

UNIVERSITY
OF MINNESOTA

2005

Annual Report

Transforming
the U

Dear Friends of the University:

With the Board of Regents' approval this past June, we've put in motion our vision to become within a decade one of the top three public research universities in the world.

We're redesigning the University's academic architecture, including the integration of the programs of six colleges into larger collegiate structures on our Twin Cities campus. These changes are the most visible, but they are part of a systemwide initiative that encompasses our work across all of our coordinate campuses and all of our research, extension, and outreach programs.

We're also working to reform our administrative operations to improve service and efficiency. These are complex undertakings that will affect all parts of the University system, but they will free up resources for our academic mission and keep the University flourishing.

A rapidly changing economic, demographic, and global environment requires that the University take charge of its destiny—to transform this very good university into a great one. By charting this new course, we will be in a better position to build on the University's many strengths and to provide Minnesotans with the world-class education, research, and public service they need and deserve.

Task forces will consider and review the following areas: the continued improvement of support and services for undergraduate students, the possible reconfiguration of life sciences and technology, the renewal of our liberal arts programs, and a major new initiative to help Minnesota's PreK-12 schools better prepare students—particularly those from traditionally underrepresented populations—for postsecondary study.

This past year, we received from the state a strong vote of confidence, which came in the form of the first significant legislative funding increase for the University in years. Lawmakers from both sides of the aisle and the Pawlenty administration recognized the importance of keeping the state's only major public research university system strong.

Looking toward the future, I see our University as a thriving institution that expects excellence from all its students, faculty, and staff. It will be a place whose performance is managed toward results, an organization whose resources are aligned with its goals, and an institution that is committed to finding solutions to the fundamental challenges and questions faced by our society.

I hope you'll take a few moments to look at this report and see how we're preparing for a stronger future for the University of Minnesota.

Sincerely,



Robert H. Bruininks

A rapidly changing economic, demographic, and global environment requires that the University take charge of its destiny—to transform this very good university into a great one.





Meeting the challenges of the 21st century

In November 2002, when Robert Bruininks became president of the University of Minnesota, higher education was at a crossroads. Demographic, economic, political, and global changes required the University to act creatively and swiftly to remain competitive.

In response, Bruininks, a 37-year University veteran, led the charge for change. He and his leadership team set the goal for the University to become one of the top three public research institutions in the world within a decade.

The plan represents one of the most significant academic and administrative realignments in the University's history and has received widespread support. The University Senate supported the plan in a 120 to 3 vote, college deans endorsed the plan in a 21 to 2 vote, the Board of Regents approved the recommendations in an 11 to 1 vote, and there was strong support from Governor Tim Pawlenty, members of the Minnesota Legislature, and business community leaders.

This past fall 34 administrative and academic task forces appointed by the president and Provost Thomas Sullivan began meeting to develop strategies to meet the University's goal. Specifically, task force members were asked to develop ways to:

- recruit, nurture, challenge, and educate outstanding students who are bright, curious, and highly motivated.
- recruit, mentor, reward, and retain world-class faculty and staff who are innovative, energetic, and dedicated to the highest standards of excellence.
- promote an effective organizational culture that is committed to excellence and responsive to change.
- exercise responsible stewardship by setting priorities, and enhancing and effectively using resources and infrastructure.
- communicate clearly and credibly with all of our constituencies and practice public engagement responsive to the public good.

The plan is ambitious but achievable because the momentum for change is building. There is statewide recognition that the University of Minnesota is the single most important source of creative energy for the state's economy and quality of life.



"A strategic plan for the University of Minnesota that makes it a world-class competitive research university, and measures the value of all programs against this vision, is exactly what Minnesotans need."

– Citizens League report, April 2005

Building strength through collaboration

An integral part of the vision for the University includes making changes in the curriculum—with the focus on interdisciplinary studies.

Today more than ever, pushing the boundaries of knowledge in one field often means crossing into other disciplines. The process of building new knowledge in one field often benefits from innovations in another. For example, in chemical biology, interdisciplinary work that creates new drugs and therapies for cancer patients is also accelerating the miniaturization of electrical circuits.

In creating a culture of collaboration, changes will create opportunities for students and faculty to explore new fields of research and education by working across disciplines. The initial and perhaps most dramatic changes in the University's plan include redesigning six of the University's colleges into three larger collegiate structures. For example:

- An expanded, redesigned new college of education and human development will include General College and two departments from the College of Human Ecology and create new partnerships with complementary research, programs, and services.
- The proposed college of design will combine architecture, landscape architecture, interior design, and other related fields into a powerful new interdisciplinary unit.
- With a new focus on food systems, environmental science, and renewable resources, the College of Natural Resources and the College of Agricultural, Food and Environmental Sciences will be integrated into a single new college, along with the Department of Food Science and Nutrition.

Interdisciplinary studies are nothing new, of course. In 1998, for example, the Department of Genetics, Cell Biology and Development was created as part of the University's College of Biological Sciences and Medical School. The closer relationship helped promote groundbreaking research into the cause of Alzheimer's disease, among other health advancements.

Increasingly—because these types of collaborations are producing breakthroughs—the University is accelerating in this direction. In addition, more and more federal research funding has been awarded to multidisciplinary, multi-institutional efforts rather than to single disciplines.

In July, for example, the National Science Foundation (NSF) awarded the University's



The president's interdisciplinary academic initiatives

Endorsing the importance of interdisciplinary work, the president commissioned eight interdisciplinary academic initiatives in the fall of 2003 so students and faculty can create and discover unimagined opportunities.

One of the eight initiatives is on "biocatalysis"—the use of environmentally friendly enzymes to clean up toxic wastes, transform corn into biodegradable plastic, and create alternative fuel sources, among many other products. The process works in the same way yeast helps transform flour and water into bread.

The biocatalysis initiative brings together researchers in more than 10 University departments and centers to explore how to creatively use enzymes to enhance a growing bio-based economy.

