University of Minnesota

Annual Report 2002

Dear Friends

This past year has been one of sustained momentum. Under the leadership of former President Mark Yudof, we continued to improve the experience of students at the University of Minnesota and increased the level of pathbreaking research we perform, advancing the boundaries of human knowledge. True to our land-grant mission, we worked together with many communities to improve Minnesota's economy and quality of life. And, true to our responsibility as a public institution, we strove for effective management of our resources.

The University of Minnesota has built a solid foundation on which to grow even stronger. Today we have an outstanding leadership team, including deans and senior administrators from all campuses, that will keep us on course. We have made key investments in priority academic areas, from the biological sciences to the social sciences to computer science and engineering to the humanities and our professional colleges. Also noteworthy is our revitalized physical setting—the classrooms, laboratories, offices, and residences that we need to continue as a top-tier research university.

The financial information in this *Annual Report* provides an objective measure of how the University is doing. And the stories on the following pages complete the picture. This University is truly about people: a cancer patient now in remission thanks to groundbreaking research, students embracing their University education to gain brighter futures, a collaborative child care program that is changing lives for low-income mothers and their children.

These stories represent just a few of the ways in which the University makes a real impact on the lives of Minnesotans and people around the world each day. Thanks to our faculty, staff, students, alumni, and friends, we will continue to create excellence and to support an even stronger and better U.

Sincerely,

Robert H. Bruininks

Robert H. Bruininks
President

The University of Minnesota is one of the most comprehensive educational and research institutions in the country, graduating more than 10,700 students on average annually.

For the second consecutive year, a study by the University of Florida ranks the Twin Cities campus among the top three public research universities in the country. The University's programs in such areas as chemical engineering, geology, education, and agriculture are among the very best in the nation.

The Twin Cities is one of the few campuses nationwide with both a college of agriculture and a medical school. The breadth of its programs creates unique research, teaching, and learning opportunities that are the hallmark of a world-class public university.

"You can really do what you want here; when I graduate, I will be well prepared." —Minassie Tewoldebrhan, electrical engineering student

"The University of Minnesota offers so many resources." —Leila Babaeva, premedical student majoring in political science and physiology

Enhancing the Student

Today's students experience a much different University than students did a decade ago.

New freshmen are welcomed to the University with a special convocation, and freshman seminars give them the chance to interact with senior faculty in small class settings on a wide variety of topics. Online student services, including class registration and financial aid, are efficiencies that make better use of their time. More places to live on campus offer students a more collegiate experience. In the Twin Cities, more than 70 percent of freshmen live on campus; that's up from 45 percent in 1986.

These improvements are paying off. Applications for admission are up 60 percent since 1995.

Leila Babaeva was already a savvy college student when she graduated from Hopkins High School in spring 2001. By taking advantage of a program in which high school students can earn college credits, she already had 26 credits under her belt when she enrolled at the University last fall. Babaeva says her University experience was so positive, she decided to attend the U as a premedical student majoring in political science and physiology.

Babaeva, an honors student, has enhanced her academic studies by volunteering at two local hospitals and joining the College of Liberal Arts (CLA) Student Board and the Undergraduate Political Science Association, where she satisfied a keen interest for conversations about political issues.

"One of the things I like about the University is the variety of people. You can get so many different perspectives here."

"My experience at the U has been magnificent," says Babaeva. "I felt some trepidation about large class sizes, professors not knowing who you are, and getting lost in a huge university. My fears were unfounded. People are very friendly and inclusive. Many professors in large classes go out of their way to be accessible, and I've already had classes with as few as 20 students in them."

Minassie Tewoldebrhan is the kind of student who sets goals and sticks to them. He has successfully carried a full course load in electrical engineering while working in the design and engineering department of a power company.

Tewoldebrhan, originally from Eritrea, intends to graduate with honors in 2003.

"I'm impressed by the caliber of most professors; many are nationally recognized," he says. He appreciates that his professors are so willing to share their experiences with students, and that they take time to discuss academic and professional questions.

Experience

Tewoldebrhan, who plans to do graduate work in control systems and signal processing when he graduates, says, "My U experience is helping me develop essential creative-thinking and problem-solving skills. In addition, I am acquiring engineering design know-how by working in teams with fellow students."

"Dr. Okazaki has been a great doctor. He's really made a difference for me." —Steve Hanson, electronic tool technician, avid outdoors person, and kidney cancer patient

Advancing Research for an Ever-

Steve Hanson was running low on options two years ago when he met Dr. Ian Okazaki, a University of Minnesota oncologist. Hanson, a 50-year-old electronic tool technician and avid outdoors person, was in a seven-year battle with advanced kidney cancer. Okazaki was the lead researcher in a University clinical trial to see if a vaccine could be effective in treating some cancers by stimulating the immune system. "A competent immune system can potentially stop a lot of cancer growth," says Okazaki.

Hanson learned about the clinical trial from his doctor. Says Hanson, "I wanted to try it. Maybe I could help someone else down the road, and if it helped me, too, that would be great. I still have a lot I want to do in life."

The study involves gathering cancer membranes from a patient's own cancer cells to create a personal vaccine. About 30 people with advanced kidney cancer or melanoma are participating in the study. To date, results are promising. Tumors have shrunk in a few patients and the researchers have been able to detect immune stimulation in others.

Since completing the trial, Hanson has not required any further treatments; before that he needed surgery every three to six months. "I feel a lot better," he says. "My buddies have noticed. When we go on fishing trips, they see a big difference in the energy I have. I feel very lucky to have the U right here so I could be in this trial."

Okazaki says the opportunity to be involved in translational research—research that can be directly applied to patient care—was what brought him back to the University from the National Institutes of Health.

"I couldn't resist," says Okazaki. "This kind of research can only happen in a place like the University. Great clinicians, scientists, and researchers can come together to study a problem. The facilities are here to conduct the research, as is the patient population. We are able to offer patients and their families something on the cutting edge that brings hope for getting better and improving their quality of life—they're excited and we're excited."

Changing World

The University counts numerous world-renowned teachers and researchers on its faculty, and they're more productive than ever. University faculty members regularly generate nearly three times their annual salary in research grants. In fiscal year 2002, researchers garnered $527 million in sponsored research, marking the first time the University has surpassed half a billion dollars in research awards.

From examining the barriers to health care coverage in Minnesota to developing a better way to pasteurize juice to furthering our understanding of a virus that is threatening the state's swine industry, researchers are advancing our knowledge and understanding of the world in which we live.

As this research leads to pathbreaking discoveries, the University quickly applies those discoveries to change lives and improve our economic vitality and quality of life.

"This kind of research can only happen in a place like the University."
—Dr. Ian Okazaki, University of Minnesota oncologist

"Baby's Space has really helped me be a successful parent and working person. It helps our whole community." —Valerie Martinez, whose children are enrolled in Baby's Space

Meeting the Needs of

Two years ago, when Valerie Martinez heard about a new culturally based child care program opening right across the street from her home in the Little Earth housing community, she didn't waste a minute calling to reserve a spot for her soon-to-be-born child. Her daughter became the first baby to be enrolled in Baby's Space, a groundbreaking program providing infant and toddler care and family support services to parents in Little Earth and the surrounding Phillips neighborhood, one of the most economically distressed communities in Minneapolis.

"I needed to find a child care program with people and teachers I could trust and relate to, personally and culturally," says Martinez. "I really liked the cultural aspect of Baby's Space."

The University and several neighborhood early childhood programs collaborated to create Baby's Space. Parents were involved in its development, and the Minnesota Children's Museum designed the unique infant and toddler classrooms with an emphasis on nature.

"We came to the table as equals, and as a result, the collaboration worked," says Terrie Rose, associate director of the University's Irving B. Harris Center for Infant and Toddler Development and Baby's Space executive director. "We all shared a commitment to families and children."

Rose says anecdotal evidence suggests that the Baby's Space model is working. Babies are developmentally on track and mothers are delaying further pregnancies and are understanding what it takes to successfully nurture a child.

Rose and her colleague, Amos Deinard, M.D., received funding to expand to five sites and do a longitudinal study that will lead to implementing similar programs and best practices across the country.

Martinez says Baby's Space is unique because of its commitment to bring University resources into the community. "Lots of people come here to study us and find out about problems like our high infant-mortality rate, but they don't come back to help us. This program works with us to find solutions. Baby's Space has had a positive impact that goes beyond good child care. Low-income communities often get bad services. Baby's Space gives us the best of everything, which helps to lift the whole community up."

Our Communities

More than 300 University programs serve children and youth or assist organizations that benefit young people. Across the state, University centers and programs provide research and technical assistance to many communities and organizations. And, the University of Minnesota Extension Service (UMES) makes more than one million contacts annually with Minnesota residents.

Collaborative initiatives bring University resources to rural Minnesota. The Center for Small Towns, developed at the University of Minnesota, Morris, in cooperation with UMES and the College of Continuing Education, involves faculty and students directly in the issues facing rural communities.

Another program, Regional Sustainable Development Partnerships, brings together citizens and University faculty and students to strengthen the sustainability of natural-resource-based industries and the communities that depend on them.

"The Baby's Space model is on track to make a difference for at-risk families with mothers [who are] mandated to work through welfare reform."
—Terrie Rose, associate director of the University's Irving B. Harris Center for Infant and Toddler Development

"The University belongs to the people of Minnesota. Its buildings and its landscape ought to reinforce its stature as the state's most important institution and reflect Minnesota's deep commitment to education and learning." —Nina Archabal, director of the Minnesota Historical Society

Renewing Our

Campuses

As one of the University of Minnesota's nearly 412,000 alumni, Nina Archabal is part of the University's history. In fact, it was the University that attracted her to Minnesota.

Archabal, director of the Minnesota Historical Society, understands the historical value of the campus and how its buildings and landscape connect it to the students of yesterday and today.

"I walked on campus for the first time in 1965," says Archabal. "Its buildings are like old friends to me. Nearly 40 years later they evoke feelings of pride and nostalgia as well as respect for education. Of all Minnesota institutions, the University is the one I hold dearest."

Archabal says the Walter Library restoration is the centerpiece of the University's campus restoration and beautification story. The project restored the splendor of the original architecture while providing state-of-the-art technology for a 21st-century library.

"I spent a lot of time in Walter Library as a student," says Archabal. "I regarded it as a useful building, but not as a particularly attractive one. Today, it's a beautiful place. The interior shines with natural light through the restored skylight and the reflected light of gold leaf. It has come alive with the color of the original details, the owl motifs, and other symbolic decorations."

Archabal lives near the campus in St. Paul and walks its paths every day to enjoy the gardens and landscaping. She even replaces bulbs when the squirrels dig them out. "I love the benches all over the St. Paul campus. They are places for reflection and thought. Education is more than getting the facts. It's also tied to the physical beauty of a place and enhanced by having spaces to think and to rest.

"The University belongs to the people of Minnesota. Its buildings and its landscape ought to reinforce its stature as the state's most important institution and reflect Minnesota's deep commitment to education and learning."

