UNIVERSITY OF ILLINOIS

Annual Financial Report

June 30, 2012

(With Independent Auditors' Report Thereon)

UNIVERSITY OF ILLINOIS

Annual Financial Report

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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 17, 2012

The information in this Annual Financial Report of the University of Illinois for the fiscal year ended June 30, 2012, documents that the financial position of the University remains sound.

The ongoing economic challenges impacting our state and nation continued to demand the best from administrators and business staff across the University. They made wise management and budgetary decisions with the goal of ensuring the financial integrity of University programs and initiatives through efficient and effective utilization of resources.

The University of Illinois' tradition of excellence in teaching, research, public service, health care and economic development has made it a distinguished leader in higher education. Our efforts focus on continuing that tradition, while increasing the stature of the University of Illinois and the return on investment it provides to the state and the nation.

Respectfully submitted,

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

KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

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 of the State of Illinois, we have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units (University Related Organizations) of the University of Illinois, a component unit of the State of Illinois, as of and for the year ended June 30, 2012, which collectively comprise the University of Illinois' financial statements. These financial statements are the responsibility of the University of Illinois' management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the discretely presented component units. The financial statements of the discretely presented component units were audited by other auditors whose reports thereon have been provided to us, and our opinion, insofar as it relates to the amounts included for the aggregate discretely presented component units, is based solely on the reports of the other auditors. The 2011 comparative information has been derived from the University of Illinois' 2011 financial statements and in our report dated December 16, 2011 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. The financial statements of The University of Illinois Alumni Association, Wolcott, Wood, and Taylor, Inc., Prairieland Energy, Inc., Illinois Ventures, LLC, The University of Illinois Research Park, LLC, and UI Singapore Research, LLC (all discretely presented component units) were not audited in accordance with *Government Auditing Standards*. 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 University of Illinois' 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 and the reports of other auditors provide a reasonable basis for our opinions.

As discussed in note (1) (r) to the financial statements, the University of Illinois adopted the provisions of Governmental Accounting Standards Board Statement No. 64, *Derivative Instruments:Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53*, as of July 1, 2011.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of the University of Illinois as of June 30, 2012, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2012 on our consideration of the University of Illinois' 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.

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4 through 12 be presented 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 audit 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.

KPMG LLP

Chicago, Illinois
December 17, 2012

Introduction and Background

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activities of the University of Illinois (University) for the year ended June 30, 2012. The MD&A should be read in conjunction with the audited financial statements and notes appearing in this report.

The University was founded in 1867 in response to the federal Land Grant Act of 1862. The University's evolution over 145 years as a land-grant institution has produced a set of core values that underlie all aspects of its present and future programs. The University is a comprehensive public university, a family of three distinct campuses – Urbana-Champaign, Chicago and Springfield serving the people of Illinois through a shared commitment to the University's missions of excellence in teaching, research, public service and economic development.

The University's campuses currently enroll approximately 78,000 students. The University has internationally renowned faculty that are known for being world leaders in research and currently employs approximately 5,600 faculty members on its three campuses. The University offers a diverse range of degree programs from baccalaureate to doctoral levels. Approximately 19,000 degrees are awarded annually. The operating budget for fiscal year 2012, from all fund sources, was approximately $5 billion. University faculty, staff and students share their knowledge and expertise and the resources of the University with citizens in every corner of Illinois through more than 700 public service and outreach programs.

Using the Financial Statements

The University's financial report includes three financial statements: the Balance Sheet; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. The 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 and require that financial statements focus on the University as a whole.

The financial statements encompass the University and its discretely presented component units: University of Illinois Foundation; University of Illinois Alumni Association; Wolcott, Wood and Taylor, Inc.; Illinois Ventures, LLC; University of Illinois Research Park, LLC; Prairieland Energy, Inc.; and UI Singapore Research, LLC. This MD&A focuses on the University, excluding the discretely presented component units. Condensed financial information is disclosed separately for each of the discretely presented component units in note 16 to the financial statements.

Financial Highlights and Key Trends

The fiscal year 2012 state appropriations (excluding capital) were $693 million, down from $700 million in fiscal year 2011. In addition to this appropriation, and consistent with the prior year, the four scientific surveys included within the University were separately appropriated by the state in the amount of $16 million. The overall budget utilized by the University increased by 5%, even though direct funding from the State of Illinois declined. This trend demonstrates the University's ability to rely on other diverse sources of funding to provide services to University students and support the University mission.

Net assets, which represent the residual interest in the University's assets after liabilities, increased during the current year by $462 million.

Balance Sheet

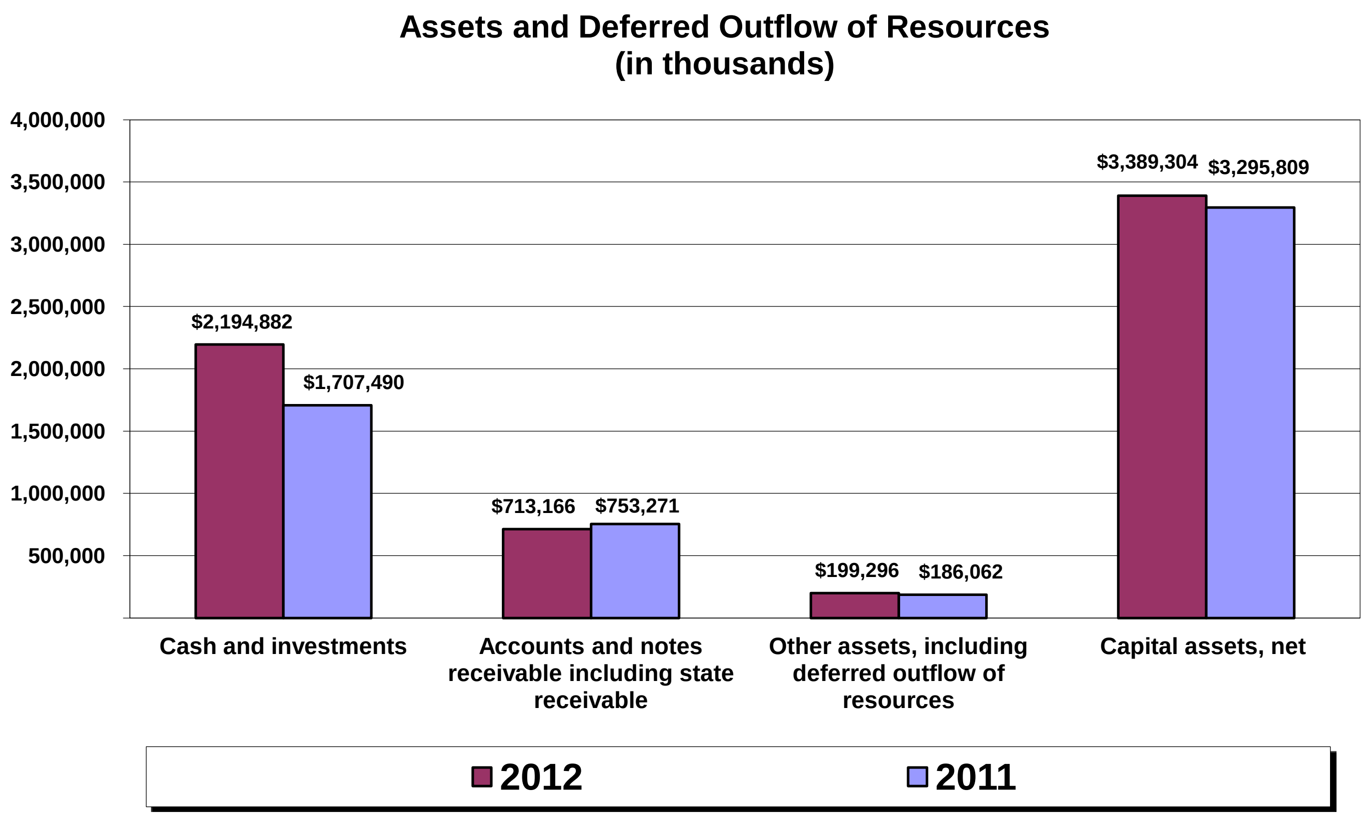
The Balance Sheet presents the financial position of the University at the end of the fiscal year and includes all assets, deferred outflow of resources, and liabilities of the University using the accrual basis of accounting. The difference between total assets and deferred outflows of resources and total liabilities, net assets, is one indicator of the current financial condition of the University. The changes in net assets that occur over time indicate improvement or deterioration in the University's financial condition. Generally, assets and liabilities are reported at cost with the exception of investments and permanently endowed real estate and farms, which are reported at fair value. Capital assets are reported at historical cost less accumulated depreciation. Deferred outflow of resources represents the change in fair value of the swap agreements associated with the related bonds and certficates of participation. A summarized comparison of the University's assets, deferred outflow of resources, liabilities and net assets at June 30, 2012 and 2011 is as follows:

		2012	2011
		(In thousands)	
Current assets:			
Cash and investments	$	916,543	888,911
Accounts and notes receivable		454,659	411,866
Receivable from State of Illinois, related to appropriation		204,972	288,669
Other current assets		152,120	150,944
Noncurrent assets:			
Cash and investments		1,278,339	818,579
Notes receivable		53,535	52,736
Capital assets, net of accumulated depreciation		3,389,304	3,295,809
Other assets		14,148	15,542
Deferred outflow of resources		33,028	19,576
Total assets and deferred outflow of resources	$	6,496,648	5,942,632
Current liabilities:			
Accounts payable, accrued liabilities and deferred revenue	$	576,185	517,035
Bonds payable		41,066	37,683
Leaseholds payable and other obligations		145,836	28,430
Accrued self-insurance		60,933	60,388
Other current liabilities		173,399	167,736
Noncurrent liabilities:			
Bonds payable		1,093,724	1,058,324
Leaseholds payable and other obligations		353,916	496,353
Accrued self-insurance		184,777	184,106
Accrued compensated absences		178,434	180,198
Derivative instruments – swap liability		37,169	22,919
Total liabilities		2,845,439	2,753,172
Net assets		3,651,209	3,189,460
Total liabilities and net assets	$	6,496,648	5,942,632

Total assets and deferred outflow of resources increased by $554 million or 9.3% to $6.5 billion during fiscal year 2012. The main drivers of this change were increases in cash and investments associated with tuition revenues invested for future use and an increase in capital assets, partially offset by a reduction in the receivable from the State of Illinois related to appropriated funds.

Total liabilities increased $92 million, or 3.3% for fiscal year 2012. This change largely resulted from an increase of $59 million in accounts payable, accrued liabilities, and deferred revenues, along with increases of $14 million in long-term debt and $14 million related to interest rate swap agreements. In fiscal year 2012, a liquidity facility agreement related to variable-rate certificates of participation was set to expire in fiscal year 2013, resulting in the related certificates of participation classified as current liabilities.

The following graphs illustrate the University's assets, deferred outflows of resources, and liabilities with the current and noncurrent categories combined:



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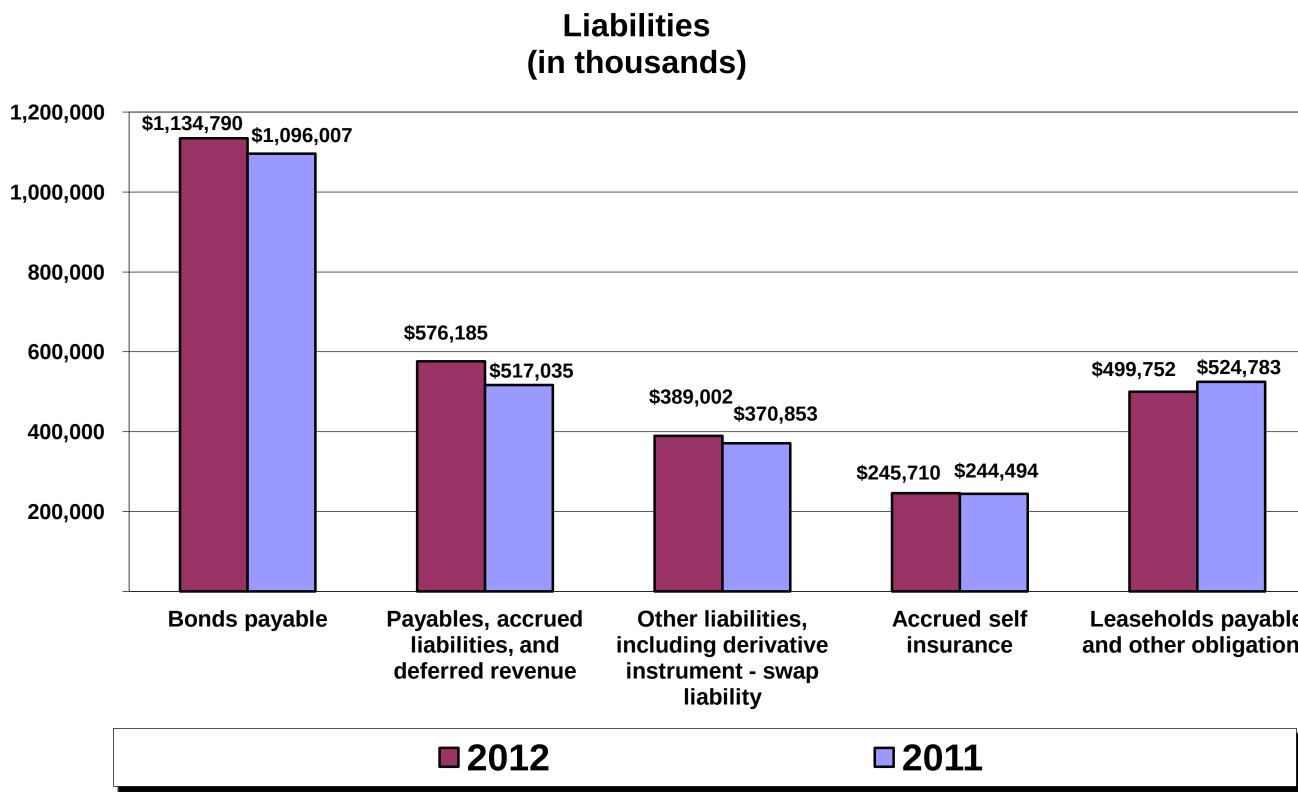


Capital Assets

The University's policy requires the capitalization of equipment at $5,000, software and other intangibles at $100,000, buildings and improvements at $100,000, infrastructure at $1,000,000 and all land and collection purchases regardless of cost. The University depreciates its capital assets on a straight-line basis, using estimated useful lives ranging from three to fifty years. The following table illustrates the composition of the University's capital assets, net of accumulated depreciation, by category:

Capital Assets, Net of Accumulated Depreciation
(In thousands)

	2012		2011	
Buildings	$ 2,353,319	69.4%	$ 2,294,089	69.6%
Improvements and infrastructure	328,780	9.7	349,177	10.6
Construction in progress	168,383	5.0	122,123	3.7
Land	134,707	4.0	133,273	4.0
Equipment and software	260,401	7.7	259,377	7.9
Collections	143,714	4.2	137,770	4.2
	$ 3,389,304	100.0%	$ 3,295,809	100.0%

Capital assets, net of accumulated depreciation, increased by $93 million in fiscal year 2012. This increase was largely due to current year building additions and construction in progress, partially offset by current year

(Continued)

depreciation. Facilities under construction included projects funded by revenue bonds, certificates of participation, federal grants, private gifts, internal funds and state capital appropriations. Significant capital asset additions during the year included $50.9 million funded by federal grants for equipment under development in the Petascale Computing Facility and $20.9 million funded by State capital appropriations for Lincoln Hall renovations on the Urbana campus.

