

**UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM**

Annual Financial Report

June 30, 2010

(With Independent Auditors' Report Thereon)

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Walter K. Knorr Vice President/Chief Financial Officer, Comptroller

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Maxine E. Sandretto Assistant Vice President for Business and Finance

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Michael E. Bloechle Director of Business Services (effective January 1, 2010)

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Annual Financial Report

June 30, 2010

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From the Vice President/Chief Financial Officer, Comptroller

UNIVERSITY OF ILLINOIS
Urbana-Champaign • Chicago • Springfield

Office of Vice President/Chief Financial Officer, Comptroller
349 Henry Administration Building
506 South Wright Street
Urbana, IL 61801

December 20, 2010

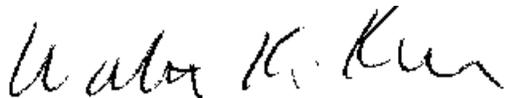
Holders of University of Illinois
Auxiliary Facilities System Revenue Bonds
And The Board of Trustees of the University of Illinois:

I am pleased to transmit the Annual Financial Report of the University of Illinois Auxiliary Facilities System for the fiscal year ended June 30, 2010. This report supplements the financial statements of the University of Illinois presented in the Annual Financial Report.

The 2010 financial statements and accompanying notes appearing on pages 4 through 22 have been audited by KPMG LLP, Independent Certified Public Accountants, as special assistants to the Auditor General of the State of Illinois, whose report on the financial statements appears on pages 2 and 3.

KPMG LLP will also prepare a report for the year ended June 30, 2010, containing special data requested by the Auditor General and another report covering their audit of the compliance of the University with applicable state and federal laws and regulations for the year ended June 30, 2010. These reports, which include some data related to the Auxiliary Facilities System, are not contained herein and are primarily for the use of the Auditor General and state and federal agencies.

Very truly yours,



Walter K. Knorr,
Vice President/Chief Financial Officer,
Comptroller



KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Honorable William G. Holland
Auditor General of the State of Illinois
and
The Board of Trustees
University of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying balance sheet of the University of Illinois Auxiliary Facilities System (System), a segment of the University of Illinois, as of June 30, 2010, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on the financial statements based on our audit. The 2009 comparative information has been derived from the System's 2009 financial statements and, in our report dated February 26, 2010 we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements of the System are intended to present the financial position, the changes in its financial position, and cash flows of only that portion of the business-type activities of the University of Illinois that are attributable to the transactions of the System relating to complying with the requirements of the indentures for the System's Revenue Bonds. The financial statements do not purport to, and do not, present fairly the financial position of the University of Illinois as of June 30, 2010 or the changes in its financial position or its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

The System has not presented Management's Discussion and Analysis as required supplementary information that U.S. generally accepted accounting principles has determined is necessary to supplement, although not required to be part of, the basic financial statements.



In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2010 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

This report is intended solely for the information and use of the Auditor General of the State of Illinois, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, the Board of Trustees and the management of the University of Illinois, and the holders of the System's Revenue Bonds, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Chicago, Illinois
December 20, 2010

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Balance Sheet

June 30, 2010

(with comparative totals for 2009)

Assets	2010	2009
Current assets:		
Claim on cash and on pooled investments:		
Cash and cash equivalents	\$ 110,112,463	110,269,577
Cash and cash equivalents, restricted	24,581,240	38,269,881
Investments	3,002,689	9,009,425
Accrued investment income	232,065	432,623
Accounts receivable, net of allowance of \$3,038,474 in 2010	7,962,468	8,287,425
Inventories	10,790,881	7,907,381
Prepaid expenses and deferred charges	808,289	566,333
Total current assets	<u>157,490,095</u>	<u>174,742,645</u>
Noncurrent assets:		
Investments, restricted	14,364,266	14,764,709
Capital assets:		
Land	19,238,069	19,238,069
Buildings, net of accumulated depreciation	888,067,909	821,111,618
Improvements, net of accumulated depreciation	19,658,310	20,757,362
Equipment, net of accumulated depreciation	5,425,692	5,211,243
Construction in progress	13,631,653	74,752,578
Subtotal for capital assets	<u>946,021,633</u>	<u>941,070,870</u>
Prepaid expenses and deferred charges	5,527,724	6,038,606
Total noncurrent assets	<u>965,913,623</u>	<u>961,874,185</u>
Total assets	<u>\$ 1,123,403,718</u>	<u>1,136,616,830</u>
Liabilities		
Current liabilities:		
Accounts payable	\$ 18,345,130	28,194,242
Accrued liabilities	3,714,420	3,157,519
Accrued compensated absences	602,244	629,176
Accrued interest	9,762,568	10,007,475
Deferred revenue	6,812,154	7,174,533
Notes payable to the University	3,431,500	3,137,092
Bonds and leaseholds payable	50,481,627	29,699,441
Total current liabilities	<u>93,149,643</u>	<u>81,999,478</u>
Noncurrent liabilities:		
Accrued compensated absences	5,874,508	5,841,012
Notes payable to the University	11,765,704	12,387,147
Bonds and leaseholds payable	889,705,045	931,232,181
Total noncurrent liabilities	<u>907,345,257</u>	<u>949,460,340</u>
Total liabilities	<u>1,000,494,900</u>	<u>1,031,459,818</u>
Net Assets		
Invested in capital assets, net of related debt	9,907,091	2,854,854
Restricted:		
Expendable for debt service	19,646,684	22,340,612
Unrestricted	93,355,043	79,961,546
Total net assets	<u>122,908,818</u>	<u>105,157,012</u>
Total liabilities and net assets	<u>\$ 1,123,403,718</u>	<u>1,136,616,830</u>