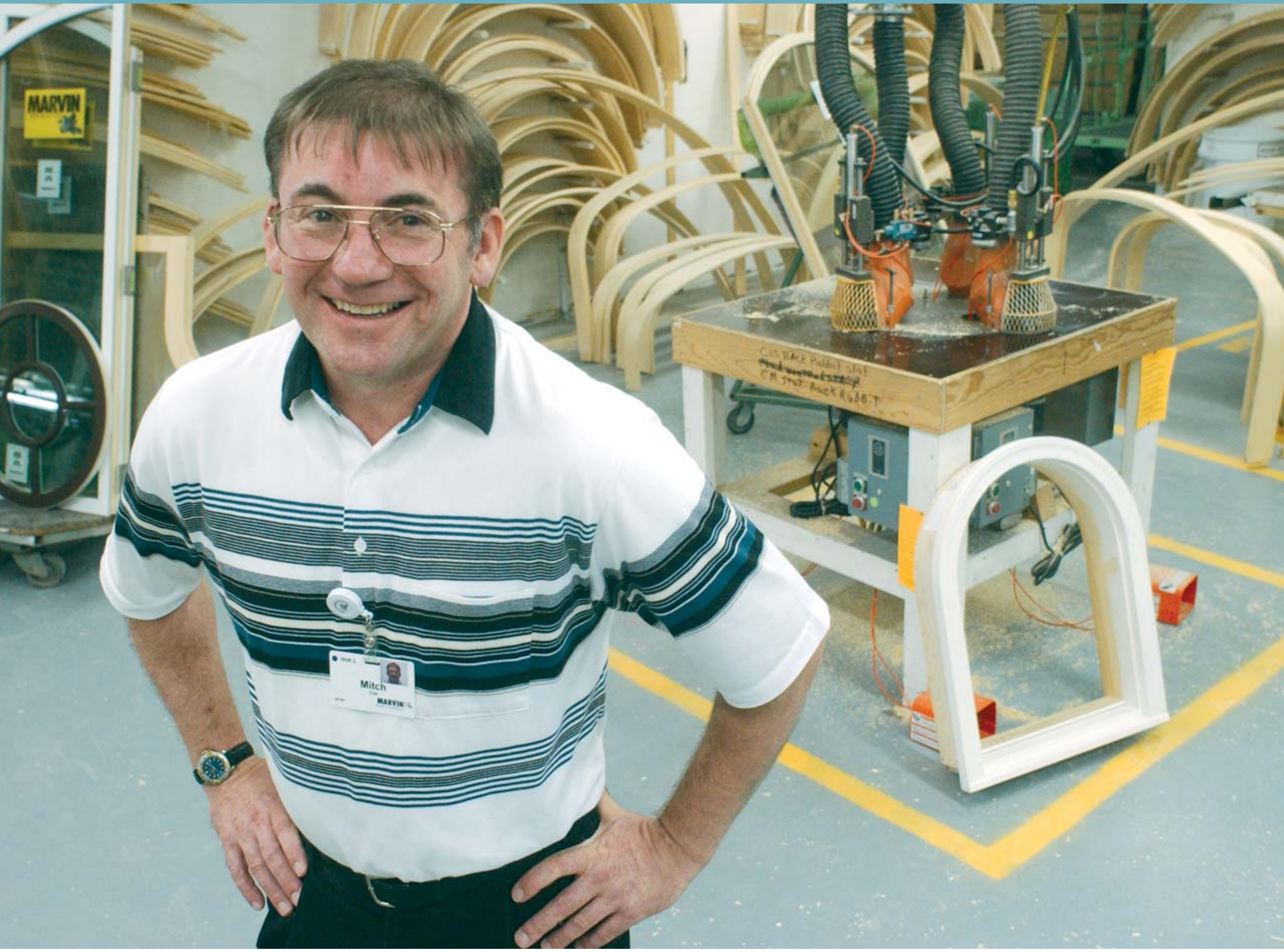
Physical renewal of the University of Minnesota's campuses has improved the academic and aesthetic environment. Since 1997, the University has allocated $1.2 billion for renovation and new construction. The five-year roofs, windows, and walls initiative invested $46 million in more than 130 University facilities. Recently completed or soon-to-be-completed projects include:

- Walter Library
- Rapson Hall, renovation and addition to the architecture building
- Riverbend Commons for student housing, parking, and public spaces
- Molecular and Cellular Biology building
- Coffman Memorial Union renovation
- Washington Avenue pedestrian bridges
- Ridder Hockey Arena and Baseline Tennis Center
- Duluth Library
- Morris Science and Mathematics building

Campus beautification efforts—flowers, greenery, gardens, new walkway lighting, walking paths, benches, and banners—instill a sense of place throughout campus and create a lovelier and more colorful University setting.

"This kind of program can bring new life to small towns."

—Mitch Cole, Marvin Windows employee and graduate of the University's first completely off-campus, four-year degree program



Fueling Minnesota's

Economy

Well-educated graduates are one of the University of Minnesota's greatest contributions to Minnesota's economic health and quality of life. But, many who want to earn a degree live and work in communities far from a University of Minnesota campus. Today, because of partnerships with other institutions and distance learning, more Minnesotans have access to U of M degree programs.

Now, an innovative partnership between the University of Minnesota, Crookston (UMC), and Marvin Windows and Doors is offering a four-year degree program completely on-site in Warroad, Minnesota. In spring 2002, the first five students graduated in Warroad with bachelor of manufacturing management (B.M.M.) degrees from the University of Minnesota.

Mitch Cole, a 22-year Marvin employee, is one of those first graduates. Years ago, Cole completed two years of college, but a tour of duty with the Navy cut his education short. Returning to Warroad to work and raise a family, Cole moved up the ladder at Marvin to his current position as a product group manager. When he learned of the opportunity to earn his degree on-site, he jumped at the chance.

"I've had my current position at Marvin since 1996," says Cole. "It's about as far as you can go without a degree. Finishing my education with a degree that fits what I do has opened new doors for me. It also gave me an extreme sense of accomplishment and fulfillment."

Marvin, a family-held company, is investing $350,000 a year to enable about 100 employees to take college classes in Warroad. Currently, 25 employees are enrolled in the B.M.M. program; the rest are in a two-year feeder program offered collaboratively with Northwest Technical College. The Marvin family is committed to improving employees' educational and promotional opportunities, as well as contributing to northern Minnesota's economic health.

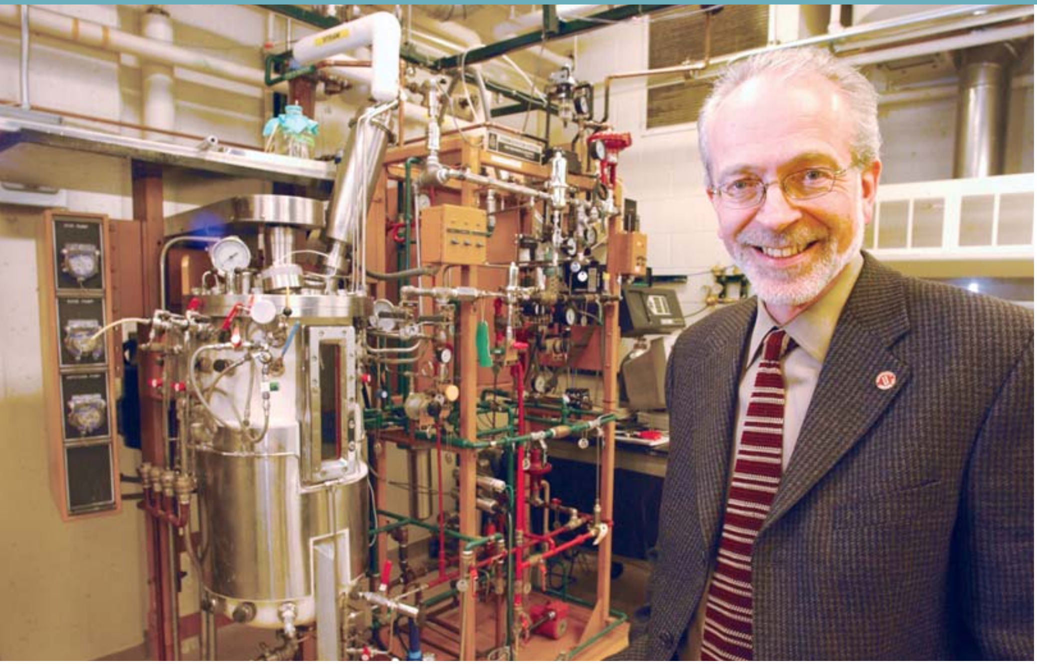
For UMC, this program's success demonstrates that partnerships with businesses are a viable way to bring the University directly to people. The University is forging similar partnerships with Polaris in Roseau and Arctic Cat in Thief River Falls.

Says Cole, "One of the reasons people leave small towns is the lack of educational opportunities. This kind of program can bring new life to small towns."

The University of Minnesota has 411,834 living alumni. More than 200,000 Minnesotans are University graduates.

University alumni have founded 1,500 technology companies in the state; these companies employ about 100,000 Minnesotans and add $30 billion annually to the state's economy.

"Small start-up companies need the University's support to succeed, and we need to provide opportunities for our graduates to do their work in Minnesota." —Robert Elde, dean of the College of Biological Sciences



Robert Elde, dean of the College of Biological Sciences (CBS), says the University is fueling Minnesota's biotechnology industry. "We have faculty and facilities that are dramatically improving the molecular and cellular biology portfolio at the University," says Elde. "Now we are getting out of the ivory tower to facilitate a technology and knowledge transfer to the marketplace.

Research in technology is progressing at an astounding pace, directly helping Minnesota compete in the new knowledge economy. In fiscal year 2002, royalties generated by University-developed technologies totaled $26.5 million. Based on University research, 38 new U.S. patents were issued and six more companies were started.

"Biotechnology provides great opportunities for job growth and increased tax revenue for the state. However, small start-up companies need the University's support to succeed, and we need to provide opportunities for our grads to do their work in Minnesota."

A University initiative called Biodale is a one-stop shopping mall for biotech research services that support emerging biotech companies. Located on campus in St. Paul, it houses $40 million in high-tech research equipment in six shops. Users include University faculty, staff, and students, as well as many start-up companies that cannot afford their own equipment yet.

In 2001, to further support the growth of emerging life-science companies, the University helped create University Enterprise Laboratories, Inc. (UEL), a nonprofit, public-private partnership between the University of Minnesota Foundation and Minnesota Technology, Inc. The goal is to build a 50,000-square-foot laboratory to provide flexible lab space for University faculty, students, and start-up companies.

Transferring Technology to the Marketplace

UEL provides support for life-science companies and builds the infrastructure needed to turn new discoveries into commercial technologies. This, in turn, according to Elde, helps the University attract and retain great faculty and students and strengthen the state's economy.

University of Minnesota

Financial Report
2002

Introduction

This discussion and analysis of the University of Minnesota's consolidated financial statements provides an overview of the consolidated financial position and activities of the University for the year ended June 30, 2002. The discussion has been prepared by management and should be read in conjunction with the consolidated financial statements and the accompanying notes. Consolidated financial data from fiscal year 2001 is not discussed in the following analysis, but a comparative analysis will be presented in future years.

The University of Minnesota is both the state's land-grant university, with a strong tradition of education and public service, and a major research institution, with faculty of national and international reputation. Its statutory mission is to offer undergraduate, graduate, and professional instruction through the doctoral degree, and to be the primary state-supported academic agency for research and extension services.

The University of Minnesota, founded in 1851, has four campuses (Twin Cities, Duluth, Morris, Crookston), a collaborative center at Rochester, and research and outreach centers and extension service offices throughout the state.

The Twin Cities campus is one of the three largest campuses in the country in terms of enrollment (approximately 46,500 students) and also one of the most comprehensive. It is the state's major research campus with expenditures of approximately $334.0 million in fiscal year 2002 for research under various programs funded by governmental and private sources.

The Duluth campus (approximately 9,400 students) is a comprehensive regional university that offers instruction through the master's degree and has unique research strengths in natural and freshwater resources.

The Morris campus (approximately 1,900 students) provides an innovative and high-quality residential undergraduate liberal arts education to a very select and intellectually gifted student body.

The Crookston campus (approximately 2,500 students) provides career-oriented education at the baccalaureate level, primarily in polytechnical disciplines.

The Rochester collaborative center is focused on meeting the educational needs of students in the Rochester area at the upper division and postbaccalaureate levels.

Mission

The University of Minnesota's three mission activities are instruction, research, and public service.

- **Instruction:** to provide instruction through a broad range of educational programs that prepare undergraduate, graduate, and professional students for productive roles in society.
- **Research:** to generate and preserve knowledge, understanding, and creativity by conducting research, scholarship, and artistic activity.
- **Public Service:** to exchange the University's knowledge and resources with society by making them accessible to the citizens of the state.

