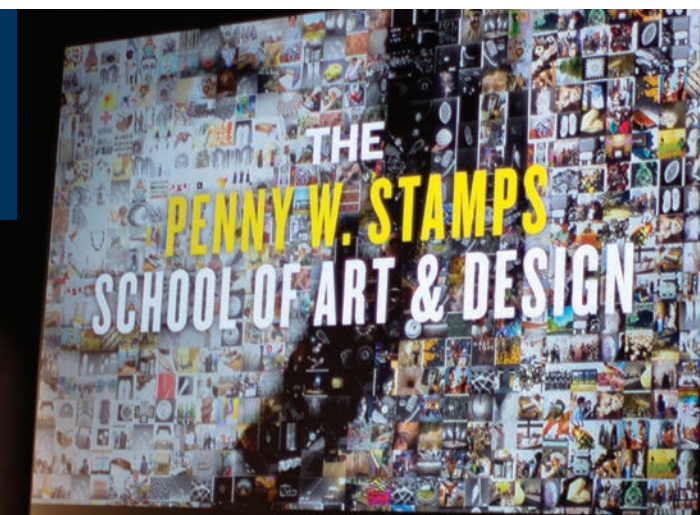
CHICAGO PHILANTHROPIST HELEN ZELL (AB '64) donated \$50 million through the Zell Family Foundation to the College of Literature, Science, and the Arts, the largest gift in the college's history. The gift permanently funds the Master of Fine Arts (MFA) in Creative Writing Program, for which Zell initially committed \$10 million in seed funding beginning in 2004. Her previous donations fueled the program's growth, and in the past nine years it has earned recognition as one of the top writing programs in the country. The program is now named the Helen Zell Writers' Program in gratitude for her support. These transformative gifts have resulted in hundreds of published books, many of which have won prestigious awards, including National Book Critics Circle Award, Oprah's Book Club selection, and National Book Award, among others. Zell had previously endowed the department's first visiting professorship in fiction which will now be named the Nicholas Delbanco Visiting Professorship to honor Delbanco, the Robert Frost Distinguished University Professor of English Language and Literature, and one of the first directors of the program.

120,000
donors

Approximately 120,000 donors made gifts under \$25,000, totaling \$74 million, a record.

THE LATE SAMUEL ('28-'30) AND JEAN (BA '36) FRANKEL When the University of Michigan Cardiovascular Center opened in 2007 the late Samuel and Jean Frankel made an anonymous \$25 million gift to the center from the Samuel and Jean Frankel Foundation. The gift offered immediate support for the center's clinical approach—a model never before attempted by a health-care institution—which emphasized cooperation among healthcare providers and put patients and families first. The Cardiovascular Center brings together all of the U-M Health System's specialists in preventing, treating and studying heart disease, blood vessel disorders and stroke. At the time, the Frankels pledged an additional \$25 million on condition that the center meet certain goals agreed upon by the donor and leaders of the center. Pleased with the success in meeting those goals, the family has committed the additional gift. In recognition of their exceptional generosity, the center has been named the Samuel and Jean Frankel Cardiovascular Center. The Frankels were also generous donors to the Center for Jewish Studies in the College of Literature, Science, and the Arts, renamed to recognize them, and in 2004 they made the largest gift to LSA at the time creating the Frankel Institute for Advanced Judaic Studies.

In addition to these extraordinary individual gifts, donors also made thousands of gifts under \$25,000 that made amazing things possible. Schools and units at the university are able to combine these gifts of all sizes to meet their priorities.



Here are just three examples:

- At the Ford School of Public Policy, gifts funded two fellowships to incoming Masters of Public Policy students and nine summer internships at sites such as the Center for Policy on Emerging Technologies, the Washtenaw Prisoner Reentry, and the National Association of Housing and Redevelopment Officials.
- At the University of Michigan-Flint, gifts supported 74 students who participated in an Alternative Spring Break program where they partnered with local organizations to renovate homes for homeless veterans, and other projects that improved the lives of people in their communities.
- At the School of Information, gifts funded the OptiMize Social Innovation Challenge that helped students take action to solve problems in the world through entrepreneurial activities. Ninety students applied and created 19 teams that applied innovation and entrepreneurship to projects they envisioned. The winning team created Volunteer Buddy, a web and mobile application that matches volunteers with organizations where they are needed.

The records our donors have broken in so many areas are most significant because, once again, they make apparent how much donors contribute to the success of this great university. These 129,000 generous donors support our students, provide great programs and facilities, and make possible exceptional patient care. And their philanthropy ultimately enriches the world. We are humbled by this generosity and grateful for it.

Thank you.

Jerry A. May
Vice President for Development

NEW DEGREES, NEW FUNDING, AND 99 GRAD PROGRAMS IN THE TOP 10

ACADEMICS

NEW MAJORS

- ~ The new **Master of Health Professions Education (MHPE)** degree will be offered beginning in Fall Term 2013. Targeted to practicing professionals including pharmacists, dentists, doctors, nurses, and social workers, the MHPE aims to help develop highly motivated and highly competent educators who will in turn train the next generation of clinicians.
- ~ A joint degree program of the Ross School of Business and the College of Engineering, the **Master of Entrepreneurship (MsE)** program began in the fall of 2012. The degree enables students to create new technology-focused ventures, either as standalone entities or within established innovative organizations.
- ~ The **Master of Management (MM)** degree from the Ross School will be offered for the first time in Summer 2014. Designed for new grads interested in learning the essentials of business, the MM will provide a solid grounding in the business fundamentals critical to achieving success.



65+
languages
taught

19
schools
and colleges

16:1
student-to-
faculty ratio

250+
degree
programs

RANKINGS

- ~ 99 graduate programs in the Top 10 of *U.S. News & World Report's* best graduate schools rankings.
- ~ U-M is listed as the top U.S. public university in the *QS World Rankings* for 2012, and is ranked 17th among all institutions worldwide.



NANO-ORIGAMI COMBINES ART AND ENGINEERING

The National Science Foundation is contributing nearly \$2 million to a four-year research campaign to learn whether the ancient art of origami could bring nanotech into the third dimension. The cross-disciplinary team comprises faculty and researchers from the College of Engineering and the Stamps School of Art & Design. The program "is really geared toward producing fundamental knowledge," says principal investigator and CoE professor Max Shtein. "We want to say, 'Look, here are the principles, this is how you can apply these principles. Can we have industrial engineers put the ideas into wider practice?'"

THIRD CENTURY INITIATIVE

The Third Century Initiative is a \$50 million program that seeks to develop innovative approaches to teaching and scholarship. Inspired by U-M's upcoming bicentennial celebration in 2017, the program's goal is to stimulate creative thinking about how to intensify learning experiences in and beyond the classroom. The initiative has two components: creating innovative student learning experiences, and developing creative approaches to tackling complex global challenges. Students benefit by gaining access to immersive and innovative multidisciplinary educational opportunities including global engagement, undergraduate research, service learning, and entrepreneurial activities. Funded through 2017, Third Century is another example of Michigan's foundational commitment to learning and teaching, one that will continue to have impact long after the bicentennial year is past.

MAJOR RENOVATION TO THE CLEMENTS LIBRARY

The Regents approved a major renovation to the Clements Library, funded in large part by a \$6 million donation from the Avenir Foundation. The Clements is one of the country's preeminent repositories of "Americana," with collections comprising books, manuscripts, maps, and more. The gift will be used to fund infrastructure improvements and to expand collections space.

A PROFILE OF THE NEW CROP OF LEADERS AND BEST

STUDENT PROFILE

NEW STUDENT PROFILE

Enrollment at U-M's Ann Arbor campus reached 43,426 students in fall 2012, according to the Office of the Registrar. Freshman applications totaled 41,885, with 14,971 admitted. The entering class has an average GPA of 3.83, up from last year, and also netted average ACT composite scores of 29–33 and SAT totals of 1990–2230.

KEEPING U-M AFFORDABLE

The budget approved for FY 2014 by the U-M Board of Regents contains the smallest in-state tuition increase in nearly 30 years and the largest-ever increase in financial aid. That combination means that, for the fifth straight year, there will be no increase in the net cost of attendance for the typical undergraduate resident student with financial need.

2012 FALL TERM ENROLLMENT

	Undergraduate	Graduate/Professional	Total
ANN ARBOR	27,979	15,447	43,426
DEARBORN	7,550	1,533	9,083
FLINT	6,984	1,305	8,289
ALL CAMPUSES	42,513	18,285	60,798

2012–13 DEGREES GRANTED

	Undergraduate	Graduate/Professional	Total
ANN ARBOR	6,741	6,873	13,614
DEARBORN	1,267	465	1,732
FLINT	1,112	434	1,546
ALL CAMPUSES	9,120	7,772	16,892

More than 34% had an ACT composite score between 31 and 36.

Students come from all 50 states and 122 countries; 60% of undergrads are from Michigan.

An all-time high, up 6%, which is credited in part to the Common Application.

3.83
grade point
average

60%
undergrads from
Michigan

41,885
freshman
applicants

\$25,848
yearly under-
grad cost

\$11,038
need-based
grant

70%
Michigan
students with
aid

Annual U-M tuition and required fees, room and board, books, and personal spending for a lower-division, full-time resident student.

Typical U-M grant award for a resident student with a family income of \$60,000–\$80,000.

70% of undergrad students from the state of Michigan receive some form of financial aid.

CONTINUING U-M'S COMMITMENT TO GLOBAL ENGAGEMENT

GLOBAL

COLEMAN LED DELEGATION TO BRAZIL

U-M scientists and scholars, led by President Mary Sue Coleman, traveled to Brazil Sept. 22–28, 2012, to strengthen research and academic collaboration with leading universities and foundations. The delegation attended meetings and working sessions in four cities, including São Paulo, Campinas, Rio de Janeiro, and Brasília; the sessions included discussions with U.S. Embassy and Brazilian government officials in Brasília to discuss broader partnership possibilities. U-M and Brazil already have important partnerships in place (many of them through the U-M Center for Latin American and Caribbean Studies) in a wide array of disciplines from environmental studies and health sciences to history and the arts in collaboration with the University Musical Society.

FIRST WALLENBERG FELLOW NAMED

The first-ever \$25,000 Raoul Wallenberg Fellowship will be awarded to Zachary Petroni, a senior from the Gerald R. Ford School of Public Policy. President Coleman announced the award, among the largest for a graduating senior, at spring commencement. Petroni will use his award to study conservation governance in Kenya. The fellowship is named for U-M alumnus Raoul Wallenberg, who earned a degree in architecture in 1935. A Swedish diplomat, he is credited with saving 100,000 lives during the Holocaust. The award is presented to a graduating senior who demonstrates exceptional promise, character, accomplishment, and capacity for public service, and gives the graduate the ability to carry out independent explorations, projects, or activities anywhere in the world.

12th
top institution in
the world

(Times Higher Education)

8th
in number of
international
students

(Open Doors Report)

1,655
international
undergrads1,655 international under-
graduate students on the
UM-Ann Arbor campus.3,869
grad
students3,869 international
graduate students on the
UM-Ann Arbor campus.

SEARCHING FOR A LOST ANCIENT CITY IN SUDAN

U-M researcher Geoff Emberling is working with archaeologists from Denmark and Sudan to search for a lost royal city. The ancient capital was ruled by the kings of Nubia, in what is now northern Sudan. Nubia, also known as Kush, was one of Africa's earliest centers of political authority, wealth, and military power, although it's not as well known as ancient Egypt and Mesopotamia. Even less is known about the kings who suddenly appeared on the historical stage about 800 B.C. and conquered Egypt before fading back into the desert. "We have no idea where these kings came from," said Emberling, a research scientist at the Kelsey Museum of Archaeology at the University of Michigan. "They basically appeared out of nowhere."

NEW GRANT PROGRAM TO TACKLE GLOBAL CHALLENGES

Nadine Naber is playing a key role in helping women's groups in Egypt share their stories in a public digital archive. The associate professor of Women's Studies and the Program in American Culture received a \$31,000 grant to set up the archive. Funding comes from the Third Century Initiative; Naber's grant was one of 15 that received funding from the "Global Challenges" component of the initiative.

U-M AND QATAR UNIVERSITY PARTNER ON SURVEY RESEARCH IN THE ARAB GULF

Partnering with Qatar University, U-M has helped create an institute that is doing the most rigorous, state-of-the-art social science research in the Arab Gulf. The Social and Economic Survey Research Institute was an outgrowth of Qatar University's decision to enhance its social science research capacity. U-M was sought out as a partner by the Qataris largely because of the reputation of the Institute for Social Research, the world's largest academic social science survey and research organization.

CENTER FOR JAPANESE STUDIES AWARDED \$450,000 GRANT

The Center for Japanese Studies has been awarded a \$450,000 Institutional Support Grant from the Japan Foundation to create new fellowships for graduate students enrolled in its interdisciplinary master's program. The grant will support two Japan Foundation Graduate Fellowships for students pursuing advanced training in Japanese studies. Fellowship recipients will also be involved in the creation and implementation of new education-abroad opportunities in Japan.

→ U-M leads nation in Fulbright grants, as 40 students travel to 24 countries for research and study.
→ U-M's global engagement honored again with Simon Award for Comprehensive Internationalization.

HEALTHCARE THAT SERVES THE STATE AND FUELS NATIONAL PROGRESS

HEALTH SYSTEM

PARTNERING FOR HEALTHCARE SUCCESS

With the major provisions of federal healthcare reform poised to take effect, the U-M Health System this year embarked on a broad range of efforts designed to move medicine forward and strengthen its care for patients.

These include:

- An affiliation with, and partial ownership of, the four-hospital MidMichigan Health System;
- Under a master affiliation with the Michigan hospitals of Trinity Health, expanded inpatient space at Chelsea Community Hospital, and added a new Acute Care for Elders joint inpatient unit at Saint Joseph Mercy Health-Ann Arbor;
- The launch of POM ACO, a new accountable care organization based at U-M that will help physicians from nine organizations around the Lower Peninsula provide better, lower-cost care for Medicare participants;
- Survival Flight air medical service coverage for Sparrow Health System in Lansing, and three new state-of-the-art Survival Flight helicopters put into service;
- The launch of a new electronic health record system, MiChart, in U-M's outpatient environment—making possible a new patient portal, myuofmhealth.org, and meeting federal goals for healthcare information technology;
- Newly published proof of the care-improving, cost-saving effect of UMHS initiatives, including efforts to reduce unnecessary hospitalization and coordinate the care of Medicare patients;
- Timely research on the potential impact of Medicaid expansion, performed by the Center for Healthcare Research & Transformation; and
- A new partnership, Paradigm, formed with the International Genomics Consortium to harness the power of “personalized medicine” made possible by modern gene sequencing technology.

#17
in the U.S.

#1
in Michigan

U.S. News & World Report's
2012 Best Hospitals ranking

HEALTH POLICY INSTITUTE BLOSSOMS

More than 400 health researchers—from a broad range of U-M colleges, schools, and institutes, and outside partners—teamed up to launch the Institute for Healthcare Policy and Innovation (IHPI). With a newly renovated hub for hundreds of faculty and staff at the North Campus Research Complex (NCRC), and a Harvard health expert recruited to head the institute, the energy and innovation are palpable. The NCRC location facilitates collaboration among the researchers, physicians, health scientists, and policy analysts who study how healthcare works and how it can be improved. IHPI includes members from more than 30 research groups, focusing on issues ranging from kidney and heart disease to surgical care, children's health, and mental health.

RANKINGS

- 100 Top Hospitals: UMHS named to national hospital quality list, receives Everest Award for rapid improvement.
- C.S. Mott: 10 Best Children's Hospitals (*Parents* magazine) and nationally ranked in all 10 specialties by *U.S. News & World Report*.



RESEARCH CONTINUES TO FLOURISH, WITH \$1.3 BILLION IN SPENDING

RESEARCH

R&D spending at U-M rose to a record \$1.3 billion, a 4.3% increase. U-M ranks first in R&D spending among the nation's public universities, and behind only Johns Hopkins on the list of all U.S. universities.