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Statement of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2010
(with comparative totals for 2009)

	2010	2009
Operating revenues:		
Room and board, net of waivers of \$1,441,781 in 2010	\$ 121,897,163	116,367,807
Merchandise and food sales	31,850,997	32,034,691
Student service fees	88,193,121	82,522,186
Public events and recreation fees	8,256,358	7,628,246
Parking income	22,352,952	21,893,092
Rental and lease income	20,515,928	17,769,580
Vending income	1,342,674	1,296,914
Other operating revenue	11,880,089	10,485,042
	306,289,282	289,997,558
Operating expenses:		
Salaries and wages	82,470,032	82,336,187
Merchandise and food for resale	31,508,083	32,968,192
Repair and maintenance	3,521,268	3,070,837
Professional and other contractual services	33,430,926	37,441,274
Utilities	26,355,186	25,945,477
Supplies	12,496,674	15,213,498
Noncapitalized equipment and equipment rentals	1,788,554	1,878,523
Administrative services	14,377,333	14,073,226
Other operating expense	10,502,254	12,554,148
Depreciation and amortization	28,673,198	24,845,142
On behalf payments for fringe benefits	26,900,395	20,369,977
	272,023,903	270,696,481
Operating income	34,265,379	19,301,077
Nonoperating revenues (expenses):		
On behalf payments for fringe benefits	26,900,395	20,369,977
Investment income (net of related expenses)	3,507,810	4,911,137
Interest on capital asset-related debt	(45,521,604)	(45,627,849)
Amortization of issuance costs	(275,283)	(283,848)
Loss on disposal of capital assets	(164,055)	(422,389)
Other nonoperating expenses, net	(960,836)	(975,968)
	(16,513,573)	(22,028,940)
Increase (decrease) in net assets	17,751,806	(2,727,863)
Net assets, beginning of year	105,157,012	107,884,875
Net assets, end of year	\$ 122,908,818	105,157,012

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2010
(with comparative totals for 2009)

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Room and board	\$ 121,927,267	116,193,977
Merchandise and food sales	31,839,458	31,870,743
Student service fees	88,150,734	82,108,011
Public events and recreation fees	8,252,098	7,583,650
Parking income	22,354,027	22,167,241
Rental and lease income	20,508,792	17,691,255
Vending income	1,342,301	1,291,145
Other sources	11,877,184	10,415,031
Payments to employees and benefits	(81,906,567)	(81,844,948)
Payments to suppliers	<u>(132,883,124)</u>	<u>(144,373,248)</u>
Net cash provided by operating activities	<u>91,462,170</u>	<u>63,102,857</u>
Cash flows from noncapital financing activities:		
Other disbursements	<u>(271,831)</u>	<u>(87,579)</u>
Net cash used in noncapital financing activities	<u>(271,831)</u>	<u>(87,579)</u>
Cash flows from capital and related financing activities:		
Proceeds from issuance of bonds		86,284,909
Purchase of capital assets	(38,748,163)	(89,927,126)
Principal paid on bonds and capital leases	(30,552,277)	(95,658,189)
Repayment of notes payable to the University	(5,012,301)	(3,244,325)
Interest paid on bonds and notes payable	(40,838,899)	(38,175,224)
Payments of bond issuance costs		<u>(769,909)</u>
Net cash used in capital and related financing activities	<u>(115,151,640)</u>	<u>(141,489,864)</u>
Cash flows from investing activities:		
Interest and dividends on investments, net	3,613,607	4,974,119
Proceeds from sales and maturities of investments	21,416,248	19,386,843
Purchase of investments	<u>(14,914,309)</u>	<u>(2,305,914)</u>
Net cash provided by investing activities	<u>10,115,546</u>	<u>22,055,048</u>
Net decrease in cash and cash equivalents	<u>(13,845,755)</u>	<u>(56,419,538)</u>
Cash and cash equivalents, beginning of year	<u>148,539,458</u>	<u>204,958,996</u>
Cash and cash equivalents, end of year	<u>\$ 134,693,703</u>	<u>148,539,458</u>

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2010
(with comparative totals for 2009)

	<u>2010</u>	<u>2009</u>
Reconciliation of operating income to net cash provided		
by operating activities:		
Operating income	\$ 34,265,379	19,301,077
Adjustments to reconcile operating income to net cash provided		
by operating activities:		
Depreciation and amortization	28,673,198	24,845,142
On-behalf payment of fringe benefits	26,900,395	20,369,977
Changes in assets and liabilities:		
Accounts receivable (net)	324,957	(1,444,437)
Inventories	(2,883,500)	(601,577)
Prepaid expenses and deferred charges	(6,355)	505,300
Accounts payable	3,987,010	(1,131,796)
Accrued liabilities	563,465	491,238
Deferred revenue	(362,379)	767,933
Net cash provided by operating activities	\$ <u>91,462,170</u>	<u>63,102,857</u>
Noncash investing, capital and financing activities:		
On-behalf payments for fringe benefits	\$ 26,900,395	20,369,977
Change in fair value of investments	(5,257,592)	599,911
Capital assets acquisition via notes payable to the University	4,777,547	8,011,541
Adjustments to notes payable to the University	(92,280)	
Decrease of capital assets obligations in accounts payable	(13,836,121)	(18,308,267)
Capital appreciation on bonds payable	10,390,180	10,415,308
Net interest capitalized	4,123,765	2,693,796
Other capital asset adjustments	35,788	28,928
Loss on disposal of capital assets	(164,055)	(422,389)