Operations

The University of Minnesota conducts its mission activities at its campuses and other facilities throughout the state. Each year, the University of Minnesota

- provides instruction for more than 60,000 students;
- graduates approximately 10,700 students, 40 percent with graduate or first professional degrees on the Twin Cities campus;
- conducts research sponsored by the National Institutes of Health, the National Science Foundation, other federal agencies, and numerous private companies and foundations;
- reaches out to more than one million Minnesotans through various outreach and public service activities.

Consolidated Financial Statements

The consolidated financial statements are prepared in accordance with generally accepted accounting principles prescribed by the Governmental Accounting Standards Board (GASB). Effective July 1, 2001, the University adopted GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* as amended by GASB Statement No. 35, *Basic Financial Statements—Management's Discussion and Analysis—for Public Colleges and Universities;* Statement No. 37, *Basic Financial Statements—and Management's*

Discussion and Analysis—for State and Local Governments: Omnibus; and Statement No. 38, *Certain Financial Statement Disclosures* (GASB accounting standards). These standards establish comprehensive new financial reporting requirements for public colleges and universities, requiring an economic-resources-measurement focus and the accrual basis of accounting.

The consolidated financial statements required under the new reporting standards include the Consolidated Statement of Net Assets; the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets; and the Consolidated Statement of Cash Flows. All are reported on a consolidated basis for the University as a whole, rather than on the fund basis used under the former accounting model.

Consolidated Statement of Net Assets

The Consolidated Statement of Net Assets presents the consolidated financial position of the University at the end of the fiscal year, under a classified balance sheet format that reflects current and noncurrent assets and liabilities, and reports net assets under the following three separate classifications:

- **Invested in capital assets, net of related debt.** This category includes property, plant, and equipment, net of accumulated depreciation, reduced by the outstanding balances of debt attributable to these capital assets.
- **Restricted, which is divided into two categories — expendable and nonexpendable.** Expendable assets are available for expenditure by the institution, but only in accordance with restrictions placed on their use by donors and other external entities. Nonexpendable assets are externally restricted, but are also required to be retained in perpetuity, including the University's true endowments.
- **Unrestricted.** Includes assets that are not subject to limitations or stipulations imposed by external entities and that have not been set aside for capital or endowment purposes. These assets are available for any lawful purpose of the institution and include resources that may be designated for specific purposes as determined by management, financial, or Board of Regents policies.

The University's consolidated assets, liabilities, and net assets at June 30, 2002, are summarized below (in thousands of dollars).

Current assets	$ 511,457
Capital assets, net	1,789,695
Other noncurrent assets	1,063,686
Total assets	3,364,838
Current liabilities	629,255
Noncurrent liabilities	564,280
Total liabilities	1,193,535
Unrestricted	334,989
Restricted — expendable	486,067
Restricted — nonexpendable	188,742
Invested in capital assets, net of related debt	1,161,505
Net assets	$2,171,303

Current assets at June 30, 2002, totaled $511.5 million, consisting primarily of cash and cash equivalents, securities lending collateral, and net receivables. State and federal appropriations receivable totaled $131.0 million, and receivables from students amounted to $46.0 million net of estimated uncollectible amounts, including student loans scheduled for collection within the next year. Sponsored programs and trade and other receivables, net of allowances, totaled approximately $77.8 million and $51.3 million, respectively, at June 30, 2002.

Capital assets, net of accumulated depreciation, totaled $1,789.7 million, and included significant investment in buildings and infrastructure assets of $1,279.4 million and construction in progress of another $205.0 million. Other noncurrent assets totaled $1,063.7 million, including long-term endowment and other investments of $913.2 million, unspent bond proceeds that are earmarked for approved capital projects, and the portion of student loan receivables scheduled for collection beyond June 2003.

Current liabilities totaled $629.3 million and consisted primarily of accounts payable, securities lending collateral, and accrued liabilities and other, including significant expected obligations under the University's self-insured medical plan. Current liabilities also included revenue related to summer session tuition deferred to fiscal year 2003, funds received in advance of expenditures on sponsored accounts, and the current portion of bonds payable. Four of the University's bond issuances have demand provisions that require the University to repurchase the bonds upon notice from bondholders. The University has entered into a standby purchase agreement to provide liquidity support for only the Series 2001C bonds. Although management believes that these bonds will continue to be paid according to the original noncurrent payment schedules, $252.6 million was reported as current liabilities, including all of the outstanding obligations under the Series 1999A, 2001A, and 2001B bonds and a portion of the Series 2001C bonds that would be due within the next year if the standby purchase agreement is exercised.

Noncurrent liabilities, totaling $564.3 million, included primarily principal amounts due on University bonds and vacation and other compensation-related liabilities that are payable beyond June 2003.

Beginning net assets have been restated to reflect implementation of the new GASB accounting standards and have been recorded as a cumulative effect of change in accounting principles. These changes are as follows:

- Unexpended cash advances received for sponsored programs are recorded as unearned income. In prior years, such advance payments were recognized as revenue immediately, and the change related to prior fiscal years reduced beginning net assets by $69.0 million.
- Federal Capital Contributions to the Perkins Loan program, ultimately refundable if new student loan originations cease, have been reclassified to liabilities, with a decrease to beginning net assets of $54.2 million. Previously, the amounts received from the federal government were considered to be part of net equity.
- Revenues for summer session have been prorated between fiscal years, based on the revenue earnings stream; expenses related to the delivery of these courses have been matched to the revenue. In prior years, summer session revenue was recorded in the period in which the majority of the session occurred.
- Adjustments to the useful lives of infrastructure assets, defined as long-lived capital assets that normally can be preserved for a significantly greater number of years than most capital assets, were also recorded as a change in accounting principle.

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

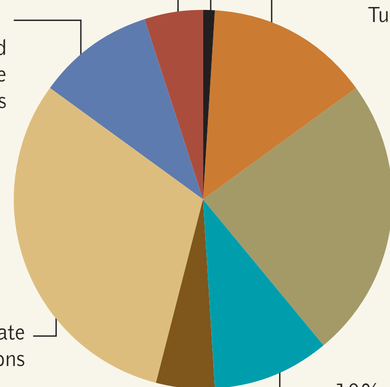
The Consolidated Statement of Revenues, Expenses, and Changes in Net Assets presents the institution's operating, nonoperating, and capital- and endowment-related activity during the year. This statement differentiates between operating and nonoperating revenues and expenses, and displays the net income or loss from operations. Operating revenues are those generated by the University's principal ongoing operations such as tuition, sponsored research grants and contracts, and sales and services provided by the University's educational and self-supporting auxiliary units. State appropriations, under GASB Statement No. 34, are considered nonoperating revenues, as are gifts and other revenues for which the University does not give equal value in exchange for the resources provided.

The University's consolidated revenues, expenses, and changes in net assets for the year ended June 30, 2002, are summarized as follows (in thousands of dollars):

Operating revenues	
Student tuition and fees (net)	$ 293,127
Grants and contracts	508,328
Auxiliary enterprises (net)	206,721
Educational activities	104,422
Federal appropriations	18,215
Other revenues	4,833
Total operating revenues	1,135,646
Operating expenses	2,005,138
Operating loss	(869,492)
Nonoperating revenues (expenses)	
State appropriations	643,088
Grants and gifts	203,895
Net investment loss	(56,719)
Interest expense	(22,400)
Other nonoperating expenses (net)	(1,432)
Loss before other revenues	(103,060)
Capital appropriations	81,711
Capital and endowment gifts and grants	23,631
Total other revenues	105,342
Increase in net assets	2,282
Net assets, beginning of year	2,281,059
Cumulative effect of change in accounting principles	(112,038)
Net assets, end of year	$2,171,303

The following graph illustrates the sources of the University's operating and nonoperating revenues for the year ended June 30, 2002.

FY2002 TOTAL REVENUES



One of the University's strengths is that it is not overly dependent on any of its four main sources of revenue: student tuition and fees, grants and contracts, sales by auxiliary and educational units, and state appropriations. During fiscal year 2002, the combined student tuition and fee rate increases amounted to 13.8 percent, with another 16 percent increase in effect for fiscal year 2003. As a result of implementing the new GASB accounting standards, the student tuition and fees and auxiliary revenues were reduced by scholarship and fellowship amounts already recognized as revenues. These changes eliminated the double counting of revenues that resulted from recording gifts received for scholarships and the tuition or auxiliary revenue from recipients of such scholarships. For the year ended June 30, 2002, student tuition and fees totaled $293.1 million, net of $68.3 million of scholarship allowances; auxiliary revenues of $206.7 million were net of $7.4 million of scholarship allowances.

Grants and contracts from the federal government totaled $319.8 million in fiscal year 2002, with an additional $188.5 million from other government and private sources, all primarily related to the funding of research, instruction, and public service programs.

Capital appropriations are awarded biennially, and the amount approved by the state of Minnesota in fiscal year 2002 totaled $97.9 million, including funding for preservation and replacement of campus facilities, classroom improvements, and new construction and renovation of facilities on three campuses. The University records state capital appropriation revenue only when approved capital expenditures have been incurred, however; thus it recorded revenue for the year ended June 30, 2002, of $81.7 million.

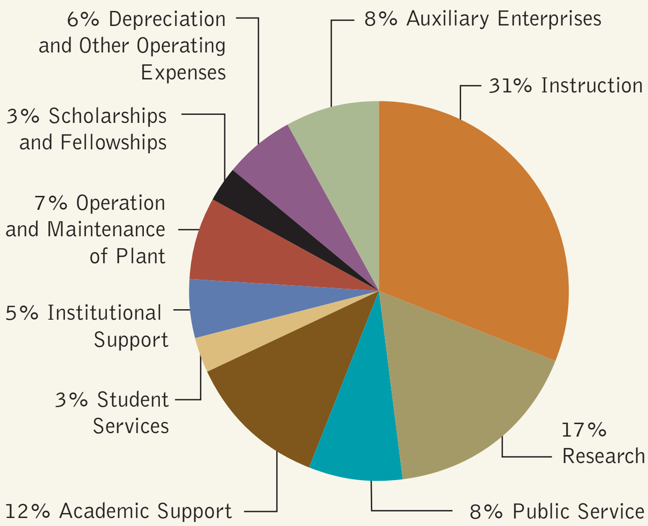
State operating appropriations totaled $643.1 million. This source, in addition to other sources of unrestricted revenue (tuition and educational and auxiliary activities) and nonoperating grants totaling $114.8 million, funded a number of University priorities including competitive compensation plans for faculty and staff; various academic initiatives; enhancement of services to students including technology improvements, upgrades to the financial aid process, and freshman seminars; and increases in facilities costs. Other significant sources of revenue to the University in fiscal year 2002 included donations and gifts in support of operating expenses of $89.1 million, and gifts for capital purposes of $21.5 million.

The University's expenses for the year ended June 30, 2002, broken down by functional and natural category, are as follows (in thousands of dollars):

	Compensation and benefits	Supplies and services	Scholarships and fellowships	Depreciation	Total
Instruction	$ 519,180	$103,039			$ 622,219
Research	215,972	117,856			333,828
Public service	107,749	44,488			152,237
Academic support	182,216	61,819			244,035
Student services	55,707	11,288			66,995
Institutional support	99,424	9,214			108,638
Operation and maintenance of plant	79,901	68,351			148,252
Scholarships and fellowships	3,669	245	$55,075		58,989
Depreciation				$119,041	119,041
Auxiliary enterprises	63,370	87,048			150,418
Other expenses		486			486
Total	$1,327,188	$503,834	$55,075	$119,041	$2,005,138

Total expenses by functional category are illustrated below.

FY2002 FUNCTIONAL EXPENSES



Across almost all functional categories, salaries and compensation-related expenditures continued to represent the most significant expense to the University. Early in the fiscal year, the University initiated a self-insured health plan, moving away from the Minnesota State Employees Group Insurance Program (SEGIP), in which the University had been a participant since 1964. The change was made in the interest of gaining more control over the management of health care benefits, containing the rising cost of health care, which is projected to increase 20 percent per year through 2004, and tailoring benefits to meet the expressed needs of employees. Additional details on the self-insurance programs can be found in Note 9 of the consolidated financial statements.