Long – Term Debt

The University has historically utilized revenue bonds to finance capital projects related to the Auxiliary Facilities System (AFS), the Health Services Facilities System and the UIC South Campus project. These activities have the ability to generate resources from student fees, users and third parties to service the debt. In fiscal year 2012, the University issued AFS Revenue Bonds of $165 million to fund the costs of various improvements and additions to AFS along with refunding previously issued bonds. The following table details the various bonded debt outstanding at June 30, 2012 and 2011:

Bonds Payable
(In thousands)

		2012	2011
Auxiliary Facilities System	$	1,025,068	977,742
Health Services Facilities System		53,507	58,431
UIC South Campus		56,215	59,834
	$	1,134,790	1,096,007

The University has issued certificates of participation (COPs), which are reported as leaseholds payable on the financial statements. The COPs have funded projects such as UI Integrate, utility infrastructure, College of Medicine facilities, Petascale Computing Facility and deferred maintenance on medical, academic and research facilities. The reduction in the outstanding balance of the COPs was due to scheduled redemptions. The outstanding balances of the COPs as of June 30, 2012 and 2011 were $444,129,000 and $464,274,000 respectively.

Net Assets

The University's resources are classified into net asset categories on 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 nonexpendable – net assets restricted by externally imposed stipulations, (c) Restricted expendable – net assets subject to externally imposed restrictions that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time and (d) Unrestricted – net assets not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board of Trustees. The University's net assets increased by $462 million during fiscal year 2012. Net assets balances are detailed below:

Net Assets
(In thousands)

		2012	2011
Net assets:			
Invested in capital assets, net of related debt	$	1,932,473	1,865,699
Restricted		677,838	636,520
Unrestricted		1,040,898	687,241
	$	3,651,209	3,189,460

The growth in unrestricted net assets was $354 million. This resulted from increased tuition revenue, various expenditure constraints and increases related to self-supporting activities, such as the auxiliary operations. The largest components of the $41 million increase in restricted net assets included increases in unexpended private gifts and increases in net assets related to the medical service plans. The amount of net assets invested in capital assets, net of related debt, increased by $67 million, which included changes in capital assets and long-term debt as discussed in preceding sections of this MD&A.

Statement of Revenues, Expenses and Changes in Net Assets

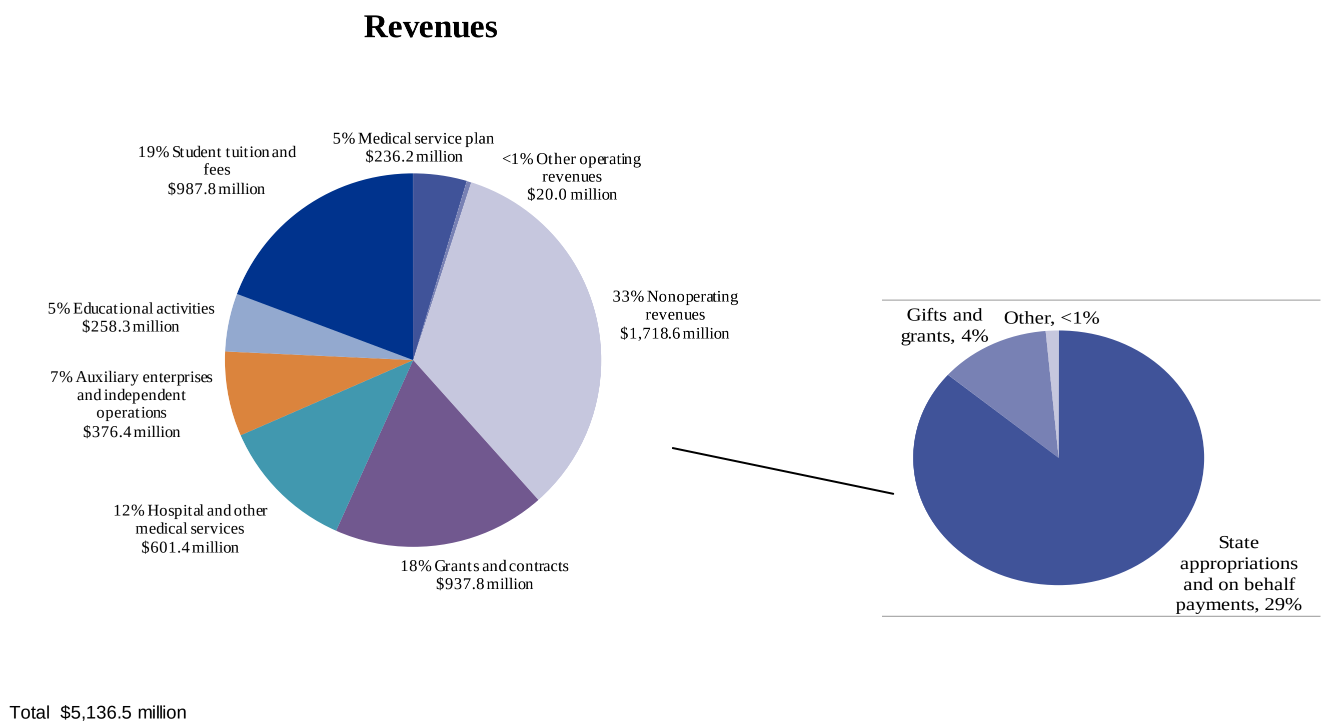
The Statement of Revenues, Expenses and Changes in Net Assets presents the University's results of operations. In accordance with GASB reporting standards, revenues and expenses are classified as either operating or nonoperating. A summarized comparison of the University's Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30, 2012 and 2011 is as follows:

	2012	2011
	(In thousands)	
Operating revenues:		
Student tuition and fees	$ 987,796	905,693
Grants and contracts	937,811	915,156
Hospital and other medical activities	601,360	547,168
Auxiliary enterprises and independent operations	376,402	389,817
Educational activities	258,298	267,609
Medical service plan	236,160	223,654
Other	20,017	15,456
Total operating revenues	3,417,844	3,264,553
Operating expenses	4,744,967	4,465,371
Operating loss	(1,327,123)	(1,200,818)
Nonoperating revenues (expenses):		
State appropriations and on behalf payments	1,527,767	1,399,995
Transfer of state appropriation to the Hospital Services Fund	(45,000)	(45,000)
Private gifts	141,700	133,498
Federal grants, nonoperating	69,529	67,404
Investment income	24,656	26,066
Net increase in the fair value of investments	10,979	68,810
Other nonoperating expenses, net	(30,421)	(77,984)
Net nonoperating revenues	1,699,210	1,572,789
Capital state appropriations and capital gifts and grants	87,293	31,019
Endowment gifts	323	924
Increase in net assets	459,703	403,914
Net assets, beginning of year	3,189,460	2,785,546
Change in accounting principles	2,046	
Net assets, end of year	$ 3,651,209	3,189,460

Revenues

The University's revenues are generated from multiple sources, which supplement what is received from state appropriations and student tuition and fees. GASB reporting standards require revenues to be categorized as operating or nonoperating. Operating revenues are derived from activities associated with providing goods and services by the University and generally result from exchange transactions where each of the parties to the transaction either give up or receive something of equal or similar value. The University also relies on revenue, such as state appropriations, gifts, certain federal grants and investment income to support operations, which GASB reporting standards define as nonoperating.

The following graph illustrates the revenues by source (both operating and certain nonoperating), which were used to fund the University's operating activities for the year ended June 30, 2012:



Operating and nonoperating revenues experienced a net increase of $285 million in fiscal year 2012. This increase included several significant components. Revenues from payments made by the State on behalf of the University to Central Management Services (CMS) and the State Universities Retirement System (SURS), classified as nonoperating, for fiscal year 2012 were $818.1 million compared to $683.2 million in fiscal year 2011, representing an increase of $134.9 million. This increase was caused by growth in state funding for employer required contributions to SURS and CMS. Tuition and fee revenue increased by $82.1 million during fiscal year 2012 primarily due to a tuition increase approved by the Board of Trustees. Hospital and other medical activities revenues increased by $54.2 million largely due to patient growth and rate increases along with reimbursements for services provided in prior fiscal years. Medical service plan revenues increased by $12.5 million largely due to revenues generated from external contracts, e-health records incentives, and other clinical charges.

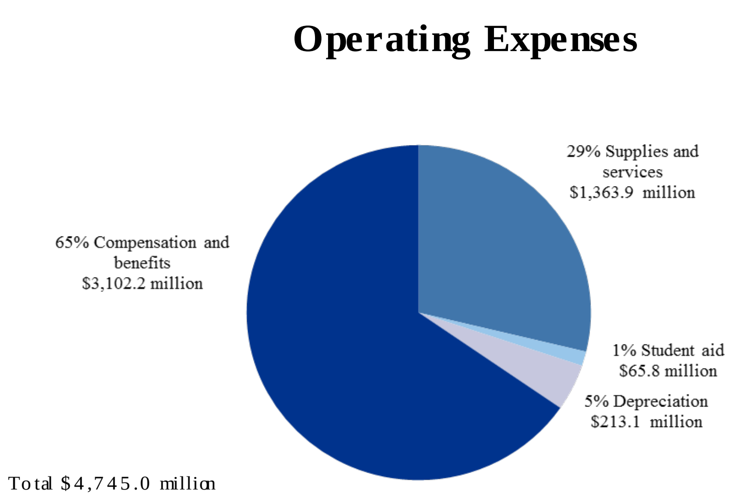
Expenses

The majority of the University's expenses are exchange transactions, which GASB standards define as operating expenses. Nonoperating expenses include capital financing and other costs related to capital assets.

		2012			2011	
		(In thousands)				
Operating expenses:						
Instruction	$	1,114,474	23.5%	$	1,006,190	22.5%
Research		710,656	15.0		680,651	15.2
Public service		413,988	8.7		387,461	8.7
Support services		751,135	15.8		690,674	15.5
Hospital and medical activities		709,650	15.0		633,795	14.2
Auxiliary enterprises and independent operations		320,039	6.7		330,308	7.4
Scholarships and fellowships		241,008	5.1		238,722	5.3
Operation and maintenance of plant		270,947	5.7		287,825	6.5
Depreciation		213,070	4.5		209,745	4.7
Total operating expenses	$	4,744,967	100.0%	$	4,465,371	100.0%

The increase in operating expenses included increases in payments on behalf, which are allocated across the operating functions, and other increases associated with growth in activities and payroll expenses. Excluding the $134.9 million increase in on behalf payments, total operating expenses increased by $144.7 million, or 3.8%. This rate of increase, as compared to the 4.7% increase in operating revenues, illustrates conservative spending policies aligned with budgetary constraints.

The University chooses to report its expenses by functional classifications in the Statement of Revenues, Expenses and Changes in Net Assets. For the reader's information, the expenses are displayed in their natural classifications in note 14. The following graph illustrates the expenses by natural classification:



The University’s Economic Outlook

The University continues to maintain its level of excellence in service to students, patients, the research community, the state and the nation. A critical element to the University’s future continues to be a strong relationship with the State of Illinois since state appropriations from the Governor and General Assembly provide essential operating support for University programs. The direct general funds appropriation for fiscal year 2013, signed into law by the Governor, reflects a decrease of $42.5 million (6.2%) from the budget appropriated in fiscal year 2012. While all major sources of funding for the University were strong in fiscal year 2012, cash flow issues that began in fiscal year 2010 continued to be an issue in fiscal year 2012, where the University ended the year with a receivable of $205 million from the state. Similar to the previous two years, the state has extended the state lapse period (PA097-0732) allowing the state to pay liabilities related to fiscal year 2012 until December 31, 2012. Therefore, the University anticipates full payment of the fiscal year 2012 appropriation by the end of the calendar year; however, the University expects cash flows from the state to continue to be a major concern even with the tax increase, as the economy slowly recovers. The State of Illinois also appropriates funds for on-behalf payments of University employees to CMS, as well as SURS, to pay benefits for University employees.