\$1.3
billion

The Business Engagement Center reports that industry-sponsored research was up by 14% to \$72 million in 2013.

\$72
million

MCUBED TURNS ONE

May marked the first anniversary of MCubed, U-M's innovative research funding program that has already awarded \$11 million to interdisciplinary teams collaborating on new pilot projects. More than 190 teams of qualifying faculty members have received funding. The novel program has been a springboard for bringing faculty from across campus together to embark on promising cross-disciplinary investigations.

U-M PARTNERS WITH ISRAELI UNIVERSITY ON RENEWABLE ENERGY

The U-M Office of Research initiated a partnership with Ben Gurion University of the Negev (BGU) in Israel to explore renewable energy technologies. Faculty teams with members from both institutions will work together to address challenges in photovoltaics and solar technology, liquid fuels, and thermoelectric energy conversion devices—areas of common and complementary strength for the two universities. The partnership is an example of the priority U-M has placed on international research collaborations. As Vice President of Research Stephen Forrest notes, "universities need to globalize their activities because we need to solve problems that are larger than one country can manage alone." The entrepreneurial, startup culture of Israel in particular makes BGU a perfect partner for U-M in the search for innovative solutions to energy resource issues.

U-M PART OF \$120 MILLION NATIONWIDE BATTERY RESEARCH HUB

U-M researchers will play an integral role in a national collaborative effort to develop breakthrough batteries for longer-range electric vehicles and a power grid that can store electricity generated from solar and wind energy. U.S. Secretary of Energy Steven Chu made the announcement that the Department of Energy will establish the Joint Center for Energy Storage Research with an award of up to \$120 million over five years (U-M's portion of the grant is \$7 million). Argonne National Laboratory will lead the center, and U-M is one of five universities, five DOE national laboratories, and four private firms involved. The hub will bring together some of the most advanced energy storage research programs in the U.S. today.

COMPREHENSIVE CANCER CENTER AWARDED \$28.4 MILLION GRANT

The National Cancer Institute (NCI) has awarded the U-M Comprehensive Cancer Center a grant worth \$28.4 million over five years, and renewed the center's designation as a "comprehensive cancer center." U-M has received NCI funding for its Cancer Center since 1988; the new grant will fund the center through 2017. The funding will allow ongoing research in 13 basic, clinical, and prevention/control programs, including cancer stem cells, experimental therapeutics, and cancer genetics. The grant renewal process included a rigorous site visit by reviewers, who gave U-M an "outstanding" rating. Reviewers also commented that the Cancer Center has had "a significant impact not only on cancer research but increasingly on the burden of cancer."

GROUNDBREAKING 3D DEVICE SAVES BABY'S LIFE AT UMHS

In a case reported in the *New England Journal of Medicine*, two U-M doctors used a groundbreaking 3D printed device to restore breathing to a baby whose collapsed bronchus was blocking the crucial flow of air to his lungs. U-M doctors Glenn Green, M.D., associate professor of pediatric otolaryngology, and colleague, Scott Hollister, Ph.D., professor of biomedical engineering and mechanical engineering and associate professor of surgery, obtained emergency FDA clearance to use the innovative tracheal splint, which is made from a biopolymer called polycaprolactone. The custom-designed, custom-fabricated device was made using high-resolution imaging and computer-aided design.



A BANNER YEAR FOR SUSTAINABILITY RESEARCH, OPERATIONS,
AND EDUCATION

PLANET BLUE

640
sustainability-
related
courses

667
faculty with
sustainability
backgrounds

640 sustainability-related courses are offered at U-M, and 667 U-M faculty members have sustainability backgrounds.

→ Total energy use per person per square foot of building space on campus is down by 22% since 2004.

→ U-M launched the Planet Blue Ambassadors, an online tool for students, faculty, and staff interested in becoming campus sustainability leaders.

DOW AND U-M LAUNCH INNOVATIVE SUSTAINABILITY LEADERSHIP PROGRAM

Nearly 70 masters and professional degree scholars were nominated by U-M schools and colleges for the first Dow Sustainability Fellowship Program. Administered by U-M's Graham Environmental Sustainability Institute, the program will prepare up to 300 future sustainability leaders to make a positive difference in organizations worldwide.

U-M LAUNCHES GREAT LAKES WATER CENTER

The new U-M Water Center, a \$9 million research and education center, will guide efforts to protect and restore the world's largest group of freshwater lakes by reducing toxic contamination, combating invasive species, protecting wildlife habitats, and promoting coastal health. With a \$4.5 million, three-year grant from the Fred A. and Barbara M. Erb Family Foundation and matching funds from the university, the new U-M Water Center will provide a solid scientific framework for more efficient and effective Great Lakes restoration.



U-M HIGHLIGHTS SUSTAINABILITY ACHIEVEMENTS IN MULTIMEDIA REPORT

U-M shows immense growth and engagement in sustainability education, research, and operations, according to a new report designed to track and measure progress. Using an innovative new format, the interactive digital 2012 Sustainability Progress Report combined video, animation, and data to show U-M's many efforts to tackle sustainability challenges. The report shows that funding for sustainability research at U-M has increased by 200 percent since 2003, signaling the growing recognition of the importance of this research to address global challenges such as ensuring safe food and water sources.

NORTH CAMPUS SOLAR PANELS

Ground was broken in October 2012 for the new solar energy installation at the North Campus Research Complex. The partnership between U-M and DTE Energy is part of DTE Energy's SolarCurrents program, which resulted in a ground-mounted solar array capable of producing up to 430 kilowatts, equivalent to enough energy to power approximately 100 homes. Construction started in May 2013 on a second solar array on North Campus.



CAMPUS FARM EXPANDS AT BOTANICAL GARDENS

Part of U-M's Sustainable Food Program, the Campus Farm at Matthaei Botanical Gardens continues to grow. The farm plot was greatly expanded for 2013 to more than a quarter of an acre, and a "Quick Wins" grant from the president and provost's offices funded the hiring of a farm manager and assistant. As much laboratory as classroom, the hands-on experience provides invaluable lessons, connecting students with nature in ways they might never have experienced before.

COMMUNITY

URC ALUMNI STARTING BUSINESSES FASTER THAN NATIONAL AVERAGE

The state of Michigan's University Research Corridor (URC) is proving to be a powerful business incubator, playing a dramatically increased role in nurturing startup efforts and providing a boost to aspiring entrepreneurs, a new report shows. The "Embracing Entrepreneurship" report shows that URC alumni were 1.5 times as successful as the average U.S. business owner at keeping those startups and acquisitions. Graduates of the three URC schools (Michigan State University, the University of Michigan, and Wayne State University) have started or acquired businesses at double the national average rate among college graduates since 1996. The study also found that more than 19 percent of the URC alumni surveyed have started a company, and some have created more than one.

UM-FLINT STUDENT HONORED

UM-Flint student Robert Burack was honored with an Outstanding Community Impact award from the Michigan Campus Compact (MICC). The award honors students who have made significant contributions to community service and who demonstrate a commitment to lifelong engagement. MICC promotes the education and commitment of Michigan college students to be civically engaged citizens through creating and expanding academic, co-curricular, and campus-wide opportunities for community service, service learning, and civic engagement.

BIRDING BY EAR

UM-Dearborn student Donna Posont teaches kids and young adults who are blind or visually impaired to identify and enjoy Michigan birds by sound rather than sight. The Celebrate Urban Birds event on the Dearborn campus drew attendees from throughout Michigan, who left with a greater awareness of the birds that inhabit their cities. Additionally, says Posont, who serves as field services director of Opportunities Unlimited for the Blind, "confidence is gained by the youth in having skills of bird identification and also improved mobility skills from traveling trails in search of birds."

93
graduates serving
in Peace Corps

U-M made the Peace Corps' annual list of the top volunteer-producing large universities for the 13th year in a row. With 93 graduates currently serving, U-M moved to the No. 4 spot.

U-M ANNOUNCES PARTNERSHIP WITH SPECIAL OLYMPICS

The Athletic Department announced a community service relationship with the Special Olympics of Michigan, committing team member and venue support to the nonprofit organization. The kickoff event was the popular "Polar Plunge" at Michigan Stadium. A major fundraiser for the Special Olympics, the Polar Plunge raises funds that will go to support the athletes competing in the local, regional, state, national, and international competitions. Michigan Athletics team members also worked with the Special Olympics on local and regional events held throughout the year.

STATE-IMPACT NEWSLETTERS: A COMMUNICATIONS VEHICLE FOR ALUMNI

Getting the word out about U-M's state-focused initiatives was the reason behind the newly launched "Michigan Impact" e-newsletter. Three times a year, President Coleman writes to alumni and friends from Detroit to Grand Rapids about the impact the university is having within Michigan. The newsletters are segmented by geographical region (northern, western, southeast, and mid-Michigan) to provide a better focus on local initiatives. The Wolverine Patriot Project, featured in a recent e-newsletter, is an example of one such program. Students from the U-M School of Dentistry have teamed with a pair of Dentistry alumni to provide oral healthcare to disabled and homeless veterans in Gaylord. The free-care clinic is a pilot project that could serve as a model for a larger statewide rollout in the future.

FROM LONDON TO ATLANTA: A BANNER YEAR FOR BLUE

ATHLETICS

The University of Michigan Athletic Department recruits the very best talent, both on and off the field, to compete for championships and national recognition, while always remembering what Bo Schembechler taught us: "The Team, The Team, The Team."

7,205
community service
hours

SWEET, ELITE, AND BEYOND: WOLVERINES SHINE IN MARCH MADNESS

Making its first NCAA Final Four appearance in 20 years, the men's basketball team beat Syracuse in the semi-finals and went all the way to the championship game. Although they eventually fell to #2-ranked Louisville, it was a banner season for the Wolverines, who went 31-8 overall.

226
Academic All
Big 10 student
athletes

BLUE GOES FOR THE GOLD

Twenty-two Wolverines represented U-M at the 2012 London Olympics. Wolverines medaled in three sports, with swimmer Michael Phelps netting four golds and two silvers. Nearly 230 U-M student-athletes have participated in Olympic competition since 1900, and have won 150 medals between them, including 72 gold. And Michigan student Ralph Rose served as the nation's first Olympic flag bearer in 1908.

SELF-FUNDED, SELF-SUSTAINING

Michigan Athletics is one of only 23 NCAA Division I athletic departments that earned sufficient revenue to cover expenses. A self-sustaining auxiliary unit of the institution, athletics does not receive any funds from the university's general fund or receive state appropriations. This is a rare position of strength that is made possible in large part by generous donors who believe in the shared vision of Leaders and Best.

CONTINUING THE WINNING TRADITION

Twenty U-M teams participated in postseason action this year. The men's swimming and diving and gymnastics teams captured NCAA titles; the volleyball team made its first national semifinal appearance in the program's history; the softball team made its 10th Women's College World Series appearance; and the women's tennis and soccer teams reached the Sweet 16 in the NCAA Tournament. And Michigan's cheerleading squad won the National Cheerleaders Association Intermediate Co-Ed 1 national title. These successes helped propel us to a fourth-place finish in the NACDA Learfield Sports Directors' Cup rankings.

MAINTAINING A SUPPORTIVE CULTURE

The Athletic Department was recognized as one of Metro Detroit's 101 Best and Brightest Places to Work this year. We believe that in order to be successful we must maintain a culture that is enriching and supportive for the 900-plus student-athletes and 325-plus team members that represent the department on a daily basis.

4th
final NACDA
Directors' Cup
rankings

UM-DEARBORN AND UM-FLINT REACH OUT TO NEW AUDIENCES

DEARBORN ~ FLINT

7,550
undergraduate
enrollment

UM-Dearborn undergraduate enrollment continued to grow with a record 7,550 students, an increase of nearly 2 percent. Undergraduate enrollment has increased each year since 2004.

DEARBORN

- UM-Dearborn students have a new housing option. A \$30-million privately developed student housing project was constructed adjacent to campus. The Union at Dearborn, located directly across Evergreen Road from main campus, opened September 1, 2013. The facility, which can accommodate 505 students, includes furnished apartments as well as a shared university common area which promotes student life with informal gathering spaces, meeting rooms, and study areas.
- UM-Dearborn officials announced the largest enrollment in the university's 52-year history, marking the fourth consecutive year of growth. Total enrollment for fall 2012 was 9,083 students, an increase of 128 students from the previous fall.
- UM-Dearborn's College of Engineering and Computer Science launched Ph.D. programs in automotive systems engineering and information systems engineering. In December 2012, Xuan Zhou became the first person to earn a Ph.D. from UM-Dearborn. More than 30 students have enrolled in the Ph.D. programs since their inception.



#3
online graduate
nursing program

UM-Flint's online Graduate Nursing Program has been rated one of the best in the country by *U.S. News & World Report*. Of the hundreds of programs that were surveyed, Flint's Accelerated Nursing (MSN) was ranked #3.



FLINT

- The generosity of a retired accounting professor helped launch UM-Flint's first all-student orchestra. Walker E. Fesmire, Emeritus Professor of Accounting, presented UM-Flint a gift of \$100,000 to establish the Chieko Fesmire String Instrument Scholarship in honor of the memory of Chieko "Peggy" Fesmire, his late wife.
- UM-Flint Professor of Physics and Engineering Mojtaba Vaziri, Ph.D., received a Distinguished Professor of the Year Award from the Presidents Council, State Universities of Michigan. The award recognizes the outstanding contributions made to the education of undergraduate students by faculty from Michigan's 15 public universities.

NEW DIVISION, NEW DEANS, NEW SOLAR CAR, AND MORE

NEWSMAKERS

1st

seven, first-place
finishes

The U-M Solar Car team has seven first-place finishes in the American Solar Car Challenge since 1990.

5

languages

U-M news now available in five languages.

U-M IN D.C.

➤ Betsey Stevenson was appointed to President Obama's Council of Economic Advisors. Stevenson is an associate professor at the Ford School, whose research focuses on the impact of public policies on the labor market. She was previously chief economist for the U.S. Department of Labor and a former research associate with the National Bureau of Economic Research.

➤ School of Education Dean Deborah Loewenberg Ball was named as one of seven new members of President Obama's National Science Board. Ball, who is the William H. Payne Collegiate Professor of Education, an Arthur F. Thurnau Professor, and a research professor at ISR, also finds time every summer to teach elementary students in a unique laboratory program that draws educators from across the country and the world. In September, she appeared on NBC's Education Nation Summit and discussed the changing landscape of teacher evaluation with anchor Brian Williams.

NEW SOLAR CAR HAS SLEEK, ASYMMETRICAL DESIGN

The lopsided solar car named Generation, unveiled in June, might be the oddest-looking vehicle the top-ranked University of Michigan team has ever built. But the bold shape is a calculated effort to design the most efficient car possible, given major changes in World Solar Challenge race rules. The World Solar Challenge is an 1,800-mile, week-long endurance contest across the continent of Australia that takes place every other fall. The U-M team has come in third place five times, most recently in 2011. The U-M Solar Car team has seven first-place finishes in the American Solar Car Challenge since 1990.

DPSS: A NEW DIVISION ESTABLISHED

In October 2012, the Division of Public Safety & Security was established. The new department represents a realignment of campus safety and security services to better serve the needs of campus constituents, and includes the U-M Police Department, Hospitals and Health Centers Security Services, Housing Security and Safety Services, and University Security Services.



HELPING GALLUP POLL

Professor Michael Traugott, a senior research scientist at ISR, is working with the Gallup Organization, reviewing the survey methodology it uses in political polling, with a particular look at the 2012 presidential election. Traugott has a longstanding association with Gallup; as an undergrad at Princeton, he worked part-time at the company, and served as a research assistant for George Gallup during the 1964 election campaign.

NEW LEADERS APPOINTED

➤ **Martha Pollack** was named the new U-M provost effective May 2013. Pollack previously served as dean of the School of Information and before that as associate chair for Computer Science and Engineering in the Department of Electrical Engineering and Computer Science.