Consolidated Statement of Cash Flows

The Consolidated Statement of Cash Flows, a new reporting requirement for public higher education under the new GASB accounting standards, presents information about changes in the University's cash position using the direct method of reporting sources and uses of cash. The direct method reports all major cash inflows and outflows gross, differentiating these activities into those arising from operating activities; noncapital financing, such as nonexchange grants and contributions; capital financing, including bond proceeds from debt issued to purchase or construct buildings and other capital assets; and investing activities.

The University's cash flows for the year ended June 30, 2002, are summarized below (in thousands of dollars).

Cash provided (used) by	
Operating activities	$(760,429)
Noncapital financing activities	878,968
Capital and related financing activities	(62,292)
Investing activities	28,338
Net change in cash	84,585
Cash, beginning of the year	154,037
Cash, end of the year	$ 238,622

The University's cash and cash equivalents increased $84.6 million due to the inflow of funds provided by noncapital financing and investing activities and offset by the use of funds for capital acquisitions and related financing activities. The most significant sources of cash provided by noncapital financing activities included state appropriations totaling $684.7 million, grants of $99.6 million, and gifts of $88.2 million in fiscal year 2002. Cash inflows for capital acquisitions from state appropriations, gifts and grants, and bonds issued during the year funded the University's equipment needs and ongoing renovation and construction initiatives.

Investment Activities

The endowment funds of the University are invested to preserve the inflation-adjusted value of the endowment and to maximize total return within acceptable risk parameters. These objectives are meant to be achieved over three- to five-year periods. Given the current, challenging investment environment, the endowment portfolio has not been able to maintain its inflation-adjusted value for the most recent three-year period. For longer term five- and ten-year periods, the strong performance of the equity markets was more than adequate to allow the endowment funds to achieve this objective.

During fiscal year 2002, the market value of endowment funds decreased approximately $103.2 million. This decrease was primarily the result of net investment losses totaling $87.5 million and distributions of $37.9 million to departments for spending purposes, partially offset by new contributions to the endowment funds.

To provide a relatively stable level of support for endowed programs, a specified percent of a three-year, moving average market value of the endowment is distributed each year. These distributions provide funds for a variety of purposes, including instructional needs, research activities, scholarships, and academic support. An endowment spending policy requires balancing current needs with the long-term focus of the institution. During fiscal year 2002, the University reduced the level of endowment funds available for distribution from 5.50 percent at the beginning of the year, to 5.25 percent midyear, to 5.00 percent beginning July 1, 2002. This adjustment was made according to University policy, which links the distribution rate to the ability to maintain the real value of the endowment funds.

Capital and Debt Activities

Capital additions totaled $322.4 million in fiscal year 2002; these related primarily to renovation and construction of academic and research facilities. Current year capital asset additions were funded primarily with capital appropriations of $79.8 million, debt proceeds of $127.3 million, and $17.0 million from gifts designated for capital purposes.

Construction in progress at June 30, 2002, included significant ongoing expenditures related to the Molecular and Cellular Biology building, Coffman Memorial Union remodeling, Art Teaching and Research building, and numerous other continuing projects.

Bonds and other debt payable totaled $719.3 million at June 30, 2002, and included proceeds from bonds issued during fiscal year 2002 totaling $180.0 million, and another $15.7 million of capital leases and debt-service obligations related to state of Minnesota infrastructure development bonds. The University's bonds were issued to finance a variety of new capital and renovation projects, including acquisition of a new telephone system and School of Dentistry clinical equipment, improvements to Mariucci Arena, remodeling of Coffman Memorial Union, construction of the new Riverbend Commons residence hall and parking complex and the art building facility, and construction and renovation of various other academic and housing complexes. Additional details on capital and long-term debt activities can be found in Notes 4 and 5 of the consolidated financial statements.

The University takes seriously its role of financial stewardship and works hard to manage its financial resources effectively, including the prudent use of debt to finance capital projects. There have been no significant changes in credit ratings or debt limitations that may affect future financing for the University. The University has chosen not to enter into long-term, take-out agreements on the Series 1999A, 2001A and 2001B bonds. This causes these bonds to be classified as current liabilities in the Consolidated Statement of Net Assets. Both Standard & Poor's and Moody's Investors Services assigned excellent ratings to the $159.9 million variable-rate demand bonds, Series 2001C, issued in December 2001. Their stable outlook reflects the University's creditworthiness, its position as the state's flagship higher education institution, competitive demand trends and stable enrollment, good financial performance, high levels of unrestricted monies, and a manageable debt burden. The long-term, stable outlook anticipates that a potentially weak state-funding environment will be countered by rising student demand, strong private support and research funding, and the benefits of new capital investments.

The University continues to execute its long-range plan to modernize and expand its teaching, research, and public service facilities. The Board of Regents approved a six-year capital budget plan that calls for the investment of $775.0 million in capital improvements through fiscal year 2008, including financial support of $647.0 million from the state of Minnesota and $128.0 million of University financing. The capital plan balances expenditures for renovation and renewal with the need for new and modern facilities. The goals of the capital plan include preserving campus facilities through an emphasis on general infrastructure and basic building components, advancing key academic priorities, investing in research infrastructure for future competitiveness, enhancing the student experience, and improving outreach and engagement. Levels of state funding, changes in the University's priorities, ability to generate fund-raising and private investment goals identified in the plan, and unknown project complexities could alter the University's decision to fully implement this capital plan.

Important Economic Factors

The University of Minnesota concluded fiscal year 2002 in an exceptionally strong operational and financial position, including ending the year in a strong net asset position. Faculty, staff, and students remained committed to the goals of the institution. University faculty, as leaders in their fields, excelled in their pursuit of sponsored research awards. There was continued improvement in the ability to attract highly qualified students. The University invested in significant improvements to the physical capital through the renovation of existing buildings and the construction of new academic facilities. Significant capital investments have also been made in student housing and related services.

The very nature of these accomplishments in a highly competitive and highly complex environment creates many challenges for the future. Because of these successes, the stakeholders have raised their expectations of the University. Management believes that the University is well positioned to face these additional challenges.

The University's strong financial position, as evidenced by its annual consolidated financial statements, diverse revenue streams, strong student demand, and high degree of success in research funding, will continue to enable the University, over the long-term, to advance its excellence. For example, the University's debt management practices have established an aggressive payback of outstanding debt; approximately 88 percent of all existing debt is scheduled to be retired by fiscal year 2020, and the average cost of capital is currently 4.25 percent. An analysis of student demand, market position, and financial indicators places the University solidly in the strong "Aa" category and indicates a strong level of additional capacity.

Despite the University's recent successes, the short term does hold some degree of risk. A crucial element in the University's next two-year financial period will be the relationship with the state of Minnesota. The University currently receives an annual appropriation from the state totaling more than $640.0 million, which represents approximately 31 percent of annual revenues that support the mission activities. The national economic downturn has affected state revenues in Minnesota and could negatively impact the pace at which the University is able to advance in several key areas.

Currently, the University is preparing a two-year budget proposal to the state of Minnesota that will cover the period beginning July 1, 2003, through the fiscal year ending June 30, 2005. The budget proposal represents a responsible assessment of the University's needs within the context of the state's current financial outlook. The proposal asks the state to enter into a 50-50 partnership with the University to fund its mission activities. Strategies include setting academic directions, supporting talented faculty and staff, helping students realize their educational goals, and investing in key academic infrastructure.

Added pressures have been experienced during this past year due to the decline in the value of endowment funds. Private gifts are an important supplement to the fundamental support that comes from state appropriations and student tuition. Economic pressures affecting donors may well affect the future level of support the University receives through giving. The University intends to continue employing long-term investment strategies to maximize total returns at an appropriate level of risk. The value of endowment funds managed by the University totaled approximately $554.0 million on June 30, 2002, net of investment gains and losses and the impact of distributions to the University's academic units. The University will continue to utilize an appropriate spending-rate policy that will help insulate University operations from temporary market volatility.

During the past year the University separated the management of its health insurance programs from the state of Minnesota. This action was taken in order for the University to gain greater control over the cost of health insurance for its employees as well as to improve service. Rising health care costs continue to be of concern. However, management is now better positioned to respond to cost pressures in the area of health insurance for its employees.

As solid as the University's financial and operational accomplishments have been during the past year, University management believes that it can accomplish even more. Because of the strength and commitment of the faculty, staff, and students, the University has positioned itself well to respond to future opportunities and challenges.

Independent Auditors' Report

To the Board of Regents, University of Minnesota

We have audited the accompanying consolidated statement of net assets of the University of Minnesota (the University) as of June 30, 2002, and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audit.

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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the University as of June 30, 2002, and the consolidated changes in revenues, expenses, and net assets and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the consolidated financial statements, the University adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* as amended by GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities;* GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus;* and GASB Statement No. 38, *Certain Financial Statement Note Disclosures,* as of July 1, 2001.

The Management's Discussion and Analysis (MD&A) on pages 14–21 is not a required part of the financial statements but is supplemental information required by the GASB. The MD&A has been reviewed in accordance with standards established by the American Institute of Certified Public Accountants. Such a review, however, is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion on the information.

In accordance with *Government Auditing Standards,* we will issue a separate report on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte + Touche LLP

Minneapolis, Minnesota
October 18, 2002

University of Minnesota

Consolidated Statement of Net Assets

June 30, 2002 (in thousands)

Assets

Current assets	Cash and cash equivalents		$ 149,554
	Securities lending collateral		30,997
	Short-term investments		750
	Receivables, net		296,970
	Inventories		17,737
	Current portion of student loan receivables, net		9,124
	Current portion of prepaid expenses and deferred charges		6,125
	Other assets		200
	Total current assets		511,457
Noncurrent assets	Restricted cash and cash equivalents		89,068
	Investments		913,162
	Receivables, net		1,480
	Student loan receivables, net		57,724
	Prepaid expenses and deferred charges		2,141
	Other assets		111
	Capital assets, net		1,789,695
	Total noncurrent assets		2,853,381
Total assets			3,364,838

Liabilities

Current liabilities	Accounts payable		79,635
	Accrued liabilities and other		162,630
	Securities lending collateral		30,997
	Unearned income		89,726
	Long-term liabilities–current portion		266,267
	Total current liabilities		629,255
Noncurrent liabilities	Accrued liabilities and other		109,974
	Unearned income		1,300
	Long-term liabilities		453,006
	Total noncurrent liabilities		564,280
Total liabilities			1,193,535

Net Assets

	Unrestricted		334,989
	Restricted	Expendable	486,067
		Nonexpendable	188,742
	Invested in capital assets, net of related debt		1,161,505
Total net assets			$2,171,303

See notes to consolidated financial statements.

University of Minnesota

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

Year ended June 30, 2002 (in thousands)

Revenues			
Operating revenues	Student tuition and fees, net of scholarship allowances of $68,314		$ 293,127
	Federal appropriations		18,215
	Federal grants and contracts		319,825
	State and other government grants		43,866
	Nongovernmental grants and contracts		144,637
	Student loan interest income		1,851
	Sales and services of educational activities		104,422
	Auxiliary enterprises, net of scholarship allowances of $7,346. Revenues of $2,663 are pledged as security for various auxiliary revenue bonds		206,721
	Other operating revenues		2,982
Total operating revenues			1,135,646
Expenses			
Operating expenses	Education and general	Instruction	622,219
		Research	333,828
		Public service	152,237
		Academic support	244,035
		Student services	66,995
		Institutional support	108,638
		Operation and maintenance of plant	148,252
		Scholarships and fellowships	58,989
		Depreciation	119,041
	Auxiliary enterprises		150,418
	Other operating expenses		486
Total operating expenses			2,005,138
Operating Loss			(869,492)
Nonoperating Revenues (Expenses)			
State appropriations			643,088
Grants			114,816
Gifts			89,079
Investment losses			(56,719)
Interest on capital asset-related debt			(22,400)
Other nonoperating expenses, net			(1,432)
Net nonoperating revenues			766,432
Loss Before Other Revenues			(103,060)
Capital appropriations			81,711
Capital grants and gifts			21,503
Additions to permanent endowments			2,128
Total other revenues			105,342
Increase in Net Assets			2,282
Net Assets			
Net assets at beginning of year before cumulative effect of change in accounting principles			2,281,059
	Cumulative effect of change in accounting principles	Change in method of accounting for unearned income	(61,771)
		Change in method of accounting for refundable capital contributions	(54,243)
		Change in method of accounting for capital and other assets	3,976
Net assets at beginning of year, restated			2,169,021
Net assets at end of year			$2,171,303

See notes to consolidated financial statements.