Based on known enrollment levels and tuition rates, the University projects an increase in tuition and miscellaneous departmental revenue in fiscal year 2013. The recommended $1,012.1 million fiscal year 2013 tuition and miscellaneous departmental revenue budget represents a $73.0 million (7.8%) increase from fiscal year 2012. Undergraduate students have a four-year tuition guarantee. Incremental tuition income of $71.8 million results from tuition increases of $266 per semester at Urbana, $234 per semester at Chicago and $14 per credit hour at Springfield for the freshman cohort, and varying increases in the graduate and professional programs. The remaining increase results from cost recovery programs, extramural, adjustments for enrollment levels, investment income on tuition revenue, and non-recurring funds carried forward from fiscal year 2012.

In fiscal year 2009, the Governor and General Assembly transferred control of the four state scientific surveys, previously operated as divisions of the Illinois Department of Natural Resources, to the University of Illinois. For fiscal year 2013, the funds for the State Surveys were directly included in the University of Illinois appropriation, rather than as a transfer of funds to the University’s Income Fund as in years past. Private gifts are an important supplement to the University’s sources of funding for operating costs, a significant factor in the growth of academic units, and essential for capital acquisition and construction.

Research is one of four components of the University’s mission. Research leading to the development of new products and services is also the engine driving economic development, another component of the University's mission. The growth in externally sponsored research illustrates the public and private sectors’ confidence in the University's research faculty. The fiscal year 2013 sponsored project budget is an estimate of grant and contract awards for direct costs and represents a 6.2% increase from fiscal year 2012 budget.

The University experienced growth from a variety of funding sources during fiscal year 2012. To maintain its financial position, the University continues to develop multiple and diverse sources of revenue to support the University mission of instruction, research, public service and economic development. The University's Board of Trustees and management are committed to upholding the University's outstanding academic reputation and solid financial condition.

UNIVERSITY OF ILLINOIS

Balance Sheet

June 30, 2012
(with comparative totals for June 30, 2011)

(In thousands)

		University		University Related Organizations	
Assets and Deferred Outflow of Resources		**2012**	**2011**	**2012**	**2011**
Current assets:					
Cash and cash equivalents	$	609,372	633,283	7,032	7,354
Cash and cash equivalents, restricted		182,490	193,338	1,581	1,853
Investments		93,418	49,706	1,366	230
Investments, restricted		31,263	12,584		
Securities lending collateral		90,732	92,895		
Accrued investment income		3,936	2,297	1,273	1,265
Accounts receivable, net of allowance for uncollectible		446,014	403,136	8,267	16,028
Receivable from State of Illinois, related to appropriations		204,972	288,669		
Pledges receivable, net of allowance				35,010	13,023
Notes receivable, net of allowance for uncollectible		8,645	8,730	66	73
Accrued interest on notes receivable		3,149	2,929		
Inventories		32,481	31,187	9	7
Prepaid expenses and deferred charges		20,397	20,723	2,222	2,118
Due from related organizations		1,425	913		
Total current assets		1,728,294	1,740,390	56,826	41,951
Noncurrent assets:					
Cash and cash equivalents, restricted		17,615	32,040	147	607
Investments		812,879	430,811	22,113	25,410
Investments, restricted		447,845	355,728	1,356,305	1,349,639
Pledges receivable, net of allowance				73,019	71,007
Notes receivable, net of allowance for uncollectible		53,535	52,736		
Prepaid expenses and deferred charges		9,797	9,750		
Due from related organizations			701		
Capital assets, net of accumulated depreciation		3,389,304	3,295,809	12,007	13,308
Other assets		4,351	5,091	131	132
Total noncurrent assets		4,735,326	4,182,666	1,463,722	1,460,103
Deferred outflow of resources		33,028	19,576		
Total assets and deferred outflows of resources	$	6,496,648	5,942,632	1,520,548	1,502,054
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued liabilities	$	284,357	230,825	15,003	33,242
Accrued payroll		145,172	139,128	167	311
Accrued compensated absences, current portion		22,618	21,090	1,402	1,782
Accrued self-insurance, current portion		60,933	60,388		
Deferred revenue and student deposits		146,656	147,082	900	50
Accrued interest payable		17,455	17,503		
Securities lending collateral		90,732	92,895		
Notes payable				4,084	4,932
Bonds payable, current portion		41,066	37,683		
Due to related organizations, current portion				1,425	913
Leaseholds payable and other obligations, current portion		145,836	28,430	6,310	6,503
Assets held for others		42,594	36,248	2,013	2,013
Total current liabilities		997,419	811,272	31,304	49,746
Noncurrent liabilities:					
Bonds payable		1,093,724	1,058,324		
Leaseholds payable and other obligations		353,916	496,353	47,367	47,943
Due to related organizations					701
Accrued compensated absences		178,434	180,198		
Accrued self-insurance		184,777	184,106		
Deferred distributions				55	129
Derivative instrument – swap liability		37,169	22,919		
Total noncurrent liabilities		1,848,020	1,941,900	47,422	48,773
Total liabilities		2,845,439	2,753,172	78,726	98,519
Invested in capital assets, net of related debt		1,932,473	1,865,699	7,923	8,376
Restricted:					
Nonexpendable		78,446	75,065	766,644	726,649
Expendable		599,392	561,455	661,460	642,646
Unrestricted		1,040,898	687,241	5,795	25,864
Total net assets		3,651,209	3,189,460	1,441,822	1,403,535
Total liabilities and net assets	$	6,496,648	5,942,632	1,520,548	1,502,054

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS

Statement of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)

(In thousands)

	University		University Related Organizations	
	2012	2011	2012	2011
Operating revenues:				
Student tuition and fees, net	$ 987,796	905,693		
Federal appropriations	18,072	13,919		
Federal grants and contracts	718,621	684,392		
State of Illinois grants and contracts	81,478	83,625		175
Private and other governmental agency grants and contracts	137,712	147,139	139,766	100,186
Educational activities	258,298	267,609		
Auxiliary enterprises, net	363,319	374,644		
Hospital and other medical activities, net	601,360	547,168		
Medical service plan	236,160	223,654		
Independent operations	13,083	15,173		
Interest and service charges on student loans	1,945	1,537		
Allocation from the University			14,845	14,548
Other sources			47,984	44,943
Total operating revenues	3,417,844	3,264,553	202,595	159,852
Operating expenses:				
Instruction	1,114,474	1,006,190		
Research	710,656	680,651		
Public service	413,988	387,461		
Academic support	377,982	349,095		
Student services	141,130	131,827		
Institutional support	232,023	209,752	73,339	66,042
Operation and maintenance of plant	270,947	287,825		
Scholarships and fellowships	241,008	238,722		
Auxiliary enterprises	307,597	316,442		
Hospital and medical activities	709,650	633,795		
Independent operations	12,442	13,866		
Depreciation	213,070	209,745	1,091	1,161
Distributions on behalf of the University			151,657	147,404
Total operating expenses	4,744,967	4,465,371	226,087	214,607
Operating loss	(1,327,123)	(1,200,818)	(23,492)	(54,755)
Nonoperating revenues (expenses):				
State appropriations	709,683	716,794		
Transfer of state appropriations to the Illinois DHFS Hospital Services Fund	(45,000)	(45,000)		
Private gifts	141,700	133,498		
Federal grants, nonoperating	69,529	67,404		
On-behalf payments for fringe benefits	818,084	683,201		
Net investment income (net of investment expense of $3,171)	24,656	26,066	14,784	14,999
Net increase in the fair value of investments	10,979	68,810	7,020	207,445
Interest expense	(71,489)	(76,672)	(76)	(95)
Loss on disposal/impairment of capital assets	(9,653)	(35,675)		
Other nonoperating revenues, net	50,721	34,363	31	144
Net nonoperating revenues	1,699,210	1,572,789	21,759	222,493
Income before other revenues	372,087	371,971	(1,733)	167,738
Capital state appropriations	30,910	21,274		
Capital gifts and grants	56,383	9,745		
Private gifts for endowment purposes	323	924	40,020	60,948
Increase in net assets	459,703	403,914	38,287	228,686
Net assets, beginning of year	3,189,460	2,785,546	1,403,535	1,174,849
Cumulative effect of change in accounting principle	2,046			
Net assets, beginning of year, as adjusted	3,191,506	2,785,546	1,403,535	1,174,849
Net assets, end of year	$ 3,651,209	3,189,460	1,441,822	1,403,535

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS

Statement of Cash Flows

Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)

(In thousands)

	University 2012	University 2011
Cash flows from operating activities:		
Student tuition and fees	$ 983,949	906,919
Federal appropriations	17,625	14,503
Federal, state, and local grants and contracts	754,233	757,831
Other governmental agencies and private grants, and contracts	143,829	144,562
Sales and services of educational activities	253,552	272,031
Auxiliary activities and independent operations	382,860	390,939
Hospital and other medical activities	592,608	552,598
Medical service plan	251,607	201,317
Payments to employees and for benefits	(2,271,990)	(2,207,330)
Payments to suppliers	(1,316,977)	(1,277,270)
Payments for scholarships and fellowships	(65,213)	(63,499)
Student loans issued	(9,869)	(9,454)
Student loans collected	8,623	8,670
Student loan interest and fees collected	1,725	1,536
Net cash used in operating activities	(273,438)	(306,647)
Cash flows from noncapital financing activities:		
State appropriations	748,379	648,749
Gifts transferred from University of Illinois Foundation	141,700	133,498
Direct lending receipts	502,286	477,604
Direct lending payments	(501,534)	(479,025)
Federal grants and contracts, nonoperating	69,529	67,404
Private gifts for endowment purposes	323	924
Repayments from related organizations	189	468
Other receipts	38,435	33,689
Other disbursements	(5,152)	(187)
Net cash provided by noncapital financing activities	994,155	883,124
Cash flows from capital and related financing activities:		
Proceeds from issuance of capital debt	169,424	77,689
Capital state appropriations		1,394
Capital gifts and grants	52,451	7,552
Purchase of capital assets	(255,625)	(194,871)
Principal payments on bonds, capital leases, and other obligations	(161,764)	(118,734)
Interest payments on bonds, capital leases, and other obligations	(70,106)	(69,184)
Payment of bond and installment payment contract issuance costs	(1,702)	(646)
Net cash used in capital and related financing activities	(267,322)	(296,800)
Cash flows from investing activities:		
Interest and dividends on investments, net	18,401	19,446
Proceeds from sales and maturities of investments	1,433,924	1,712,106
Purchase of investments	(1,954,904)	(1,861,937)
Net cash used in investing activities	(502,579)	(130,385)
Net (decrease) increase in cash and cash equivalents	(49,184)	149,292
Cash and cash equivalents, beginning of year	858,661	709,369
Cash and cash equivalents, end of year	$ 809,477	858,661

(Continued)

UNIVERSITY OF ILLINOIS

Statement of Cash Flows

Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)

(In thousands)

		University 2012	University 2011
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(1,327,123)	(1,200,818)
Adjustments to reconcile operating loss to net cash used in operating activities:			
On-behalf payments for fringe benefits expense		818,084	683,201
Depreciation expense		213,070	209,745
Changes in assets and liabilities:			
Accounts receivable, net		(32,824)	(29,492)
Notes receivable, net		(714)	(681)
Accrued interest on notes receivable		(220)	(1)
Inventories		(1,294)	394
Prepaid expenses and deferred charges		659	726
Accounts payable and accrued liabilities		43,980	(5,772)
Accrued payroll		6,044	2,093
Deferred revenue and student deposits		(426)	4,791
Accrued compensated absences		(236)	(13,700)
Accrued self-insurance		1,216	37,665
Assets held for others		6,346	5,202
Net cash used in operating activities	$	(273,438)	(306,647)
Noncash investing, capital, and financing activities:			
On-behalf payments for fringe benefits	$	818,084	683,201
State appropriation		45,000	45,000
Transfers to Illinois DHFS Hospital Services Fund		(45,000)	(45,000)
Net increase in fair value of investments		10,979	68,810
Gifts in kind – capital assets		2,340	2,044
Increase (decrease) of capital asset obligations in accounts payable		9,552	(10,408)
Capital asset acquisitions by Capital Development Board		30,910	19,880
Capital asset acquisitions via leaseholds payable		4,913	1,128
Net interest capitalized		6,210	2,216
Other capital asset adjustments		6,668	1,691
Loss on sale/disposal/impairment of capital assets		(9,653)	(35,675)
Capital appreciation on bonds payable		9,476	9,955

See accompanying notes to financial statements.

(1) Organization and Summary of Significant Accounting Policies

Organization

The University of Illinois (University), a federal land grant institution and a component unit of the State of Illinois, conducts education, research, public service and related activities principally at its three campuses in Urbana-Champaign, Chicago, which includes the University of Illinois Hospital (Hospital) and other healthcare facilities, and Springfield. The governing body of the University is The Board of Trustees of the University of Illinois (Board).

As required by U.S. generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB), these financial statements present the financial position and financial activities of the University (the primary government) and its component units as well as certain activities and expenses funded by other State agencies on behalf of the University or its employees. The component units discussed below are included in the University's financial reporting entity (Entity) because of the significance of their financial relationship with the University.

The University Related Organizations (UROs) column in the financial statements includes the financial data of the University's discretely presented component units. The University of Illinois Foundation (Foundation), the University of Illinois Alumni Association (Alumni Association), Wolcott, Wood and Taylor, Inc. (WWT), Prairieland Energy, Inc. (Prairieland), Illinois Ventures, LLC (Illinois Ventures), The University of Illinois Research Park, LLC (Research Park) and UI Singapore Research, LLC (Singapore Research) are included in the University's reporting entity because of the significance of their operational or financial relationship with the University. These component units are discretely presented in a separate column and are legally separate from the University.