➤ **Laurie McCauley** begins a five-year term in September as dean of the School of Dentistry. McCauley is currently the William K. and Mary Anne Najjar Professor of Periodontics at the school, and a professor of pathology in the Medical School.

➤ LSA Dean **Terrence McDonald** was named the new director of the Bentley Library; his term will begin in September.

➤ **James Hilton** was appointed to a five-year term as dean of libraries and university librarian. In September he'll replace Paul Courant, who returns to teaching.

➤ **Mark D. West** will be the new dean of the Michigan Law School. Currently associate dean for academic affairs, West, a highly regarded scholar whose research focuses on the Japanese legal system, starts in September.

NATIONAL TOBACCO-FREE INITIATIVE LAUNCH

Dr. Howard Koh, assistant secretary for health at the U.S. Department of Health and Human Services, was on campus in September 2012 to participate in the launch of the Tobacco-Free College Campus Initiative, a national initiative to eliminate tobacco use on college campuses. U-M is a model for the national program, due to its highly successful smoke-free campus rollout in 2011. President Coleman and School of Public Health Dean Martin Philbert joined tobacco policy experts and educational leaders from across the country at the event, which was streamed live.

MAJOR PROJECTS

PROJECTS IN PLANNING

George Granger Brown Memorial Laboratories Room 2514 Renovation
 George Granger Brown Memorial Laboratories Renovation
 William L. Clements Library Infrastructure Improvements and Addition
 Dearborn Fairlane Center Renovations
 Dearborn Science Building and Computer Information Science Building Renovation
 East Hall Renovation for Department of Psychology
 New Field Hockey Team Center, New Field Hockey Stadium, and Ocker Field Improvements
 Flint William R. Murchie Science Building Renovation
 Earl V. Moore Building Addition and Renovation
 Munger Graduate Residences
 North Campus Research Complex Building 10 Air Handling Unit Replacement
 North Campus Research Complex Building 80 Switchgear Replacement
 North Hall Infrastructure Improvements
 Power Center for Performing Arts Improvements
 School of Nursing New Building
 A. Alfred Taubman Health Sciences Library Renovation
 University of Michigan Hospitals and Health Centers Projects

- 2205 Commonwealth Boulevard, Ann Arbor, Michigan Leasehold Improvements for Pediatric Speech Language Pathology, Physical Therapy and Occupational Therapy
- Domino's Farms Leasehold Improvements for Wound Care Program Expansion
- University Hospital Critical Power Distribution Improvements

Varsity Drive Building Ruthven Dry Collection Relocation
 West Hall Renovation for the College of Literature, Science, and the Arts
 West Quadrangle and Michigan Union-Cambridge House Renovation
 Wilpon Baseball and Softball Complex Site Improvements

PROJECTS IN PROGRESS

Vera B. Baits Houses II Renewal | Work started December 2011 with an estimated completion date of September 2013. Financing is from University Housing.

George Granger Brown Memorial Laboratories Mechanical Engineering Addition | Work started April 2012 with an estimated completion date of September 2014. Financing is from the College of Engineering, gifts, investment proceeds, and a construction grant from the National Institute of Standards and Technology.

Central Campus Area Utility Tunnel Replacement | Work started April 2013 with an estimated completion date of December 2013. Financing is from utilities reserves.

Central Power Plant Distributed Control System Upgrades | Work started January 2012 with an estimated completion date of December 2014. Financing is from utilities reserves.

Central Power Plant Feed Water System Deaerator Upgrade | Work started April 2013 with an estimated completion date of December 2014. Financing is from utilities reserves.

College of Pharmacy Building Basement and First Floor Renovations | Work started April 2013 with an estimated completion date of December 2013. Financing is from the College of Pharmacy.

OVERVIEW OF PROJECTS IN PLANNING, IN PROGRESS, AND COMPLETED

MAJOR PROJECTS

Martha Cook Building Fire Suppression System Installation | Work started February 2013 with an estimated completion date of December 2013. Financing is from University Housing.

East Quadrangle Renovation | Work started February 2012 with an estimated completion date of September 2013. Financing is from University Housing, the College of LSA, and investment proceeds.

Flint Central Energy Plant Boiler Replacement | Work started February 2013 with an estimated completion date of December 2013. Financing is from UM-Flint.

Flint Northbank Center Elevator Replacement | Work started February 2012 with an estimated completion date of September 2013. Financing is from UM-Flint.

Hutchins Hall and William W. Cook Legal Research Library Law School Renovation Phase II | Work started September 2012 with an estimated completion date of September 2013. Financing is from the Office of the Provost and the Law School.

Institute for Social Research Addition | Work started August 2012 with an estimated completion date of September 2014. Financing is from an American Recovery and Reinvestment Act of 2009 grant from the National Institutes of Health, the Office of the Provost, and the Institute for Social Research.

The Lawyers Club Building and John P. Cook Building Renovation | Work started April 2012 with an estimated completion date of September 2013. Financing is from a gift, investment proceeds, and the Lawyers Club.

Lorch Hall Roof Replacement | Work started May 2013 with an estimated completion date of December 2013. Financing is from the general fund.

Mason Hall Angell Hall Courtyard Computing Site and Classroom Renovation | Work started April 2013 with an estimated completion date of December 2013. Financing is from investment proceeds and the Office of the Provost.

Michigan Stadium Bowl Painting | Work started March 2013 with an estimated completion date of September 2014. Financing is from the Athletic Department.

Michigan Stadium Marquee | Work started December 2012 with an estimated completion date of December 2013. Financing is from the Athletic Department.

Modern Languages Building Elevator Replacement | Work started December 2012 with an estimated completion date of June 2014. Financing is from the general fund.

Earl V. Moore Building Roof Replacement | Work started May 2013 with an estimated completion date of December 2013. Financing is from investment proceeds.

North Campus Research Complex Building 22 Electron Microbeam Analysis Laboratory Renovation | Work started April 2013 with an estimated completion date of March 2014. Financing is from the College of Engineering and the Medical School.

Power Center for the Performing Arts Electrical System Improvements | Work started January 2013 with an estimated completion date of March 2014. Financing is from the general fund.

Regional Chiller Plant for South and West Quadrangles and the Michigan Union | Work started May 2013 with an estimated completion date of September 2014. Financing is from University Housing.

Glenn E. Schembechler Hall Entrance and Museum Renovation | Work started February 2013 with an estimated completion date of March 2014. Financing is from the Athletic Department and gifts.

Softball Center New Facility | Work started May 2013 with an estimated completion date of March 2014. Financing is from the Athletic Department and gifts.

South Quadrangle Renovation | Work started May 2013 with an estimated completion date of September 2014. Financing is from University Housing.

University of Michigan Hospitals and Health Centers Projects | Financing is from the U-M Hospitals and Health Centers.

- I-275 Corridor Clinic Expansion Leasehold Improvements | Work started March 2013 with an estimated completion date of March 2014.
- Cancer Center Backfill Renovations | Work started April 2013 with an estimated completion date of December 2013.
- Livingston County Survival Flight Hangar Leasehold Improvements | Work started November 2012 with an estimated completion date of September 2014.
- A. Alfred Taubman Health Care Center Backfill Renovations (Levels 1 and 2) | Work started September 2012 with an estimated completion date of August 2013.
- A. Alfred Taubman Health Care Center Internal Medicine Renovation | Work started September 2012 with an estimated completion date of September 2013.
- University Hospital Communication Closet Upgrades | Work started June 2013 with an estimated completion date of June 2014.
- University Hospital Ethylene Oxide Sterilizers Replacement | Work started May 2013 with an estimated completion date of December 2013.
- University Hospital and A. Alfred Taubman Health Care Center Fire Alarm Upgrades | Work started October 2012 with an estimated completion date of September 2013.

Wall Street East Parking Structure | Work started May 2013 with an estimated completion date of June 2014. Financing is from U-M Parking and Transportation Services.

PROJECTS COMPLETED

Chemistry Building and Willard H. Dow Laboratory Chiller Replacement | Completed June 2013. Financed by the general fund.

Crisler Arena Expansion | Completed March 2013. Financed by the Athletic Department.

Institute for Social Research Wing One Fire Suppression System | Completed September 2012. Financed by the Institute for Social Research and the Office of the Provost.

Alice Crocker Lloyd Hall Renovation | Completed August 2012. Financed by University Housing.

Edward Henry Kraus Building Auditorium Renovation | Completed September 2012. Financed by the College of LSA and the Office of the Provost.

Michigan Memorial Phoenix Laboratory Addition and Second Floor Renovation | Completed April 2013. Financed by investment proceeds, the Office of the Vice President of Research, and the College of Engineering.

North Campus Support Facility | Completed July 2012. Financed by investment proceeds.

Northwood Apartments I, II, and III Fire Alarm and Boiler Upgrades | Completed July 2012. Financed by University Housing.

University of Michigan Hospitals and Health Centers Programs | Financed by the U-M Hospitals and Health Centers.

- Cardiovascular Center Central Uninterruptible Power Supply | Completed March 2013.
- Med Inn Electrical Substation and Riser Upgrades | Completed May 2013.
- C. S. Mott Children's and Von Voigtlander Women's Hospitals Cardiac Catheterization Laboratory | Completed July 2012.
- Parkview Medical Center and Scott and Amy Prudden Turner Memorial Clinic Building Demolition | Completed December 2012.
- University Hospital Kitchen Renovations for Room Service Protocol | Completed September 2012.
- University Hospital Magnetic Resonance Imaging Scanner Replacement | Completed June 2013.
- University Hospital Trauma Burn Unit Renovations | Completed September 2012.

Varsity Drive Building and Alexander G. Ruthven Museums Building Museum of Zoology Collection Relocation and Renovations | Completed February 2013. Financed by investment proceeds.

Yost Ice Arena Seating Replacement and Fan Amenities Improvement | Completed October 2012. Financed by the Athletic Department and gifts.

MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS



September 18, 2013

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 62 to 87, 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 pages 43-44.

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

INDEPENDENT AUDITOR'S REPORT



The Regents of the University of Michigan

We have audited the accompanying financial statements of the University of Michigan (the "University"), as of and for the years ended June 30, 2013 and 2012 and the related notes to the financial statements which collectively comprise the statements of net position and the related statements of revenues, expenses and changes in net position and cash flows.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the University's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

INDEPENDENT AUDITOR’S REPORT



OPINION

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University at June 30, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

OTHER MATTERS

The accompanying management’s discussion and analysis on pages 45 through 61 is required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

September 18, 2013

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, 2013 and 2012 and its activities for the three fiscal years ended June 30, 2013. 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 61,000 students and 7,500 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 also has a nationally renowned health system which includes three hospitals, 40 health centers, more than 120 outpatient clinics, the University’s Medical School and Michigan Health Corporation, a wholly-owned corporation created to pursue joint venture and managed care initiatives. The University, in total, employs approximately 44,000 permanent employees and 13,000 temporary staff.

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. Research is central to the University’s mission and a key aspect of its strong reputation among educational institutions. The University is widely recognized for the breadth and excellence of its research enterprise as well as for the exceptional level of cooperation across disciplines, which allows faculty and students to address the full complexity of real-world challenges. 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 \$16.4 billion and liabilities of \$4.9 billion at June 30, 2013, compared to assets of \$15.7 billion and liabilities of \$4.9 billion at June 30, 2012. Net position, which represents the residual interest in the University’s assets after liabilities are deducted, totaled \$11.5 billion at June 30, 2013 as compared to \$10.8 billion at June 30, 2012. Changes in net position represent the University’s results of operations and are summarized for the years ended June 30, 2013 and 2012 as follows:

(in millions)	2013	2012
Operating revenues and educational appropriations	\$ 5,676.4	\$ 5,391.5
Private gifts for operating activities	168.6	131.6
Total operating and net interest expenses	(6,162.1)	(5,878.9)
	(317.1)	(355.8)
Net investment income	847.3	68.7
Endowment and capital gifts/grants and other	199.7	116.0
Increase (decrease) in net position	\$ 729.9	\$ (171.1)

Net position increased \$730 million in fiscal 2013 after a decrease of \$171 million in fiscal 2012 primarily due to volatility in net investment income which totaled \$847 million and \$69 million in 2013 and 2012, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

In 2013, operating revenues and educational appropriations increased 5.3 percent, or \$285 million, while total operating and net interest expenses increased 4.8 percent, or \$283 million. Gifts for operating activities, endowment and capital increased significantly in 2013 as the silent phase of the University's next major fundraising campaign is underway.

The results of operations reflect the University's focus on maintaining its national standards academically, in research and in health care in a competitive recruitment environment for faculty and health care professionals. At the same time, the University is addressing constrained state appropriations and rising health care, regulatory and facility costs with aggressive cost cutting and productivity gains to help preserve access to affordable higher education for Michigan families. To achieve aggressive and sustainable long-term goals for cost cutting and productivity gains, the University is also strategically utilizing resources to bridge cuts and support enterprise-wide information technology projects and other initiatives.

The University's long-term investment strategy combined with its endowment spending policy serves to insulate operations from expected volatility in the capital markets and provide for a stable and predictable level of spending distributions from the endowment. Endowment spending rate distributions totaled \$276 million and \$270 million in 2013 and 2012, respectively. The success of the University's long-term investment strategy is evidenced by strong returns over sustained periods of time and the ability to limit losses in the face of challenging markets.

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, through its Daily and Monthly Portfolios, while the endowment is invested, along with the noncurrent portion of the insurance and benefit reserves, in an equity oriented long-term strategy, through its Long Term Portfolio.

USING THE FINANCIAL STATEMENTS

The University's financial report includes three financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board ("GASB") principles, which establish standards for external financial reporting for public colleges and universities.

STATEMENT OF NET POSITION

The statement of net position 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 position — is one indicator of the current financial condition of the University, while the change in net position 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 position at June 30, 2013 and 2012 is summarized as follows:

(in millions)	2013	2012
Current assets	\$ 2,155	\$ 2,107
Noncurrent assets:		
Endowment, life income and other investments	8,674	7,949
Capital assets, net	5,369	5,338
Other	237	263
Total assets	16,435	15,657
Current liabilities	1,399	1,588
Noncurrent liabilities	3,553	3,316
Total liabilities	4,952	4,904
Net position	\$ 11,483	\$ 10,753

The University continues to maintain and protect its strong financial foundation. This financial health, as reflected in the statement of net position at June 30, 2013 and 2012, 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 and totaled \$2.2 billion and \$2.1 billion at June 30, 2013 and 2012, respectively. Cash, cash equivalents and investments for operating activities totaled \$934 million at June 30, 2013, which represents approximately two months of total expenses excluding depreciation.

Current liabilities consist primarily of accounts payable, accrued compensation, unearned revenue, commercial paper, the current portion of bonds payable and net long-term bonds payable subject to remarketing. Current liabilities totaled \$1.4 billion and \$1.6 billion at June 30, 2013 and 2012, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

ENDOWMENT, LIFE INCOME AND OTHER INVESTMENTS

The composition of the University's endowment, life income and other investments at June 30, 2013 and 2012 is summarized as follows:

(in millions)	2013	2012
Endowment investments	\$ 8,382	\$ 7,691
Life income investments	111	101
Noncurrent portion of insurance and benefits obligations investments	181	157
	\$ 8,674	\$ 7,949

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 7,800 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 endowment spending rule provides for distributions from the University Endowment Fund to the University units that benefit from the endowment fund. Commencing with the quarter ending September 30, 2010, the annual distribution rate began to be reduced from 5 percent of the one-quarter lagged seven year moving average fair value of University Endowment Fund shares to 4.5 percent. This change is one element of an ongoing financial management strategy that has allowed the University to effectively weather the recent recession while avoiding drastic measures taken by many of our peer institutions, such as faculty hiring freezes, furloughs, program cuts or halting construction. To avoid negative impacts of this change on near-term budgets, endowment distributions are being managed toward the new rate by keeping quarter to quarter distributions per share unchanged and gradually moving toward the 4.5 percent rate when increases in share value would otherwise 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.