University of Minnesota

Consolidated Statement of Cash Flows

Year ended June 30, 2002 (in thousands)

Cash Flows from Operating Activities	
Student tuition and fees	$ 287,203
Federal appropriations	16,562
Grants and contracts (federal, state, nongovernmental, other)	488,045
Student loan interest income	1,851
Sales and services of educational activities	103,708
Auxiliary enterprises	207,322
Other operating revenues	2,124
Payments to employees for services	(1,032,331)
Payments for fringe benefits	(274,201)
Payments to suppliers for goods and services	(507,321)
Payments for scholarships and fellowships	(55,084)
Loans issued to students	(12,199)
Collection of loans to students	13,892
Net cash used in operating activities	(760,429)
Cash Flows from Noncapital Financing Activities	
State appropriations	684,693
Grants for other than capital purposes	99,572
Gifts for other than capital purposes	88,170
Private gifts for endowment purposes	2,128
Other nonoperating revenues, net	2,387
Direct lending receipts	172,113
Direct lending disbursements	(171,795)
Agency transactions	1,700
Net cash provided by noncapital financing activities	878,968
Cash Flows from Capital and Related Financing Activities	
Capital appropriations	96,378
Capital grants and gifts	20,996
Proceeds from capital debt	179,609
Payments for bond issuance costs	(328)
Proceeds from sale of capital assets	827
Purchases of capital assets	(311,540)
Principal paid on capital debt	(21,851)
Interest paid on capital debt	(26,383)
Net cash used in capital and related financing activities	(62,292)
Cash Flows from Investing Activities	
Investment income, net	25,875
Proceeds from sales and maturities of investments	998,710
Purchase of investments	(996,247)
Net cash provided by investing activities	28,338
Net Increase in Cash	84,585
Cash at Beginning of Year	154,037
Cash at End of Year	$ 238,622

See notes to consolidated financial statements.

University of Minnesota

Consolidated Statement of Cash Flows *(Concluded)*

Year ended June 30, 2002 (in thousands)

Reconciliation of Net Operating Revenues (Expenses) to Net Cash Used for Operating Activities

Operating loss	$(869,492)
Adjustments to reconcile net operating loss to net cash used for operating activities	
Depreciation expense	119,041
Changes in assets and liabilities	
Receivables, net	(22,675)
Inventories	850
Prepaid items	4,378
Accounts payable	(10,329)
Accrued liabilities	24,118
Unearned income	(6,320)
Net Cash Used for Operating Activities	$(760,429)

Noncash Transactions

Borrowing under capital lease	$ (2,259)
Equipment	2,259

See notes to consolidated financial statements.

1. Organization, Basis of Presentation, and Summary of Significant Accounting Policies

Organization

The University of Minnesota (the University) is both a state land-grant university, with a strong tradition of education and public service, and a major research institution serving the state of Minnesota through four campuses: Crookston, Duluth, Morris, and Twin Cities.

The University is considered a constitutional corporation and an agency of the state of Minnesota. As a result of this unique status, authority to govern the University is reserved to the Board of Regents rather than state law. The University complies with state law when specifically included by statute or when compliance does not conflict with the University's ability to accomplish its mission and purpose as established by the constitution of the state of Minnesota.

Reporting Entity

The financial reporting entity for the University of Minnesota includes the financial results of the four campuses and RUMINCO, Ltd. (a wholly owned captive insurance company). In accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity,* the four foundations affiliated with the University—the University of Minnesota Foundation, Minnesota Medical Foundation, Minnesota Landscape Arboretum Foundation, and Minnesota 4-H Foundation—are not included in the financial statements because they are separate legal entities, and the University does not appoint any members of their respective boards. The condensed financial statements of the foundations are reported in Note 7.

Also, in accordance with GASB Statement No. 14, the University is considered a part of the financial reporting entity of the state of Minnesota and is discretely presented in the State of Minnesota's Comprehensive Annual Financial Report.

The Internal Revenue Service has ruled that the University is an integral part of the state of Minnesota. As an integral part of the state, the University is generally exempt from federal income taxes, although certain activities are subject to federal unrelated business income tax.

Financial Statement Presentation

The financial statements have been prepared in accordance with accounting principles prescribed by the Governmental Accounting Standards Board.

Effective July 1, 2001, the University adopted GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* as amended by GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities;* Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus;* and Statement No. 38, *Certain Financial Statement Disclosures.* These statements establish comprehensive, new financial reporting requirements for governmental colleges and universities. Under the new standards, the statements are prepared on a consolidated, entity-wide basis rather than the fund presentation displayed under the former accounting model. All significant interfund balances have been eliminated upon consolidation.

For the first year of implementation, the University elected to report only the current year financial results under the new reporting model. Comparative statements will be presented in future fiscal years.

Basis of Accounting

Under GASB Statements No. 34 and 35, the University is considered to be a special purpose government engaged primarily in business type activities (BTA). As a BTA, the University prepares its financial statements using the accrual basis of accounting and the economic-resources-measurement focus. Under the accrual basis of accounting, revenue and expense are recognized when earned or incurred.

As a GASB institution, the University has the option of applying pronouncements issued by the Financial Accounting Standards Board (FASB) after November 30, 1989, unless FASB conflicts with GASB. The University has elected not to adopt FASB pronouncements issued after the applicable date.

Significant Accounting Policies

Cash and Cash Equivalents – For purposes of the Consolidated Statement of Cash Flows, the University defines cash equivalents as highly liquid, short-term (90 days or less) investments that bear no market risk. Cash equivalents held in the Consolidated Endowment Fund (CEF), the Group Income Pool (GIP), and the Separately Invested Funds (SIF) are included in investments because the intent of these pools is long-term appreciation. Any cash equivalents held at the date of the statements are due to the timing of reinvesting the proceeds within the funds.

Year ended June 30, 2002 (Amounts in thousands)

Investments – Investments in securities are reported at market value as determined by the major securities markets. Market values of thinly traded alternative investments, including venture capital and real estate investments, are generally based on investment manager quarterly valuation estimates rather than established market rates. As a result, these investments bear a greater risk that the reported value may be materially different than actual value. Purchases and sales of investments are recorded on a trade-date basis. Investment income is reported on the accrual basis and includes interest income, endowment income (interest earned on endowments but allocated to other funds), and realized and unrealized gains and losses.

The University uses derivative instruments for a variety of purposes. Financial futures are used to maintain investment portfolio asset allocations in accordance with institutional policy. Forward foreign exchange contracts are used to hedge foreign currency exposure while interest rate swaps are used to manage the cost of debt. Financial futures and forward foreign exchange contracts are recorded on the contract date and are carried at fair value using listed price quotations or amounts that approximate fair value. The University is required to post collateral, typically U.S. Treasury bills, for derivative contracts held. Collateral required by these contracts is monitored daily and required deposits or withdrawals are made as necessary.

In general, the University follows the Uniform Management of Institutional Funds Act (UMIFA), as adopted in Minnesota, for donor-restricted endowments. Under UMIFA, the regents determine the prudent amount of realized and unrealized endowment appreciation to be allocated to fund current operations. Investment of the realized or unrealized appreciation in excess of the annual spending limits is discussed in Note 2.

Inventories – Inventories held for resale are carried at the lower of cost (first-in, first-out) or market value. Other inventories are carried primarily at cost, which approximates market value.

Restricted Cash and Cash Equivalents – Restricted cash and cash equivalents represent unspent bond proceeds of $89,068 that are externally restricted for the construction or purchase of buildings or other capital assets. Although these funds meet the University's definition of cash and cash equivalents, they are recorded as long-term assets to be consistent with the purpose for which the funds are required to be used—for long-term capital projects.

Capital Assets – Land, buildings, and other property are recorded at cost if purchased or constructed, or at market value on the date of gift, if received by gift or bequest. Interest expense of $27,139 was incurred during construction, of which $4,739 was capitalized as a cost of the assets constructed. Depreciation is determined using the straight-line method, based on the estimated useful lives of the assets.

The following schedule summarizes the useful lives and capitalization threshold for capitalized, depreciable assets.

Asset Category	Useful life (in years)	Capitalization threshold
Buildings and improvements	10–40	$50,000
Leasehold improvements	Lease term	50,000
Infrastructure	20–40	50,000
Equipment – technology	3–12	2,500
Equipment – other	3–20	2,500
Library and reference books	10	2,500

The University maintains certain collections (works of art or historical treasures) for public exhibition, education, or research in furtherance of public service. These collections are preserved, unencumbered, and cannot be disposed of for financial gain (proceeds from sales of collection items must be used to acquire other items for the collections). As such, the collections are not capitalized for financial statement reporting purposes.

Unearned Income – Unearned income represents amounts received for tuition, auxiliary services, and grants and contracts prior to fiscal year-end but not yet earned.

Noncurrent Liabilities – Noncurrent liabilities represent the principal portion of bonds, notes, and capital lease obligations as well as estimated amounts of accrued compensated absences and other liabilities that will not be paid within the next fiscal year.

Net Assets – Net assets are reported in three components based upon the type of external restriction imposed.

- **Unrestricted:** Net assets that have no external restriction imposed. Unrestricted net assets may be designated for specific purposes by the Board of Regents or subject to contractual limitations, but, generally, are designated to fund the academic, research, and public service mission of the University.
- **Restricted:**

  Expendable – Net assets that are restricted for specific purposes by grantors, donors, or law. Restrictions on these assets are released when the University complies with the stipulations required by the grantor, donor, or legislative act.

  Nonexpendable – Net assets that are required to be retained permanently by the University. These assets represent the principal portion (historical value) of gifts to the University's true and life endowment funds.
- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding debt used to purchase, construct, or improve such assets. If debt has been incurred but not yet expended for capital assets, these unspent proceeds are classified as restricted-expendable net assets.

If both restricted and unrestricted resources are to be used for the same purpose, the resources are used in accordance with applicable instructions of the grantor, donor, or law.

Revenue Classification – The University has classified revenues as operating or nonoperating based upon the following criteria:

- Operating revenues result from exchange activities. Exchange activities are transactions where the amount received approximates the fair market value of the goods or services given up. The University considers student tuition and fees (net of scholarship allowances), federal appropriations, most grants and contracts, interest on student loans, and sales and services of auxiliary and educational activities to be exchange transactions.
- Nonoperating revenues represent nonexchange activities. The primary source of these revenues is state appropriations, gifts, capital grants, federal and state financial aid grants (such as Pell and SEOG), and other nonexchange grants and contracts. Although the institution relies upon these revenue sources to fund the cost of operations, the grantor or donor is not the direct recipient of the goods or services delivered under the grant or gift terms.

Use of Estimates – To prepare the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management must make estimates and assumptions. These estimates and assumptions may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant areas that require the use of management's estimates relate to allowances for uncollectible accounts and self-insurance reserves, scholarship discounts and allowances, arbitrage rebates, and vacation pay and pension accruals.

Change in Accounting Principles

Implementation of GASB Statements No. 34, 35, 37, and 38 required restatement of beginning net assets due to the change in accounting methods used for determining unearned income and capital and other assets. The University also adopted the National Association of College and University Business Officers (NACUBO) recommendation for changing the classification of refundable capital contributions in the student loan funds from net assets to noncurrent liabilities.

NACUBO's recommendation evolved as an emerging issue related to the implementation of GASB Statement No. 35.

The change in beginning net assets is summarized below.