The Foundation was formed for the purpose of providing fund-raising and other assistance to the University in order to attract private gifts to support the University's instructional, research and public service activities. In this capacity, the Foundation solicits, receives, holds and administers gifts for the benefit of the University. Complete financial statements for the Foundation may be obtained by writing the Senior Vice President for Administration, 400 Harker Hall, 1305 W. Green Street, Urbana, Illinois 61801.

The Alumni Association was formed to promote the general welfare of the University and to encourage and stimulate interest among students, former students and others in the University's programs. In this capacity, the Alumni Association offers memberships in the Alumni Association to former students, conducts various activities for students and alumni, and publishes periodicals for the benefit of alumni. Complete financial statements for the Alumni Association may be obtained by writing the Chief Financial Officer, Alice Campbell Alumni Center, 601 S. Lincoln Avenue, Urbana, Illinois 61801.

WWT was formed to provide practice management support services and operate as a billing/collection entity for healthcare activities under the laws of the State of Illinois. Complete financial information may be obtained by writing the President and CEO, 200 W. Adams, Suite 225, Chicago, Illinois 60606.

Prairieland, a for-profit, wholly owned corporation, was formed for the purpose of providing support for the University through delivery of comprehensive economical utility services to the University and other organizations. Complete financial information may be obtained by writing the Controller, 106 Town Center, Suite 304, Champaign, Illinois 61820.

(Continued)

Illinois Ventures, a for-profit, wholly owned corporation, exists to facilitate the development of new companies commercializing technology originated or developed by faculty, staff and/or students of the University and other organizations. The University desires Illinois Ventures to foster technology commercialization and economic development in accordance with the teaching, research and public service missions of the University. Complete financial information may be obtained by writing the CEO and Managing Director, 2001 South First Street, Suite 201, Champaign, Illinois 61820.

Research Park, a for-profit, wholly owned corporation, was formed to aid and assist the University and other organizations by establishing and operating a research park on the University's Urbana-Champaign campus. The Research Park was designed to promote the development of new companies, which commercialize University technologies. Complete financial information may be obtained by writing The University of Illinois Research Park, LLC, 60 Hazelwood Drive, Champaign, Illinois 61820.

Singapore Research, a for-profit, wholly owned corporation, was formed to organize, develop, hold and operate, through a Singapore entity, a research center in Singapore to encourage and facilitate research, development and commercialization of the intellectual assets of the University. Complete financial information may be obtained by writing the Treasurer, UI Singapore Research, LLC, 349 Henry Administration Building, 506 South Wright Street, Urbana, Illinois 61801.

The Foundation, Alumni Association, WWT, Prairieland, Illinois Ventures, Research Park and Singapore Research are related organizations as defined under *University Guidelines* adopted by the State of Illinois Legislative Audit Commission.

The University is a component unit of the State of Illinois for financial reporting purposes. The financial balances and activities included in these financial statements are, therefore, also included in the State's comprehensive annual financial report.

Significant Accounting Policies

(a) Financial Statement Presentation and Basis of Accounting

University

The University prepared its financial statements as a Business-Type Activity, as defined by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, 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. Grant and contract revenues, which are received or receivable from external sources, are recognized as revenues to the extent of related expenses or satisfaction of eligibility requirements. Advances are classified as deferred revenue. Appropriations made from the State of Illinois for the benefit of the University are recognized as nonoperating revenues when eligibility requirements are satisfied.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Entity follows all applicable GASB pronouncements. In addition, the Entity applies 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 Entity has elected not to apply FASB pronouncements issued after November 30, 1989, excluding certain FASB disclosures related to the Foundation URO.

The financial statements include certain prior year comparative information, which has been derived from the University's 2011 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 University's financial statements for the year ended June 30, 2011.

Certain items in the June 30, 2011 comparative information have been reclassified to correspond to the June 30, 2012 financial statement presentation.

UROs

The financial statements of WWT, Prairieland, Illinois Ventures, Research Park and Singapore Research are prepared using the same presentation and basis of accounting as the University, as described above.

Beginning in fiscal year 2010, the Foundation and Alumni Association follow FASB standards for financial statement presentation. Consequently, reclassifications have been made to convert their financial statements to the GASB format for inclusion in the UROs column of the financial statements and disclosure in note 16.

(b) Cash and Cash Equivalents

The Statements of Cash Flows details the change in the cash and cash equivalents balance for the fiscal year. Cash and cash equivalents include bank accounts and investments with original maturities of ninety days or less at the time of purchase. Such investments consist primarily of U.S. Treasury bills, commercial paper, repurchase agreements and money market funds.

(c) Inventories

Inventories are stated at the lower of cost or market. Cost is determined principally by the average cost method, or the first-in, first-out method depending on the type of inventory.

(d) Investments

Investments are recorded at fair value. Fair value is determined by quoted market prices for the University's investments. The fair values of the real estate and farm properties held as investments by permanent and term endowments are determined by a periodic appraisal of the property by a certified real estate appraiser. Fair value for investments in limited partnerships and certain mutual funds is determined using net asset values as provided by external investment managers. The University also has real estate and farm properties held as investments by quasi-endowments, which are carried at cost, or when donated, at the fair value at the date of donation.

Changes in fair value during the reporting period are reported as a net increase (decrease) in the fair value of investments. Net investment income includes interest, dividends, and realized gains and losses.

(e) Endowments

For donor-restricted endowments, the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted in Illinois, permits the respective Boards for both the University and the Foundation to appropriate an amount of realized and unrealized endowment appreciation as they determine to be prudent. The University's policy is to retain the realized and unrealized appreciation within the endowment after spending rule distributions.

University

The University utilizes the total return concept in allocating endowment income. The focus is to preserve the real value or purchasing power of endowment pool assets and the annual support the assets provide. Distributions are made from the University Endowment Fund to the University entities that benefit from the endowment funds. The endowment spending rule provides for an annual distribution of 4.00% of the two-quarter lagged, seven-year moving average market value of fund units. At June 30, 2012, net appreciation of $13,770,000 was available to be spent, of which $10,734,000 was restricted to specific purposes.

URO – Foundation

Interpretation of Relevant Law: The board of directors of the Foundation interprets UPMIFA to require consideration of the following factors, if relevant, in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the endowment fund
- The purposes of the institution and the endowment fund
- General economic conditions
- The possible effect of inflation or deflation
- The expected total return from income and the appreciation of investments
- Other resources of the institution
- The investment policy of the institution

In accordance with the Foundation's interpretation of UPMIFA, absent explicit donor stipulation to the contrary, the Foundation shall classify as permanently restricted net assets (restricted – nonexpendable) the original value of the gifts donated to the permanent endowment, but such classification does not limit the expenditures from the endowment fund only to income, interest, dividends, or rents, issues or profits. The portion of the fund's value spendable annually for the donor-designated purpose is to be determined, from time to time, by the Foundation's board of directors, acting in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, considering the above relevant factors. The Foundation's Board approved spending was $71,991,000 for fiscal year ended June 30, 2012.

(f) 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 (noted below) of the 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 University 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. Estimated useful lives for capital assets are as follows:

	Useful life (in years)		Useful life (in years)
Buildings:		Improvements other than buildings:	
Shell	50	Site improvements	20
Service systems	25	Infrastructure	25
Fixed equipment	15		
Remodeling	25	Moveable equipment	3 – 15
Intangibles:			
Software	5 – 10		

(g) Deferred Outflow of Resources

Under hedge accounting, the University has determined that the interest rate swap agreements on bonds payable and certificates of participation, as hedging derivative instruments, are an effective hedge, and accordingly, changes in the fair values of the interest rate swaps, since being associated with the related outstanding bonds or certificates, are reported as deferred outflow of resources on the accompanying balance sheet. Additionally, interest rate swaps reassigned to new debt, after a refunding of debt that the swap was previously hedging, normally have an other than zero fair value upon the reassociation. For swaps with a fair value of other than zero upon reassociation with a hedgeable item, the fair value is amortized as an adjustment to interest expense in a systematic manner.

(h) Compensated Absences

Accrued compensated absences for University personnel are charged as an operating expense, using the vesting method, based on earned but unused vacation and sick leave days including the University's share of social security and Medicare taxes. At June 30, 2012, the University estimates that $103,176,000 of the accrued compensated absences liability will be paid out of State of Illinois appropriations to the University in subsequent years, rather than from unrestricted net assets available at June 30, 2012. The amount associated with future State appropriations was calculated based upon the unused vacation and sick leave days and pay rates for the applicable employees.

(i) Premiums, Issuance Costs and Deferred Loss on Refundings

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

(j) ***Net Assets***

The Entity'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 attributable to the acquisition, construction, or improvement of those capital assets, (b) Restricted nonexpendable – net assets restricted by externally imposed stipulations, (c) Restricted expendable – net assets subject to externally imposed restrictions that can be fulfilled by actions of the Entity pursuant to those stipulations or that expire by the passage of time, and (d) Unrestricted – net assets not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board. The Entity first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

(k) ***Classification of Revenues***

The Statement of Revenues, Expenses and Changes in Net Assets classifies the Entity's fiscal year activity as operating and nonoperating. Operating revenues generally result from exchange transactions such as payments received for providing goods and services, including tuition and fees, net of scholarships and fellowships, certain grants and contracts, sales and services of educational activities, hospital, medical service plans, and auxiliary enterprises revenues. Certain revenue sources that the Entity relies on to provide funding for operations including State appropriations, gifts, on-behalf payments for fringe benefits and investment income are defined by GASB Statement No. 35 as nonoperating revenues. In addition, transactions related to capital and financing activities are components of nonoperating revenues.

In fiscal year 2012, $45,000,000 of State appropriations were transferred to the University of Illinois Hospital Services Fund, which is a special fund established in the State of Illinois Treasury pursuant to the State Finance Act, 30 ILCS 105/6z-30. This fund is owned and operated by the Illinois Department of Healthcare and Family Services (DHFS) and this fund is not part of or a related organization of the University.

(l) ***Tuition, Scholarships and Fellowships***

Scholarships and fellowships of $234,814,000 and $7,019,000 are netted against student tuition and fees and auxiliary enterprises revenues, respectively. Stipends and other payments made directly to students are reported as scholarship and fellowship expense. Net tuition and fees, except for summer session, are recognized as revenues as they are assessed. The portion of summer session tuition and fees applicable to the following fiscal year is deferred.

(m) ***Patient Services Revenue – Hospital***

With respect to the Hospital, net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge reimbursed costs, discounted charges and per diem payments. Approximately 96% of the Hospital's net patient service revenues were derived from Medicare, Medicaid, Blue Cross and managed care programs for the year ended June 30, 2012. Payments under these programs are based on established program rates or cost, as defined, of rendering services to program beneficiaries. The Hospital provides contractual allowances on a current basis for the differences between charges for services rendered and the expected payments under these programs. For the year ended June 30, 2012, the contractual allowances totaled $1,169,062,000.

The University provides care without charge or at amounts at less than its established rates to patients who meet the criteria of its charity care policy. Because the University does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Consideration for eligibility of charity care is based on the application of the University's charity care policy and includes patient qualification criteria, financial resource criteria and service criteria. The University does not include the unreimbursed cost of providing care to Medicaid and Medicare patients as charity care.

The net cost of charity care provided in 2012 was $17,806,000, an increase of 10% from the prior year. The net cost of charity care is determined by the total charity care cost less any patient related revenue due to the sliding scale payments or other patient specific resources. Most of the patient specific resources came from the Center for Medicare & Medicaid Services 1011 program reimbursement.

(n) Classification of Expenses

The majority of the Entity's expenses are exchange transactions, which GASB defines as operating expenses for financial statement presentation. Nonoperating expenses include transfers of state appropriations and capital financing costs.

(o) Employment Contracts

Employment contracts for certain academic personnel provide for twelve monthly salary payments, although the contracted services are rendered during a nine-month period. The liability for those employees who have completed their contracted services, but have not yet received final payment, was $53,441,000 at June 30, 2012 and is recorded in the accompanying financial statements. This amount will be paid from amounts specifically included in State appropriations to the University for fiscal year 2013 rather than from the unrestricted net assets available at June 30, 2012.

(p) 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 University reported payments made to the State Universities Retirement System on behalf of the Entity for contributions to retirement programs for Entity employees of $403,628,000 for the year ended June 30, 2012. Substantially all employees participate in group health insurance plans administered by the State of Illinois. The employer contributions to these plans for University employees paid by State appropriations and auxiliary enterprises are paid to Central Management Services on behalf of the University and include postemployment benefits. The employer contributions to these plans on behalf of employees paid from other University held funds are paid by the University. The on-behalf payments were $414,456,000 for year ended June 30, 2012. On-behalf payments are reflected as nonoperating revenues. The corresponding on-behalf expense is reflected as an operating expense and is allocated by function.

(q) 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 reported period. Actual results could differ from those estimates.

(r) New Accounting Pronouncements

The University adopted the provisions of GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53* (GASB 64), which was effective July 1, 2011. This statement clarifies whether an effective hedging relationship continues after the replacement of a swap counterparty. In September 2008, Lehman Brothers Holdings Inc. (LBHI), the parent of Lehman Brothers Commercial Bank (LBCB) filed for protection under Chapter 11 of the bankruptcy code. This caused an event of default under the interest rate swap agreement dated April 2, 2007 by and between LBCB and the University. The University entered into a novation agreement, which terminated the swap with LBCB and entered into a new interest rate swap agreement with a different counterparty with the same terms and conditions that were present in the April 2, 2007 agreement. As of July 1, 2011, the implementation of GASB 64 required the University to eliminate the accounting treatment previously applied for the swap transaction through a retroactive adjustment to beginning net assets. In implementing this pronouncement, the University recorded an effect of a change in accounting principle to beginning of year net assets by $2,046,000 as follows:

- A retroactive adjustment of ($1,194,000) representing the reestablishment of the difference between the deferred outflow of resources and derivative instrument-swap liability due to the interest rate swap agreement being disassociated with the Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2007, due to its refunding in fiscal year 2008.