To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. 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 totaled \$276 million, \$270 million and \$266 million and withdrawals from funds functioning as endowment totaled \$24 million, \$39 million and \$44 million in 2013, 2012 and 2011, respectively. Total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 4.8 percent, 5.2 percent and 5.4 percent of the current year average fair value of the University Endowment Fund for 2013, 2012 and 2011, respectively. Over the past ten years, total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 5.1 percent.

CAPITAL AND DEBT ACTIVITIES

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

Capital asset additions totaled \$519 million in 2013, as compared to \$591 million in 2012. Capital asset additions primarily represent renovation and new construction of student residence, academic, research, clinical and athletic facilities, as well as significant investments in equipment, including information technology. Current year capital asset additions were primarily funded with net position and gifts designated for capital purposes of \$463 million, as well as debt proceeds of \$56 million. Construction in progress, which totaled \$328 million at June 30, 2013 and \$227 million at June 30, 2012, includes important projects for student residential life, research, instruction, patient care and athletics.

At June 30, 2013, renovations of East Quadrangle, the Lawyers Club building and the John P. Cook building continue. The infrastructure of these student residences is being thoroughly upgraded, including wireless high-speed network access, accessibility improvements, renovated bath facilities and new plumbing, heating, cooling, ventilation, fire detection and suppression systems. In addition, energy conservation measures are being implemented to improve the energy performance of the overall buildings.

Renovation of East Quadrangle, which was originally constructed in 1940, is part of the University's residential life initiatives and follows the extensive renovations to Alice Lloyd, Mosher Jordan, Stockwell and Couzens residence halls in previous years. This project includes improved dining and Residential College facilities as well as new spaces for living-learning initiatives, student interaction and community. The Lawyers Club and John P. Cook buildings comprise the student-housing portion of the Law Quadrangle and were opened in 1924 and 1931, respectively. One of the largest gifts ever made to the Law School is helping to revitalize these student living spaces and create a sense of community, while preserving the historic collegiate gothic exteriors. In honor of the gift, the north wing of the Lawyers Club will be called the Charles T. Munger Residences. These projects are expected to be completed in August 2013.

Expansion of the George Granger Brown Memorial Laboratories building, which houses the Department of Mechanical Engineering, is also in process at June 30, 2013. Originally constructed in 1958, this building will be expanded by 62,500 gross square feet to add research laboratories and offices for faculty and graduate students to support emerging research endeavors. Designed to support interdisciplinary collaboration within the University and with other academic institutions and industry, the expansion also provides spaces to enhance the ability to realize ultra-high-resolution measurements at molecular and atomic scales to enable researchers to study the forces at work at the smallest scales and advance nanotechnologies in energy, manufacturing, healthcare and biotechnology. This project is expected to be completed in Summer 2014.

Projects completed in 2013 include renovation and expansion of the Michigan Memorial Phoenix Laboratory and Crisler Arena. The renovation and expansion of Michigan Memorial Phoenix Laboratory created state-of-the-art research laboratory space to support the Michigan Memorial Phoenix Energy Institute's energy-related research. This project included transformation of approximately 10,000 gross square feet into advanced laboratories for energy research, replacement of the facility's existing electrical substation and the addition of 10,000 gross square feet of new space for research, collaboration and interaction and administrative offices for the Institute. This facility will serve as a fulcrum for energy-related activities at the University, providing outstanding facilities for energy research and inter-disciplinary cooperation.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The renovation of Crisler Arena, which was originally built in 1967, included core infrastructure improvements, replacement of spectator seating to accommodate accessible seats, improved circulation and egress, increased number of restrooms and concession areas and the addition of other fan amenities. The expansion of this facility, now known as the Crisler Center, added approximately 63,000 gross square feet for new spectator entrances, retail spaces, ticketing areas, indoor and outdoor meeting and entertainment spaces as well as a private club area, media center and production studio. The expansion incorporated many environmentally responsible features, such as a high performance building envelope, natural lighting and low emitting carpet and paint products, and received a Leadership in Energy and Environmental Design (LEED) gold certification.

The University takes its financial stewardship responsibility seriously and works diligently 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. In February 2013, Moody’s Investors Service, Inc. (“Moody’s”) affirmed its highest credit rating (Aaa) for bonds backed by a broad revenue pledge based on 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 academic and research excellence, strong financial resources, positive financial performance, exceptional record of fundraising and manageable debt burden and capital plan. Only two other public universities have received the highest credit ratings from both Moody’s and Standard & Poor’s.

Long-term debt activity for the year ended June 30, 2013, 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	\$ 63	\$ 88	\$ 96	\$ 55
Bonds and Notes:				
General revenues	1,421	412	81	1,752
Hospital revenues	280		280	—
Faculty Group Practice revenues	60		60	—
Student residences revenues	2		2	—
	\$ 1,826	\$ 500	\$ 519	\$ 1,807

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, 2013 and 2012, commercial paper totaled \$55 million and \$63 million, respectively.

During 2013, consistent with capital and debt financing plans, the University issued \$355 million of variable rate tax-exempt general revenue bonds, and \$54 million of fixed rate tax-exempt general revenue bonds, with a net original issue premium of \$3 million. Bond proceeds, which totaled \$412 million, were utilized to refund \$266 million of Hospital Revenue Bonds and \$57 million of Medical Service Plan Revenue Bonds, convert \$23 million of commercial paper to long-term debt, and provide \$66 million for capital projects and debt issuance costs.

The University maintains a combination of fixed and variable rate debt, which totaled \$1.8 billion at June 30, 2013 and 2012. The composition of the University's debt at June 30, 2013 and 2012 is summarized as follows:

(in millions)	2013	2012
Variable rate:		
Commercial paper	\$ 55	\$ 63
Bonds	864	854
Fixed rate bonds	888	909
	\$ 1,807	\$ 1,826

A significant portion of the University’s variable rate bonds are subject to remarketing and, in accordance with GASB Interpretation No. 1, such debt is classified as current 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 variable rate bonds are put back to the University by the debt holder, management believes that the bonds 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 four remarketing agents to achieve a wide distribution of its variable rate debt.

While fixed rate bonds typically have a higher effective rate of interest as compared to variable rate bonds, they reduce the volatility of required debt service payments and do not require liquidity support, such as letters of credit or guarantees.

Effective interest rates averaged 2.2 percent in 2013 and 2.3 percent in 2012, including the amortization of bond premiums and discounts and federal subsidies for interest on taxable Build America Bonds. Interest expense net of federal subsidies received for interest on taxable Build America Bonds and interest capitalized during construction totaled \$41 million in 2013 and \$37 million in 2012, while capitalized interest on debt financed construction in progress totaled \$2 million and \$6 million in 2013 and 2012, respectively.

OBLIGATIONS FOR POSTEMPLOYMENT BENEFITS

In accordance with the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, the University recognizes the cost of postemployment benefits during the periods when employees render their services. Using current actuarial assumptions, and presuming a continuation of the current level of benefits, the University’s obligations for postemployment benefits totaled \$1.70 billion and \$1.67 billion at June 30, 2013 and 2012, respectively. Since a portion of retiree medical services will be provided by the University’s Health System, this liability is net of the related margin and fixed costs of providing those services which totaled \$290 million and \$263 million at June 30, 2013 and 2012, respectively.

By implementing a series of health benefit initiatives over the past eight years, the University has favorably impacted its actuarial accrued liability for postemployment benefits by approximately \$486 million as of June 30, 2013. These initiatives have included cost sharing changes, elimination of Medicare Part B reimbursements for certain retirees and adjustment of retirement eligibility criteria. The University amortizes changes in actuarial assumptions, plan design and experience gains and losses over a ten year closed period. Accordingly, the liability for net postemployment benefits obligations recorded in the statement of net position differs from the actuarial accrued liability by the unamortized portion of these changes. At June 30, 2013, the recorded liability for net postemployment benefits obligations totaled \$1.70 billion and the actuarial accrued liability totaled \$1.34 billion.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

NET POSITION

Net position represents the residual interest in the University's assets after liabilities are deducted. The composition of the University's net position at June 30, 2013 and 2012 is summarized as follows:

(in millions)	2013	2012
Net investment in capital assets	\$ 3,637	\$ 3,598
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,432	1,346
Expendable:		
Net appreciation of permanent endowments	1,339	1,193
Funds functioning as endowment	1,748	1,597
Restricted for operations and other	602	493
Unrestricted	2,725	2,526
	\$ 11,483	\$ 10,753

Net investment in capital assets represents the University's capital assets net of accumulated depreciation and outstanding principal balances of debt related to the acquisition, construction or improvement of those assets. The \$39 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 position represents the historical value (corpus) of gifts to the University's permanent endowment funds. The \$86 million increase primarily represents new gifts. Restricted expendable net position is subject to externally imposed stipulations governing their use. This category of net position includes net appreciation of permanent endowments, funds functioning as endowment and net position restricted for operations, facilities and student loan programs. Restricted expendable net position totaled \$3.7 billion at June 30, 2013, as compared to \$3.3 billion at June 30, 2012.

Although unrestricted net position is not subject to externally imposed stipulations, all of the University's unrestricted net position has been designated for various academic and research programs and initiatives, as well as capital projects. Unrestricted net position at June 30, 2013 and 2012 totaled \$2.7 billion and \$2.5 billion, respectively. At June 30, 2013, unrestricted net position included funds functioning as endowment of \$3.7 billion offset by unfunded obligations for postemployment benefits of \$1.7 billion. At June 30, 2012, unrestricted net position included funds functioning as endowment of \$3.5 billion offset by unfunded obligations for postemployment benefits of \$1.7 billion. Unrestricted net position also included other net resources of \$700 million at June 30, 2013 and 2012.

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

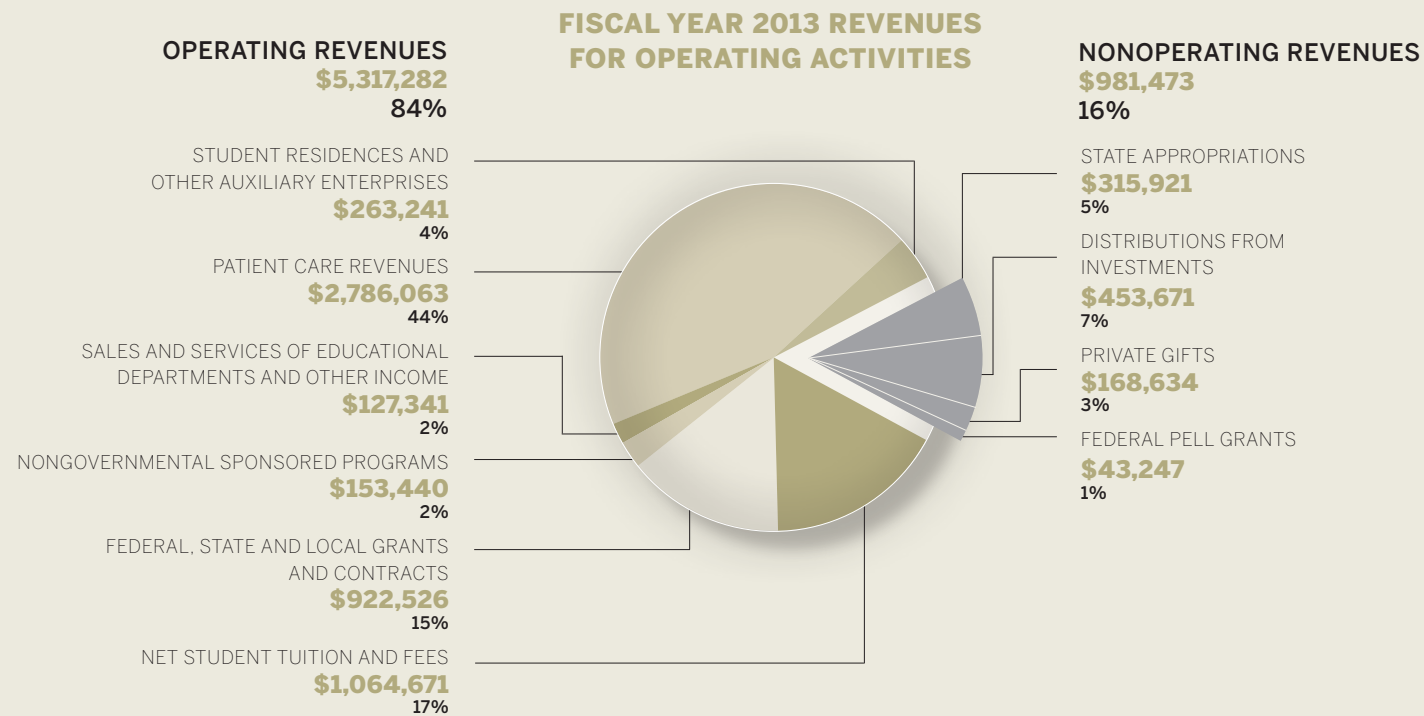
The statement of revenues, expenses and changes in net position presents the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as either operating or nonoperating. A comparison of the University's revenues, expenses and changes in net position for the three years ended June 30, 2013 is summarized as follows:

(in millions)	2013	2012	2011
Operating revenues:			
Student tuition and fees, net of scholarship allowances	\$ 1,064.7	\$ 998.4	\$ 915.7
Sponsored programs	1,076.0	1,045.8	1,072.9
Patient care revenues, net	2,786.1	2,601.8	2,411.1
Other	390.5	392.6	378.1
	5,317.3	5,038.6	4,777.8
Operating expenses	6,121.0	5,842.1	5,437.8
Operating loss	(803.7)	(803.5)	(660.0)
Nonoperating and other revenues (expenses):			
State educational appropriations	315.9	307.6	361.9
Federal Pell grants	43.2	45.3	46.7
Private gifts for operating activities	168.6	131.6	127.8
Net investment income	847.3	68.7	1,633.0
Interest expense, net	(49.3)	(45.1)	(33.1)
Federal subsidies for interest on Build America Bonds	8.2	8.3	7.1
State capital appropriations		0.1	0.8
Endowment and capital gifts and grants	212.1	107.6	82.3
Other	(12.4)	8.3	(5.2)
Nonoperating and other revenues, net	1,533.6	632.4	2,221.3
Increase (decrease) in net position	729.9	(171.1)	1,561.3
Net position, beginning of year	10,753.2	10,924.3	9,363.0
Net position, end of year	\$ 11,483.1	\$ 10,753.2	\$ 10,924.3

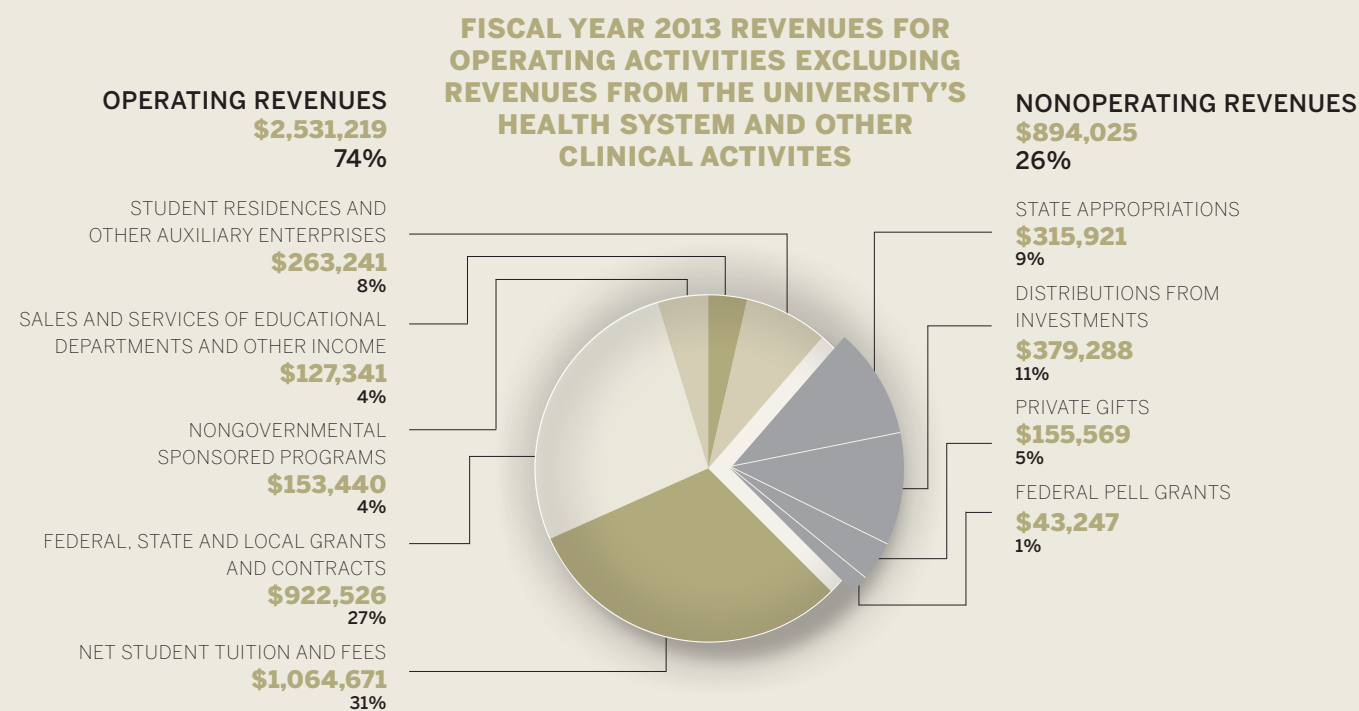
One of the University's greatest strengths is the diverse streams of revenue that supplement its student tuition and fees, including private support from individuals, foundations and corporations, along with government and other sponsored programs, state appropriations and investment income. The University 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, which include instruction, patient care and research.