	Combined beginning net assets (in thousands)
Combined net assets, as previously reported	$2,281,059
Unearned income recognition	(61,771)
Refundable capital contributions	(54,243)
Change in estimated lives for capital and other assets	3,976
Restated, combined net assets	$2,169,021

New Accounting Pronouncement

In May 2002, the GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units.* This statement, which amends GASB Statement No. 14, *The Financial Reporting Entity,* is effective for the University for the year ending June 30, 2004. Under GASB Statement No. 39, the University will be required to present the financial results of its four foundations, the University of Minnesota Foundation, Minnesota Medical Foundation, Minnesota Landscape Arboretum Foundation, and Minnesota 4-H Foundation (and potentially other organizations meeting GASB Statement No. 39 criteria), either in a discrete or blended presentation within the University's financial statements. The University currently provides condensed operating results of the foundations within Note 7 of the financial statements. The University has not yet determined the full impact of GASB Statement No. 39 on its financial statements.

2. Cash and Investments

Summary

The University maintains centralized management for substantially all of its cash and investments. With the exception of insurance reserves maintained by RUMINCO, the wholly owned insurance subsidiary (Note 9), and other funds whose terms require separate management, the invested assets of the University are managed through several internal investment pools. Each investment pool has a different set of objectives designed to maximize investment return within consistent risk parameters established for that pool.

In general, investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term, and that such changes could materially affect the amounts reported in the consolidated financial statements.

As of September 30, 2002, the fair value of investments had declined $70,178 since June 30, 2002, due to overall investment market conditions.

Authorizations

The Board of Regents establishes University investment policies and objectives. The internal investment pools created under these guidelines to manage the invested assets of the University are described below.

Temporary Investment Pool (TIP) – Short-term reserves – The Temporary Investment Pool is invested to meet the current obligations of the University. The investment objective for this pool is to maximize current income while preserving principal and maintaining liquidity. The pool is invested primarily in domestic and foreign commercial paper, money market funds, short-term corporate obligations, and short- and intermediate-term U.S. government securities. University departments may receive distributions from the TIP pool, depending upon current investment yields.

Consolidated Endowment Fund (CEF) – The Consolidated Endowment Fund represents the pooling of funds from both public and private sources for which donor intent, law, or institutional decree determines the principal amount that must be invested either in perpetuity or other specified time-frames. The funds are invested to achieve a return of at least 5 percent above inflation over a three- to five-year period. The allocation policy for this fund targets a 40 percent investment in domestic equities, 30 percent investment in international equities, 20 percent investment in alternative investments, and 10 percent in fixed-income related investments. To maintain the allocation targets, the pool may invest in various bond and stock index futures contracts. The University has deposited U.S. government securities with a market value of $4,156 as collateral for these future commitments.

The University distributes funds from the Consolidated Endowment Fund to activities targeted by the endowment purpose. The annual distribution is based on the University's spending policy of 5 percent of the three-year moving average of the unit value of the fund. When investment income is less than 5 percent, accumulated capital gains are used to supplement investment income to meet the spending policy. If investment income exceeds the amount needed for distribution, the excess remains in the respective endowment funds.

Year ended June 30, 2002 (Amounts in thousands)

Group Income Pool (GIP) – Long-term reserves – The Group Income Pool represents assets invested for the purpose of various auxiliary and support-service units as well as long-term capital purposes. The investment objective of the GIP is to maximize income until the principal is required for departmental needs; therefore GIP is invested in global, fixed-income securities through an institutional mutual fund. All income received from these investments is available for spending.

Separately Invested Funds (SIF) – Separately invested funds represent endowment and other restricted assets that by the terms of the gift or by administrative decision cannot be combined with the major investment pools.

Invested Assets Related to Indebtedness (IARI) – Included in investments are the invested assets related to indebtedness that are held by the bond trustee primarily in the debt-service reserve funds of the outstanding University bond issuances. In addition, unspent bond proceeds held by the University are invested for short-term income until needed for the capital projects for which the bonds were issued. The market value of debt related investments held by the bond trustee and internally managed was $102,066 at June 30, 2002.

Custodial Credit Risk

Custodial credit risk, defined as the risk that the counter-party to the transaction will not fulfill its obligations, is categorized depending upon the degree of risk. The degree of custodial credit risk for cash equivalents or investments evidenced by securities is determined by who holds the collateral insuring the deposits or investments and under what name the collateral is held.

Risk Category 1: Securities that are insured or registered or held by the University or its agent in the University's name

Risk Category 2: Securities that are uninsured and unregistered held in the University's name by the counterparty or its agent

Risk Category 3: Securities that are uninsured and unregistered and held by the counterparty or its agent in their name

Cash and Cash Equivalents

The University had cash deficits in its bank accounts of $(24,076). Balances in excess of Federal Deposit Insurance Corporation limits were $857. The University held risk category 1 cash equivalents of $262,698 at June 30, 2002. At certain times during the year, deposits (cash) temporarily fell into risk category 3 due to higher cash flows arising from state appropriations, tuition receipts, and various state or federal draws.

Investments

The University investment pools hold risk category 1 and uncategorized investments. Investments held at June 30, 2002, which include amounts held by the University's insurance subsidiary, are summarized in the following table:

Risk category 1 investments	
Cash equivalents, noncurrent	$ 64,695
Government agency securities	275,365
Corporate bonds and preferred stock	69,724
Common stock and convertibles	242,608
Total risk category 1 investments	652,392
Noncategorized investments	
Securities lending collateral	30,997
Mutual funds	168,042
Nonmarketable alternative investments	73,478
Other miscellaneous	20,000
Total noncategorized investments	292,517
Total investments	$944,909

The University has entered into various forward contracts to manage its exposure against foreign currency exchange-rate fluctuations. As of June 30, 2002, the University had $2,374 in open foreign currency purchase contracts and $7,553 in open foreign currency sales contracts with a net market value of $(281). In addition, the University has entered into various hedge contracts to minimize interest rate risk in the debt markets.

Year ended June 30, 2002 (Amounts in thousands)

Securities Lending

To enhance the return on investments, the regents of the University have authorized participation in a global securities lending program. The program is managed by the University's custodian bank, which lends securities to approved broker-dealers in return for cash or other acceptable collateral. By contractual agreement, the level of collateralization must be at least 100 percent of the market value of the securities loaned. Types of securities lent include domestic and foreign equities and domestic government, agency, and corporate bonds, as well as foreign, sovereign, fixed-income securities. Collateral received is generally in the form of cash, although U.S. government or agency securities, sovereign debt—rated A or better, convertible bonds, and irrevocable bank letters of credit are also acceptable forms of collateral. The University retains all rights to ownership of the loaned securities and receives all dividend and interest income. Neither the University nor its securities lending agent has the ability to pledge or sell collateral securities unless a borrower defaults.

In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions,* the University records the market value of the collateral as an asset in the balance sheet along with a corresponding liability. At June 30, 2002, the University had loaned securities with market values of approximately $29,981. These loaned securities were supported by collateral of approximately $30,997, which is included as securities lending collateral in the Consolidated Statement of Net Assets. Of this collateral amount, approximately $27,032 was cash and approximately $3,965 was acceptable noncash collateral.

In general, since the value of collateral received exceeded the market value of the securities on loan, the University did not have credit risk at fiscal year-end. The University and the borrowers of its securities maintain the right to terminate all securities lending transactions on demand. The cash collateral received on each loan is invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. The average duration of such pools as of June 30, 2002, was 56 days. Since the loans are terminable at will, their duration does not generally match the duration of the investments made with the cash collateral. If the University must terminate a term loan, the lending agent has the ability to substitute the same security from a different client while returning the University's security.

Income and cost from its participation in this securities lending program were $1,331 and $1,061, respectively, for the year ended June 30, 2002.

3. Other Net Asset Information

Receivables, net, and student loans receivable at June 30, 2002, consisted of the following:

	Total	Amounts not scheduled for collection during the subsequent year
State and federal appropriations	$130,997	
Sponsored grants and contracts	81,502	
Notes receivables	70,249	$58,424
Student loan receivables	37,324	
Trade receivables	48,171	780
Accrued interest	4,569	
Other	3,223	
Allowance for uncollectible accounts	(10,737)	
Total receivables	$365,298	$59,204

Accounts payable and accrued liabilities at June 30, 2002, consisted of the following:

Trade liabilities	$113,613
Compensation and benefits	133,634
Self-insurance reserves	28,989
Accrued interest	5,987
Refundable advances	55,166
Other	14,850
Total accounts payable and accrued liabilities	$352,239

Year ended June 30, 2002 (Amounts in thousands)

Other long-term liabilities at June 30, 2002, consisted of the following:

	Beginning balance	Additions	Reductions	Ending balance	Current portion
Compensated balances	$ 60,080	$ 52,926	$ (51,327)	$ 61,679	$50,918
Self-insurance reserves (see Note 9)	18,953	53,883	(43,847)	28,989	17,256
Refundable advances		55,166		55,166	
Other	27,150	20,849	(16,560)	31,439	11,523
Total long-term liabilities	$106,183	$182,824	$(111,734)	$177,273	$79,697

4. Capital Assets

Capital assets, net, at June 30, 2002, consisted of the following:

	Beginning balance	GASB adjustment	Additions	Transfers	Retirements	Ending balance
Depreciable capital assets						
Buildings and improvements	$1,854,391	$(196,034)	$ 1,708	$ 273,023	$ (70)	$1,933,018
Leasehold improvements				617		617
Equipment: Technology	230,136		25,273	3,182	(60,070)	198,521
Other equipment	351,198		32,541	(2,053)	(28,120)	353,566
Infrastructure	50,254	192,650	14,538	20,716		278,158
Library and reference books	92,513		11,349		(6,927)	96,935
Total depreciable capital assets	2,578,492	(3,384)	85,409	295,485	(95,187)	2,860,815
Nondepreciable capital assets						
Land	34,117	(521)	1,256			34,852
Museums and collections	28,918		995			29,913
Construction in progress	263,553	2,106	234,743	(295,437)		204,965
Total nondepreciable capital assets	326,588	1,585	236,994	(295,437)	–	269,730
Accumulated depreciation						
Buildings and improvements	846,113	(74,350)	53,224			824,987
Leasehold improvements			71	48		119
Equipment: Technology	167,315		24,836		(58,477)	133,674
Other equipment	232,245		23,511		(26,213)	229,543
Infrastructure	28,730	70,127	7,927			106,784
Library and reference books	43,198		9,472		(6,927)	45,743
Total accumulated depreciation	1,317,601	(4,223)	119,041	48	(91,617)	1,340,850
Net capital assets	$1,587,479	$ 2,424	$203,362	$ –	$ (3,570)	$1,789,695
Summary						
Depreciable capital assets	$2,578,492	$ (3,384)	$ 85,409	$ 295,485	$(95,187)	$2,860,815
Nondepreciable capital assets	326,588	1,585	236,994	(295,437)		269,730
Total capital assets	2,905,080	(1,799)	322,403	48	(95,187)	3,130,545
Less accumulated depreciation	1,317,601	(4,223)	119,041	48	(91,617)	1,340,850
Capital assets, net	$1,587,479	$ 2,424	$203,362	$ –	$ (3,570)	$1,789,695

Year ended June 30, 2002 (Amounts in thousands)

5. Long-Term Debt

Long-term debt at June 30, 2002, consisted of the following:

	Interest rate	Due at various dates through	Beginning balance	Additions	Reductions	Ending balance	Current portion
General Obligation Bonds							
Series 2001C	4.40%	2005		$159,950		$159,950	$ 39,987
Series 2001B	4.33%	2003		3,500		3,500	3,500
Series 2001A	3.08%	2003		16,500		16,500	16,500
Series 1999A	4.16%	2003	$200,650		$ 8,050	192,600	192,600
Series 1996A	4.50% to 5.75%	2021	190,787		6,039	184,748	7,039
Series 1993A	4.80%	2003	84,000			84,000	
Obligations to the state of Minnesota pursuant to Infrastructure Development Bonds	4.00% to 6.90%	2022	51,979	12,316	4,292	60,003	4,303
Auxiliary revenue bonds	3.00%	2013	11,535		719	10,816	750
Capital leases and other	2.19% to 8.00%	2011	6,589	3,356	2,789	7,156	1,588
Total			$545,540	$195,622	$21,889	$719,273	$266,267

General Obligation Bonds

In November 2001, the regents of the University of Minnesota authorized the issuance of new general obligation debt securities to provide funds for certain approved capital projects, costs of issuance, and refunding of the Series 1993A bonds. Of the $501,000 of debt authorized under the February 2001 and November 2001 resolutions, $380,600 was issued for the Series 1999A and 2001 bonds; $120,400 remains unissued.