- A retroactive adjustment of $3,240,000 representing the elimination of the unamortized financing payable which was recognized when the interest rate swap agreement novated from LBHI to the current counterparty, Loop Financial Products, in fiscal year 2009.

Net assets, beginning of year, as previously reported	$	3,189,460,000
Cumulative effect of change in accounting principle		2,046,000
Net assets, beginning of year, as adjusted	$	3,191,506,000

(2) Cash, Cash Equivalents and Investments

The carrying amount of the University's cash totaled $217,164,000 at June 30, 2012. The June 30, 2012 total bank account balances for the University aggregated $230,603,000 and was covered by federal depository insurance.

Certificates of deposit held by the University totaled $7,751,000 at June 30, 2012 of which $6,350,000 was uncollateralized.

Illinois Statutes require a third-party custodian to perfect the University's security interest under repurchase agreements. The University follows industry standards and requires that securities underlying repurchase agreements must have a fair value of at least 102% of the cost of the repurchase agreement. At June 30, 2012, the University had repurchase agreements of $333,000 and the market value of securities underlying these repurchase agreements was $352,000 at June 30, 2012.

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 defined by the Illinois Banking Act
- Asset-backed securities
- Corporate bonds, stocks and equities
- Commercial paper
- Repurchase agreements
- Mutual funds

Additionally, the University has real estate and farm properties held as investments by permanent and term endowments reported at fair value of $68,015,000. The fair value of the real estate and farm properties is determined by a periodic appraisal of the property by a certified real estate appraiser. Changes in fair value during the reporting period are reported as investment income. The University also has real estate and farm properties held as investments by quasi-endowments reported at $7,860,000, which are carried at cost, or when donated, at the fair value at the date of donation. All other investments are carried at their fair value, as determined by quoted market prices when available, and otherwise by generally accepted valuation principles.

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 UPMIFA and the State of Illinois Public Funds Investment Act when investing its funds. The following details the carrying value of the University's cash, cash equivalents and investments as of June 30, 2012:

University Cash, Cash Equivalents and Investments

(In thousands)

U.S. Treasury bonds and bills	$	268,785
U.S. government agencies		266,759
Commercial paper		13,838
Corporate bonds		274,782
Bond mutual funds		71,390
Nongovernment mortgage-backed securities		66,836
Other asset-backed securities		85,706
Non-U.S. government bonds		35,797
Money market funds		545,456
Illinois public treasurer's investment pool		28,088
Subtotal before cash deposits, equities and other investments		1,657,437
U.S. equities		26,940
International equities		37,251
International equities traded in U.S. dollars		5,573
U.S. equity mutual funds		146,998
Limited partnerships		19,560
Repurchase agreements		333
Certificates of deposit		7,751
Real estate and farm properties		75,875
Cash deposits		217,164
Total	$	2,194,882

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, 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 the Barclays Capital one-year 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 University’s debt securities and maturities at June 30, 2012 are illustrated below:

University Investment Maturities

(In thousands)

		Total	Less than 1 year	1 – 5 years	6 – 10 years	Greater than 10 years
U.S. Treasury bonds and bills	$	268,785	76,749	147,560	39,349	5,127
U.S. government agencies		266,759	62,712	83,521	20,097	100,429
Commercial paper		13,838	13,838			
Corporate bonds		274,782	29,359	216,606	25,368	3,449
Bond mutual funds		71,390		774	70,616	
Nongovernment mortgage-backed securities		66,836			643	66,193
Other asset-backed securities		85,706		67,616	9,617	8,473
Non-U.S. government bonds		35,797	6,049	24,004	3,913	1,831
Money market funds		545,456	545,456			
Illinois public treasurer’s investment pool		28,088	28,088			
Total	$	1,657,437	762,251	540,081	169,603	185,502

At June 30, 2012, the University’s operating funds pool portfolio had an effective duration of 1.5 years.

(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 that fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager’s discretion. Per the University’s investment policy, the average credit quality of the operating funds will not fall below Standard & Poor’s AA – or equivalent.

At June 30, 2012, the University had debt securities and quality ratings as illustrated below:

University Investments Quality Ratings

(In thousands)

	Total	AAA	AA	A	BBB	BB	Less than BB or not rated
U.S. Treasury bonds and bills	$ 268,785		268,785				
U.S. government agencies	266,759		266,759				
Commercial paper	13,838	13,838					
Corporate bonds	274,782	9,637	60,782	140,469	53,422	2,178	8,294
Bond mutual funds	71,390	16,043	54,573	774			
Nongovernment mortgage-backed securities	66,836	45,834	42	2,717	2,347	882	15,014
Other asset-backed securities	85,706	74,925	4,290	1,803		97	4,591
Non-U.S. government bonds	35,797	9,132	18,307	3,728	935		3,695
Money market funds	545,456	541,698	3,758				
Illinois public treasurer's investment pool	28,088	28,088					
Total	$ 1,657,437	739,195	677,296	149,491	56,704	3,157	31,594

(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 investment policy does not limit the value of investments that may be held by an outside party. At June 30, 2012, the University's investments and deposits had 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 investment 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. Within the University's investment policy, the manager guidelines for operating investments provide that non-U.S. government obligations 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, 2012, 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's operating fund investments generally are not exposed to foreign currency risk. 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 U.S. dollar balances of the University's cash equivalents and investments exposed to foreign currency risk as of June 30, 2012 are categorized by currency below:

University Investments Foreign Currency Exposure
(In thousands)

		Total	**Cash equivalents**	**Equity investments**
European Euro	$	14,671	34	14,637
British Pound		7,518		7,518
Japanese Yen		3,390		3,390
Swiss Franc		3,163		3,163
Hong Kong Dollar		3,083		3,083
Norwegian Krone		1,364		1,364
South Korean Won		1,448		1,448
Singapore Dollar		1,091		1,091
Canadian Dollar		851	155	696
Swedish Krona		454		454
Australian Dollar		407		407
Total	$	37,440	189	37,251

(f) Securities Lending

To enhance the return on investments, the Board has authorized participation in a securities lending program. Through its custodian bank, 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 the custodian bank in a short-term investment pool. As of June 30, 2012, the short-term investment pool has a weighted average maturity of one hundred and eight 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 $90,732,000 at June 30, 2012, and is recorded as an asset and corresponding liability on the University's Balance Sheet. As of June 30, 2012, $89,659,000 of the investments reported on the University's Balance Sheet were on loan, secured by collateral with a fair value of $91,319,000. At June 30, 2012, 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.

(g) URO – Foundation Investments

As the investments of the University's Foundation are considered material to the University's financial statements taken as a whole, the following disclosures are made:

The Foundation financial statements follow FASB standards; therefore, the required disclosures, within the University's statements, for the Foundation investments differ from GASB requirements.

The Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and requires disclosure of fair value measurements. Effective July 1, 2009, the Foundation adopted the portion of the Topic which requires disclosure of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis. The fair value hierarchy set forth in the Topic is as follows:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date. Level 1 inputs would also include investments valued at prices in active markets that the Foundation has access to where transactions occur with sufficient frequency and volume to provide reliable pricing information.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Level 2 investments also include alternative investments, measured using the practical expedient, that do not have any significant redemption restrictions, lock up periods, gates or other characteristics that would cause liquidation and report date net asset value (NAV) to be significantly different, if redemption were requested at report date.

Level 3 – Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability. The Foundation reports the fair value of certain Level 3 investments using the practical expedient. The practical expedient allows for the use of NAV, either as reported by the investee fund or as adjusted by the Foundation based on various factors, to be used to determine fair value, under certain conditions. The fair value of the investment is based on a combination of audited financial statements of the investees and monthly or quarterly statements received from the investees. These investments could have significant redemption and other restrictions that would limit the Foundation's ability to redeem out of the fund at report date NAV.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Investments: Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, exchange-traded equities and mutual funds.

If quoted market prices are not available, then the fair values are estimated by using pricing models, quoted prices of securities with similar characteristics and other valuation methodologies. Level 2 securities would include mortgage-backed agency securities, certain corporate securities, mutual funds of Level 1 securities where values are based on net asset value provided by the investment manager, emerging market funds where the value is based on the net asset value provided by the investment manager and other certain securities. These securities are valued primarily through a multidimensional relational model including standard inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, offers and reference data and net asset value provided by the investment manager.

In certain cases where there is limited activity or less transparency around inputs to the valuation, including alternative investments, securities are classified within Level 3 of the valuation hierarchy and may include equity and/or debt securities issued by private entities and certain corporate bonds. The Foundation's private equity, hedge and real estate investment funds do not have a readily determinable fair value. These funds are valued using the practical expedient.

Beneficial interest in trusts and trusts held by others: The values of the beneficial interest in trusts are derived from the underlying investments of the trusts. The value of those investments is determined in the same manner as investments described above. The Foundation owns an interest in trust and not the underlying investments. The estimated future value of that interest in the trust based on Foundation management's estimate of the trusts' expected performance is then present valued back to the date of the financial statements based on life expectancy factors published by the Internal Revenue Service.

There have been no changes in valuation techniques used for any assets measured at fair value during the year ended June 30, 2012.

The following table summarizes assets measured at fair value on a recurring basis as of June 30, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

URO – Foundation Fair Value Measurements as of June 30, 2012

(In thousands)

	Fair value	Level 1	Level 2	Level 3
Assets:				
U.S. Treasury bonds and bills	$ 4,840		4,840	
International government bonds	941		158	783
U.S. government agencies	24,887		24,797	90
International government agencies	539		539	
Municipal bonds	1,065		1,065	
Corporate bonds and notes	22,781		22,781	
Commercial mortgage-backed securities	1,139		1,139	
Guaranteed fixed income	141		141	
Asset-backed securities	3,460		3,330	130
Nongovernment backed collateralized mortgage obligation (c.m.o.s.)	2,511		2,511	
Other fixed income	3,358		3,358	
Common stock, domestic:				
Consumer goods	45,172	45,172		
Energy	11,075	11,075		
Financial services	13,477	12,471	1,006	
Healthcare	21,827	21,827		
Industrials	15,673	15,673		
Information technology	29,685	29,685		
Materials	9,679	9,679		
Telecommunications	1,096	1,096		
Utilities	2,721	2,721		
Common stock, foreign:				
Consumer goods	21,225	21,225		
Energy	4,670	4,670		
Financial services	9,148	9,148		
Health care	6,721	6,721		
Industrials	11,832	11,832		
Information technology	1,709	1,709		
Materials	3,754	3,754		
Miscellaneous	13,221			13,221
Hedged/alternative investments	365,988			365,988
Private equity	103,634			103,634
Real estate trusts and partnerships	74,952			74,952
Subtotal forward	$ 832,921	208,458	65,665	558,798

URO – Foundation Fair Value Measurements as of June 30, 2012 (Continued)

(In thousands)

	Fair value	Level 1	Level 2	Level 3
Subtotal forward	$ 832,921	208,458	65,665	558,798
Bond mutual funds:				
U.S. government	34,099	1,001	33,098	
Mortgages	27,804	757	27,047	
Corporate bonds and notes	15,877	474	15,403	
High Yield	2,888	102	2,786	
Municipals	5,541	130	5,411	
Internationals	12,184	390	11,794	
Equity mutual funds:				
Small cap	603	574	29	
Mid cap	10,228	10,228		
Large cap	120,179	37,110	83,069	
International	87,634	11,147	76,487	
Money market mutual funds	92,802	92,802		
Other	2,750			2,750
Farms	46,599		46,599	
Beneficial interest in trusts	30,289			30,289
Trusts held by others	15,483			15,483
Cash surrender value of life insurance	5,363			5,363
Other assets	6,633		6,633	
Total investments	$ 1,349,877	363,173	374,021	612,683

The investments above exclude $6,428,000 of real estate, which is carried at cost.

The following table presents additional information about investments measured at fair value on a recurring basis for which the URO – Foundation has utilized Level 3 inputs to determine fair value:

URO – Foundation Significant Unobservable Inputs (Level 3) as of June 30, 2012
(In thousands)

	Beginning balance	Purchases	Sales (distributions)	Total gains or losses*	Net transfers in/out of Level 3	Ending balance
U.S. government agencies	$ 267	98	(10)	(7)	(258)	90
International Government Bonds		743		40		783
Municipal bonds	397		(25)	21	(393)	
Corporate bonds/notes	312		(317)	5		
International common stock	15,388	251		(2,418)		13,221
Hedged/alternative assets	363,426			2,562		365,988
Private equity	97,141	10,946	(7,223)	2,770		103,634
Real estate trusts and partnerships	81,847	813	(8,739)	1,031		74,952
Other investments	3,026		(140)	(136)		2,750
Beneficial interest in trusts	28,969			1,320		30,289
Trusts held by others	11,851	4,037		(405)		15,483
Cash surrender value of life insurance	5,299			64		5,363
Asset backed securities	309	130	(41)	11	(279)	130
Nongovernment backed c.m.o.s.	464	1	(11)	1	(455)	
Balance, ending	$ 608,696	17,019	(16,506)	4,859	(1,385)	612,683

*(realized/unrealized) included in change in net assets

Cash surrender value of life insurance was disclosed as a Level 2 investment in the prior year.

Gains and losses on Level 3 investments included in change in net assets for the period above are reported as realized and unrealized gains (losses) on investments.