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Notes to Financial Statements

June 30, 2010

(1) Summary of Significant Accounting Policies

Organizational Background and Basis of Presentation

The University of Illinois (University) Auxiliary Facilities System (System) was created in June 1978 pursuant to the provisions of the Act which authorized the University's Board of Trustees (Board) to combine and consolidate into a single System, facilities which were then pledged to secure outstanding indebtedness of the Board. These financial statements have been prepared to satisfy the requirements of the System's Revenue Bonds master indenture. The financial balances and activities of the System, included in these financial statements, are included in the University's financial statements. The financial statements of the System are prepared in accordance with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The System is not a separate legal entity and has not presented management's discussion and analysis.

System financial activity is mainly comprised of housing, parking and student activities, which span across the three campuses of the University. The operating revenues of the system largely consist of student service fees, various user fees, room and board charges, sales from merchandise/vending and rental of certain facilities. Facilities consist of buildings and other structures that have been constructed or remodeled with funding provided from issuance of related revenue bonds. System facilities include Memorial Stadium, the Assembly Hall, student unions, housing residence halls, parking and other structures.

Certain System revenues are derived from the rental of Memorial Stadium and the Assembly Hall, directly from the University's Division of Intercollegiate Athletics department, and are reflected as rental income within the System's financial statements. Such rental payments are determined based on the amount of debt service requirements and/or certain operation and maintenance consideration that apply to the facilities. Ticket revenues received by the University for events occurring at these facilities are not included within the System's reporting structure, in accordance with the related bond indentures. Housing revenues consist of charges for room, board and meal plans. Student activities buildings consist of student unions, and recreation and athletic facilities and student service buildings which generate lease and rental income, student fees and various other types of revenue. Operating expenses of the System include all necessary current maintenance charges, expenses of reasonable upkeep and repairs, allocations of a share of certain charges for insurance and other expenses incidental to the operations of all of the various activities and facilities of the System in accordance with the bond indentures.

The financial statements include certain prior year comparative information, which has been derived from the System's 2009 financial statements. Such information does not include all of the information required to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2009.

Significant Accounting Policies

(a) *Financial Statement Presentation and Basis of Accounting*

The System prepared its financial statements as a Business Type Activity, as defined by GASB Statement No. 35, using the economic resources measurement focus and the accrual basis of

accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

Under the accrual basis revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Advances are classified as deferred revenue.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System follows all applicable GASB pronouncements. In addition, the System follows all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The System has elected not to apply FASB pronouncements issued after November 30, 1989.

(b) *Cash and Cash Equivalents*

The Statement of Cash Flows details the change in the cash and cash equivalents balance for the fiscal year. Cash and all liquid investments with original maturities of ninety days or less are defined as cash and cash equivalents.

(c) *Investments*

Investments are recorded at fair value. Fair value is determined by quoted market prices for the System's investments. Changes in fair value during the reporting period are reported as a net increase (decrease) in the fair value of investments.

(d) *Inventories*

Inventories are stated at the lower of cost or market with cost determined as follows:

- Books and other merchandise for resale – principally the retail inventory method
- Food – average cost method
- Other inventories – principally the first-in, first-out method

(e) *Capital Assets*

Capital assets are recorded at cost or, if donated, at fair value at the date of a gift. Depreciation of the capital assets is calculated on a straight-line basis over the estimated useful lives (see below) of the respective assets. The University's policy requires the capitalization of all land and collection purchases regardless of cost, equipment over \$5,000, software, easements, buildings and improvements over \$100,000, and infrastructure over \$1,000,000. The System does not capitalize collections of works of art or historical treasures held for public exhibition, education, or research in furtherance of public service rather than capital gain, unless they were previously capitalized as of June 30, 1999. Proceeds from the sale, exchange, or other disposal of any item belonging to a collection of works of art or historical treasures must be applied to the acquisition of additional items for the same collection.

	<u>Useful life (in years)</u>		<u>Useful life (in years)</u>
Buildings:		Improvements other than buildings:	
Shell	50	Site improvements	20
Service systems	25	Infrastructure	25
Fixed equipment	15	Moveable equipment:	
Remodeling	25	Equipment	3 – 15

(f) *Compensated Absences*

Accrued compensated absences for System personnel are charged to operations using the vested method based on earned but unused vacation and sick leave days including the System's share of Social Security and Medicare taxes.

<u>Changes in Compensated Absences Balance</u>	
Balance, beginning of year	\$ 6,470,188
Additions	531,422
Deductions	<u>(524,858)</u>
Balance, end of year	6,476,752
Less current portion	<u>602,244</u>
Balance, end of year – noncurrent portion	<u><u>\$ 5,874,508</u></u>

(g) *Premiums, Issuance Costs, and Deferred Loss on Refundings*

Premiums, issuance costs, and losses on refundings for the System's bonds are deferred and amortized over the life of the debt issue using the straight-line method.