The following academic initiatives have been developed through years of study, review, consensus, and investment, and represent only a fraction of interdisciplinary activity at the University:

- Arts and Humanities
- Biocatalysis
- Brain Function Across the Lifespan
- Children, Youth, and Families
- Environment and Renewable Energy
- Healthy Foods, Healthy Lives
- Law and Values in Health, Environment, and the Life Sciences
- Translational Research in Human Health



Interdisciplinary research in action: the translational research facility

Tuberculosis, HIV, malaria, heart disease, Parkinson's disease, and spinal cord injury are among the health care challenges that researchers will study in the University's new McGuire Translational Research Facility, which opened in June on the Twin Cities campus.

"Translational" research bridges the gap between basic science and breakthrough therapies, which helps move new discoveries from the lab to patient care more quickly. The state-of-the-art facility will house interdisciplinary researchers from the Stem Cell Institute, the College of Pharmacy's Orphan Drug Center, and the new Center for Infectious Diseases and Microbiology Translational Research. Medical breakthroughs are expected at this new translational research facility that will improve the health of people around the world.



Institute for Mathematics and its Applications (IMA) a \$19.5 million grant over five years—the largest single research investment the NSF has ever made in mathematics. This award, in terms of funding, now makes IMA the top math institute in the country. The institute was founded in 1982 to bring together mathematicians, statisticians, scientists, engineers, and social scientists from all over the world to collaborate—a radical notion at the time.

In a possible reconfiguration of sciences and engineering, collaborations among four colleges—the College of Biological Sciences, the Institute of Technology (IT), the College of Agricultural, Food and Environmental Sciences, and the College of Natural Resources (CNR)—will create a platform for strengthening biology and environmental studies, as well as enhance the work in each of the other fields. IT is working with CNR's bio-based products department (formerly the Department of Wood and Paper Science) to offer a new undergraduate major—bio-based products engineering—one of the first of its kind in the world.

Student access to excellence and success

In order for students to be successful during college and after graduation, they must first have access to excellence. In its commitment to access and diversity, the University has proposed several strategies to offer students from all backgrounds—in Minnesota and beyond—the opportunity to obtain a high-quality education at a world-class research institution. For example, the University will focus on recruiting students of color, students who are the first in their families to attend college, and immigrants.

To attract the best students and to make the University more affordable and accessible for low- and middle-income students, the University has also made scholarships the No. 1 fund-raising priority.

In 2003, the president launched the Promise of Tomorrow scholarship campaign to double the number of students with scholarships from private sources. By the end of October 2005, the University had raised \$101 million for new scholarships and fellowships, two-thirds of the drive's goal of \$150 million. As a result of this campaign, 1,043 more students received scholarships in 2004–05. And the average scholarship now stands at \$3,225—an average increase of \$707 over the level awarded before the campaign.

Special matching opportunities, including the new President's Scholarship Match, have encouraged donors to make gifts. This annual program matches the payout on new endowed scholarships, thereby doubling the amount of the scholarship. By the end of October,





255 new scholarship gifts, totaling \$30 million, were approved for the match.

Renewing the commitment to access to excellence for students with the greatest financial need, the president announced the creation of the Founders Opportunity Scholarship in February 2005. These scholarships, which are intended to bridge the financial gap for students who receive Pell Grants, state financial aid, and other scholarships, enable qualified students to attend the University for free. And these scholarships are renewable for up to four years.

Many University summer programs, like the School of Journalism and Mass Communication's free "J Camp," already offer training designed for young people of diverse backgrounds. One measure of the program's success: 75 percent of its graduates go on to study journalism in college. Other continuing opportunities include the McNair Scholars Program, which encourages and assists minority, disabled, and low-income undergraduates to enroll in graduate programs or professional schools.

The University also has a major initiative to improve its PreK–12 outreach to prepare students—particularly those from traditionally underrepresented populations—for a postsecondary education. For example, the Carlson School of Management's annual LEAD (Leadership, Education, and Development) program brings top high school students from diverse backgrounds to campus to work with Twin Cities business leaders and to experience the Carlson School firsthand. And it's working. This fall, 21 former LEAD students are enrolled at Carlson.

Another example is the University's Institute on Community Integration, which will play a key role in implementing a new four-year, \$1.1 million federal grant to help prepare students from the Red Lake Band of Chippewa Indians for a successful transition to postsecondary programs.

The University's plan also includes increased student academic support and advising services; the creation of a new vice president for access, equity, and multicultural affairs; a new initiative focused on writing; and a new campus-wide honors program. In addition, liberal arts programs will be revitalized with the goal of making the College of Liberal Arts an international model for a more competitive liberal arts education.

Building on an international reputation

More than ever, the University must look beyond its borders to thrive in an increasingly competitive and global higher education environment.

In response to the difficulty that international students have had in obtaining visas following September 11, many countries around the world are devoting huge resources to improve their research universities and are aggressively recruiting students and faculty. As part of this worldwide competition, the University will be held to world-class standards.

The University already has a well-established international reputation, particularly in China. The first three Chinese students enrolled at the University in 1914. Since then, more than 8,000 Chinese have worked or studied here, and the University is currently home to more than 1,200 visiting Chinese scholars and students, the largest contingent on a North American campus. The University also offers a number of programs in China.

The Carlson School's executive MBA program, for example, was recently ranked the best such program in the country, according to a survey of leading Chinese media organizations. And the University's Law School, in partnership with the China University of Political Science and Law and the Beijing Fazheng Group, is poised to open a master of laws program in Beijing in June 2006.

In 2004 and 2005, President Bruininks visited China to strengthen the University's existing academic exchange programs and to pursue new partnerships and opportunities in education, research, and business.

The University also plans to expand international student services and learning abroad programs and develop a network of faculty who can share their international expertise. On the Twin Cities campus, a new Center for Transfer and International Admissions will aggressively recruit international faculty and students and help them obtain visas.

Transforming the way the University does business

President Bruininks wants the University to be known for its good management as much as for its research breakthroughs and high-quality educational programs. In his plan to transform the University, Bruininks is also focusing on efficient and effective business practices.