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, 2013 (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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)



The University measures its performance both for the University as a whole and for the University without its Health System and other clinical activities. The exclusion of these activities 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 and other clinical activities, for the year ended June 30, 2013 (amounts are presented in thousands of dollars).



Tuition and state appropriations are the primary sources of funding for the University's academic programs. There is a 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 state appropriations increased 6 percent, or \$75 million, to \$1.38 billion in 2013, as compared to 2 percent, or \$28 million, to \$1.31 billion in 2012.

The University has been able to avoid the severe cuts and double digit tuition increases experienced elsewhere in the country because of a prudent long-term plan which anticipated the realities of the state's challenging economy. The University's plan includes an ongoing commitment to cost containment and reallocating resources to the highest priorities to provide support for innovative new academic initiatives to maintain academic excellence and help students keep pace with the ever evolving needs of society.

In 2013, the University's state educational appropriations increased by 3 percent, or \$8 million, to \$316 million. This follows a year when the University received the largest cut in state appropriations in its history, a 15 percent, or \$54 million reduction in 2012.

For the three years ended June 30, 2013, net student tuition and fees revenue consisted of the following components:

(in millions)	2013	2012	2011
Student tuition and fees	\$ 1,349.1	\$ 1,269.7	\$ 1,177.9
Scholarship allowances	(284.4)	(271.3)	(262.2)
	\$ 1,064.7	\$ 998.4	\$ 915.7

In 2013, net student tuition and fees revenue increased 7 percent, or \$66 million, to \$1.06 billion, which reflects a 6 percent, or \$79 million, increase in gross tuition and fee revenues offset by a 5 percent, or \$13 million increase in scholarship allowances. Tuition rate increases in 2013 were 2.8 percent for resident undergraduate students, 3.5 percent for nonresident undergraduate students and 3.0 percent for most graduate students on the Ann Arbor campus, with a 3.7 percent tuition rate increase for most undergraduate and graduate students on the Dearborn campus and 3.6 percent and 2.8 percent tuition rate increases for undergraduate and graduate students on the Flint campus, respectively. The University also experienced moderate growth in the number of students, particularly nonresident students.

In 2012, net student tuition and fees revenue increased 9 percent, or \$83 million, to \$998 million, which reflects an 8 percent, or \$92 million, increase in gross tuition and fee revenues offset by a 3 percent, or \$9 million increase in scholarship allowances. Tuition rate increases in 2012 were 6.7 percent for resident undergraduate students, 4.9 percent for nonresident undergraduate students and 4.9 percent for most graduate students on the Ann Arbor campus, with a 6.9 percent tuition rate increase for undergraduate and graduate students on the Dearborn campus and 6.8 percent and 4.9 percent tuition rate increases for Flint campus undergraduate and graduate students, respectively. The University also experienced moderate growth in the number of students, particularly nonresident students.

The University's tuition increases have consistently been among the lowest in the state, even in years of significant reductions in state appropriations, which reflects a commitment to affordable higher education for Michigan families. At the same time, the University has also increased scholarship and fellowship expenses and related allowances to benefit students in financial need.

While tuition and state appropriations fund a large percentage of University costs, private support is becoming increasingly essential to the University's academic distinction. Private gifts for other than capital and permanent endowment purposes totaled \$169 million in 2013, as compared to \$132 million in 2012 and \$128 million in 2011.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

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, with a significant portion related to federal research. Revenues for sponsored programs increased 3 percent, or \$30 million, to \$1.1 billion in 2013, which is consistent with the national trend of stabilized federal research funding, supplemented by increased revenue from industry sponsored activities. Revenues for sponsored programs decreased 3 percent, or \$27 million, to \$1.0 billion in 2012, primarily due to the spend down of federal stimulus awards from the American Recovery and Reinvestment Act of 2009.

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 \$184 million, to \$2.8 billion in 2013, as compared to an increase of 8 percent, or \$191 million, to \$2.6 billion in 2012. The increased revenues for both years primarily resulted from a growth in outpatient and inpatient volume, as well as increased reimbursement rates from third party payers.

Net investment income totaled \$847 million in 2013, compared to \$69 million in 2012 and \$1.6 billion in 2011. In a reversal from 2012, when fixed income gained strongly and equity oriented investments fell, developed markets equities, absolute return strategies, and private equity investments realized double digit positive returns in 2013 while fixed income experienced small losses. In 2011, most asset classes experienced double digit positive returns as financial markets rebounded from the significant losses experienced in 2009.

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.

Endowment and capital gifts and grants totaled \$212 million in 2013 as compared to \$108 million and \$82 million in 2012 and 2011, respectively, with the significant increase in 2013 due primarily to capital gifts. Private gifts for permanent endowment purposes totaled \$78 million in 2013, as compared to \$56 million in 2012 and \$57 million in 2011. Capital gifts and grants totaled \$134 million in 2013, as compared to \$52 million in 2012 and \$25 million in 2011. Over the past three years, major capital gifts have been received in support of the University's wide-ranging building initiatives which include graduate student housing, the Health System, Law School, Stephen M. Ross School of Business, College of Engineering, and Intercollegiate Athletics current and planned capital projects.

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 64 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, 2013 is as follows:

(in millions)	2013		2012		2011	
Operating:						
Compensation and benefits	\$ 3,965.0	64%	\$ 3,804.3	65%	\$ 3,633.8	66%
Supplies and services	1,555.8	25	1,473.7	25	1,299.6	24
Depreciation	476.9	8	443.1	7	390.1	7
Scholarships and fellowships	123.3	2	121.0	2	114.3	2
	6,121.0	99	5,842.1	99	5,437.8	99
Nonoperating:						
Interest, net	41.1	1	36.8	1	26.0	1
	\$ 6,162.1	100%	\$ 5,878.9	100%	\$ 5,463.8	100%

The University is committed to recruiting and retaining outstanding faculty and staff and the compensation package is one way to successfully compete with peer institutions and nonacademic employers. The resources expended for compensation and benefits increased 4 percent, or \$161 million, to \$4.0 billion in 2013, as compared to a 5 percent, or \$171 million, increase to \$3.8 billion in 2012. Of the 2013 increase, compensation increased 4 percent, to \$3.1 billion, and employee benefits increased 4 percent, to \$901 million. For 2012, compensation increased 6 percent, to \$2.9 billion, and employee benefits increased 2 percent, to \$870 million. During 2013 and 2012, nursing and other health professionals were added to support higher patient volume levels associated with the new facility for C.S. Mott Children's Hospital and Von Voigtlander Women's Hospital, which opened in fiscal 2012.

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 health care plan that meets their needs and share a larger portion of health care cost increases with employees.

Compared to most employers, the University is in a unique position to utilize internal experts to advise and guide its health care and drug plans. For example, the Pharmacy Benefits Advisory Committee, which consists of internal experts including Health System physicians, School of Pharmacy faculty and an on-staff pharmacist, monitors the safety and effectiveness of covered medications as well as optimizes appropriate prescribing, dispensing and cost effective use of prescription drugs. The University also actively promotes and manages generic drug utilization and has achieved an 84 percent generic dispensing rate in 2013, as compared to 82 percent in 2012 and 76 percent in 2011.

In addition, the University utilizes its nationally recognized health policy experts to guide future health plan strategies. After careful review, a series of changes are being implemented to help the University maintain competitive active and retiree benefits while helping control the growth in costs.

During 2013, the University began to implement changes to eligibility requirements for retiree health benefits and the related amount of the University's contributions. These changes are based on the work of a committee on retiree health benefits that was formed to propose a means to maintain competitive retiree health benefits while helping address the acceleration of health benefits costs for current and future retirees and their dependents. To assist current employees with the transition, these changes, which were originally announced in 2011, are being phased in gradually over the eight-year period January 1, 2013 through January 1, 2021.

Commencing January 1, 2013, the University utilizes a point system to determine retirement eligibility, where points represent the combination of age and years of service for full-time employees. The points needed for retirement total 76 in 2013 and will gradually be increased to 80 by 2021. During this time period, the University's contributions towards health care benefits for employees who retire in each of these years will gradually be reduced. Employees who retire after December 31, 2020 will need a minimum of twenty years of service to receive the maximum retiree health benefit contribution. Specifically, the University's contributions towards health care benefits will decrease from 87.5 percent for the retiree and 65 percent for any dependents for those employees who retire in 2013 to a maximum of 80 percent for the retiree and 50 percent for any dependents for those employees who retire in 2021. For new hires, the maximum University contribution upon retirement with twenty or more years of service will be 68 percent for the retiree and 26 percent for any dependents. These adjustments will keep the University's retiree benefits competitive with peer institutions while producing an estimated \$9 million reduction in annual cash outlay by 2020 and an estimated \$165 million reduction in annual cash outlay by 2040.

During 2012, the University substantially completed a multi-year phase in of a new health benefits cost sharing program. Once fully implemented in July 2014, the University's overall contribution toward the health care of employees, retirees and dependents is expected to be 70 percent of the total cost of premiums, co-pays and deductibles. Down from an 80 percent overall contribution in 2009, the new target is more in line with average contributions of peer universities and health systems. In addition, the University's health premium contribution for part-time employees working between 20 and 31 hours per week was reduced from 100 percent to 80 percent of the contribution made for full-time staff in the lowest salary band. Once fully implemented, these changes are expected to reduce the University's annual cash outlay for health care expenses by approximately \$31 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The MHealthy initiative is a university-wide effort to improve the health and well-being of faculty, staff and their dependents by creating a culture of health, reducing health risks in our population, and containing health related costs through prevention, early intervention. Over the past four years, more than 33,000 of the University's employees participated in a health risk assessment, allowing them to learn more about their health risks and take action to improve them through follow-up programs and services. In 2013 alone, 56 percent of employees completed a health risk assessment and more than 80 percent of participating employees also completed at least one qualifying health and wellness program. MHealthy has also begun to provide special targeted health improvement programs to high-risk job families. A three-year evaluation of the program's impact was completed in 2012 by faculty researchers from the Michigan Institute for Clinical and Health Research and the University's Health Management Research Center. Faculty and staff who participated all three years showed statistically significant improvement in their risk levels, with the number of high risk individuals decreasing and the number of low risk individuals increasing.

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

Supplies and services expenses increased 6 percent, or \$82 million, to \$1.6 billion in 2013, as compared to an increase of 13 percent, or \$174 million, to \$1.5 billion in 2012. These increases were primarily due to growth in patient care related expenses as well as activation costs associated with significant capital projects. During 2012, a new facility for the C.S. Mott Children's and Von Voigtlander Women's Hospitals was placed in service and the University implemented several significant information technology systems, including the first phase of an electronic medical record and patient billing system and a new donor and alumni relationship system. In addition, the University experienced increased self insurance costs in 2012 due to higher incurred losses in medical professional liability and workers compensation.

Depreciation expense increased 8 percent, or \$34 million, to \$477 million in 2013, as compared to a 14 percent, or \$53 million, increase to \$443 million in 2012. The increased depreciation expense is primarily related to the completion of current year capital projects, as well as the impact of a full year of depreciation for the capital projects completed during the prior year. Capital assets placed in service during 2013 include the renovation and expansion of Crisler Arena and the Michigan Memorial Phoenix Laboratory. During 2012, capital assets placed in service included a new facility for C.S. Mott Children's and Von Voigtlander Women's Hospitals, renovation of Alice Lloyd Hall, and the new William Davidson Player Development Center. In addition, the remaining net book value of certain capital assets of the legacy children and women's hospitals that were deemed to have no future utility were written off in 2012 based on current renovation plans for that facility.

Net interest expense increased \$4 million in 2013 to \$41 million, from \$37 million in 2012 and \$26 million in 2011. The significant increase in 2012 primarily resulted from a decrease in the amount of capitalized interest on debt financed construction due to decreased construction in process.

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, 2013 is as follows:

(in millions)	2013		2012		2011	
Operating:						
Instruction	\$ 924.5	15%	\$ 892.5	15%	\$ 853.1	16%
Research	750.2	12	718.8	12	733.5	13
Public service	148.9	2	129.6	2	131.5	2
Institutional and academic support	530.8	9	504.5	9	486.3	9
Auxiliary enterprises:						
Patient care	2,752.5	44	2,532.4	43	2,285.2	42
Other	157.6	3	215.6	4	168.5	3
Operations and maintenance of plant	256.3	4	284.6	5	275.3	5
Depreciation	476.9	8	443.1	7	390.1	7
Scholarships and fellowships	123.3	2	121.0	2	114.3	2
	6,121.0	99	5,842.1	99	5,437.8	99
Nonoperating:						
Interest, net	41.1	1	36.8	1	26.0	1
	\$ 6,162.1	100%	\$ 5,878.9	100%	\$ 5,463.8	100%

Instruction expenses increased 4 percent, or \$32 million in 2013, and 5 percent, or \$39 million in 2012. This increase is consistent with the modest level of growth in the related revenue sources offset by cost containment efforts.

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 \$1.33 billion in 2013, as compared to \$1.27 billion in 2012 and \$1.24 billion in 2011. This represents an increase of 7 percent, or \$92 million, from 2011 to 2013.