(h) *Net Assets*

The System's resources are classified into net asset categories and reported in the Balance Sheet. These categories are defined as (a) Invested in capital assets, net of related debt – capital assets net of accumulated depreciation and related outstanding debt balances (b) Restricted expendable – net assets subject to externally imposed restrictions that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time and (c) Unrestricted – net assets not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board. The System first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

(i) *Classification of Revenues*

The Statement of Revenues, Expenses, and Changes in Net Assets classifies the System's fiscal year activity as operating and nonoperating. Operating revenues generally result from exchange transactions such as payments received for providing goods and services.

Certain revenue sources that the System relies on for operations including on-behalf payments for fringe benefits and investment income are defined by GASB Statement No. 35 as nonoperating. In

addition, certain transactions related to capital and financing activities are components of net nonoperating revenue.

Housing charges billed or received in advance are deferred and recognized as revenue during the period of occupancy. Student service fees for the summer academic term are deferred and recognized as revenue over the summer semester.

(j) *Classification of Expenses*

The majority of the System's expenses are exchange transactions which GASB defines as operating expenses for financial statement presentation. Nonoperating expenses include capital financing costs and costs related to investment activity.

(k) *On-behalf Payments for Fringe Benefits*

In accordance with GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the System reported payments made by the State of Illinois on behalf of the System for contributions to State group insurance and retirement programs including postemployment benefits for System employees and its retirees of \$26,900,395 for the year ended June 30, 2010. On-behalf payments are classified as nonoperating revenues and the corresponding expenses are reported in on-behalf payments for fringe benefits of the System as operating expenses.

(l) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(m) *New Accounting Pronouncements*

Effective for the year ended June 30, 2010, the System adopted GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which establishes accounting and financial reporting for intangible assets. This statement had no impact on the System's financial statements.

The System adopted the provisions of GASB 53, *Accounting and Financial Reporting for Derivative Instruments*, which was effective July 1, 2009. This statement required that the System measure its derivative instruments at fair value in its financial statements. Changes in fair value are recognized in the reporting period to which they relate. The changes in fair value of effective hedging derivative instruments do not affect investment revenue but are reported as deferrals. On the other hand, the changes in fair value of investment derivative instruments (which include ineffective hedging derivative instruments) are reported as part of investment revenue in the current reporting period. The System did not have any significant investment derivative instruments or hedging derivative instruments in fiscal year 2010.

(2) *Cash, Cash Equivalents and Investments*

The System has cash and certain investments which are pooled with other University funds for the purpose of securing a greater return on investment and providing an equitable distribution of investment return. Income is distributed based upon average quarterly balances invested in the investment pool.

Illinois Statutes govern the investment policies of the University. Allowable investments under these policies include:

- Obligations of the U.S. Treasury, other federal agencies, and instrumentalities
- Interest-bearing savings accounts and time deposits of any bank as identified by the Illinois Banking Act
- Corporate bonds, stocks, and equities
- Commercial paper
- Repurchase agreements
- Mutual funds

Nearly all of the University's investments are managed by external professional investment managers, who have full discretion to manage their portfolios subject to investment policy and manager guidelines established by the University, and in the case of mutual funds and other commingled vehicles, in accordance with the applicable prospectus.

The Board develops University policy on investments and delegates the execution of those policies to its administrative agents. The University follows the State of Illinois Uniform Prudent Management of Institutional Funds Act when investing its endowment funds. The State of Illinois Public Funds Investment Act provides the context and framework for other investments.

The following details the carrying value of the System's cash, cash equivalents, and investments as of June 30, 2010:

U.S. government securities	\$ 3,974,069
U.S. government treasuries	6,549,578
U.S. Treasury put	4,345,000
Mutual funds – money market	28,405,541
Commercial paper	<u>3,897,608</u>
Subtotal – subject to measurable risks	47,171,796
Claim on pooled investments of University	<u>104,888,862</u>
Total	<u><u>\$ 152,060,658</u></u>

These cash, cash equivalents, and Investments are classified in Balance Sheet as follows:

Claim on cash and pooled investments:	
Cash and cash equivalents	\$ 110,112,463
Cash and cash equivalents, restricted	24,581,240
Investments	3,002,689
Investments, restricted	<u>14,364,266</u>
Total	<u><u>\$ 152,060,658</u></u>

(a) **Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University employs multiple investment managers, of which each has specific maturity assignments related to the operating funds. The funds are structured with different layers of liquidity. Funds expected to be used within one year are invested in money market instruments. Core operating funds are invested in longer maturity investments. Core operating funds investment manager's performance benchmarks are Barclays one to three-year Government Credit Bond Index and the Barclays Capital Intermediate Aggregate Bond Index. The University's manager guidelines provide that the average weighted duration of the portfolio, including option positions, not vary from that of their respective performance benchmarks by more than +/-20%. The System's investments and maturities at June 30, 2010 are illustrated as follows:

	Maturities (in years)				Total
	Less than 1	1 – 5	6 – 10	Greater than 10	
Mutual funds – money markets	\$ 28,405,541				28,405,541
Commercial paper	1,399,300				1,399,300
Total cash equivalents	29,804,841				29,804,841
U.S. Treasury put				4,345,000	4,345,000
U.S. Treasuries		6,549,578			6,549,578
U.S. government securities	504,381	3,469,688			3,974,069
Commercial paper	2,498,308				2,498,308
Total investments	3,002,689	10,019,266		4,345,000	17,366,955
Total cash equivalents and investments	\$ 32,807,530	10,019,266		4,345,000	47,171,796

(b) **Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's investment policy requires that operating funds be invested in fixed income securities and money market instruments. Fixed income securities shall be rated investment grade or better by one or more nationally recognized statistical rating organizations. Securities not covered by the investment grade standard are allowed if, in the manager's judgment, those instruments are of comparable credit quality. Securities which fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager's discretion. It is expected that the average credit quality of the operating funds will not fall below Standard & Poor's AA- or equivalent. At June 30, 2010, all of the System's investments carried a AAA quality rating except for the U.S. Treasury Put, which is not rated.

(c) **Custodial Credit Risk**

Custodial credit risk is the risk that in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Exposure to custodial credit risk relates to investment securities that are held by someone other than the University and are not registered in the University's name. The University's

investment policy does not limit the value of investments that may be held by an outside party. At June 30, 2010, the System's investments and deposits have no custodial credit risk exposure.

(d) *Concentration of Credit Risk*

Concentration of credit risk is the risk of loss attributed to the magnitude of the University's investment in a single issuer. The University's policy provides that the total operating funds portfolio will be broadly diversified across securities in a manner that is consistent with fiduciary standards of diversification. This diversification is achieved by employing multiple investment managers and imposing maximum position limits for each manager. The University's manager guidelines for operating investments provide that non-U.S. government obligations (other national governments) may not exceed 10% per issuer and private mortgage-backed and asset-backed securities may not exceed 10% per issuer (unless collateral is credit independent of the issuer and the security's credit enhancement is generated internally, in which case the limit is 25% per issuer). Obligations with other issuers, other than the U.S. government, U.S. agencies, or U.S. government sponsored corporations and agencies, may not exceed 5%. As of June 30, 2010, not more than 5% of the University's total investments were invested in securities of any one issuer, excluding securities issued or guaranteed by the U.S. government, mutual funds, and external investment pools or other pooled investments.

(e) *Foreign Currency Risk*

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The University does not have an overarching policy related to foreign currency risk; however, under the investment manager's guidelines, the portfolio's foreign currency exposure may be unhedged or hedged back into U.S. dollars. Cross hedging is not permitted. The University's operating fund investments generally are not exposed to foreign currency risk.

(f) *Securities Lending*

To enhance the return on investments, the Board has authorized participation in a securities lending program. Through its custodian bank, Northern Trust, the University loans securities to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. government securities and irrevocable bank letters of credit in an amount not less than 102% of the fair value of the securities loaned. Noncash collateral cannot be pledged or sold by the University unless the borrower defaults. Cash collateral is invested by Northern Trust in a short-term investment pool. As of June 30, 2010, the short-term investment pool has a weighted average maturity of 115 days. The University receives interest and dividends during the loan period as well as a fee from the custodian. Marking to market is performed every business day and the borrower is required to deliver additional collateral when necessary so that the total collateral held by the custodian will equal at least the fair value plus accrued interest of the borrowed securities. All security loans can be terminated on demand by either the University or the borrowers. The University's pro rata share of cash received as securities lending collateral was approximately \$82,720,000 at June 30, 2010, and is recorded as an asset and corresponding liability on the University's Balance Sheet. As of June 30, 2010, approximately \$80,747,000 of the investments reported on the University's Balance Sheet was on loan, secured by collateral with a fair value of approximately \$82,871,000. At June 30, 2010, the University has no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University. The System does not directly participate in this securities lending program, and hence, no amounts have been recorded in the accompanying financial statements related to securities lending transactions.

(3) Capital Assets

Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Net interest of \$4,123,765 was capitalized during the year ended June 30, 2010.

Capital asset activity for the year ended June 30, 2010 is summarized as follows:

Capital assets for the System					
	Beginning balance	Additions	Retirements	Transfers	Ending balance
Nondepreciable capital assets:					
Land	\$ 19,238,069				19,238,069
Construction in progress	74,752,578	32,409,535		(93,530,460)	13,631,653
Total nondepreciable capital assets	93,990,647	32,409,535		(93,530,460)	32,869,722
Depreciable capital assets:					
Buildings	1,066,924,310			93,211,158	1,160,135,468
Improvements	49,249,976			319,302	49,569,278
Equipment	13,318,641	1,378,481	701,611		13,995,511
Total depreciable capital assets	1,129,492,927	1,378,481	701,611	93,530,460	1,223,700,257
Less accumulated depreciation:					
Buildings	245,812,692	26,254,867			272,067,559
Improvements	28,492,614	1,418,354			29,910,968
Equipment	8,107,398	999,977	537,556		8,569,819
Total accumulated depreciation	282,412,704	28,673,198	537,556		310,548,346
Total net depreciable capital assets	847,080,223	(27,294,717)	164,055	93,530,460	913,151,911
Total	\$ 941,070,870	5,114,818	164,055		946,021,633