Plans are underway to roll out best-practice management tools throughout the University, as well as embrace and enhance a culture that is committed to excellence, service, and continuous improvement. Among the strategies for providing better service and lowering administrative costs are:

- better purchasing standards and decisions;
- an improved internal budget model;
- streamlined financial reporting;
- strengthened information technology standards and investment;
- better utility cost control;
- expanded health initiatives and incentives.

The savings gleaned from the restructuring of the University will be reallocated to its teaching, research, and public engagement mission.





Investing in Minnesota's future

The University is the state's only major research university, bringing in more than \$500 million in sponsored research awards annually—more than 98 percent of all research dollars coming to higher education institutions in Minnesota.

The University provides essential educational programs across the state, and its discoveries become the new ideas, new products, and new services that improve Minnesota's quality of life. In the University's Institute of Technology alone, for example, graduates have created 2,600 active companies in Minnesota, with annual revenue of \$46 billion, that employ about 175,000 people. Medtronic, ADC Telecommunications, and Cray Research are just a few of the many companies started by Institute of Technology graduates.

During the 2005 legislative session, in the midst of a continuing state budget deficit, the Minnesota Legislature recognized the University's value to the state and approved \$105.6 million in new funding for the University—a 9.6 percent increase over the previous biennium. The legislature also approved \$169.9 million for capital projects.

As a magnet for talent, the University has helped make Minnesota a destination state in the Upper Midwest. From the talent it attracts, the University graduates educated professionals in critical areas such as advanced health care. For example, two thirds of the state's physicians, dentists, pharmacists, and veterinarians have been educated at the University, as have many of its entrepreneurs and civic and artistic leaders. This is just one reason why a strong University is so important to the state.

Upholding the University's core values of public service and stewardship, the president is committed to making a very good university into a great one. The changes the University makes now and in the future will strengthen its ability to deliver the high-quality education, research, and public service programs that its students, faculty, staff, and stakeholders deserve and expect.

This vision for the University of Minnesota—to be one of the top three public research universities in the world—will position the University to meet the challenges of today's changing world, build on its commitment to excellence, and ensure the high quality of life that Minnesotans enjoy.



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Management's Discussion and Analysis

(Unaudited)

Introduction

This discussion and analysis of the University of Minnesota's (the University) consolidated financial statements provides an overview of the consolidated financial position and activities of the University for the years ended June 30, 2005 and 2004. The discussion has been prepared by management and should be read in conjunction with the consolidated financial statements and the accompanying notes.

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 institution 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, research and outreach centers, and extension service offices throughout the state.

The Twin Cities campus is the second largest campus in the country in terms of enrollment (approximately 51,000 students; an increase of 3 percent over previous year) and also one of the most comprehensive. It is the state's major research institution with expenditures of approximately \$464.9 million and \$422.3 million in fiscal years 2005 and 2004, respectively, for research under various programs funded by governmental and private sources.

The Duluth campus (approximately 10,400 students; an increase of 3 percent over previous year) 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 1,800 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 2,100 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 mission, carried out on multiple campuses and throughout the state, is threefold: research and discovery, teaching and learning, and outreach and public service.

- **Research and Discovery** To generate and preserve knowledge, understanding, and creativity by conducting high-quality research, scholarship, and artistic activity that benefit students, scholars, and communities across the state, the nation, and the world.
- **Teaching and Learning** To share that knowledge, understanding, and creativity by providing a broad range of educational programs in a strong and diverse community of learners and teachers, and prepare graduate, professional, and undergraduate students, as well as non-degree-seeking students interested in continuing education and lifelong learning, for active roles in a multiracial and multicultural world.
- **Outreach and Public Service** To extend, apply, and exchange knowledge between the University and society by applying scholarly expertise to community problems, by helping organizations and individuals respond to their changing environments, and by making the knowledge and resources created and preserved at the University accessible to the citizens of the state, the nation, and the world.

Operations

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

- provides instruction for more than 65,300 students;
- graduates approximately 12,400 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.

Management's Discussion and Analysis

(Unaudited)

Consolidated Financial Statements

The consolidated financial statements are prepared in accordance with generally accepted accounting principles prescribed by the Governmental Accounting Standards Board (GASB). The consolidated financial statements required under these reporting standards include the Consolidated Statements of Net Assets; the Consolidated Statements of Revenues, Expenses, and Changes in Net Assets; and the Consolidated Statements of Cash Flows. All are reported on a consolidated basis for the University as a whole. Also required are the financial results of the University's legally separate component units.

Consolidated Statements of Net Assets

The Consolidated Statements of Net Assets present 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:

- **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.
- **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 also externally restricted, but are required to be retained in perpetuity, including the University's true endowments and institutional contributions to refundable loan programs.
- **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.

The University's consolidated assets, liabilities, and net assets at June 30, 2005 and 2004, are summarized below (in thousands of dollars).

	2005	2004
Current assets	\$ 543,582	\$ 548,431
Capital assets, net	1,911,321	1,862,746
Other noncurrent assets	1,360,331	1,178,258
Total assets	3,815,234	3,589,435
Current liabilities	823,309	665,640
Noncurrent liabilities	365,821	521,086
Total liabilities	1,189,130	1,186,726
Net assets		
Unrestricted	364,387	315,377
Restricted—expendable	807,257	687,461
Restricted—nonexpendable	206,647	199,369
Invested in capital assets, net of related debt	1,247,813	1,200,502
Net assets	\$2,626,104	\$2,402,709

Current assets at June 30, 2005, totaled \$543.6 million, a decrease of \$4.8 million over the prior year. Current assets consist primarily of cash and cash equivalents, securities lending collateral, and net receivables. Cash and cash equivalents increased by \$6.1 million to \$130.6 million at June 30, 2005. State and federal appropriations receivables decreased \$16.5 million or 13 percent to \$109.5 million at June 30, 2005, from \$126.0 million at June 30, 2004. The decrease in the receivables was primarily due to a reduction in capital appropriations receivable. Other state and federal appropriations receivable remained consistent.