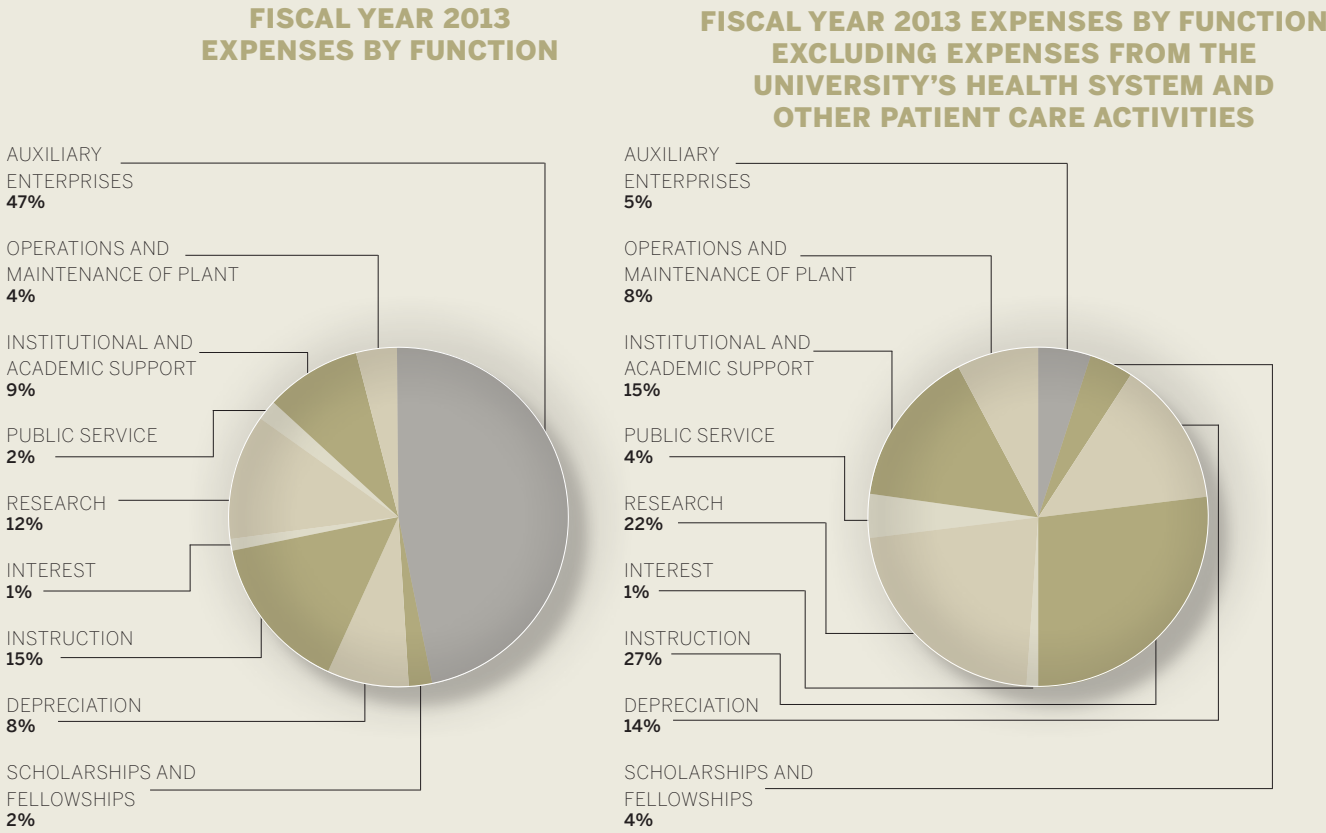
Patient care expenses increased 9 percent, or \$221 million, in 2013 and 11 percent, or \$247 million, in 2012. These increases are the result of increased patient activity from the opening of the new children and women's hospital facility, including costs of staffing, medical supplies and pharmaceuticals.

Total scholarships and fellowships provided to students aggregated \$426 million in 2013, as compared to \$411 million in 2012 and \$395 million in 2011, an increase of 8 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, 2013 are summarized as follows:

(in millions)	2013	2012	2011
Paid directly to students	\$ 123.3	\$ 121.0	\$ 114.3
Applied to tuition and fees	284.4	271.3	262.2
Applied to University Housing	18.0	19.0	18.2
	\$ 425.7	\$ 411.3	\$ 394.7

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

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



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, 2013 and 2012 is as follows:

(in millions)	2013	2012
Cash received from operations	\$ 5,270.9	\$ 5,011.9
Cash expended for operations	(5,575.2)	(5,332.5)
Net cash used in operating activities	(304.3)	(320.6)
Net cash provided by investing activities	64.0	141.3
Net cash used in capital and related financing activities	(463.3)	(436.2)
Net cash provided by noncapital financing activities	566.2	537.7
Net decrease in cash and cash equivalents	(137.4)	(77.8)
Cash and cash equivalents, beginning of year	238.7	316.5
Cash and cash equivalents, end of year	\$ 101.3	\$ 238.7

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, federal Pell grants and private gifts used to fund operating activities.

ECONOMIC FACTORS THAT WILL AFFECT THE FUTURE

The University continues to 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 consistent 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 relationship between the growth, or reduction, of state support and the University's ability to control tuition increases. Over the past several years, the University has successfully addressed the realities of the state's difficult economy and, pursuant to a long-range plan, continues to work relentlessly to cut and mitigate operational costs in order to remain affordable and preserve access, while protecting the academic enterprise.

The University's budget for 2014 anticipates a 2.2 percent increase in state educational appropriations and achieves the lowest tuition rate increase for Ann Arbor campus resident undergraduates since 1985 of 1.1 percent and the largest ever increase in financial aid, which includes a 13.7 percent increase in centrally awarded financial aid. Nonresident undergraduate tuition rates will increase 3.2 percent, while most graduate and professional rates will increase 1.8 percent. Resident undergraduate tuition rates on the Dearborn and Flint campuses will increase 3.5 percent.

While tuition and state appropriations fund a large percentage of University costs, private support is becoming increasingly essential to the University's academic distinction. In November 2013, the University will kick off the most ambitious fundraising campaign in its history.

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, clinical and research activities. Authorized costs to complete construction and other projects totaled \$1.17 billion at June 30, 2013. Funding for these projects is anticipated to include \$1.13 billion from gifts, grants and net position designated for capital purposes as well as future borrowings and \$42 million from the utilization of unexpended debt proceeds.

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.

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 University also faces rising costs of health benefits for its employees and retirees. The University has successfully taken and will continue to take proactive steps to respond to these challenges while protecting the quality of the overall benefits package.

U.S. health care reform will also influence benefits planning. Since the Affordable Care Act was signed into law in March 2010, and affirmed by the Supreme Court, new regulatory requirements will affect health plans, providers and employers alike. The implementation of the changes has begun and will span several years into the future, with most changes taking place by 2015. 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 coming years 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 POSITION

	June 30,	
(in thousands)	2013	2012
Assets		
Current Assets:		
Cash and cash equivalents	\$ 101,327	\$ 238,690
Investments for operating activities	832,280	737,384
Investments for capital activities	357,495	388,637
Investments for student loan activities	60,732	55,706
Accounts receivable, net	574,810	494,787
Current portion of notes and pledges receivable, net	118,648	59,553
Current portion of prepaid expenses and other assets	66,907	78,254
Cash collateral held by agent	43,000	54,300
Total Current Assets	2,155,199	2,107,311
Noncurrent Assets:		
Endowment, life income and other investments	8,674,180	7,948,955
Notes and pledges receivable, net	206,982	196,692
Prepaid expenses and other assets	29,455	66,718
Capital assets, net	5,369,400	5,337,664
Total Noncurrent Assets	14,280,017	13,550,029
Total Assets	\$ 16,435,216	\$ 15,657,340
Liabilities and Net Position		
Current Liabilities:		
Accounts payable	\$ 219,581	\$ 195,055
Accrued compensation and other	354,745	350,508
Unearned revenue	214,381	200,966
Current portion of insurance and benefits reserves	86,173	84,155
Current portion of obligations for postemployment benefits	61,258	56,131
Commercial paper and current portion of bonds payable	117,907	135,193
Long-term bonds payable subject to remarketing, net	267,060	482,202
Collateral held for securities lending	43,000	54,300
Deposits of affiliates and others	35,283	29,988
Total Current Liabilities	1,399,388	1,588,498
Noncurrent Liabilities:		
Accrued compensation	64,944	68,498
Insurance and benefits reserves	109,415	102,821
Obligations for postemployment benefits	1,636,833	1,615,433
Obligations under life income agreements	46,849	44,056
Government loan advances	91,418	91,211
Bonds payable	1,421,935	1,208,869
Deposits of affiliates and other	181,305	184,757
Total Noncurrent Liabilities	3,552,699	3,315,645
Total Liabilities	4,952,087	4,904,143
Net Position:		
Net investment in capital assets	3,637,027	3,597,540
Restricted:		
Nonexpendable	1,432,191	1,345,859
Expendable	3,689,208	3,283,639
Unrestricted	2,724,703	2,526,159
Total Net Position	11,483,129	10,753,197
Total Liabilities and Net Position	\$ 16,435,216	\$ 15,657,340

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

CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Year Ended June 30,	
(in thousands)	2013	2012
Operating Revenues		
Student tuition and fees	\$ 1,349,057	\$ 1,269,703
Less scholarship allowances	284,386	271,276
Net student tuition and fees	1,064,671	998,427
Federal grants and contracts	914,012	901,764
State and local grants and contracts	8,514	4,154
Nongovernmental sponsored programs	153,440	139,840
Sales and services of educational departments	124,533	127,473
Auxiliary enterprises:		
Patient care revenues (net of provision for bad debts of \$114,025 in 2013 and \$105,618 in 2012)	2,786,063	2,601,803
Student residence fees (net of scholarship allowances of \$18,008 in 2013 and \$19,201 in 2012)	89,035	94,134
Other revenues	174,206	168,204
Student loan interest income and fees	2,808	2,772
Total Operating Revenues	5,317,282	5,038,571
Operating Expenses		
Compensation and benefits	3,965,030	3,804,225
Supplies and services	1,555,800	1,473,665
Depreciation	476,898	443,132
Scholarships and fellowships	123,287	121,040
Total Operating Expenses	6,121,015	5,842,062
Operating loss	(803,733)	(803,491)
Nonoperating Revenues (Expenses)		
State educational appropriations	315,921	307,582
Federal Pell grants	43,247	45,288
Private gifts for other than capital and endowment purposes	168,634	131,602
Net investment income	847,273	68,650
Interest expense, net	(49,342)	(45,096)
Federal subsidies for interest on Build America Bonds	8,251	8,258
Total Nonoperating Revenues, Net	1,333,984	516,284
Income (loss) before other revenues (expenses)	530,251	(287,207)
Other Revenues (Expenses)		
Capital gifts and grants	134,498	51,934
State capital appropriations		100
Private gifts for permanent endowment purposes	77,567	55,742
Other	(12,384)	8,366
Total Other Revenues, Net	199,681	116,142
Increase (decrease) in net position	729,932	(171,065)
Net Position, Beginning of Year	10,753,197	10,924,262
Net Position, End of Year	\$ 11,483,129	\$ 10,753,197

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

FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	Year Ended June 30,	
	2013	2012
Cash Flows from Operating Activities		
Student tuition and fees	\$ 1,065,578	\$ 1,003,383
Federal, state and local grants and contracts	914,079	899,174
Nongovernmental sponsored programs	158,017	149,902
Sales and services of educational departments and other	298,140	295,671
Patient care revenues	2,726,203	2,549,627
Student residence fees	88,801	93,892
Payments to employees	(3,063,397)	(2,962,246)
Payments for benefits	(872,199)	(806,769)
Payments to suppliers	(1,501,979)	(1,427,728)
Payments for scholarships and fellowships	(123,287)	(121,025)
Student loans issued	(14,377)	(14,761)
Student loans collected	17,339	17,497
Student loan interest and fees collected	2,808	2,772
Net Cash Used in Operating Activities	(304,274)	(320,611)
Cash Flows from Investing Activities		
Interest and dividends on investments, net	55,231	55,934
Proceeds from sales and maturities of investments	3,849,010	3,583,260
Purchases of investments	(3,804,124)	(3,704,732)
Net (increase) decrease in cash equivalents from noncurrent investments	(50,795)	209,804
Net increase (decrease) in deposits of affiliates and others	14,678	(3,002)
Net Cash Provided by Investing Activities	64,000	141,264
Cash Flows from Capital and Related Financing Activities		
Private gifts and other receipts	93,820	58,056
State capital appropriations		100
Proceeds from issuance of capital debt	500,053	326,730
Principal payments on capital debt	(489,259)	(189,366)
Interest payments on capital debt, net of capitalized interest	(54,792)	(47,895)
Federal subsidies for Build America Bonds interest	8,258	8,258
Payments for bond refunding and related costs	(1,500)	(650)
Purchases of capital assets, including capitalized interest	(520,926)	(592,357)
Proceeds from sales of capital assets	1,055	890
Net Cash Used in Capital and Related Financing Activities	(463,291)	(436,234)
Cash Flows from Noncapital Financing Activities		
State educational appropriations	314,405	317,454
Federal Pell grants	43,247	45,288
Private gifts and other receipts	207,982	177,698
Student direct lending receipts	345,412	371,963
Student direct lending disbursements	(346,634)	(372,703)
Amounts received for annuity and life income funds	8,828	4,886
Amounts paid to annuitants and life beneficiaries and related expenses	(7,038)	(6,849)
Net Cash Provided by Noncapital Financing Activities	566,202	537,737
Net decrease in cash and cash equivalents	(137,363)	(77,844)
Cash and Cash Equivalents, Beginning of Year	238,690	316,534
Cash and Cash Equivalents, End of Year	\$ 101,327	\$ 238,690

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

CONSOLIDATED STATEMENT OF CASH FLOWS, CONTINUED

(in thousands)	Year Ended June 30,	
	2013	2012
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (803,733)	\$ (803,491)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	476,898	443,132
Changes in assets and liabilities:		
Accounts receivable, net	(74,109)	(48,579)
Prepaid expenses and other assets	9,919	(7,199)
Accounts payable	32,969	36,526
Accrued compensation and other	5,228	(4,177)
Unearned revenue	13,415	7,165
Insurance and benefits reserves	8,612	21,100
Obligations for postemployment benefits	26,527	34,912
Net cash used in operating activities	\$ (304,274)	\$ (320,611)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013 AND 2012

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 61,000 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 University reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB, on the accrual basis. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

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.

During 2013, the University adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. The adoption of this statement did not have a material impact on the University’s financial statements.

Net position is categorized as:

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

Restricted:

Nonexpendable – Net position subject to externally imposed stipulations that it be maintained permanently. Such net position includes 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 position 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 position includes net appreciation of the University’s permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.

Unrestricted: Net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. Substantially all unrestricted net position is designated for academic and research programs and initiatives and capital programs.

Summary of Significant Accounting Policies: 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 position. 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 investments for operating activities.

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, 2013 and 2012, as adjusted by cash receipts, cash disbursements and securities distributions through June 30, 2013 and 2012, 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, 2013 and 2012. 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 and 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 generally 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.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

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

For donor restricted endowments, the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate amounts for endowment spending rule distributions as is considered prudent. The University's policy is to retain net realized and unrealized appreciation with the endowment after spending rule distributions. Net appreciation of permanent endowment funds, which totaled \$1,339,000,000 and \$1,193,000,000 at June 30, 2013 and 2012, respectively, is recorded in restricted expendable net position. The University's endowment spending rule is further discussed in Note 2.

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

Patient care revenues are reported net of contractual allowances and bad debt expenses. Contractual allowances are established based on agreements with third-party payers that provide payments for patient care services at amounts different from established rates. 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.

Patient care services are provided to patients who meet certain criteria under the Hospitals and Health Centers' charity care policy without charge or at amounts less than its established rates. Accordingly, charity care is not reported as revenue in the accompanying statement of revenues, expenses and changes in net position. Charges forgone for charity care services totaled \$54,803,000 and \$34,811,000 in 2013 and 2012, respectively.

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 position 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, federal Pell grants, gifts and investment income.

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

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

NOTE 2—CASH AND INVESTMENTS

Summary: The University maintains centralized management for substantially all of its cash and investments.

Working capital of individual university units is invested in the University Investment Pool ("UIP"). Together with the University's short-term insurance and other benefits reserves, the UIP is invested 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.

The University collectively invests substantially all of the assets of its endowment funds along with a portion of its insurance and benefits reserves, charitable remainder trusts and gift annuity program in the Long Term Portfolio. 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, natural resources and absolute return strategies.