(4) Bonds Payable

Bonds payable activity for the year ended June 30, 2010 was as follows:

Bonds payable							
Series	Rate on June 30 outstanding debt	Fiscal year maturity dates	Beginning balance	Additions	Deductions	Ending balance	Current portion
1979	—	2010	\$ 660,000		660,000	—	—
1991	7.30% – 7.35%	2010 – 2021	195,240,000		16,270,000	178,970,000	16,270,000
1996	5.20%	2010 – 2011	435,000		210,000	225,000	225,000
1999A	—	2010	1,910,000		1,910,000	—	—
1999A	6.05% – 6.33%	2015 – 2030	39,820,000			39,820,000	—
1999B	7.56%	2010 – 2015	4,410,000		715,000	3,695,000	875,000
2000	—	2010	180,000		180,000	—	—
2001A	5.00% – 5.50%	2010 – 2030	99,675,000		1,345,000	98,330,000	1,410,000
2001B	4.50% – 5.50%	2010 – 2032	38,075,000		555,000	37,520,000	585,000
2001C	6.35% – 7.00%	2010 – 2021	12,740,000		1,085,000	11,655,000	1,220,000
2003A	3.25% – 5.50%	2010 – 2034	60,580,000		1,270,000	59,310,000	1,335,000
2005A	4.625% – 5.50%	2010 – 2031	154,955,000		3,710,000	151,245,000	5,650,000
2006	4.00% – 5.00%	2010 – 2036	315,160,000		1,565,000	313,595,000	2,295,000
2008	variable	2010 – 2038	20,485,000		365,000	20,120,000	20,120,000
2009A	3.00% – 5.75%	2010 – 2038	84,100,000		665,000	83,435,000	720,000
			1,028,425,000		30,505,000	997,920,000	50,705,000
Unaccreted appreciation			(88,954,471)	10,390,180		(78,564,291)	(849,359)
			939,470,529	10,390,180	30,505,000	919,355,709	49,855,641
Unamortized debt premium			34,289,887		1,338,802	32,951,085	1,337,101
Unamortized deferred loss on refunding			(12,936,575)		(755,949)	(12,180,626)	(755,949)
Total bonds payable			\$ 960,823,841	10,390,180	31,087,853	940,126,168	50,436,793

Capital appreciation bonds (Series 1991 and 1999A) of \$218,790,000 outstanding at June 30, 2010 do not require current interest payments and have a net unappreciated value of \$140,226,000. The University records the annual increase in the principal amount of these bonds as interest expense and accretion on bonds payable.

Costs associated with the issuance of the Series 1991, 1996, 1999A, 1999B, 2001A, 2001B, 2001C, 2003A, 2005A, 2006, 2008, and 2009A Bonds have been recorded as a prepaid expense and are being amortized over the life of the related bond issue.

Certain bonds of the System (Series 1991 and Series 1996 Bonds) have debt service reserve requirements. The Maximum Annual Net Debt Service for those bonds, as defined, is \$15,138,394.

None of the System's bonds constitute obligations of the State of Illinois, but are payable solely by the Board from net revenues of the System, student tuition and fees, and Retirement of Indebtedness funds.

The resolutions authorizing the University of Illinois Auxiliary Facilities System Revenue Bonds provide for the establishment of separate funds as follows: Current Unrestricted Fund, Unexpended Fund, Repair and Replacement Reserve, Equipment Reserve, Bond and Interest Sinking Fund, Debt Service Reserve, and Development Reserve. All System revenues, including student tuition and fees as provided for by the

Bond Resolutions are to be deposited in the Current Unrestricted Fund and used to pay necessary operation and maintenance expenses of the System. The Bond Resolutions also require transfers to funds as follows:

Unexpended Fund – amounts, as determined by the Board, not needed to complete construction and renovation projects specified in the Bond Resolutions are required to be transferred from the Unexpended Fund to the Bond and Interest Sinking Fund.

Repair and Replacement Reserve – an amount calculated as specified in the Bond Resolutions to provide for the cost of unusual maintenance and repairs.

Equipment Reserve – an amount approved by the Board for the acquisition of movable equipment to be installed in the facilities constituting the System. The reserve may not exceed 20% of the book value of the movable equipment of the System. Additions of \$1,703,935 were made to the Equipment Reserve during the year ended June 30, 2010. Expenditures of \$196,719 were made to replace movable equipment during the year ended June 30, 2010. The fund balance of the Equipment Reserve was \$3,951,072 at June 30, 2010.

Bond and Interest Sinking Fund and Debt Service Reserve – amounts are transferred into the Bond and Interest Sinking Fund sufficient to pay principal and interest as it becomes due on the outstanding bonds and amounts fund a Debt Service Reserve at least equal to the Maximum Annual Net Debt Service, as defined. At June 30, 2010 the Debt Service Reserve was funded in excess of the Maximum Annual Net Debt Service. If at any time the Debt Service Reserve is less than the Maximum Annual Net Debt Service, the System is required to restore the Debt Service Reserve to the Maximum Annual Net Debt Service by the end of the next fiscal year.

Development Reserve – an amount approved by the Board for System development. No transfers were authorized by the Board during the year ended June 30, 2010, and there was no balance in the reserve at June 30, 2010.

The System made all required transfers for the year ended June 30, 2010.