Receivables from students amounted to \$32.2 million and \$35.5 million at June 30, 2005 and 2004, respectively, net of estimated uncollectible amounts of \$6.9 million and \$7.0 million, at June 30, 2005 and 2004, respectively. The gross receivable balance decreased by \$3.4 million or 8 percent to \$39.1 million at June 30, 2005, due to better collection results on past due student receivables. Sponsored receivables, net of allowances, were \$73.7 million and \$63.0 million at June 30, 2005 and 2004, respectively. The increase of \$10.7 million or 17 percent is mainly a result of gross sponsored receivables increasing due to timing of collections at end of year. Also adding to the net increase was the reduction of the allowance for doubtful accounts due to increased collections on past due

Management's Discussion and Analysis

(Unaudited)

accounts. Trade and other receivables, net of allowances, decreased \$13.8 million or 20 percent to \$56.2 million at June 30, 2005, from \$70.0 million at June 30, 2004. Several departments reported reductions in receivables resulting from customers paying in a more timely manner. The most significant impact to the reduction in trade receivables was due to the prompt payment from the State of Minnesota for Medical Education and Research Costs (MERC) and the Prepaid Medical Assistance Program (PMAP).

Total student loans receivable remained fairly consistent at \$69.9 million, net of allowances of \$3.2 million, at June 30, 2005, from \$70.2 million, net of allowance of \$3.8 million, at June 30, 2004.

Capital assets, net of accumulated depreciation, totaled \$1,911.3 million at June 30, 2005. Net capital assets increased \$48.6 million or 2.6 percent over the prior year. Fiscal year 2005 had increased spending on capital projects as compared to the prior year. Some of the major building projects that were completed in fiscal year 2005 included the Swenson Science Building on the Duluth campus, the McGuire Translational Research Facility, and the Cargill Building for Microbial and Plant Genomics located on the Twin Cities campus, and phase two of the Oswald Visitor Center (Arboretum). The Twin Cities campus also completed a \$16 million data network upgrade in 2005. See Note 4 of the consolidated financial statements for more detailed information regarding capital assets.

Other noncurrent assets totaled \$1,360.3 million and \$1,178.3 million at June 30, 2005 and 2004, respectively, and include long-term endowment and other investments of \$1,294.2 million and \$1,112.2 million at June 30, 2005 and 2004, respectively. The increase of \$182.0 million or 16.4 percent in long-term endowment and other investments includes increases from net unrealized and realized gains on the endowment and other investments of \$116.3 million; reinvested endowment earnings of \$7.8 million; and a decrease of \$30.2 million related to the annual distribution of 5 percent of the three-year, moving average market value of the endowment to departments. The remaining increase relates to a change in the nature of the investments held, which increased the amount classified as investments. Also included in other noncurrent assets are unspent bond proceeds of \$1.0 million at June 30, 2005, and \$.4 million at June 30, 2004, which are earmarked for approved capital projects. Student loan

receivables scheduled for collection beyond June 2005 and 2004, and prepaid expenses and deferred charges make up the majority of the remaining noncurrent assets.

Current liabilities totaled \$823.3 million at June 30, 2005, up 23.7 percent or \$157.7 million, from \$665.6 million at June 30, 2004. Current liabilities 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 and fees deferred to the next fiscal year, funds received in advance of expenditures on sponsored accounts, and the current portion of bonds payable.

Accounts payable of \$66.8 million at June 30, 2005, remained consistent with June 30, 2004. Securities lending collateral remained relatively consistent at \$70.9 million at June 30, 2005, compared to \$75.7 million at June 30, 2004.

Accrued liabilities and other increased \$6.9 million to \$192.2 million at June 30, 2005, from \$185.3 million at June 30, 2004. Accrued liabilities and other consists primarily of the current portions of compensation and benefit accruals and the University's self-insurance reserves. Compensation and benefit accruals increased \$10.1 million to \$133.9 million at June 30, 2005. The increase was primarily due to higher payroll accruals resulting from a salary increase between years and one extra day of accrued payroll versus June 30, 2004. Trade liabilities of \$14.4 million at June 30, 2005, were fairly consistent with \$14.7 million at June 30, 2004. Interest and retainage accruals associated with construction in progress at the University remained relatively unchanged between fiscal year 2005 and 2004. Other accrued liabilities also remained consistent at \$20.6 million at June 30, 2005.

Management's Discussion and Analysis

(Unaudited)

Unearned income of \$93.4 million at June 30, 2005, consists of revenue related to summer session tuition and fees deferred to fiscal year 2006; funds received in advance of expenditures on sponsored accounts; and deferred revenue related to contracts with outside corporations. This balance increased \$7.2 million over June 30, 2004, due to an increase in sponsored deferred revenue. Also adding to the increase in deferred revenue were higher tuition and fees related to summer session, more students using the prepayment option, and an increase in enrollment at the Learning Abroad Center. The payment received from TCF for Gopher stadium naming rights of \$2 million is unearned income and will be refunded to TCF unless the Minnesota Legislature enacts a bill providing funding for the construction of the stadium.

Four of the University's bond issuances totaling \$329.2 million have demand provisions that require the University to repurchase the bonds upon notice from bondholders. As of June 30, 2005, the University had standby purchase agreements related to the 1999A and 2001C bonds. While the 2001C standby purchase agreement provides long-term liquidity support, the 1999A bonds are classified as short-term since the related standby purchase agreement expires in June 2006. Although management believes that all of these bonds will continue to be paid according to the original noncurrent payment schedules, \$222.0 million and \$237.3 million were reported as current liabilities at June 30, 2005 and 2004, respectively. Included in current liabilities at June 30, 2005, were all of the outstanding obligations under the Series 1999A, 2001A, and 2001B bonds and a portion of the Series 2001C bond that would be due within the next year if the standby purchase agreement were exercised for the year then ended. The University's Series 1996A bond issuance that was classified as noncurrent at June 30, 2004, was moved to current liabilities at June 30, 2005 due to the exercise of a related put option that required the University to refund the Series 1996A General Obligation Bond. This change in classification is the major cause for the \$148.4 million increase in the current long-term debt. On October 4, 2005, the University issued \$159.1 million in tax-exempt Commercial Paper Notes, Series A, to refund the General Obligation Bonds, Series 1996A and to pay costs of issuance thereof.