The University also separately invests certain insurance reserves, endowments and charitable remainder trusts, unexpended bond proceeds and other funds with investment restrictions outside of the Daily, Monthly and Long Term Portfolios.

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

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

Cash and Cash Equivalents: Cash and cash equivalents, which totaled \$101,327,000 and \$238,690,000 at June 30, 2013 and 2012, respectively, represent short-term money market investments in mutual funds, overnight collective funds managed by the University's custodian or short-term highly liquid investments registered as securities and held by the University or its agents in the University's name. Of its cash and cash equivalents, the University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation ("FDIC") limits in the amount of \$13,026,000 and \$92,000 at June 30, 2013 and 2012, respectively. Under FDIC rules implemented during 2011, the University's noninterest-bearing transaction accounts had temporarily unlimited insurance coverage through December 31, 2012. Effective January 1, 2013, the FDIC reduced its coverage to \$250,000 per insured depository institution. The University does not require its deposits to be collateralized or insured.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2—CASH AND INVESTMENTS, CONTINUED

Investments: At June 30, 2013 and 2012, the University’s investments, which are held by the University or its agents in the University’s name, are summarized as follows:

(in thousands)	2013	2012
Cash equivalents, noncurrent	\$ 88,641	\$ 37,846
Fixed income securities	2,034,823	1,640,239
Commingled funds	1,864,955	1,630,173
Equity securities	910,308	783,792
Nonmarketable alternative investments	5,019,809	5,029,814
Other investments	6,151	8,818
	<u>\$ 9,924,687</u>	<u>\$ 9,130,682</u>

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 position 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 4.5 years at June 30, 2013, compared to 5.6 years at June 30, 2012. 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, 2013 and 2012, along with credit quality and effective duration measures, is summarized as follows:

2013						
(in thousands)	U.S. Government	Investment Grade	Non- Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	\$ 532,978				\$ 532,978	2.7
U.S. Treasury inflation protected	319,351				319,351	2.9
U.S. government agency	378,079	\$ 2,884			380,963	0.5
Mortgage backed		33,459	\$ 20,331	\$ 1,365	55,155	1.7
Asset backed		21,354	2,184		23,538	4.9
Corporate and other		653,778	58,152	10,908	722,838	8.8
	<u>\$ 1,230,408</u>	<u>\$ 711,475</u>	<u>\$ 80,667</u>	<u>\$ 12,273</u>	<u>\$ 2,034,823</u>	<u>4.5</u>

2012						
(in thousands)	U.S. Government	Investment Grade	Non- Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	\$ 251,671				\$ 251,671	4.7
U.S. Treasury inflation protected	351,700				351,700	4.6
U.S. government agency	218,340				218,340	0.6
Mortgage backed		\$ 27,593	\$ 19,322	\$ 1,999	48,914	0.4
Asset backed		31,680	2,091		33,771	2.3
Corporate and other		717,245	11,462	7,136	735,843	8.4
	<u>\$ 821,711</u>	<u>\$ 776,518</u>	<u>\$ 32,875</u>	<u>\$ 9,135</u>	<u>\$ 1,640,239</u>	<u>5.6</u>

Of the University’s fixed income securities, 95 percent and 97 percent were rated investment grade or better at June 30, 2013 and 2012, and 64 percent and 55 percent of these securities consisted of either U.S. treasury and government agencies or non-U.S. government securities rated AAA/Aaa at June 30, 2013 and 2012, 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, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Absolute return	\$ 795,019	\$ 772,830
U.S. equities	265,073	225,631
Non-U.S./global equities	746,108	590,330
U.S. fixed income	51,007	33,714
Other	7,748	7,668
	<u>\$ 1,864,955</u>	<u>\$ 1,630,173</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2—CASH AND INVESTMENTS, CONTINUED

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, 2013 and 2012, approximately 72 percent and 71 percent are redeemable within one year, with 50 and 48 percent redeemable within 90 days under normal market conditions. The remaining amounts are redeemable beyond one year, with redemption of certain funds dependent on disposition of the underlying assets.

Nonmarketable alternative investments consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. There is no active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner. The composition of these partnerships at June 30, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Private equity	\$ 1,293,353	\$ 1,295,654
Real estate	1,281,143	1,176,080
Venture capital	948,372	959,906
Absolute return	766,836	797,173
Natural resources	730,105	801,001
	<u>\$ 5,019,809</u>	<u>\$ 5,029,814</u>

The University’s limited partnership investments are diversified in terms of manager selection and industry and geographic focus. At June 30, 2013 and 2012, 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, price changes of the underlying securities in local markets as well as changes to the value of local currencies relative to the U.S. dollar are embedded in 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 risks 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, which may result in short exposure to certain foreign currencies.

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 totaled \$959,154,000, or 10 percent of total investments at June 30, 2013, and \$993,456,000, or 11 percent of total investments at June 30, 2012. Non-U.S. dollar exposures are summarized as follows:

(in thousands)	2013	2012
Euros	\$ 745,144	\$ 554,088
British pounds sterling	195,440	152,504
Canadian dollar	45,391	79,117
Japanese yen	60,882	51,082
Other	(87,703)	156,665
	<u>\$ 959,154</u>	<u>\$ 993,456</u>

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 Monthly Portfolio held positions in bond futures at June 30, 2013, while the Daily and Monthly Portfolios held positions in bond futures at June 30, 2012. Bond futures are used to adjust the duration of cash equivalents and the fixed income portion of the portfolios. During 2013, the University removed the bond futures overlay in the Daily Portfolio to shorten its duration.

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 \$41,443,000 and \$51,987,000 in securities loans outstanding at June 30, 2013 and 2012, respectively. At loan inception, an approved borrower must deliver collateral of cash, securities or letters of credit to the University’s lending agent equal to 102 percent of fair value for domestic securities and 105 percent for foreign securities. Collateral positions are monitored daily to insure that borrowed securities are never less than 100 percent collateralized. At June 30, 2013, collateral of \$43,000,000 (104 percent of securities on loan) includes invested cash of \$40,975,000 and U.S. government securities of \$2,025,000, while at June 30, 2012, collateral of \$54,300,000 (104 percent of securities on loan) consisted entirely of invested cash.

Cash collateral held by the University’s lending agent, along with the offsetting liability to return the collateral at loan termination, are recorded in the statement of net position. Neither the University nor its securities lending agent has the ability to pledge or sell securities received as collateral unless a borrower defaults. Securities loans may be terminated upon notice by either the University or the borrower.

NOTE 3—ACCOUNTS RECEIVABLE

The composition of accounts receivable at June 30, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Patient care	\$ 608,538	\$ 529,079
Sponsored programs	96,099	84,303
State educational appropriations	57,440	55,924
Student accounts	24,145	23,482
Other	43,083	36,750
	829,305	729,538
Less provision for uncollectible accounts receivable	254,495	234,751
	<u>\$ 574,810</u>	<u>\$ 494,787</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4—NOTES AND PLEDGES RECEIVABLE

The composition of notes and pledges receivable at June 30, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Notes:		
Federal student loan programs	\$ 85,793	\$ 87,628
University student loan funds	18,829	19,916
Other	488	537
	105,110	108,081
Less allowance for doubtfully collectible notes	3,100	3,100
Total notes receivable, net	102,010	104,981
Gift pledges:		
Capital	124,088	91,054
Operations	108,257	73,896
	232,345	164,950
Less:		
Allowance for doubtfully collectible pledges	6,455	11,303
Unamortized discount to present value	2,270	2,383
Total pledges receivable, net	223,620	151,264
Total notes and pledges receivable, net	325,630	256,245
Less current portion	118,648	59,553
	\$ 206,982	\$ 196,692

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, 2013 are expected to be received in the following years ended June 30 (in thousands):

2014	\$ 104,405
2015	40,275
2016	24,071
2017	17,069
2018	13,619
2019 and after	32,906
	\$ 232,345

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 \$48,080,000 and \$57,642,000 at June 30, 2013 and 2012, 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, 2013 and 2012 is summarized as follows:

2013				
(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	\$ 94,743	\$ 6,171		\$ 100,914
Land improvements	111,806	5,238	\$ 4,743	112,301
Infrastructure	223,292	8,566		231,858
Buildings	6,775,245	245,3381	21,688	6,898,895
Construction in progress	226,816	101,602		328,418
Property held for future use	47,073	(16,294)		30,779
Equipment	1,692,537	145,460	98,162	1,739,835
Library materials	495,702	23,020		518,722
	9,667,214	519,101	224,593	9,961,722
Less accumulated depreciation	4,329,550	476,898	214,126	4,592,322
	\$ 5,337,664	\$ 42,203	\$ 10,467	\$ 5,369,400
2012				
(in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	\$ 94,365	\$ 378		\$ 94,743
Land improvements	106,849	5,065	\$ 108	111,806
Infrastructure	217,591	5,701		223,292
Buildings	6,021,971	850,314	97,040	6,775,245
Construction in progress	824,907	(598,091)		226,816
Property held for future use	53,823	(6,750)		47,073
Equipment	1,628,714	312,096	248,273	1,692,537
Library materials	473,414	22,288		495,702
	9,421,634	591,001	345,421	9,667,214
Less accumulated depreciation	4,228,461	443,132	342,043	4,329,550
	\$ 5,193,173	\$ 147,869	\$ 3,378	\$ 5,337,664

The increase in construction in progress of \$101,602,000 in 2013 represents the amount of capital expenditures for new projects of \$441,873,000 net of assets placed in service of \$340,271,000. The decrease in construction in progress of \$598,091,000 in 2012 represents the amount of capital expenditures for new projects of \$498,442,000 net of assets placed in service of \$1,096,533,000. Interest of \$1,504,000 and \$6,073,000 was capitalized in 2013 and 2012, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6—LONG-TERM DEBT

Long-term debt at June 30, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Commercial Paper:		
Tax-exempt, variable rate (.14%)*	\$ 44,395	\$ 57,575
Taxable, variable rate (.14%)*	10,945	5,370
General Revenue Bonds:		
Series 2013A, 2.00% to 5.00% through 2029	53,510	
unamortized premium	2,861	
Series 2012A, variable rate (.05%)* through 2036	50,000	50,000
Series 2012B, variable rate (.02%)* through 2042	65,000	65,000
Series 2012C, 2.00% to 5.00% through 2017	83,920	89,605
unamortized premium	11,426	13,802
Series 2012D-1, variable rate (.01%)* to fixed via swap through 2025	75,745	
deferred amount on refunding	(18,796)	
Series 2012D-2, variable rate (.04%)* to fixed via swap through 2026		
and variable rate 2027 through 2030	82,645	
deferred amount on refunding	(7,539)	
Series 2012E**, variable rate (.26%)* through 2033	95,029	
Series 2012F**, variable rate (.46%)* through 2043	100,970	
Series 2010A, taxable-Build America Bonds, 4.926% to 5.593% through 2040	163,110	163,110
Series 2010C, 2.00% to 5.00% through 2027	171,440	178,820
unamortized premium	12,748	14,363
Series 2010D, taxable-Build America Bonds, 1.051% to 5.333% through 2041	204,655	212,345
Series 2009A, 2.50% to 5.00% through 2029	79,305	86,680
Series 2009B, variable rate (.13%)* through 2039	118,710	118,710
unamortized premium	6,273	6,724
Series 2009D, taxable-Build America Bonds, 5.155% to 6.172% through 2030	89,815	89,815
Series 2008A, variable rate (.05%)* through 2038	105,810	105,810
Series 2008B, variable rate (.05%)* to fixed via swap through 2026		
and variable rate 2027 through 2028	101,240	106,665
Series 2005A, 5.00% through 2018	12,830	17,560
unamortized premium	426	704
unamortized loss on extinguishment	(37)	(72)
Series 2002, variable rate (.05%)* to fixed via swap through 2018		
and variable rate 2019 through 2032	89,080	95,035
General Revenue Refunding Bonds:		
Series 2003, 3.50% to 5.00% through 2015	1,365	6,745
unamortized premium	23	118
unamortized loss on extinguishment	(2)	(18)
Hospital Revenue Bonds:		
Series 2007A, variable rate		26,195
Series 2007B, variable rate		44,310
Series 2005A, variable rate		69,315
Series 2005B, variable rate		61,900
Hospital Revenue Refunding Bonds:		
Series 2002A, fixed rate		35,015
unamortized premium		213
unamortized loss on extinguishment		(1,251)
Series 1998A-2, variable rate		44,670
Medical Service Plan Revenue Bonds, Series 1995A, variable rate		26,200
Medical Service Plan Revenue Refunding Bonds, Series 1998A-1, variable rate		33,595
Housing Energy Conservation HUD Loan, fixed rate		1,636
	1,806,902	1,826,264
Less:		
Commercial paper and current portion of bonds payable	117,907	135,193
Long-term bonds payable subject to remarketing, net	267,060	482,202
	\$ 1,421,935	\$ 1,208,869

* Denotes variable rate at June 30, 2013
** Denotes variable rate bonds not subject to remarketing

Certain variable rate bonds have remarketing features which allow bondholders to put debt back to the University. Accordingly, variable rate bonds payable with such remarketing features 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, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Variable rate bonds payable subject to remarketing	\$ 688,230	\$ 847,405
Less:		
Current principal maturities	18,405	17,635
Long-term liquidity agreements:		
Unsecured line of credit	150,000	150,000
Standby bond purchase agreements	252,765	197,568
Long-term bonds payable subject to remarketing, net	\$ 267,060	\$ 482,202

The University's available line of credit and standby bond purchase agreements were entirely unused at June 30, 2013.

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, 2013 is summarized as follows:

(in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Commercial Paper:				
General revenues	\$ 62,945	\$ 88,257	\$ 95,862	\$ 55,340
Bonds and Notes:				
General revenues	1,421,521	411,796	81,755	1,751,562
Hospital revenues	280,367		280,367	—
Faculty Group Practice revenues	59,795		59,795	—
Student residences revenues	1,636		1,636	—
	\$ 1,826,264	\$ 500,053	\$ 519,415	\$ 1,806,902

The University maintains a combination of variable and fixed rate debt, with effective interest rates that averaged approximately 2.2 percent and 2.3 percent in 2013 and 2012, respectively, including the amortization of bond premiums and discounts and net of federal subsidies for interest on taxable Build America Bonds. The University utilizes commercial paper to provide interim financing for its capital improvement program. The Board of Regents has authorized the issuance of up to \$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 2013, the University issued \$408,840,000 of General Revenue Bonds with a net original issue premium of \$2,956,000. Total bond proceeds of \$411,796,000 were utilized to convert \$22,865,000 of commercial paper to long-term debt, refund \$266,275,000 of Hospital Revenue Bonds and \$57,125,000 of Medical Service Plan Revenue Bonds, and provide \$64,031,000 for capital projects and \$1,500,000 for debt issuance costs. General Revenue Bonds issued in 2013 include \$355,330,000 of variable rate bonds (Series 2012D-1, 2012D-2, 2012E, and 2012F) and \$53,510,000 of fixed rate bonds (Series 2013A).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6—LONG TERM DEBT, CONTINUED

During 2012, the University issued \$204,605,000 of General Revenue Bonds with a net original issue premium of \$14,595,000. Total bond proceeds of \$219,200,000 were utilized to convert \$119,310,000 of commercial paper to long-term debt and provide \$99,240,000 for capital projects and \$650,000 for debt issuance costs. General Revenue Bonds issued in 2012 include \$115,000,000 of variable rate bonds (Series 2012A and Series 2012B) and \$89,605,000 of fixed rate bonds (Series 2012C).