The table below shows the amount of revenues pledged for future principal and interest payments on the bonds:

Pledged revenues					Debt service to pledged revenues (current year)
Bond issue(s)	Purpose	Source of revenue pledged	Future revenues pledged¹	Term of commitment	(current year)
Auxiliary facilities system (AFS)	Refundings, various improvements and additions to the System	Net AFS revenue, student tuition and fees	\$ 1,599,405	2038	8.24%

¹ Total future principal and interest payments on debt (in thousands)

After fulfillment of the provisions described above, the surplus, if any, remaining in the Current Unrestricted Fund may be used (a) to redeem bonds of the System which are subject to early redemption, (b) to purchase any outstanding bonds for cancellation, or (c) to advance refund any bonds outstanding.

(a) **Advance Refunded Bonds**

The System has defeased bonds through advance refunding in prior years, and accordingly, they are not reflected in the accompanying financial statements. The amount of bonds that have been advance refunded as of June 30, 2010 is as follows:

Advance refunded bonds	
	Outstanding at June 30, 2010
Series 2001B	\$ <u>55,315,000</u>
Total advance refunded bonds	\$ <u><u>55,315,000</u></u>

(b) **Debt Service Requirements**

Future debt service requirements for all bonds outstanding at June 30, 2010 are as follows:

Debt service requirements		
	<u>Principal</u>	<u>Interest</u>
Year(s):		
2011	\$ 50,705,000	39,073,349
2012	31,715,000	38,338,304
2013	32,895,000	37,562,857
2014	34,200,000	36,710,879
2015	35,555,000	35,780,473
2016 – 2020	197,825,000	163,777,791
2021 – 2025	195,345,000	129,963,031
2026 – 2030	214,540,000	85,022,619
2031 – 2035	180,015,000	33,880,644
2036 – 2038	25,125,000	1,374,762
Total debt service	997,920,000	\$ <u><u>601,484,709</u></u>
Unaccreted appreciation	(78,564,291)	
Unamortized debt premium	32,951,085	
Unamortized deferred loss on refunding	(12,180,626)	
Total bonds payable	\$ <u><u>940,126,168</u></u>	

(c) **Auxiliary Facilities System Variable Rate Debt**

The System's variable rate bonds mature serially through April 2038 and have variable interest rates that are adjusted periodically (i.e. daily, weekly, or monthly), generally with interest paid at the beginning of each month. The bonds are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days notice and delivery to the System's remarketing agents. The System pays the remarketing agent fees on the outstanding bond balance. If the remarketing agent is unable to resell any bonds that are "put" to the agent, the System has a standby bond purchase agreement with a liquidity facility entity.

The System, in the event a liquidity facility is utilized, has a reimbursement agreement with different financial entities. Generally, the payback period is five to seven years, at an interest rate initially set

at slightly above prime or the federal funds rate. The required future interest payments for these variable rate bonds have been calculated using the current interest rate, based upon short term tax exempt rates, or the synthetic fixed rate, as illustrated in the table below:

Variable rate bonds at June 30, 2010							
Bond issue	Interest rate at June 30, 2010	Remarketing agent	Remarketing fee	Liquidity facility			
				Bank	Expiration	Insurer	Fee
AFS, Series 2008	0.22%	Loop Capital	0.075%	JPMorgan Chase	6/18/2011	None	0.30%

As mentioned above, the AFS Series 2008 is supported by a liquidity facility provided by JPMorgan Chase. Since this facility will expire in June of 2011, the University is currently in the process of obtaining a replacement liquidity facility. Due to the expiration date of the current liquidity facility, the outstanding balance is reported within the current portion of bonds payable at June 30, 2010.

(5) Leaseholds Payable

Leaseholds payable activity for the year ended June 30, 2010 consisted of the following:

Leaseholds payable				
Beginning balance	Additions	Deductions	Ending balance	Current portion
\$ 107,781	—	47,277	60,504	44,834

Capital lease obligations have maturity dates from 2011 through 2012 and have interest rates ranging from 4.3% to 5.0%. As of June 30, 2010, future minimum lease payments are as follows:

	Principal	Interest
2011	\$ 44,834	1,875
2012	15,670	311
Total minimum payments	\$ 60,504	2,186

(6) Related Party Transactions

The University charged the System administrative service charges totaling \$14,377,333 in 2010, based upon the gross expenditures and debt service transfers of various operations of the System. These charges represent a portion of estimated administrative and other service costs incurred by the University in support of the System and are recorded as administrative services expense in the accompanying financial statements.

The System includes certain athletic facilities and office space utilized by the Division of Intercollegiate Athletics. Student fees provide the primary funding for the operation of these athletic facilities and office space. The Division of Intercollegiate Athletics transferred funds to the System of \$11,091,227 in 2010, to fund the operations not covered by student fees. This transfer has been recorded as rental and lease income on the statement of revenue, expenses, and changes in net assets.

At June 30, 2010, the System had borrowings of \$15,197,204 under multiple internal financing notes with the University for construction of System facilities. The notes have varying repayment terms and interest rates of 4.5% to 5.4%.