Noncurrent liabilities, totaling \$365.8 million and \$521.1 million at June 30, 2005 and 2004, respectively, primarily included principal amounts due on University bonds and long-term vacation and other compensation-related liabilities. As previously noted the majority of the decrease in long-term debt at June 30, 2005, of \$146.4 million or 35.4 percent was caused by a change in classification due to the put option on the Series 1996A University bonds being exercised. See Note 5 of the consolidated financial statements for more detailed information regarding long-term debt. Noncurrent accrued liabilities and other decreased to \$94.7 million at June 30, 2005, from \$102.4 million at June 30, 2004. This change was mainly the result of a decrease in the liability to University of Minnesota Medical Center, Fairview for the prior settlement of hospital claims due to payments as well as a reclassification of amounts to current liabilities.

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

The Consolidated Statements of Revenues, Expenses, and Changes in Net Assets present the institution's operating, nonoperating, and capital- and endowment-related financial 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 received.

Management's Discussion and Analysis

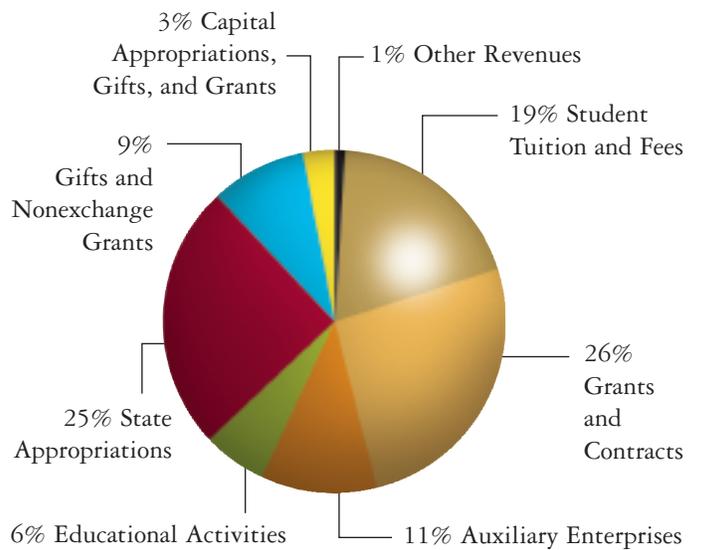
(Unaudited)

The University's consolidated revenues, expenses, and changes in net assets for the years ended June 30, 2005 and 2004, are summarized as follows (in thousands of dollars):

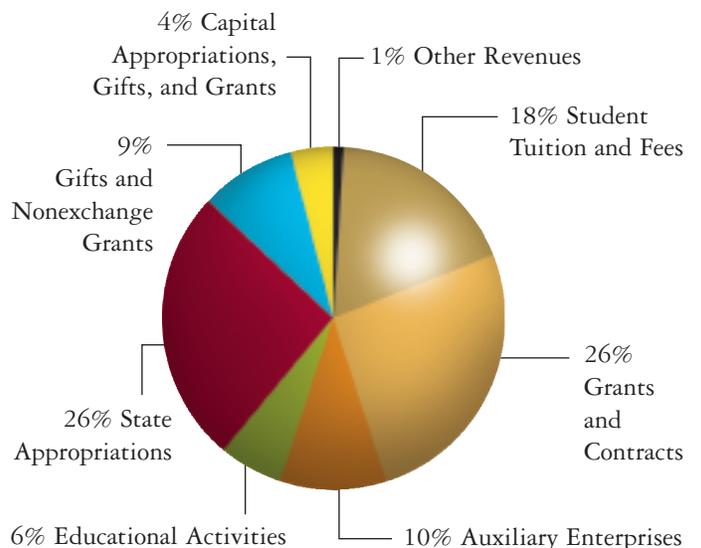
	2005	2004
Operating revenues		
Student tuition and fees, net	\$ 463,417	\$ 407,631
Grants and contracts	592,567	588,994
Auxiliary enterprises, net	244,889	238,275
Educational activities	132,401	127,149
Federal appropriations	14,294	16,657
Other revenues	5,608	2,069
Total operating revenues	1,453,176	1,380,775
Operating expenses	2,201,238	2,098,030
Operating loss	(748,062)	(717,255)
Nonoperating revenues (expenses)		
State appropriations	573,392	577,648
Grants and gifts	205,935	197,585
Net investment gain	148,847	115,272
Interest expense	(27,470)	(28,024)
Other nonoperating revenues, net	164	4,133
Income before other revenues	152,806	149,359
Capital appropriations		
Capital appropriations	50,936	58,892
Capital and endowment gifts and grants	19,653	31,063
Total other revenues	70,589	89,955
Increase in net assets	223,395	239,314
Net assets, beginning of year	2,402,709	2,163,395
Net assets, end of year	\$2,626,104	\$2,402,709

The following graphs illustrate the sources of the University's operating and nonoperating revenues, excluding investment-related revenues, for the years ended June 30, 2005, and June 30, 2004.

FY2005 Total Revenues



FY2004 Total Revenues



Management's Discussion and Analysis

(Unaudited)

and contracts, sales by auxiliary and educational units, and state appropriations.

For the year ended June 30, 2005, student tuition and fees totaled \$463.4 million, net of \$96.3 million of scholarship allowances. This revenue represents an increase of \$55.8 million or 13.7 percent over the year ended June 30, 2004, when student tuition and fees totaled \$407.6 million net. The increase in student tuition and fees revenue is due to tuition and required fee increases averaging approximately 10 percent, an increase in enrollment by 2.3 percent, and an increase of 1.8 percent in the average credit hours.