The University has entered into a standby bond purchase agreement (take-out agreement) to provide liquidity support for the Series 2001C bonds. The take-out agreement requires the banks to provide funds for the repurchase of Series 2001C bonds that have been tendered or deemed tendered and not remarketed, subject to certain conditions. The available principal commitment is initially the aggregate principal amount of the Series 2001C bonds outstanding of $159,950. For the Series 2001C bonds, principal and interest obligations are in accordance with the payment terms established in the take-out agreement rather than the payment terms of the bond prospectus. The take-out agreement provides for four installment payments at six-month intervals of the bonds put back to the banks holding the agreement. No amounts have been drawn under this agreement through June 30, 2002. The University has agreed to pay a nonrefundable commitment fee of 0.09 percent per annum times the available commitment (principal and interest) of $161,738 through December 18, 2002. The rate increases to 0.12 percent per annum the second year of the agreement. The standby bond purchase agreement expires on December 17, 2003.

Under generally accepted accounting principles, the Series 2001A, 2001B, 2001C, and 1999A bonds are defined as demand bonds because bondholders have the option to put the bonds back (demand repayment) to the University at any time. In the absence of take-out agreements, the University has classified the entire obligation of the Series 2001A, 2001B, and 1999A bonds as current liabilities, and one fourth of the obligation due under the take-out agreement for the Series 2001C is classified as a current liability. As of the date of this report, none of the bondholders has exercised the put option. Thus, management believes that the bond obligations will continue to be met in accordance with the longer term payment schedules provided for within the bond prospectuses.

In connection with the issuance of the 2001A, 2001B, 2001C, and 1999A variable-rate bonds, the University entered into floating-to-fixed interest-rate swap agreements for notional amounts tied to the outstanding balance of the bonds. The University makes monthly payments at fixed rates between 3.08 percent and 4.40 percent and receives the weighted average rate that was paid to the bondholders during the previous month. The final maturity dates of the swaps are tied to the final maturity dates of the underlying bonds. With the exception of the Series 2001B taxable bonds, the University treats these swaps as qualified hedges with respect to such bonds.

In connection with the issuance of the Series 1996A bonds, the University has entered into a fixed-to-floating interest-rate swap agreement on a notional amount of $190,000. The University makes floating-rate interest payments monthly based upon the weekly Bond Market Association (BMA) Municipal Swap Index. The interest obligation for future years is calculated on the basis of the interest rate in effect at June 30, 2002, of 1.23 percent. The actual rates to be paid to bondholders over the life of the bonds will be at rates determined on the basis of prevailing market conditions. The University receives fixed-rate interest payments ranging from 4.45 to 5.43 percent semiannually. The final maturity date of this swap is 2021, although there are specified notional reductions annually that began in 2001. The University treats this swap as a qualified hedge with respect to such bonds.

The University has sold a put option, which allows the counterparty to put up to $190,000 of Series 1996A University bonds or eligible AAA-rated governmental or municipal securities to the University. This option may be exercised at any time. At the date of this report, the counterparty has not exercised the put option.

All general obligation bonds are secured by the full faith and credit of the University and subject to mandatory sinking fund requirements set forth in the prospectuses. In addition, the bonds are tax-exempt with the exception of the $3,500 Series 2001B.

Auxiliary Bonds

The University's auxiliary bonds are secured by the net revenues of the auxiliary activity to which they relate, debt-service subsidy grants provided by the Department of Housing and Urban Development, and the full faith and credit of the University. The auxiliary bond agreements require minimum mandatory reserves sufficient to cover the principal and interest due in any future fiscal year. To comply with this requirement, the University has set aside $11,694 for future debt service. These mandatory reserves are included in restricted expendable net assets in the financial statements.

Infrastructure Development Bond Obligations

Pursuant to Minnesota law, the University is obligated to pay the state one third of the debt services of Infrastructure Development Bonds (IDB) issued by the state for University capital projects. The amount of outstanding debt issued by the state on behalf of the University was $180,011 as of June 30, 2002.

Capital Leases and Other Debt

Capital lease and other commitments consist of fleet vehicle leases, a real estate contract for deed, and a note payable. The leases bear interest rates between 2.19 percent and 4.37 percent with none extending beyond 2010. The real estate contract for deed bears interest at 8.00 percent and is due 2011. The note payable for equipment bears interest at 6.30 percent and is due 2006.

Year ended June 30, 2002 (Amounts in thousands)

Long-term debt obligations for the next five years and in subsequent five year periods:

	Bonds and obligations	Capital lease and other	Total principal	Net interest	Total obligations
Fiscal year ending June 30					
2003	$264,680	$1,587	$266,267	$26,401	$292,668
2004	175,129	1,535	176,664	13,059	189,723
2005	51,197	1,438	52,635	6,736	59,371
2006	11,350	1,200	12,550	4,963	17,513
2007	11,246	855	12,101	4,550	16,651
2008–2012	54,876	541	55,417	17,151	72,568
2013–2017	58,894		58,894	9,000	67,894
2018–2022	84,745		84,745	3,300	88,045
	$712,117	$7,156	$719,273	$85,160	$804,433

Defeased Bonds

In prior years, the University defeased various bonds by placing the proceeds from new bond issuances into an irrevocable trust to provide for all future debt service payments on the old bonds. The defeased bonds are as follows:

	Amount defeased	Amount outstanding at June 30, 2002
General Obligation Bonds		
1986 Series A	$ 14,196	$ 9,625
1982 Series A	112,635	29,600
	$126,831	$39,225

Neither the outstanding indebtedness nor the related trust account assets for the above bonds are included in the University's financial statements.

6. Pension Plans

Description of Plans

The University contributes to a single-employer defined contribution plan, the Faculty Retirement Plan (FRP), and two cost-sharing, multiple-employer, defined-benefit plans—the State Employees' Retirement Fund (SERF) of the Minnesota State Retirement System and the Public Employee Police and Fire Fund (PEPFF) of the Public Employees Retirement Association pension plans. In addition, some employees eligible for the FRP may be eligible for additional benefits from the University of Minnesota Supplemental Benefits Plan (SBP), which is a single-employer, defined-benefit plan. For faculty members employed prior to 1963 and female participants employed prior to July 1, 1982, the SBP is being funded in an amount equal to or greater than the amount required under Chapter 356 of the Minnesota Statutes. All SBP participants are retired. Each plan provides retirement, disability, and death benefits to plan members and beneficiaries.

SERF and PEPFF each issue a publicly available financial report that includes financial statements and required supplementary information for that plan. Those reports may be obtained by writing or calling the plan, as follows:

Minnesota State Retirement System
60 Empire Drive, Suite 300
St. Paul, Minnesota 55103-1855
(651) 296-2761

Public Employees Retirement Association
60 Empire Drive, Suite 200
St. Paul, Minnesota 55103-1855
(651) 296-7460 or 1-800-652-9026

Year ended June 30, 2002 (Amounts in thousands)

Funding Policy and Annual Pension Cost

The University's annual pension cost and related information for each plan is as follows:

	FRP	SERF	PEPFF	SBP
University contributions – fiscal year ended June 30				
2002	$53,331	$13,672	$257	$436
2001	48,164	12,773	232	528
2000	45,732	11,842	217	927
Current contribution rates:				
University	13.0%	4.0%	9.3%	
Plan members	2.5	4.0	6.2	

These contribution amounts are equal to contractually required contributions for each year in compliance with state statute. The University makes all contributions to the SBP using a variable rate.

The following information pertains to the SBP as of July 1:

	2001	2000	1999
Pension benefit obligation	$14,133	$15,061	$19,367
Net assets available for benefits	8,695	9,240	9,769
Unfunded accrued liability	$ 5,438	$ 5,821	$ 9,598
Funded ratio (net assets as a percentage of the pension benefit obligation)	61.52%	61.35%	50.44%

The actuarial present value of accumulated plan benefits in the SBP was not calculated.

The plans invest in various securities including U.S. government securities, corporate debt instruments, mutual funds, and corporate stocks. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported for net assets available for plan benefits.

7. Related Parties

The University of Minnesota Foundation, the Minnesota Medical Foundation, the Minnesota Landscape Arboretum Foundation, and the Minnesota 4-H Foundation (the foundations) are independent corporations formed for the purpose of obtaining and disbursing funds for the sole benefit of the University.

Year ended June 30, 2002 (Amounts in thousands)

A summarized, condensed unaudited statement of net assets and statement of activities as well as a summary of other related transactions with the foundations is as follows:

	University of Minnesota Foundation	Minnesota Medical Foundation	Minnesota Landscape Arboretum Foundation	Minnesota 4-H Foundation	Total
Condensed Statement of Net Assets					
Assets					
Noncapital assets	$1,006,116	$244,699	$32,901	$ 6,013	$1,289,729
Capital assets	1,559	596		22	2,177
Total assets	1,007,675	245,295	32,901	6,035	1,291,906
Liabilities					
Liabilities (all current)	133,041	14,693	509	174	148,417
Net assets					
Unrestricted net assets	40,541	8,697	3,997	77	53,312
Temporary restricted net assets	509,880	121,357	20,281	3,442	654,960
Permanently restricted net assets	324,213	100,548	8,114	2,342	435,217
Net assets at June 30, 2002	$ 874,634	$230,602	$32,392	$ 5,861	$1,143,489
Condensed Statement of Activities					
Net assets at June 30, 2001	$ 893,184	$260,042	$33,054	$ 5,022	$1,191,302
Plus					
Gifts and pledges	63,295	44,428	3,321	1,713	112,757
Investment income	17,587	1,734	682	43	20,046
Appreciation (depreciation) on investments	(12,531)	(33,227)	120	(59)	(45,697)
Other revenues	4,819	1,017	725	233	6,794
Less					
Distributions to the University	(74,499)	(37,907)	(4,809)	(687)	(117,902)
General expenses	(17,221)	(5,485)	(701)	(404)	(23,811)
Net assets at June 30, 2002	$ 874,634	$230,602	$32,392	$ 5,861	$1,143,489
Other information					
Funds disbursed to or on behalf of the University	$ 74,455	$ 37,246	$ 4,059	$ 687	$ 116,447
Funds collected from the University	1,180	604		129	1,913
Nonmonetary goods distributed to the University	44	661	750		1,455
Related-party receivables and payables at June 30, 2002, due to the University	1,342	3,727	109	94	5,272
Due from the University	454				454

The foundations are subject to audit by other independent auditors.

Year ended June 30, 2002 (Amounts in thousands)

8. Commitments and Contingencies

On December 31, 1996, the University of Minnesota Hospital and Clinic (UMHC) operations and certain assets and liabilities were transferred to Fairview Hospital and Healthcare Services (Fairview). Fairview and the University also agreed to affiliate with each other in support of research, education, and patient care missions of the University's Academic Health Center (AHC). Under this affiliation agreement, the University shares equally with Fairview in any deficit in the research and education budget.

The University also provides certain services to Fairview, and Fairview provides certain services to the University, to be reimbursed at negotiated rates. These services include items such as utilities, mailing and addressing services, police protection, printing services, miscellaneous services related to telecommunications, and such other items as are necessary to support the relationship, for which $7,625 was billed to Fairview in fiscal year 2002. Fairview billed the University $716 in fiscal year 2002 for pharmaceuticals, medical professionals, and transcription services.

Construction projects in progress, principally buildings, approximate $204,965 at June 30, 2002. The estimated cost to complete these facilities is $451,575, which is to be funded from plant fund assets, and $115,344 in appropriations available from the state of Minnesota.