The following table sets forth additional disclosure of the Foundation's investments whose fair value is estimated using net asset value (NAV) per share (or its equivalent) as of June 30, 2012:

URO – Foundation Investments, Fair Value Estimated Using NAV (or its equivalent)
(In thousands)

	Fair value	Unfunded commitment	Redemption frequency	Redemption notice period
Hedged/alternative investments(A)	$ 365,988		(A)	(A)
Private equity (B)	103,634	22,273	(B)	(B)
Real estate trusts and partnerships (B)	74,952	3,110	(B)	(B)
Large cap equity fund (C)	83,069		Daily	Trade Date Plus 1 - 3 Days
International equity fund (D)	76,487		Daily/10 days	Trade Date Plus 1 day - 30 Days
	$ 704,130	25,383		

(A) The partnerships in this category consist of funds that invest in multiple limited partnerships with various investment strategies and long and short positions in equity securities of companies within the USA and outside of the USA. These funds can be redeemed daily, monthly, quarterly or annually depending on the partnership agreement within redemption notice periods of none to 90 days. The fund values of these investments have been estimated using the net asset value per share of the investments provided by the fund manager.

(B) The partnerships in this category consist of funds that invest in the following types of investments in the USA and outside of the USA: venture capital partnerships, buyout partnerships, mezzanine/subordinated debt partnerships, restructuring/distressed debt partnerships and special situation partnerships, and real estate. These investments cannot be redeemed during the life of the partnership, which can be up to 12 years; however, they can be transferred to another eligible investor. Distributions will be received as the underlying investments of the funds are liquidated over time. The fair value of this investment has been estimated using the net asset value provided by the fund manager and an adjustment determined by management for the time period between the date of the last available net asset value from the investment manager and June 30, 2012.

(C) These funds invest in marketable equities that are all exchange traded in the USA and that are categorized as large cap. These funds can be redeemed at the month-end net asset value per share based on the fair value of the underlying assets. The fair values of these investments have been estimated using the net asset value per share of the investments provided by the fund manager.

(D) These funds invest in international equities that are all exchange traded in countries outside of the USA. These funds can be redeemed at the month-end net asset value per share based on the fair value of the underlying assets. The fair values of these investments have been estimated using the net asset value per share of the investments provided by the fund manager.

All URO - Foundation investments are considered noncurrent assets.

(3) Accounts, Notes and Pledges Receivable

The University provides allowances for uncollectible accounts and notes receivable based upon management’s best estimate considering type, age, collection history of receivables and any other factors as considered appropriate. Accounts and notes receivable are reported net of allowances at June 30, 2012.

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

University Accounts Receivable, Net of Allowance
(In thousands)

		Gross receivables	Allowance for uncollectible	Net receivables
Receivables from sponsoring agencies	$	217,547	(2,236)	215,311
Hospital and other medical activities		374,432	(279,110)	95,322
Student tuition and fees		38,467	(9,278)	29,189
Auxiliaries		13,601	(4,824)	8,777
Medical service plan		78,676	(27,081)	51,595
Educational activities		29,224	(3,534)	25,690
Other		25,527	(5,397)	20,130
Total	$	777,474	(331,460)	446,014

Notes and Pledges Receivable
(In thousands)

Student notes receivable - University:		
Student notes outstanding	$	64,903
Allowance for uncollectible loans		(2,723)
Total student notes receivable, net	$	62,180
Gift pledges receivable, URO - Foundation:	$	116,450
Less:		
Allowance for doubtful pledges		(6,546)
Present value discount		(1,904)
Total gift pledges outstanding, net	$	108,000

(4) 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 $6,210,000 was capitalized during the year ended June 30, 2012.

Capital assets activity during the year ended June 30, 2012 is summarized as follows:

University Capital Assets
(In thousands)

		Beginning balance	Additions	Retirements	Transfers	Ending balance
Nondepreciable capital assets:						
Land	$	133,273	2,026	(592)		134,707
Construction in progress		122,123	203,468		(157,208)	168,383
Inexhaustible collections		20,434	1,091	(205)		21,320
Total nondepreciable capital assets		275,830	206,585	(797)	(157,208)	324,410
Depreciable capital assets:						
Buildings		3,531,455		(5,429)	148,950	3,674,976
Improvements and infrastructure		675,611			2,841	678,452
Equipment		1,014,871	78,932	(69,695)	2,197	1,026,305
Software		164,175	1,858		3,220	169,253
Exhaustible collections		524,182	29,415	(1,713)		551,884
Total depreciable capital assets		5,910,294	110,205	(76,837)	157,208	6,100,870
Less accumulated depreciation:						
Buildings		1,237,366	88,424	(4,133)		1,321,657
Improvements and infrastructure		326,434	23,238			349,672
Equipment		795,459	62,537	(63,276)		794,720
Software		124,210	16,227			140,437
Exhaustible collections		406,846	22,644			429,490
Total accumulated depreciation		2,890,315	213,070	(67,409)	—	3,035,976
Total net depreciable capital assets		3,019,979	(102,865)	(9,428)	157,208	3,064,894
Total	$	3,295,809	103,720	(10,225)	—	3,389,304

(5) Accrued Self-Insurance and Loss Contingency

The University's accrued self-insurance liability of $245,710,000 at June 30, 2012 covers hospital patient liability; hospital and medical professional liability; estimated general and contract liability; and workers' compensation liability related to employees paid from local funds. The accrued self-insurance liability was discounted at rates of 2% to 5% at June 30, 2012. Amounts increasing the accrued self-insurance liability are charged as expenses based upon estimates made by actuaries and the University's risk management division. An additional workers' compensation self-insurance liability of $23,211,000 at June 30, 2012 related to employees who are paid from State appropriations is included in the University's accounts payable. These claims will be paid from State appropriations in the year in which the claims are finalized, rather than from unrestricted net assets as of June 30, 2012.

The accrued self-insurance liability includes $178,441,000 at June 30, 2012 for the currently estimated ultimate cost of uninsured medical malpractice liabilities. Ultimate cost consists of amounts estimated by the University's risk management division and independent actuaries for asserted claims, unasserted claims arising from reported incidents, expected litigation expenses and amounts determined by actuaries using relevant industry data and hospital specific data to cover projected losses for claims incurred but not reported. Because the amounts accrued are estimates, the aggregate claims actually incurred could differ significantly from the accrued self-insurance liability at June 30, 2012. Changes in these estimates will be reflected in the Statement of Revenues, Expenses and Changes in Net Assets in the period when additional information is available.

Changes in Accrued Self-Insurance
(In thousands)

		2012	2011
Balance, beginning of year	$	244,494	206,829
Claims incurred and changes in estimates		60,338	75,536
Claim payments and other deductions		(59,122)	(37,871)
Balance, end of year		245,710	244,494
Less current portion		(60,933)	(60,388)
Balance, end of year – noncurrent portion	$	184,777	184,106

The University has contracted with several commercial carriers to provide varying levels and upper limits of excess indemnity coverage. These coverages have been considered in determining the required accrued self-insurance liability. There were no material settlements that exceeded insurance coverage during the last three years.

The University purchases excess indemnity coverage for certain areas such as commercial general liability, Board legal liability, and hospital and medical liability.

(6) Accrued Compensated Absences

Accrued compensated absences includes personnel earned but unused vacation and sick leave days, including the University's share of social security and Medicare taxes, valued at the current rate of pay.

Section 14a of the State Finance Act (30 ILCS 105/14a) provides that employees eligible to participate in the State Universities Retirement System or the Federal Retirement System are eligible for compensation at time of resignation, retirement, death or other termination of University employment for one-half (1/2) of the unused sick leave earned between January 1, 1984 and December 31, 1997. Any sick leave days that were earned before or after this period of time are noncompensable.

Changes in Compensated Absences Balance
(In thousands)

Balance, beginning of year	$	201,288
Additions		22,955
Deductions		(23,191)
Balance, end of year		201,052
Less current portion		(22,618)
Balance, end of year – noncurrent portion	$	178,434

(7) Bonds Payable

On July 7, 2011, the University issued $81,970,000 of AFS Revenue Bonds, Series 2011A. The proceeds from the Series 2011A were used to pay a part of the costs of various improvements and additions to the System, to refund and redeem a portion of the outstanding principal amount of the AFS Revenue Bonds, Series 2001B, and to fund all costs incidental to the issuance of the Bonds. The refunding resulted in a projected savings of $1,284,000 over the life of the issue at a present value of $907,000. The difference between the reacquisition price and the net carrying amount of the old debt, loss on refunding, was $430,000. This loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

On July 7, 2011, the University issued $10,875,000 of AFS Revenue Bonds, Series 2011B. The proceeds from the AFS Revenue Bonds, Series 2011B were used to refund and redeem a portion of the outstanding principal amount of the AFS Revenue Bonds, Series 2001C and to fund all costs incidental to the issuance of the bonds. The refunding resulted in a projected savings of $1,851,000 over the life of the issue at a present value of $1,499,000. The difference between the reacquisition price and the net carrying amount of the old debt, loss on refunding, was $305,000. This loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

On January 12, 2012, the University issued $71,900,000 of AFS Revenue Bonds, Series 2011C. Proceeds of these bonds were used to provide for the partial refunding of the outstanding principal of three different Series of AFS Revenue Bonds, Series 2001A, Series 2001B, and Series 2003A. Proceeds were also used to fund all costs incidental to the issuance of the Series 2011C Bonds. The refunding resulted in a projected savings of $9,971,000 over the life of the issue at a present value of $7,452,000. The difference between the reacquisition price and the net carrying amount of the old debt, loss (gain) on refunding for each Series, was $103,000, $306,000 and ($511,000), respectively. This loss (gain) is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Bonds Payable
(In thousands)

	Maturity dates	Beginning balance	Additions	Deductions	Ending balance	Current portion
Auxiliary Facilities System:						
Current Interest Bonds	2013 – 2041	$ 821,110	164,745	(111,710)	874,145	18,425
Capital Appreciation Bonds	2013 – 2030	202,520		(16,270)	186,250	16,270
Health Services Facilities System	2013 – 2027	59,015		(1,935)	57,080	2,890
UIC South Campus	2013 – 2023	66,325		(4,235)	62,090	4,515
		1,148,970	164,745	(134,150)	1,179,565	42,100
Unaccreted appreciation		(68,609)	9,476		(59,133)	(849)
		1,080,361	174,221	(134,150)	1,120,432	41,251
Unamortized debt premium		34,185	4,679	(4,045)	34,819	1,606
Unamortized loss on refunding		(21,779)	(633)	1,951	(20,461)	(1,791)
Financing payable under swap		3,240		(3,240)		
Total		$ 1,096,007	178,267	(139,484)	1,134,790	41,066

Capital appreciation bonds of $186,250,000 outstanding at June 30, 2012 do not require current interest payments and have a net unappreciated value of $127,117,000. The University records the annual increase in the principal amount of these bonds as interest expense and accretion on bonds payable.

None of the University's bonds described above constitute obligations of the State of Illinois. Costs associated with the issuance of the Series 1991, 1999A, 1999B, 2001A, 2001B, 2003A, 2005A, 2006, 2008, 2009A, 2010A, 2011A, 2011B and 2011C Auxiliary Facilities System Bonds; Series 1997B and 2008 Health Services Facilities System Bonds; and Series 2000, 2003 and 2008 UIC South Campus Bonds have been recorded as deferred charges and are being amortized over the life of the related bond issue.

Included in bonds payable is $129,855,000 of variable rate demand bonds. These bonds mature serially through April 2038. These bonds 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 University's several remarketing agents. The University 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 University has a standby bond purchase agreement with a liquidity facility entity. The University has several such agreements, with the fees on the Bond Purchase Commitment (formula based on outstanding bonds plus pro forma interest). The University, in the event a liquidity facility is utilized, has reimbursement agreements 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. Other outstanding bond issues bear interest at fixed rates ranging from 2.00% to 7.96%.

Variable Rate Bonds

Bond issues	Interest rate at June 30, 2012	Remarketing agent	Remarketing fee	Liquidity facility Bank	Liquidity facility Expiration	Liquidity facility Insurer	Liquidity fee
UIC South Campus, Series 2008	0.17%	JPMorgan Securities	0.075%	JPMorgan Chase LOC	6/24/2015	JPMorgan Chase LOC	0.525%
AFS, Series 2008	0.18	Loop Capital	0.075	JPMorgan Chase	5/19/2016	None	0.525
HSFS, Series 1997B	0.18	JPMorgan Securities	0.070	JPMorgan Chase LOC	4/1/2014	JPMorgan Chase LOC	0.55
HSFS, Series 2008	0.18	Goldman Sachs	0.070	JPMorgan Chase LOC	6/3/2014	JPMorgan Chase LOC	0.55

(a) Interest Rate Swap Agreements on Bonds Payable

The University has entered into three separate pay-fixed/receive-variable interest rate swap agreements. The objective of these swaps was to effectively change the University's variable interest rate on the Bonds to a synthetic fixed rate. The notional amount of the interest rate swaps is equal to the par amount of the related bonds, except for HSFS Series 2008, of which $330,000 is not covered by the swap agreement. In addition, the swaps were entered at the same time as the Bonds were issued and terminate with maturity of the Bonds. No cash was paid or received when the original swap agreements were entered into.