Grants and contracts from the federal government increased \$4.5 million to \$363.3 million in fiscal year 2005 from \$358.8 million in fiscal year 2004. State and other governmental grants remain level at \$48.0 million in fiscal year 2005, compared to \$46.4 million in fiscal year 2004. Nongovernmental grants and contracts also remain relatively the same at \$181.3 million for fiscal year 2005 compared to \$183.8 million for fiscal year 2004. Exchange grants are recorded as operating revenues, while nonexchange grants are recorded under nonoperating revenues.

Auxiliary revenues increased slightly to \$244.9 million, net of \$10.2 million of scholarship allowances for the year ended June 30, 2005, up from \$238.3 million, net of \$9.7 million of scholarship allowances for the year ended June 30, 2004.

Revenues from sales and services of educational activities for fiscal year 2005 were \$132.4 million, up \$5.3 million from the prior year revenues of \$127.1 million. A few elements that make up the revenues from sales and services include: the Learning Abroad Center, royalty receipts from sales of products using University patents or technology, ticket sales to Northrop performances, and research work for outside businesses.

\$577.6 million for fiscal year 2004. These totals include state general fund appropriations of \$486.7 million as well as special appropriations designated by the state of \$86.7 million.

State appropriations, in addition to other sources of unrestricted revenue (tuition and educational and auxiliary activities) and nonoperating grants totaling \$111.8 million, fund 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 included donations and gifts in support of operating expenses of \$94.2 million and \$97.3 million, and gifts for capital purposes of \$14.7 million and \$25.4 million in fiscal years 2005 and 2004, respectively. A decrease of \$10.7 million in gifts for capital purposes is due to the completion of capital projects including the Oswald Visitor Center (Arboretum), the Swenson Science Building, and the Cargill Building for Microbial and Plant Genomics.

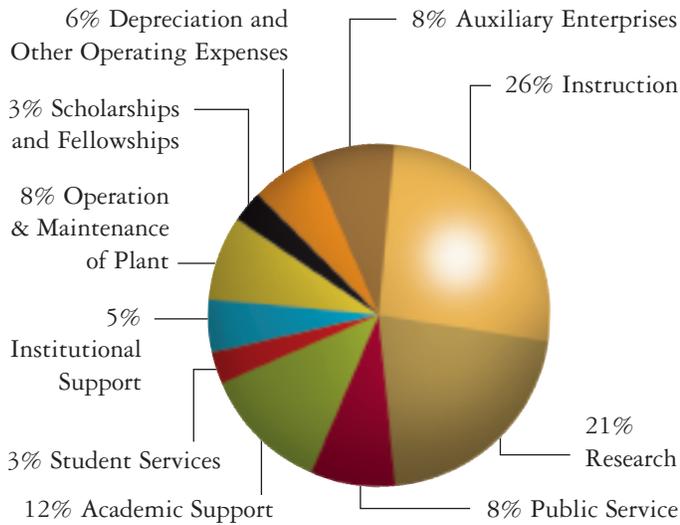
Capital appropriations are generally awarded by the State of Minnesota biennially. The University records state capital appropriation revenue only when approved capital expenditures have been incurred. Capital appropriations recorded in fiscal year 2005 are \$50.9 million, a decrease of \$8.0 million over fiscal year 2004 capital appropriations of \$58.9 million. Fiscal year 2004 spending was due to capital projects approved prior to 2004.

Management's Discussion and Analysis

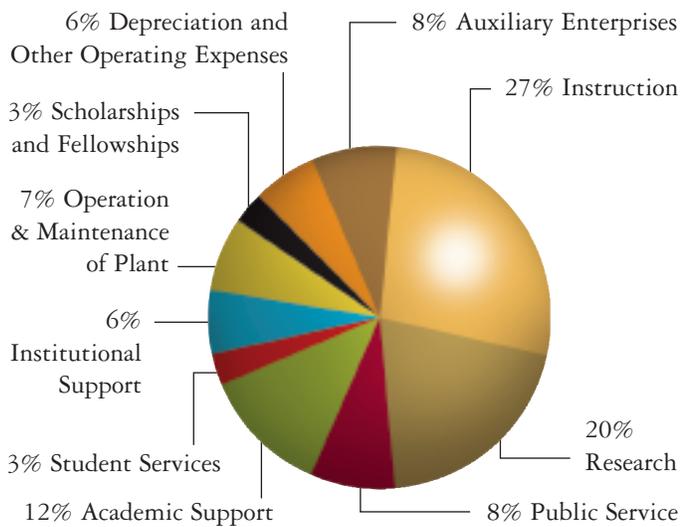
(Unaudited)

Total expenses by functional category are illustrated below.

FY2005 Functional Expenses



FY2004 Functional Expenses



Across almost all functional categories, salaries and compensation-related expenditures continued to represent the most significant expense to the University at \$1.4 billion or 65.6 percent of operating expenses in 2005. Effective January 1, 2002, the University initiated a self-insured health plan, moving away from the Minnesota State Employee Group Insurance Program (SEGIP), in which the University had been a participant since 1964. Additionally, effective January 1, 2004, the University initiated a self-insured dental program. These changes were made in the interest of gaining more control over the management of health care benefits, containing the rising cost of health care, 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 Statements of Cash Flows

The Consolidated Statements of Cash Flows present 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 at gross amounts, differentiating these activities into cash flows 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 years ended June 30, 2005 and 2004 are summarized below (in thousands of dollars).

	2005	2004
Cash (used in) provided by		
Operating activities	\$(600,810)	\$(601,667)
Noncapital financing activities	795,853	774,291
Capital and related financing activities	(124,362)	(227,890)
Investing activities	(63,873)	(160,568)
Net increase (decrease) in cash	6,808	(215,834)
Cash, beginning of the year	124,886	340,720
Cash, end of the year	\$ 131,694	\$ 124,886

Management's Discussion and Analysis

(Unaudited)

The University's cash and cash equivalents increased \$6.8 million due to the inflow of funds provided by noncapital financing and investing activities 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 \$572.7 million, grants totaling \$122.9 million, and gifts totaling \$95.1 million in fiscal year 2005. 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 University's endowment funds 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.