Debt obligations are generally callable by the University and mature at various dates through fiscal 2043. 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
2014	\$ 111,674	\$ 42,160	\$ 153,834
2015	58,520	40,846	99,366
2016	54,655	39,469	94,124
2017	119,230	38,029	157,259
2018	51,815	33,445	85,260
2019-2023	282,345	146,659	429,004
2024-2028	338,895	107,589	446,484
2029-2033	313,195	58,516	371,711
2034-2038	340,295	32,128	372,423
2039-2043	128,895	5,767	134,662
	1,799,519	\$ 544,608	\$ 2,344,127
Plus unamortized premiums, net	33,718		
Less deferred amount on refunding	26,335		
	\$ 1,806,902		

*Interest on variable rate debt is estimated based on rates in effect at June 30, 2013; 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 2014 would increase to \$378,734,000, total principal payments due in 2015 would increase to \$401,440,000, total principal payments due in 2016 would increase to \$226,420,000 and total principal payments due in 2017 would increase to \$143,510,000. Accordingly, principal payments due in subsequent years would be reduced to \$29,720,000 in 2018; \$146,605,000 in 2019 through 2023; \$220,960,000 in 2024 through 2028; \$104,735,000 in 2029 through 2033; \$92,925,000 in 2034 through 2038; and \$54,470,000 in 2039 through 2043. There would not be a significant impact on annual interest payments due to the low variable rate of interest on these bonds.

NOTE 7—DERIVATIVE INSTRUMENTS

Derivatives held by the University are recorded at fair value in the statement of net position in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. For hedging derivative instruments that are effective in significantly reducing an identified financial risk, as defined by the Statement, the corresponding change in fair value is deferred and included in the statement of net position. 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, 2013 and 2012 are summarized as follows:

	2013		2012	
(in thousands)	Notional Amount	Fair Value	Notional Amount	Fair Value
Investment Derivative Instruments:				
Investment portfolios:				
Futures	\$ 11,176	\$ (224)	\$ 352,820	\$ 186
Foreign currency forwards	862,093	(5,411)	557,644	(4,844)
Other	79,430	(2,537)	87,019	314
	\$ 952,699	\$ (8,172)	\$ 997,483	\$ (4,344)
Floating-to-fixed interest rate swap on debt	\$ 34,450	\$ (2,069)	\$ 40,405	\$ (3,600)
Effective Cash Flow Hedges:				
Floating-to-fixed interest rate swaps on debt	\$ 218,435	\$ (32,066)	\$ 230,115	\$ (44,869)

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 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.

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 generally represents the estimated amount that the University would pay to terminate the swap agreements at the statement of net position date, taking into account current interest rates and creditworthiness of the underlying counterparty. The notional amount represents the underlying reference of the instrument and does not represent the amount of the University's settlement obligations.

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

At June 30, 2013 and 2012, the fair value of floating-to-fixed interest rate swaps associated with the University's variable rate debt is a liability of \$34,135,000 and \$48,469,000, respectively, and is included in the statement of net position 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 outflow of resources for the fair value of swaps deemed effective cash flow hedges totaled \$5,731,000 and \$44,869,000, at June 30, 2013 and 2012, respectively, and is included in the statement of net position as part of noncurrent other assets. Three bond issues were refunded in 2013 and the deferred outflow of resources related to the effective cash flow hedges associated with these bonds was reclassified to deferred amount on refunding and net against bonds payable. The deferred amount on refunding is being amortized into interest expense over the remaining term of the refunding bonds and totaled \$26,335,000 at June 30, 2013.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7—DERIVATIVE INSTRUMENTS, CONTINUED

The change in fair value of derivative instruments, which includes realized gains and losses on positions closed, for the years ended June 30, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Investment Derivative Instruments:		
Investment portfolios:		
Futures	\$ 947	\$ 18,998
Foreign currency forwards	21,305	(1,198)
Other	(5,133)	(1,679)
	<u>\$ 17,119</u>	<u>\$ 16,121</u>
Floating-to-fixed interest rate swap on debt	\$ 1,531	\$ (1,132)
Effective Cash Flow Hedges:		
Floating-to-fixed interest rate swaps on debt	\$ 12,803	\$ (16,257)

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

The floating-to-fixed interest rate swap associated with the Series 2008B General Revenue Bonds has a notional amount of \$84,525,000 and \$89,950,000 at June 30, 2013 and 2012, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective from April 1, 2008, the University makes payments based on a fixed rate of 3.105 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, until the swap terminates in April 2026. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2013 and 2012 and has a fair value of (\$9,075,000) and (\$13,610,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2005B Hospital Revenue Bonds has the notional amount of \$58,315,000 and \$61,900,000 at June 30, 2013 and 2012, respectively. The Series 2005B Hospital Revenue Bonds were refunded on February 1, 2013, and the swap is now associated with the Series 2012D-2 General Revenue 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, 2013 and 2012 and has a fair value of (\$6,414,000) and (\$9,365,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2002 General Revenue Bonds has a notional amount of \$34,450,000 and \$40,405,000 at June 30, 2013 and 2012, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective from June 1, 2007, the University makes payments based on a fixed rate of 3.5375 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, through April 1, 2009, and 63 percent of the Five-Year USD LIBOR Swap Rate for the balance of the term, through April 2018. The University has the option to terminate the swap upon five business day written notice and payment of the fair market compensation for the value of the swap. This swap is not considered an effective hedge at June 30, 2013 and 2012 and has a fair value of (\$2,069,000) and (\$3,600,000), 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, 2013 and 2012 tied to the outstanding balance of the bonds. The Series 1998A-2 Hospital Revenue Refunding Bonds were refunded on January 4, 2013, and the swap is now associated with the Series 2012D-1 General Revenue 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, 2013 and 2012 and has a fair value of (\$11,596,000) and (\$15,416,000), 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 \$30,925,000 and \$33,595,000 at June 30, 2013 and 2012, respectively, tied to the outstanding balance of the bonds. The Series 1998A-1 Medical Service Plan Revenue Refunding Bonds were refunded on January 4, 2013, and the swap is now associated with the Series 2012D-1 General Revenue 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 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, 2013 and 2012 and has a fair value of (\$4,981,000) and (\$6,478,000), respectively.

Using rates in effect at June 30, 2013, 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:

(in thousands)	Variable Rate Bonds		Swap Payments, Net	Total Payments
	Principal	Interest		
2014	\$ 12,165	\$ 90	\$ 7,681	\$ 19,936
2015	12,675	85	7,258	20,018
2016	13,205	80	6,827	20,112
2017	13,775	75	6,349	20,199
2018	14,020	70	5,880	19,970
2019-2023	84,930	269	21,566	106,765
2024-2028	98,440	110	9,477	108,027
2029-2030	10,420	3		10,423
	<u>\$ 259,630</u>	<u>\$ 782</u>	<u>\$ 65,038</u>	<u>\$ 325,450</u>

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

The University is subject to collateral requirements with its counterparties on certain derivative instrument positions. To meet trading margin requirements for bond futures, the University had cash and U.S. government securities with a fair value of \$611,000 and \$2,389,000 at June 30, 2013 and 2012, respectively, on deposit with the its futures broker as collateral. To meet collateral requirements for a total return swap with a notional amount of \$56,695,000 at June 30, 2013, the University posted cash collateral of \$3,760,000 in May 2013, which is still outstanding at June 30, 2013; collateral is required when the mark-to-market reaches a minimum threshold of \$3,000,000.

For certain floating-to-fixed interest rate swaps, the University was required to post collateral if the fair value of the liability of the swap reaches a minimum threshold. For the swap that was associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds, the University posted collateral of \$1,200,000 during the first half of Fiscal 2013, which was returned in January 2013, and \$1,200,000 for less than 90 days during Fiscal 2012. At June 30, 2013, there are no collateral requirements for interest rate swaps associated with the University's debt.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2013 and 2012 are summarized as follows:

(in thousands)	2013	2012
Balance, beginning of year	\$ 186,976	\$165,876
Claims incurred and changes in estimates	474,310	464,826
Claim payments	(465,698)	(443,726)
Balance, end of year	195,588	186,976
Less current portion	86,173	84,155
	\$ 109,415	\$ 102,821

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 38,000 full-time permanent University employees may become eligible for these benefits if they reach retirement age while working for the University. For employees retiring on or after January 1, 1987, contributions toward health and welfare benefits are shared between the University and the retiree and can vary based on date of hire, date of retirement, age and coverage elections.

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

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

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

The University implemented GASB Statement No. 45 in 2008 and elected to amortize its initial unfunded actuarial accrued liability over one year, the minimum period allowed by the Statement. The University also elected to amortize subsequent changes in actuarial assumptions, plan design and experience gains and losses over a ten year closed period. Therefore, the liability for net postemployment benefits obligations recorded in the statement of net position will differ from the actuarial accrued liability by the unamortized portion of these changes. At June 30, 2013, the recorded liability for net postemployment benefits obligations and the actuarial accrued liability totaled \$1,698,091,000 and \$1,340,017,000, respectively.

Changes in the total reported liability for postemployment benefits obligations for the years ended June 30, 2013 and 2012 are summarized as follows:

2013			
(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	\$ 1,531,220	\$ 140,344	\$ 1,671,564
Service cost	43,330	2,656	45,986
Amortization of assumption changes, plan changes, and net actuarial (gains) losses	(71,676)	1,126	(70,550)
Interest cost	93,098	11,059	104,157
Payments of current premiums and claims	(39,688)	(13,378)	(53,066)
Balance, end of year	1,556,284	141,807	1,698,091
Less current portion	44,189	17,069	61,258
	\$ 1,512,095	\$ 124,738	\$ 1,636,833

2012			
(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	\$ 1,498,395	\$ 138,257	\$ 1,636,652
Service cost	43,599	3,138	46,737
Amortization of assumption changes, plan changes and actuarial (gains) losses	(62,590)	222	(62,368)
Interest cost	91,102	10,895	101,997
Payments of current premiums and claims	(39,286)	(12,168)	(51,454)
Balance, end of year	1,531,220	140,344	1,671,564
Less current portion	42,402	13,729	56,131
	\$ 1,488,818	\$ 126,615	\$ 1,615,433

Since a portion of retiree medical services will be provided by the University's Health System, the liability for postemployment benefit obligations is net of the related margin and fixed costs of providing those services which totaled \$290,402,000 of actuarial accrued liability at June 30, 2013 and \$262,905,000 at June 30, 2012. In accordance with GASB Statement No. 45, the University's liability for postemployment benefit obligations at June 30, 2013 is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods of approximately \$170,000,000 on an actuarial accrued liability basis.

The annual required contribution represents a level of funding that an employer is projected to need in order to prefund its obligations for postemployment benefits over its employees' years of service and totals \$105,503,000 and \$110,210,000 at June 30, 2013 and 2012, 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, 2013, 2012 and 2011 as a percentage of covered payroll of \$2,979,189,000, \$2,826,760,000 and \$2,665,924,000, was 57, 59 and 61 percent, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9—POSTEMPLOYMENT BENEFITS, CONTINUED

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, 2013 and 2012 are as follows:

2013		
	Retiree Health and Welfare	Long-term Disability
Discount Rate	6.08%	7.88%
Immediate/Ultimate Administrative Trend Rate	0.0%/3.0%	0.0%/3.0%
Immediate/Ultimate Medical Trend Rate	6.0%-8.0%/5.0%	6.0%-8.0%/5.0%
Immediate/Ultimate Rx Trend Rate	7.0%/5.0%	7.0%/5.0%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2000 Generational	2005 SOA Life Waiver (Modified)
2012		
	Retiree Health and Welfare	Long-term Disability
Discount Rate	6.08%	7.88%
Immediate/Ultimate Administrative Trend Rate	3.0%/3.0%	3.0%/3.0%
Immediate/Ultimate Medical Trend Rate	6.0%-7.0%/5.0%	6.0%-7.0%/5.0%
Immediate/Ultimate Rx Trend Rate	7.0%/5.0%	7.0%/5.0%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2000 Generational	2005 SOA Life Waiver (Modified)

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

NOTE 10—RETIREMENT PLAN

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

Eligible employees generally contribute 5 percent of their pay and the University generally contributes an amount equal to 10 percent of employees’ pay to the plan. 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, 2013 are summarized as follows:

(in thousands)	2013	2012	2011
University contributions	\$ 234,036	\$ 226,517	\$ 214,905
Employee contributions	\$ 122,094	\$ 117,127	\$ 108,981
Payroll covered under plan	\$ 2,979,189	\$ 2,826,760	\$ 2,665,924
Total payroll	\$ 3,092,257	\$ 2,963,848	\$ 2,802,045

NOTE 11—NET POSITION

The composition of net position at June 30, 2013 and 2012 is summarized as follows:

(in thousands)	2013	2012
Net investment in capital assets	\$ 3,637,027	\$ 3,597,540
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,432,191	1,345,859
Expendable:		
Net appreciation of permanent endowments	1,338,629	1,193,281
Funds functioning as endowment	1,748,356	1,597,480
Restricted for operations and other	602,223	492,878
Unrestricted	2,724,703	2,526,159
	\$ 11,483,129	\$ 10,753,197

Unrestricted net position, as defined by GASB, is not subject to externally imposed stipulations; however, they are subject to internal restrictions. For example, unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. At June 30, 2013 and 2012, all of the unrestricted net position has been designated for academic and research programs and initiatives and capital programs.

NOTE 12—FEDERAL DIRECT LENDING PROGRAM

The University distributed \$346,634,000 and \$372,703,000 for the years ending June 30, 2013 and 2012, 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 position includes a receivable of \$2,586,000 and \$1,364,000 at June 30, 2013 and 2012, respectively, for DoED funding received subsequent to distribution.

NOTE 13—COMMITMENTS AND CONTINGENCIES

Authorized expenditures for construction and other projects unexpended as of June 30, 2013 were \$1,173,130,000. Of these expenditures, approximately \$1,131,377,000 will be funded by internal sources, gifts, grants and future borrowings and the remaining \$41,753,000 will be funded using unexpended debt proceeds.

Under the terms of various limited partnership agreements approved by the Board of Regents or by University officers, the University is obligated to make periodic payments for advance commitments to venture capital, private equity, real estate, natural resources and absolute return strategies. As of June 30, 2013, the University had committed, but not paid, a total of \$2,153,349,000 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):

2014	\$ 755,831
2015	536,200
2016	379,238
2017	193,636
2018	103,801
2019 and beyond	184,643
	\$ 2,153,349

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13—COMMITMENTS AND CONTINGENCIES, CONTINUED

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):

2014	\$ 29,481
2015	21,083
2016	11,775
2017	8,806
2018	5,590
2019-2023	19,040
2024-2027	5,541
	<u>\$ 101,316</u>

Operating lease expenses totaled \$34,252,000 and \$32,856,000 in 2013 and 2012, 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—OPERATING EXPENSES BY FUNCTION

Operating expenses by functional classification for the years ended June 30, 2013 and 2012 are summarized as follows:

2013					
(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	\$ 797,370	\$ 127,157			\$ 924,527
Research	489,283	260,901			750,184
Public service	96,487	52,386			148,873
Academic support	194,688	47,467			242,155
Student services	70,961	21,364			92,325
Institutional support	145,676	50,668			196,344
Operations and maintenance of plant	41,371	214,907			256,278
Auxiliary enterprises	2,129,194	780,950			2,910,144
Depreciation			\$ 476,898		476,898
Scholarships and fellowships				\$ 123,287	123,287
	<u>\$ 3,965,030</u>	<u>\$ 1,555,800</u>	<u>\$ 476,898</u>	<u>\$ 123,287</u>	<u>\$ 6,121,015</u>

2012					
(in thousands)	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	\$ 771,636	\$ 120,816			\$ 892,452
Research	488,738	230,004			718,742
Public service	87,945	41,659			129,604
Academic support	191,354	40,975			232,329
Student services	68,837	20,120			88,957
Institutional support	133,302	49,941			183,243
Operations and maintenance of plant	40,269	244,300			284,569
Auxiliary enterprises	2,022,144	725,850			2,747,994
Depreciation			\$ 443,132		443,132
Scholarships and fellowships				\$ 121,040	121,040
	<u>\$ 3,804,225</u>	<u>\$ 1,473,665</u>	<u>\$ 443,132</u>	<u>\$ 121,040</u>	<u>\$ 5,842,062</u>

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