Credit Risk – As of June 30, 2012, the University was not exposed to credit risk because the swaps had a negative fair value. If interest rates change and the fair value of the swap became positive, the University would be exposed to credit risk in the amount of the derivative's fair value. The terms, fair values and credit ratings of the outstanding swaps as of June 30, 2012 are listed below:

Interest Rate Swaps

Bond issues	Outstanding notional amount	Effective date	Fixed rate paid	Variable rate received*	Fair value	Swap termination date	Counterparty	Counterparty credit rating (S&P/Moody's)
HSFS 2008	$ 39,750,000	Nov 2008**	3.534%	68% of LIBOR***	$ (7,224,000)	Oct-2026	Loop	A+/A2
UIC SC 2008	26,958,000	Feb 2006**	4.086	68% of LIBOR***	(4,967,000)	Jan-2022	Morgan Stanley	A-/Baa1
UIC SC 2008	26,472,000	Feb 2006**	4.092	68% of LIBOR***	(4,870,000)	Jan-2022	JPMorgan Chase	A+/Aa3

* SIFMA + 0.05% rate received from February 19, 2008 through February 3, 2010. Received cost of funds prior to February 19, 2008 and received 68% of LIBOR after February 3, 2010.
** Swap agreement was transferred from original issue to refunded bond issues.
*** LIBOR – London Interbank Offered Rate

The University engaged a third-party consultant to calculate the "mark to market" or "market value" of the swap transactions. Since these are negative numbers, they represent an approximation of the amount of money that the University may have to pay a swap provider to terminate the swap. The counterparty may have to post collateral in the University's favor in certain conditions, and the University would never be required to post collateral in the counterparty's favor.

Interest Rate Risk – Since inception of the swaps, declining interest rates exposed the University to interest rate risk, which adversely affected the fair values of the swap agreements.

Termination Risk – The University has the option to terminate any of the swaps early. The University or the counterparties may terminate a swap if the other party fails to perform under the terms of the contract. The University may terminate a swap if both credit ratings of the counterparties fall below BBB+ as issued by Standard & Poor's and Baa1 as issued by Moody's Investors Service. If a swap is terminated, the variable-rate bonds would no longer carry a synthetic fixed interest rate. In addition, if at the time of termination, a swap has a negative fair value, the University would be liable to the counterparties for a payment equal to the swap's fair value.

Basis Risk – The swaps expose the University to basis risk should the relationship between LIBOR and the variable weekly rate determined by remarketing agents change, changing the synthetic rate on the bonds. If a change occurs that results in the difference in rates widening, the expected cost savings may not be realized.

Other Risks – Since the swap agreements extend to the maturity of the related bond, the University is not exposed to rollover risk. In addition, the University is not exposed to foreign currency risk or to market access risk as of June 30, 2012. However, if the University decides to issue refunding bonds and credit is more costly at that time, it could be exposed to market access risk.

(b) Pledged Revenues and Debt Service Requirements

The University has pledged specific revenues, net of specified operating expenses, to repay the principal and pay the interest of revenue bonds. The following is a schedule of the pledged revenues and related debt:

Pledged Revenues

Bond issues	**Purpose**	**Source of revenue pledged**	**Future revenues pledged [2]** (In thousands)	**Term of commitment**	**Debt service to pledged revenues (current year)**
Auxiliary Facilities System	Refundings, various improvements and additions to the System	Net AFS revenue, student tuition and fees	$ 1,670,529	2041	7.47%
Health Services Facilities System	Additions to System and refunding	Net HSFS, Medical Service Plan revenue net of bad debt expense, College of Medicine net tuition revenue	68,578	2027	1.34
UIC South Campus	South Campus Development Project[1] and refunding	Defined Tax Increment Financing District (TIF) revenue, student tuition and fees, and sales of certain land in the UIC South Campus project	77,119	2023	2.17
		Total future revenues pledged	$ 1,816,226		

[1]An integrated academic, residential, recreational and commercial development south of UIC's main campus

[2]Total future principal and interest payments on debt

Future debt service requirements for all bonds outstanding at June 30, 2012 are as follows:

Debt Service Requirements

	Principal	**Interest**
	(In thousands)	
2013	$ 42,100	46,826
2014	45,170	45,593
2015	46,865	44,373
2016	48,560	43,161
2017	50,820	41,790
2018 – 2022	294,035	184,972
2023 – 2027	248,305	129,674
2028 – 2032	235,325	75,137
2033 – 2037	149,375	22,829
2038 – 2041	19,010	2,306
Total	$ 1,179,565	636,661

Using the actual rates of 0.17% (UIC South Campus, Series 2008) and 0.18% (Health Services Facilities System, Series 2008), in effect as of June 30, 2012, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will also vary.

UIC South Campus Revenue Refunding Bonds, Series 2008
Variable-Rate Debt Service Requirements
(In thousands)

		Variable-rate bonds		Interest rate	
		Principal	**Interest**	**swaps, net**	**Total**
2013	$	2,225	91	2,060	4,376
2014		4,425	87	1,938	6,450
2015		4,610	80	1,762	6,452
2016		4,810	72	1,578	6,460
2017		5,370	63	1,381	6,814
2018 – 2022		31,990	170	3,427	35,587
Total	$	53,430	563	12,146	66,139

Health Services Facilities System Revenue Bonds, Series 2008
Variable-Rate Debt Service Requirements
(In thousands)

		Variable-rate bonds		Interest rate	
		Principal	**Interest**	**swaps, net**	**Total**
2013	$	2,090	72	1,284	3,446
2014		2,105	68	1,214	3,387
2015		2,220	64	1,142	3,426
2016		2,240	61	1,068	3,369
2017		2,365	57	990	3,412
2018 – 2022		13,205	216	3,676	17,097
2023 – 2027		15,855	88	1,251	17,194
Total	$	40,080	626	10,625	51,331

Certain bonds of the University (AFS Series 1991) have debt service reserve requirements. The Maximum Annual Net Debt Service for those bonds, as defined, is $14,927,000.

(c) Advanced Refunded Bonds Payable

The University has defeased bonds through advanced funding in the current year, and accordingly, they are not reflected in the accompanying financial statements. The amount of bonds that have been defeased as of June 30, 2012 consists of the following:

Advanced Refunded Bonds
(In thousands)

Series		Outstanding at June 30, 2012
Auxiliary Facilities System, Series 2003A	$	14,095
Total	$	14,095

(8) Leaseholds Payable and Other Obligations

Leaseholds payable and other obligations activity for the year ended June 30, 2012 consist of the following:

Leaseholds Payable and Other Obligations
(In thousands)

		Beginning balance	Additions	Deductions	Ending balance	Current portion
University:						
Certificates of participation	$	459,150		(19,355)	439,795	143,855
Unamortized debt premium		11,754		(1,441)	10,313	1,403
Unamortized deferred loss on refunding		(6,630)		651	(5,979)	(5,872)
		464,274	—	(20,145)	444,129	139,386
Other capital leases		38,143	4,913	(5,824)	37,232	4,166
Energy services agreement installment payment contract		17,756		(976)	16,780	1,009
Environmental remediation liability		4,610	900	(3,899)	1,611	1,275
Total University	$	524,783	5,813	(30,844)	499,752	145,836
URO – Foundation:						
Annuities payable	$	46,636	5,969	(6,503)	46,102	6,310
Other liabilities		7,810		(235)	7,575	
Total URO – Foundation	$	54,446	5,969	(6,738)	53,677	6,310

The University leases various plant facilities and equipment under capital leases. This includes assets obtained with certificates of participation proceeds and recorded as capital leases, as well as, other capital lease agreements funded through operations.

Included in leaseholds payable is $125,280,000 of variable-rate demand Certificates of Participation (COP). These COPs mature serially through August 2021. These COPs 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 COPs 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 University's remarketing agent. The University pays the remarketing agent fees on the outstanding COPs balance. If the remarketing agent is unable to resell any COPs that are "put" to the agent, the University has a standby certificate purchase agreement with a liquidity facility entity. The University has an agreement, with the fees based on the Adjusted Principal (formula based on COPs outstanding plus pro forma interest). The University, in the event a liquidity facility is utilized, has a reimbursement agreement with a financial entity. 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 certificates have been calculated using the synthetic fixed rate for Series 2004, as illustrated in the table below. Other outstanding certificates bear interest at fixed rates ranging from 3.50% to 5.25%.

Variable Rate Certificates of Participation

COP issue	Interest rate at June 30, 2012	Remarketing agent	Remarketing fee	Liquidity facility Bank	Liquidity facility Expiration	Liquidity facility Insurer	Liquidity fee
COP Series 2004	0.32%	Morgan Stanley	0.10%	Bank of America	3/30/2013	None	0.85%

The COP Series 2004 is supported by a liquidity facility provided by Bank of America. Since this facility will expire in March of 2013, the outstanding balance of the related COP series is reported as a current liability at June 30, 2012.

(a) Interest Rate Swap Agreement on Certificates of Participation

To facilitate the advance refunding of the COP (Utility Infrastructure Projects) Series 2001 A & B; and, as a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance, the University entered into an interest rate swap in connection with its COP (Utility Infrastructure Projects) Series 2004.

The objective of the swap was to effectively change the University's variable interest rate on the COP to a synthetic fixed rate. The notional amount of the interest rate swap is equal to the par amount of the related COP. The swap agreement was entered at the same time as the COP were issued and terminate with maturity. No cash was paid or received when the original swap agreements were entered into.

Credit Risk – As of June 30, 2012, the University was not exposed to credit risk because the swaps had a negative fair value. If interest rates change and the fair value of the swap became positive, the University would be exposed to credit risk in the amount of the derivative's fair value. The terms, fair value and credit rating of the outstanding swap as of June 30, 2012 are listed below:

Interest Rate Swap

COP issue	Outstanding notional amount	Effective date	Fixed rate paid	Variable rate received	Fair value	Swap termination date	Counterparty	Counterparty credit rating (S&P/Moody's)
COP 2004	$ 125,280,000	March 2004	3.765%	100% of SIFMA	$ (20,108,000)	August 2021	Morgan Stanley	A-/Baa1

The University engaged a third-party consultant to calculate the “mark to market” or “market value” of the swap transactions. Since these are negative numbers, they represent an approximation of the amount of money that the University may have to pay a swap provider to terminate the swap. The counterparty may have to post collateral in the University’s favor in certain conditions, and the University would never be required to post collateral in the counterparty’s favor.

Interest Rate Risk – Since inception of the swap, declining interest rates exposed the University to interest rate risk, which adversely affected the fair values of the swap agreements.

Termination Risk – The University has the option to terminate the swap early. The University or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The University may terminate the swap if both credit ratings of the counterparty fall below BBB+ as issued by Standard & Poor’s and Baa1 as issued by Moody’s Investors Service. If the swap is terminated, the variable-rate certificates would no longer carry a synthetic fixed interest rate. In addition, if at the time of termination, the swap has a negative fair value, the University would be liable to the counterparty for a payment equal to the swap’s fair value.

Basis Risk – Starting in fiscal year 2006, the notional value of the swap and the principal amount of the associated COP began to decline. Conversely, the COP’s variable interest rates are expected to approximate SIFMA. For fiscal year 2012, the COP’s average variable interest rate was the same as SIFMA. As noted above, the swap exposes the University to basis risk should the relationship between SIFMA and the variable weekly rate determined by remarketing agents converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates widening, the expected cost savings may not be realized.

Other Risks – Since the swap agreements extend to the maturity of the related COP, the University is not exposed to rollover risk. In addition, the University is not exposed to foreign currency risk or to market access risk as of June 30, 2012. However, if the University decides to issue refunding COPs and credit is more costly at that time, it could be exposed to market access risk.

Using the actual rate of 0.32% in effect as of June 30, 2012, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate certificate interest payments and net swap payments will also vary.

Utility Infrastructure Certificates of Participation, Series 2004
Variable-Rate Debt Service Requirements
(In thousands)

	Variable-rate certificates		Interest rate	
	Principal	**Interest**	**swaps, net**	**Total**
2013	$ 125,280	401	4,706	130,387
Total	$ 125,280	401	4,706	130,387

(b) Capital Leases (includes Certificates of Participation)

Assets held under capital leases are included in capital assets at June 30, 2012 as follows:

Assets Held Under Capital Lease
(In thousands)

Land	$	8,423
Buildings		158,240
Improvements		263,386
Equipment		154,924
Subtotal		584,973
Less accumulated depreciation		249,795
Total	$	335,178

The net present value of outstanding capital leases at June 30, 2012 is as follows:

Outstanding Capital Leases
(In thousands)

Certificates of participation:		
Series 2003 South Farms	$	16,890
Series 2003 UI Integrate		31,700
Series 2003 Utility Infrastructure		31,970
Series 2004 Utility Infrastructure		125,280
Series 2005 College of Medicine		15,375
Series 2006A Academic Facilities		64,205
Series 2007A		72,170
Series 2007B		45,645
Series 2009A		36,560
Other capital leases		37,232
Net present value	$	477,027

As of June 30, 2012, future minimum lease payments under capital leases are as follows:

Future Minimum Lease Payments
Under Capital Leases
(In thousands)

2013	$	169,933
2014		46,175
2015		43,742
2016		38,039
2017		37,201
2018 – 2022		136,269
2023 – 2027		117,625
2028 – 2032		26,035
2033		215
Total minimum lease payments		615,234
Amount representing interest		(138,207)
Net present value	$	477,027

(c) ***Other Obligations***

As part of an energy services agreement, the University has entered into installment payment contracts to finance energy conservation measures. As of June 30, 2012, future minimum lease payments under installment payment contracts are as follows:

Future Minimum Lease Payments
Under Installment Payment Contract
(In thousands)

2013	$	1,544
2014		1,544
2015		1,544
2016		1,544
2017		1,544
2018 – 2022		7,722
2023 – 2026		5,407
Total minimum lease payments		20,849
Amount representing interest		(4,069)
Net present value	$	16,780

The University monitors environmental matters and records an estimated liability for identified environmental remediation costs. The estimated liability at June 30, 2012 is $1,611,000.

At June 30, 2012, the URO – Foundation had annuities payable outstanding of $46,102,000. Annuities payable represent an actuarial computation of the present value of future payments to annuitants.