During fiscal year 2005, the value of the University's endowment funds increased significantly. This increase was due to new contributions to the endowment fund and market value and realized gains totaling \$139.3 million and \$7.8 million in reinvested earnings. These increases were partially offset by distributions of \$30.2 million to departments for spending purposes.

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. At the beginning of fiscal year 2002, the University reduced the endowment funds distribution rate from 5.50 percent to 5.25 percent mid-year, and then to 5.00 percent beginning July 1, 2003. These adjustments were 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 \$179.5 million in fiscal year 2005. Total additions were up from the prior year's total additions of \$164.6 million as several significant projects were in the final stages of completion in fiscal year 2005. As previously noted, these completed projects include the McGuire Translational Research Facility, the Swenson Science Building, the Cargill Building for Microbial and Plant Genomics, and the Oswald Visitor Center (Arboretum). Fiscal year 2005 spending included Nicholson Hall and Jones Hall renovations and St. Paul's Chilled Water Plant.

Bonds and other debt payable totaled \$667.0 million at June 30, 2005, and included general obligation bonds, proceeds from capital leases, and debt service obligations related to State of Minnesota infrastructure development bonds of \$34.3 million issued in fiscal year 2005. Additional details on capital and long-term debt activities can be found in Notes 4 and 5 of the consolidated financial statements.

Factors Affecting Future Economic Conditions

The overall financial position of the University of Minnesota is strong. After two years of significant financial challenges stemming primarily from a reduction in state general fund support, the State of Minnesota provided substantial new operating and capital appropriations. The economic health of the University is closely tied to that of the State of Minnesota since the University relies on the state as a major source of funding for both its educational program-related needs and capital budget appropriations. For the foreseeable future, from a financial support standpoint, the University's success and, ultimately, its ability to strengthen its academic profile, will be dependent on continued strong state support—both to keep pace with the growing competitive research environment and to continue to play a vital role in the economic growth of the state and the well-being of its citizens.

Management's Discussion and Analysis

(Unaudited)

As evidenced in the annual consolidated financial statements, increased operating revenues, strong investment performance, and continued focus on cost containment, total net assets of the University increased approximately \$223.4 million or 9.3 percent, compared to the prior fiscal year.

Looking toward the next two fiscal years, state general fund operating appropriations to the University of Minnesota will grow by \$41.1 million for fiscal year 2006, compared to fiscal year 2005, with an additional \$23.4 million for fiscal year 2007, compared to fiscal year 2006. These new funds, coupled with historically modest increases in tuition rates, will provide new funds for critical research investments in areas essential to Minnesota's economic vitality and quality of life; for attracting and retaining top faculty, staff, and students; and for technology infrastructure to support research and education.

In today's competitive world of higher education, standing still means falling behind. Economic, demographic, and global changes require Minnesota's only public research university to act now. Since the summer of 2004, the University of Minnesota has undergone a wide-ranging and consultative strategic positioning process to plan for the institution's future. Through this process, the University has set a goal to become one of the top three public research universities in the world within a decade. The plan, approved by the Board of Regents on June 10, 2005, contains more than 40 recommendations for improvement, including realigning academic departments and integrating programs from six colleges into three larger collegiate structures. Other recommendations focus on increased academic support for students, the coordinate campuses, and cost-saving administrative reforms. In addition, work will be ongoing over several years to enhance and explore future directions for other colleges and parts of the University.

The University of Minnesota, already a well-managed enterprise, is stepping up to the next level of excellence in its operations and management to support the academic enterprise. Through implementing a set of recommendations on administrative processes and structures, the University hopes to realize substantial cost savings. Transforming the University's administrative processes will help strengthen the University's mission to provide world-class research, education, and better public service to Minnesota. Improving human resources, for example, will allow the University to recruit, mentor, reward, and retain outstanding faculty and staff. In other cases, the impact is more subtle. Being more efficient in how we make purchases will reduce costs, freeing up resources that can be put toward the University's goal of becoming one of the top three public research institutions in the world. The University of Minnesota is recognized for its professional management, but to carry out the goal outlined above a coherent institutional focus and a fundamental transformation of administrative operations and cultural expectations must be applied throughout all University campuses and operations.

As part of this effort, the University is also focusing its attention on revenue diversification that will provide the University with continued resources to meet its teaching, research, and outreach mission. Among the principal areas of focus for revenue growth are intellectual property commercialization, maximizing University assets with new or enhanced strategic focus, and private giving. Greater potential can be realized among these three revenue streams; fully developing these streams will be an integral part of achieving the University's long-term financial goals.

Management's Discussion and Analysis

(Unaudited)

As a result of the 2004 Minnesota Legislature's failure to enact a capital appropriation bill, the University returned to the 2005 Legislature seeking action on its original 2004 capital appropriation request. In February 2005, the Minnesota Legislature responded positively to the request by authorizing \$169.9 million in new construction funds. The University received funding for all of the projects detailed in its request, including renovations to Kolthoff Hall, the Education Sciences building (formerly the Mineral Resources Research Center), and Academic Health Center facilities on the Twin Cities campus; renovations to the Life Science building and an addition to the Sports and Health Center on the Duluth campus; and a biomass heating plant addition and a new football facility on the Morris campus. In addition to the projects in the University's updated 2004 capital request, the agreement provided funding for two additional projects: a farm shop maintenance facility at the North Central Research and Outreach Center in Grand Rapids and a plant pathology research facility on the Twin Cities campus in St. Paul. For each of the non-HEAPR (Higher Education Asset Preservation and Replacement) projects, the University will contribute one third of the costs or approximately \$35.9 million. The University received \$40 million in HEAPR funds, which are used for general repairs and maintenance projects.