The University owns certain steam production facilities, which produce steam for heating and cooling the Twin Cities campuses and which, by agreement, are managed, operated, and maintained by an unaffiliated company. The term of the agreement is for 25 years and commenced July 1, 1992. Under the agreement, the University must make minimum fixed payments for certain operating and maintenance costs as well as contingent payments based on monthly usage.

The University is obligated under various operating leases for the use of real property and equipment. Total operating lease expenditures for the year ended June 30, 2002, were $16,443 of which $10,385 was for real property and $6,058 was for equipment.

The University has entered into several swap contracts to manage the interest-rate risk in the debt portfolio. The contracts effectively convert the University's variable rates to fixed rates.

The future commitments at June 30, 2002, are as follows:

Steam plant, operating lease, and swap contract commitments for the next five years and in subsequent five-year periods:	Steam plant	Operating leases	Swap contracts	Total
Fiscal year ending June 30				
2003	$ 6,062	$ 9,738	$ 2,803	$ 18,603
2004	6,062	7,599	2,803	16,464
2005	6,062	5,965	2,803	14,830
2006	6,062	5,497	2,803	14,362
2007	6,062	4,871	2,803	13,736
2008–2012	30,311	19,995	84,020	134,326
2013–2017	30,311	7,195	76,930	114,436
Total commitments	90,932	60,860	174,965	326,757
Less current portion	(6,062)	(9,738)	(2,803)	(18,603)
Long-term commitments	$84,870	$51,122	$172,162	$308,154

Year ended June 30, 2002 (Amounts in thousands)

The University is a defendant in cases involving claims of medical malpractice, personal injuries, breach of contract, and other civil matters. While any litigation has an element of uncertainty and the University cannot, therefore, predict how these cases will be finally resolved, management and its general counsel believe the outcomes of the cases, individually and combined, will not have a material adverse effect on the overall financial position of the University.

9. Self-Insurance Programs

The University is self-insured for medical malpractice, general liability, directors and officers liability, and automobile liability through RUMINCO, Ltd., a wholly owned, single-parent captive insurance company (see Note 2). Claims are reported to a third-party administrator, which pays expenses and sets up reserves. The total expense of a claim is estimated and booked as a liability when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated in the year in which it is reported. In addition, an actuarial liability is established for incurred but not reported (IBNR) claims.

The University is also self-insured for workers' compensation through an internally maintained fund, and excess insurance is maintained through the Workers' Compensation Reinsurance Association (WCRA). The internal fund for workers' compensation is maintained only to fund the current year's expected payouts. Each year, an actuarial estimate of the University's liability for workers' compensation is compiled and recorded, but the liability is not separately funded.

Effective December 31, 2001, the University changed its medical (health) coverage for faculty and staff from the State of Minnesota's State Employees Group Insurance Program (SEGIP) to a self-insured program (UPlan). Under the UPlan, the University pays claims and establishes reserves, and the administration of the program is handled by four independent administrators: Definity Health, HealthPartners, Patient Choice, and Preferred One. Two carriers provide medical conversion policies to the University under which terminated employees are able to convert their UPlan coverage to single coverage once their continuation (COBRA) rights expire. The University also carries stop-loss coverage, which protects the University against the risk that an individual participant will incur medical expenses greater than $200,000 in a single year. Annually, an actuarial estimate of the University's liability for medical claims, including IBNR, is recorded.

Changes in reported liabilities since June 30, 2001, are shown below.

	Liability, beginning of year	New claims	Claim payments	Other adjustments	Liability, end of year
RUMINCO, Ltd.	$ 8,153	$ 840	$ (2,476)	$ (25)	$ 6,492
Workers' compensation	10,800	798	(1,305)	(1,293)	9,000
UPlan medical		40,464	(38,748)	11,781	13,497

Other adjustments reflect reserve changes on prior years' claims and changes in estimated IBNR.

Year ended June 30, 2002 (Amounts in thousands)

10. Operating Expenses by Natural Classification

Operating expenses by natural classification for June 30, 2002, are summarized as follows:

Function	Compensation and benefits	Supplies and services	Scholarships and fellowships	Depreciation	Total
Instruction	$ 519,180	$103,039			$ 622,219
Research	215,972	117,856			333,828
Public service	107,749	44,488			152,237
Academic support	182,216	61,819			244,035
Student services	55,707	11,288			66,995
Institutional support	99,424	9,214			108,638
Operation and maintenance of plant	79,901	68,351			148,252
Scholarships and fellowships	3,669	245	$55,075		58,989
Depreciation				$119,041	119,041
Auxiliary enterprises	63,370	87,048			150,418
Other operating expense		486			486
	$1,327,188	$503,834	$55,075	$119,041	$2,005,138

Independent Auditors' Report on Supplemental Schedules

To the Board of Regents, University of Minnesota

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The combining schedules on pages 42–44 are presented for the purpose of additional analysis of the basic consolidated financial statements rather than to present the financial position, results of operations, and changes in net assets of the individual campuses, and are not a required part of the basic consolidated financial statements. These schedules are the responsibility of the University's management. Such schedules have been subjected to the auditing procedures applied in our audit of the basic consolidated financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic consolidated financial statements taken as a whole.

Deloitte + Touche LLP

Minneapolis, Minnesota
October 18, 2002

University of Minnesota

Statement of Net Assets by Campus

June 30, 2002 (in thousands)

			Crookston	Duluth	Morris	Twin Cities	Total
Assets							
Current assets	Cash and cash equivalents		$ 3,280	$ 29,035	$ 1,981	$ 115,258	$ 149,554
	Securities lending collateral		184	2,367	101	28,345	30,997
	Short-term investments					750	750
	Receivables, net		1,002	11,392	2,718	281,858	296,970
	Inventories		71	1,037	246	16,383	17,737
	Current portion of student loan receivables, net		95	1,516	229	7,284	9,124
	Current portion of prepaid expenses and deferred charges		8	10	3	6,104	6,125
	Other assets					200	200
	Total current assets		4,640	45,357	5,278	456,182	511,457
Noncurrent assets	Restricted cash and cash equivalents					89,068	89,068
	Investments		3,536	41,733	3,705	864,188	913,162
	Receivables, net					1,480	1,480
	Student loan receivables, net		606	9,960	1,459	45,699	57,724
	Prepaid expenses and deferred charges					2,141	2,141
	Other assets					111	111
	Capital assets, net		19,559	123,569	47,234	1,599,333	1,789,695
	Total noncurrent assets		23,701	175,262	52,398	2,602,020	2,853,381
Total assets			28,341	220,619	57,676	3,058,202	3,364,838
Liabilities							
Current liabilities	Accounts payable		550	7,587	484	71,014	79,635
	Accrued liabilities and other		997	6,550	1,246	153,837	162,630
	Securities lending collateral		184	2,367	101	28,345	30,997
	Unearned income		16	1,976	153	87,581	89,726
	Long-term liabilities – current portion		30	190	85	265,962	266,267
	Total current liabilities		1,777	18,670	2,069	606,739	629,255
Noncurrent liabilities	Accrued liabilities and other		908	10,912	1,719	96,435	109,974
	Unearned income					1,300	1,300
	Long-term liabilities		330	2,020	835	449,821	453,006
	Total noncurrent liabilities		1,238	12,932	2,554	547,556	564,280
Total liabilities			3,015	31,602	4,623	1,154,295	1,193,535
Net Assets							
	Unrestricted		445	19,311	(221)	315,454	334,989
	Restricted	Expendable	4,553	25,780	5,750	449,984	486,067
		Nonexpendable	1,129	22,567	1,210	163,836	188,742
	Invested in capital assets, net of related debt		19,199	121,359	46,314	974,633	1,161,505
Total net assets			$25,326	$189,017	$53,053	$1,903,907	$2,171,303

University of Minnesota

Statement of Revenues, Expenses, and Changes in Net Assets by Campus

Year ended June 30, 2002 (in thousands)

			Crookston	Duluth	Morris	Twin Cities	Total
Revenues							
Operating revenues	Student tuition and fees, net of scholarship allowances of $68,314		$ 4,154	$ 38,690	$ 5,714	$ 244,569	$ 293,127
	Federal appropriations			13	1	18,201	18,215
	Federal grants and contracts		983	29,228	221	289,393	319,825
	State and other government grants		73	3,573	(12)	40,232	43,866
	Nongovernmental grants and contracts		826	2,235	205	141,371	144,637
	Student loan interest income		21	284	46	1,500	1,851
	Sales and services of educational activities		278	2,479	148	101,517	104,422
	Auxiliary enterprises, net of scholarship allowances of $7,346. Revenues of $2,663 are pledged as security for various auxiliary revenue bonds		3,676	24,537	5,236	173,272	206,721
	Other operating revenues				86	2,896	2,982
Total operating revenues			10,011	101,039	11,645	1,012,951	1,135,646
Expenses							
Operating expenses	Education and general	Instruction	4,918	42,595	9,357	565,349	622,219
		Research	315	10,978	86	322,449	333,828
		Public service	800	3,801	696	146,940	152,237
		Academic support	2,348	10,769	3,067	227,851	244,035
		Student services	1,527	6,121	3,639	55,708	66,995
		Institutional support	1,319	8,011	2,017	97,291	108,638
		Operation and maintenance of plant	2,322	15,137	3,939	126,854	148,252
		Scholarships and fellowships	799	5,347	1,379	51,464	58,989
		Depreciation	1,345	8,655	3,173	105,868	119,041
	Auxiliary enterprises		5,039	25,689	6,058	113,632	150,418
	Other operating expenses		3	230	51	202	486
Total operating expenses			20,735	137,333	33,462	1,813,608	2,005,138
Operating Loss			(10,724)	(36,294)	(21,817)	(800,657)	(869,492)
Nonoperating Revenues (Expenses)							
State appropriations			8,601	43,571	14,439	576,477	643,088
Grants			2,154	9,710	4,365	98,587	114,816
Gifts			537	2,346	286	85,910	89,079
Investment losses			(220)	(4,626)	(95)	(51,778)	(56,719)
Interest on capital asset-related debt			(6)	(33)	(12)	(22,349)	(22,400)
Other nonoperating (expenses) revenues			(6)	(136)	1	(1,291)	(1,432)
Net nonoperating revenues			11,060	50,832	18,984	685,556	766,432
Income (Loss) Before Other Revenues			336	14,538	(2,833)	(115,101)	(103,060)

Statement of Revenues, Expenses, and Changes in Net Assets by Campus *(Concluded)*

Year ended June 30, 2002 (in thousands)

		Crookston	Duluth	Morris	Twin Cities	Total
Capital appropriations		$ 3,238	$ 5,183	$ 2,720	$ 70,570	$ 81,711
Capital grants and gifts			64	92	21,347	21,503
Additions to permanent endowments			2	5	2,121	2,128
University assessments		(600)	(4,695)	(1,130)	6,425	–
Net mandatory transfers (out) in		(15)	(67)	(77)	159	–
Net nonmandatory transfers in (out)		1,213	6,467	3,816	(11,496)	–
Total other revenues		3,836	6,954	5,426	89,126	105,342
Increase (Decrease) in Net Assets		4,172	21,492	2,593	(25,975)	2,282
Net Assets						
Net assets at beginning of year before cumulative effect of change in accounting principles		22,256	182,270	51,637	2,024,896	2,281,059
Cumulative effect of change in accounting principles	Change in method of accounting for unearned income	100	(526)	102	(61,447)	(61,771)
	Change in method of accounting for refundable capital contributions	(753)	(10,131)	(1,516)	(41,843)	(54,243)
	Change in method of accounting for capital and other assets	(449)	(4,088)	237	8,276	3,976
Net assets at beginning of year, restated		21,154	167,525	50,460	1,929,882	2,169,021
Net assets at end of year		$25,326	$189,017	$53,053	$1,903,907	$2,171,303

The Office of the Controller is responsible for the content of this report.

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Production management, feature writing, photography, and editing provided by Office of University Relations.

Design by Lisa Haines at juju

Printing by Printing Services, University of Minnesota

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