Notes payable to the University						
	<u>Maturity date</u>	<u>Beginning balance</u>	<u>New debt</u>	<u>Principal paid/debt refunded</u>	<u>Ending balance</u>	<u>Current portion</u>
Payable to the University	2011 – 2018	\$ 15,524,239	4,685,266	5,012,301	15,197,204	3,431,500

Future debt service requirements for the outstanding notes payable as of June 30, 2010 are as follows:

Notes payable to the University debt service requirements		
	<u>Principal</u>	<u>Interest</u>
Year(s):		
2011	\$ 3,431,500	529,139
2012	3,148,410	409,156
2013	3,110,109	299,278
2014	2,289,177	190,751
2015	1,852,962	110,967
2016 – 2018	1,365,046	48,198
Total	\$ <u>15,197,204</u>	<u>1,587,489</u>

(7) Retirement and Postemployment Benefits

(a) Retirement Benefits

Substantially all employees of the System participate in the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined benefit pension plan. The University contributes to the plan with a special funding situation whereby the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. The University contributions include payments for System employees covered under the plan.

SURS was established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of the State universities, certain affiliated organizations, and certain other State educational and scientific agencies and for survivors, dependents, and other beneficiaries of such employees. SURS is considered a component unit of the State of Illinois' financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Section 5/15, Chapter 40, of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by accessing the website at www.surs.org, or by calling 1-800-275-7877.

Eligible employees must participate upon initial employment. Employees are ineligible to participate if (a) employed after having attained age 68; (b) employed less than 50% of full-time; or (c) employed less than fulltime and attending classes with an employer. Of those University employees ineligible to participate, the majority are students at the University.

Plan members are required to contribute 8.0% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 21.27% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The University's contributions to SURS for the years ended June 30, 2010, 2009 and 2008, were \$319,047,000, \$219,441,000, and \$174,318,000, respectively, equal to the required contributions for each year. The calculated allocation of these contributions that relate to the System was \$12,453,096 for the year ended June 30, 2010, and is reflected within the accompanying financial statements as on-behalf payments for fringe benefits expense.

(b) *Postemployment Benefits*

The State Employees Group Insurance Act of 1971 (Act), as amended, authorizes the State to provide health, dental, vision, and life insurance benefits for certain retirees and their dependents. Substantially all State and University component unit employees become eligible for these other postemployment benefits (OPEB) if they eventually become annuitants of one of the State sponsored pension plans. The Department of Healthcare and Family Services and the Department of Central Management Services administer these benefits for annuitants with the assistance of the State's sponsored pension plans. The portions of the Act related to OPEB established a cost-sharing multiple-employer defined benefit OPEB plan (plan) with a special funding situation in which the State funds substantially all nonparticipant contributions. The plan does not issue a stand-alone financial report but is included as a part of the State's financial statements. A copy of the financial statements of the State can be obtained at www.ioc.state.il.us.

The health, dental, and vision benefits provided to and contribution amounts required from annuitants are the result of collective bargaining agreements between the State and various unions. These unions represent the State's and the University's employees in accordance with limitations established in the Act. Therefore, the benefits provided and contribution amounts are subject to periodic change. The Act requires the State to provide life insurance benefits for annuitants equal to their annual salary as of the last day of employment until age 60, at which time the benefit amount becomes \$5,000. The State makes substantially all of the contributions for OPEB on-behalf of the State universities. Because the State contributes substantially all of the employer contributions, the single-employer provisions of GASB Statement No. 45 have been followed for reporting the plan. The State is not required to and does not fund the plan other than the pay-as-you-go amount necessary to provide the current benefits.

Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State or a university, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in one of the State's sponsored pension plans do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with 20 or more years of credited service to not have to contribute towards health, dental, and vision benefits. For fiscal year 2010, the annual cost of health, dental, and vision benefits before the State's contribution was \$6,744 (\$3,528 if Medicare eligible) if the annuitant chose benefits provided by a health maintenance organization (HMO) and \$9,684 (\$3,750 if Medicare eligible) if the annuitant chose other benefits. Additional contributions by annuitants for dependents ranging from \$1,056 to \$2,814 (\$996 to \$2,538 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

For current employees, contributions are dependent upon annual salary and whether or not the employee chooses to receive benefits through an HMO. Current employee contribution amounts to the plan for fiscal year 2010 are shown as follows:

Annual employee health, dental, and vision contribution requirements		
Employee annual salary	Benefits provided through	
	HMO	Others
\$29,500 and below	\$ 696	996
\$29,501 – \$44,600	756	1,056
\$44,601 – \$59,300	786	1,086
\$59,301 – \$74,300	816	1,116
\$74,301 and above	846	1,146

Additional contributions by employees for dependents ranging from \$984 to \$2,712 (\$924 to \$2,436 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

(8) Construction and Commitments

At June 30, 2010, the System had commitments on various construction projects and contracts for repairs and renovation of auxiliary facilities of \$46,765,407. These projects will be funded from the proceeds of the Series 2006, 2008, and 2009A Bonds Unexpended Fund and the Repair and Replacement Reserve.

(9) Subsequent Event

On July 21, 2010, the University issued Auxiliary Facilities System Revenue Bonds, Series 2010A, in the amount of \$56,675,000. The proceeds from the Series 2010A Bonds will be used to (i) pay a part of the costs of various improvements and additions to the System, (ii) pay capitalized interest on the Series 2010A Bonds and (iii) pay costs of issuing the Series 2010A Bonds.