(d) Operating Leases

The University also leases various buildings and equipment under operating lease agreements. Total rental expense under these agreements was $12,140,000 for the year ended June 30, 2012. The future minimum lease payments (excluding those leases renewed on an annual basis) are as follows:

Future Minimum Operating Lease Payments
(In thousands)

2013	$	9,584
2014		8,185
2015		5,825
2016		3,769
2017		2,571
2018 – 2022		2,951
Total	$	32,885

(9) Net Assets

As discussed in note 1, the University's net assets are classified for accounting and reporting purposes into one of four net asset categories according to externally imposed restrictions. The following tables include detail of the net asset balances for the University and the Foundation including major categories of restrictions and internal designations of unrestricted funds.

University Net Assets
(In thousands)

Invested in capital assets, net of related debt	$	1,932,473
Restricted – nonexpendable:		
Invested in perpetuity to produce income expendable for – scholarships, fellowships and research		78,446
Restricted – expendable for:		
Scholarships, fellowships and research		339,681
Loans		79,369
Service plans		146,170
Retirement of indebtedness		31,604
Capital projects		2,568
Unrestricted:		
Designated		1,040,898
Undesignated		
Total	$	3,651,209

URO – Foundation Net Assets

(In thousands)

Invested in capital assets, net of related debt	$	5,218
Restricted – nonexpendable:		
Invested in perpetuity to produce income expendable for – Academic Programs, scholarships, fellowships and research		766,644
Restricted – expendable for:		
Academic programs, scholarships, fellowships and research		661,460
Unrestricted		(20,689)
Total	$	1,412,633

(10) Funds Held in Trust by Others

The University and Foundation are income beneficiaries of several irrevocable trusts which are held and administered by outside trustees. The University and Foundation have no control over these funds as to either investment decisions or income distributions. In accordance with GASB standards, the principal is not recorded in the accompanying financial statements for the University. The Foundation has recorded the principal in the accompanying financial statements in accordance with FASB standards. The fair value of these funds at June 30, 2012 and the amount of income received from these trusts during the year then ended were as follows:

Funds Held in Trust by Others

(In thousands)

		University	URO – Foundation
Fair value of funds held in trust by others	$	42,984	45,772
Income received from funds held in trust by others		1,258	849

(11) State Universities Retirement System

The Entity contributes to the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined-benefit pension plan with a special funding situation whereby the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. 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 Web site 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 full time and attending classes with an employer. Of those Entity 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 34.51% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The State's contributions on behalf of the University to SURS for the years ended June 30, 2012, 2011 and 2010 were $439,316,000, $350,480,000 and $319,047,000, respectively, equal to the required contributions for each year. The UROs contributions to SURS for the years ended June 30, 2012, 2011 and 2010 were $1,116,000, $943,000 and $921,000, respectively.

The Entity's employees hired prior to April 1, 1986 are exempt from contributions required under the Federal Insurance Contribution Act. Employees hired after March 31, 1986 are required to contribute 1.45% of their gross salary for Medicare. The Entity is required to match this contribution.

Employees may also elect to participate in certain tax-sheltered retirement plans. These voluntary plans permit employees to designate a part of their earnings into tax-sheltered investments and thus defer federal and state income taxes on their contributions and the accumulated earnings under the plans. Participation and the level of employee contributions are voluntary. The employer is not required to make contributions to these plans.

(12) 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 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 establish 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 between the State and various unions that represent the State's and the University 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. Since the State contributes substantially all of the employer contributions, the single-employer provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, 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 toward 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 healthcare 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 toward health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced 5% 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 toward health, dental, and vision benefits. For fiscal year 2012, the annual cost of health, dental, and vision benefits before the State's contribution was $7,538 ($3,949 if Medicare eligible) if the annuitant chose benefits provided by a health maintenance organization (HMO) and $10,697 ($4,483 if Medicare eligible) if the annuitant chose other benefits. Additional contributions by annuitants for dependents ranging from $960 to $2,814 ($900 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 2012 are shown as follows:

Annual Employee Health, Dental, and Vision Contribution Requirements

		Benefits provided through	
		HMO	**Others**
Employee annual salary:			
$30,200 and below	$	696	996
$30,201 – $45,600		756	1,056
$45,601 – $60,700		786	1,086
$60,701 – $75,900		816	1,116
$75,901 and above		846	1,146

Additional contributions by employees for dependents ranging from $960 to $2,814 ($900 to $2,538 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

(13) Commitments and Contingencies

At June 30, 2012, the University had commitments on various construction projects and contracts for repairs and renovation of facilities of $102,606,000.

The University purchases the majority of natural gas and electricity from Prairieland and guarantees payment by Prairieland to its energy suppliers. Guarantee agreements are in place with Prairieland's energy suppliers for approximately $45,000,000.

The University receives moneys from federal and state government agencies under grants and contracts for research and other activities. The costs, both direct and indirect, charged to these grants and contracts are subject to audit and disallowance by the granting agency. The University believes that any disallowances or adjustments would not have a material effect on the University's financial position.

The University also receives moneys under third-party payor arrangements for payment of medical services rendered at its hospital and clinics. Some of these arrangements allow for settlement adjustments based on costs and other factors. The University believes that any adjustments would not have a material effect on the University's financial position.

The University is a defendant in a number of legal actions primarily related to medical malpractice. These legal actions have been considered in estimating the University's accrued self-insurance liability. The total of amounts claimed under these legal actions, including potential settlements and amounts relating to losses incurred but not reported, could exceed the amount of the self-insurance liability. In the opinion of the University's administrative officers, the University's self-insurance liability and limited excess indemnity insurance coverage from commercial carriers are adequate to cover the ultimate liability of these legal actions, in all material respects.

The University's hospital and clinics are involved in regulatory audits arising in the normal course of business. On June 8, 2007, a notice was received from the Office of Inspector General (OIG) on behalf of the Illinois Department of Healthcare and Family Services (IDHFS) indicating that the University received an overpayment of $14.8 million on behalf of Medicaid patients covering the period May 2004 through April 2006. University management is in the process of contesting this overpayment and estimates the University's probable liability related to this overpayment is $5 million based on additional documentation received from IDHFS subsequent to the original notice. During fiscal year 2010, the University submitted additional documentation and evidence of its positions. As of September 29, 2011, the OIG on behalf of the IDHFS contacted the University to request its settlement offer to resolve the audit. The University intends to pursue settlement discussion with OIG and IDHFS with a view toward resolution of the matter. The estimated liability including a provision for subsequent audits has been reflected in the University's balance sheet and results from operations as accounts payable for $9.7 million.

(14) Operating Expenses by Natural Classification

Operating expenses by natural classification for the year ended June 30, 2012 for the University and the URO – Foundation are summarized as follows:

University Operating Expenses by Natural Classification
(In thousands)

		Compensation and benefits	Supplies and services	Student aid	Depreciation	Total
Instruction	$	964,462	143,455	6,557		1,114,474
Research		457,727	250,035	2,894		710,656
Public service		249,863	162,257	1,868		413,988
Academic support		273,437	99,266	5,279		377,982
Student services		101,783	36,688	2,659		141,130
Institutional support		208,457	23,496	70		232,023
Operations and maintenance of plant		54,232	210,399	6,316		270,947
Scholarships and fellowships		214,722	2,056	24,230		241,008
Auxiliary enterprises		136,223	155,502	15,872		307,597
Hospital and medical activities		439,787	269,863			709,650
Independent operations		1,535	10,907			12,442
Depreciation					213,070	213,070
Total	$	3,102,228	1,363,924	65,745	213,070	4,744,967

URO – Foundation Operating Expenses by Natural Classification
(In thousands)

		Distributions on behalf of the University	Institutional support	Depreciation	Total
Fund-raising	$		11,257		11,257
Distributions on behalf of the University		148,373			148,373
General and administrative			12,688		12,688
Actuarial adjustments			5,694		5,694
Depreciation				519	519
Total	$	148,373	29,639	519	178,531

(15) Segment Information

The following financial information represents identifiable activities within the University financial statements for which one or more revenue bonds are outstanding. The Auxiliary Facilities System comprises University owned housing units, student unions, recreation and athletic facilities, and similar auxiliary service units, including parking. The Health Services Facilities System comprises the University of Illinois Hospital and associated clinical facilities providing patient care.

Condensed Balance Sheets

June 30, 2012

(In thousands)

		Auxiliary Facilities System	Health Services Facilities System	Total
Assets and deferred outflows of resources:				
Current assets	$	176,908	255,145	432,053
Noncurrent assets:				
Capital assets, net of accumulated depreciation		972,276	166,019	1,138,295
Other noncurrent assets		83,843	7,371	91,214
Deferred outflow of resources			6,109	6,109
Total assets and deferred outflows of resources	$	1,233,027	434,644	1,667,671
Liabilities:				
Current liabilities	$	76,565	92,230	168,795
Noncurrent liabilities:				
Long-term debt		995,405	53,987	1,049,392
Other liabilities		5,122	29,205	34,327
Total liabilities		1,077,092	175,422	1,252,514
Net assets:				
Invested in capital assets, net of related debt		9,745	106,911	116,656
Restricted:				
Expendable		24,257	7,066	31,323
Unrestricted		121,933	145,245	267,178
Total net assets		155,935	259,222	415,157
Total liabilities and net assets	$	1,233,027	434,644	1,667,671

Condensed Statement of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2012

(In thousands)

		Auxiliary Facilities System	Health Services Facilities System	Total
Operating revenues	$	321,701	585,167	906,868
Operating expenses		261,165	712,682	973,847
Depreciation expense		30,673	18,931	49,604
Operating income (loss)		29,863	(146,446)	(116,583)
Nonoperating (expenses) revenues, net		(10,519)	160,884	150,365
Increase in net assets		19,344	14,438	33,782
Net assets, beginning of year, as adjusted		136,591	244,784	381,375
Net assets, end of year	$	155,935	259,222	415,157

Condensed Statement of Cash Flows

Year ended June 30, 2012

(In thousands)

Net cash flows provided by operating activities	$	95,166	22,234	117,400
Net cash flows provided by noncapital financing activities		27	758	785
Net cash flows used in capital and related financing activities		(54,880)	(38,085)	(92,965)
Net cash flows (used in) provided by investing activities		(9,906)	2,525	(7,381)
Net increase (decrease) in cash and cash equivalents		30,407	(12,568)	17,839
Cash and cash equivalents, beginning of year		131,453	172,847	304,300
Cash and cash equivalents, end of year	$	161,860	160,279	322,139

(16) University Related Organizations

The Entity's financial statements include the activities of the University Related Organizations, which are presented as discretely presented component units in the accompanying financial statements. Below are condensed financial statements by organization:

Condensed Balance Sheets

June 30, 2012

(In thousands)

	Foundation	Alumni Association	WWT	Illinois Ventures
Assets:				
Current assets	$ 44,006	2,292	327	1,485
Noncurrent assets:				
Capital assets, net of accumulated depreciation	9,302	636	243	13
Other noncurrent assets	1,429,520	14,817		7,378
Total assets	$ 1,482,828	17,745	570	8,876
Liabilities:				
Current liabilities	$ 22,782	514	528	256
Due to related organizations		690		
Noncurrent liabilities:				
Other noncurrent liabilities	47,413	9		
Total liabilities	70,195	1,213	528	256
Net assets:				
Invested in capital assets, net of related debt	5,218	636	243	13
Restricted:				
Nonexpendable	766,644			
Expendable	661,460			
Unrestricted	(20,689)	15,896	(201)	8,607
Total net assets	1,412,633	16,532	42	8,620
Total liabilities and net assets	$ 1,482,828	17,745	570	8,876

Condensed Statements of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2012

(In thousands)

	Foundation	Alumni Association	WWT	Illinois Ventures
Operating revenues	$ 155,456	6,925	8,262	2,884
Operating expenses	178,012	7,696	8,340	2,678
Depreciation expense	519	38	201	13
Operating income (loss)	(23,075)	(809)	(279)	193
Nonoperating revenues (expenses)	23,108	60	28	(1,431)
Contributions to endowments	40,020			
Increase (decrease) in net assets	40,053	(749)	(251)	(1,238)
Net assets, beginning of year	1,372,580	17,281	293	9,858
Net assets, end of year	$ 1,412,633	16,532	42	8,620

Condensed Balance Sheets

June 30, 2012

(In thousands)

		Research Park	Prairieland	Singapore Research	Total
Assets:					
Current assets	$	480	5,830	2,406	56,826
Noncurrent assets:					
Capital assets, net of accumulated depreciation		1,345	59	409	12,007
Other noncurrent assets					1,451,715
Total assets	$	1,825	5,889	2,815	1,520,548
Liabilities:					
Current liabilities	$	3	4,207	1,589	29,879
Due to related organizations				735	1,425
Noncurrent liabilities:					
Other noncurrent liabilities					47,422
Total liabilities		3	4,207	2,324	78,726
Net assets:					
Invested in capital assets, net of related debt		1,345	59	409	7,923
Restricted:					
Nonexpendable					766,644
Expendable					661,460
Unrestricted		477	1,623	82	5,795
Total net assets		1,822	1,682	491	1,441,822
Total liabilities and net assets	$	1,825	5,889	2,815	1,520,548

Condensed Statements of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2012

(In thousands)

		Research Park	Prairieland	Singapore Research	Total
Operating revenues	$	675	19,142	9,251	202,595
Operating expenses		298	18,848	9,124	224,996
Depreciation expense		54	13	253	1,091
Operating income (loss)		323	281	(126)	(23,492)
Nonoperating revenues (expenses)			1	(7)	21,759
Contributions to endowments					40,020
Increase (decrease) in net assets		323	282	(133)	38,287
Net assets, beginning of year		1,499	1,400	624	1,403,535
Net assets, end of year	$	1,822	1,682	491	1,441,822

17) Subsequent Event

At June 30, 2012, the Variable Rate Demand Certificates of Participation (Utility Infrastructure Projects), Series 2004, were supported by a liquidity facility provided by Bank of America, N. A. (B of A). Due to declining credit ratings, B of A was replaced by The Bank of New York Mellon, effective August 30, 2012.