The University will return to the 2006 Minnesota Legislature with a new capital budget request strategically focused on capital projects that are: critical in supporting areas of academic excellence; support students and their learning environment; meet our commitment to public engagement and outreach; and solve multiple problems and realize cost savings. This new request was built around a need to address the University's future, in terms of what it provides to our students and the citizens of Minnesota; and our unique responsibility within Minnesota's system of higher education.

The University will also be updating its six-year capital plan in November 2005. It will continue to reflect a long-range strategic plan to take care of what we have and to shape the future. The major focus of the six-year capital plan will outline projects that will be requested from the State of Minnesota. The University's outstanding debt totaled \$667 million on June 30, 2005. The weighted average cost of capital was 4.48 percent per the original bond agreements, and the average life of debt was 11.2 years, with 97.0 percent fixed and 3.0 percent variable. The six-year capital plan will reflect a prudent use of debt financing based upon a careful financial analysis coupled with long-term modeling of the impact of the six-year plan on key financial operating ratios. An analysis of student demand, market position, and financial indicators places the University of Minnesota solidly in the strong "Aa" category, as rated by Moody's Investors Services and affirmed in July 2004.

In summary, as the financial statements indicate, the University continues a strong tradition of effective stewardship of the human, physical, and financial resources entrusted to it. Taken together, the University of Minnesota remains in a strong position to be a major asset of significant benefit to the citizens of Minnesota.

University of Minnesota
Independent Auditors' Report

To the Board of Regents of the University of Minnesota

We have audited the accompanying consolidated statement of net assets of the University of Minnesota (the University), as of and for the year ended June 30, 2005, and the related consolidated statements of revenues, expenses, and changes in net assets, and of cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The University's consolidated financial statements as of and for the year ended June 30, 2004 were audited by other auditors, whose report dated October 15, 2004, expressed an unqualified opinion on those consolidated financial statements. We also did not audit the financial statements of the discretely presented component units. Those statements and the prior year comparative information were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the University, is based solely on the report of such other auditors. Prior year summarized comparative information has been derived from the discretely presented component units' June 30, 2004 financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of the University, as of June 30, 2005, and the respective consolidated changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2005, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 10 through 19, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



Larson, Allen, Weishair & Co., LLP

Minneapolis, Minnesota
October 21, 2005

University of Minnesota

Consolidated Statements of Net Assets (Excluding Component Units)

June 30, 2005 and 2004 (in thousands)

		2005	2004
Assets			
Current assets	Cash and cash equivalents	\$ 130,648	\$ 124,530
	Securities lending collateral	70,879	75,696
	Short-term investments	35,649	4,481
	Receivables, net	271,569	293,049
	Inventories	18,582	18,968
	Current portion of student loan receivables, net	12,318	13,506
	Current portion of prepaid expenses and deferred charges	3,737	18,001
	Other assets	200	200
	Total current assets	543,582	548,431
Noncurrent assets	Restricted cash and cash equivalents	1,046	356
	Investments	1,294,165	1,112,242
	Receivables, net	1,337	1,451
	Student loan receivables, net	57,611	56,657
	Prepaid expenses and deferred charges	6,030	7,448
	Other assets	142	104
	Capital assets, net	1,911,321	1,862,746
	Total noncurrent assets	3,271,652	3,041,004
Total assets		3,815,234	3,589,435
Liabilities			
Current liabilities	Accounts payable	66,774	66,794
	Accrued liabilities and other	192,244	185,305
	Securities lending collateral	70,879	75,696
	Unearned income	93,393	86,230
	Long-term debt—current portion	400,019	251,615
	Total current liabilities	823,309	665,640
Noncurrent liabilities	Accrued liabilities and other	94,695	102,447
	Unearned income	4,194	5,300
	Long-term debt	266,932	413,339
	Total noncurrent liabilities	365,821	521,086
Total liabilities		1,189,130	1,186,726
Net Assets			
	Unrestricted	364,387	315,377
	Restricted		
	Expendable	807,257	687,461
	Nonexpendable	206,647	199,369
	Invested in capital assets, net of related debt	1,247,813	1,200,502
Total net assets		\$2,626,104	\$2,402,709

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Financial Position

June 30, 2005 and 2004 (in thousands)

	University of Minnesota Foundation		Minnesota Medical Foundation	
	2005	2004	2005	2004
Assets				
Cash and cash equivalents	\$ 4,682	\$ 7,463	\$ 2,941	\$ 2,449
Investments, substantially at fair market value	950,999	876,214	205,771	181,514
Investments held for unitrusts, annuity trusts, and gift annuities			13,063	11,165
Investments designated for endowments				
Investments loaned to broker	99,332	95,302	33,057	40,136
Investments collateral	101,920	97,437	34,270	41,100
Assets limited as to use				
Pledges receivable, net	42,764	49,726	26,061	24,478
Accounts and other receivables	2,240	3,899	1,983	1,866
Interest in charitable lead trusts, unitrusts, pooled income and trusts	55,709	52,111	32,758	6,184
Gift annuities	26,504	25,295		
Interest in the net assets of related parties				
Due from affiliated parties	19	19		
Property and equipment, net	773	1,024	346	371
Other assets			345	313
Total assets	1,284,942	1,208,490	350,595	309,576
Liabilities				
Accounts payable and accrued liabilities	4,184	3,806	2,769	4,803
Deferred revenue				
Gift annuities payable	14,437	14,243		
Split-interest agreement liabilities			8,040	7,437
Unitrusts, pooled income and annuity trusts payable	11,818	11,436		
Investments held for custody of others	51,623	51,466	2,590	2,698
Payable under investment loan agreement	101,920	97,437	34,269	41,100
Notes and bonds payable				
Total current liabilities	183,982	178,388	47,668	56,038
Net Assets				
Unrestricted	40,222	41,138	8,587	8,538
Temporarily restricted	664,347	611,468	134,103	124,879
Permanently restricted	396,391	377,496	160,237	120,121
Total net assets	1,100,960	1,030,102	302,927	253,538
Total liabilities and net assets	\$1,284,942	\$1,208,490	\$350,595	\$309,576

See notes to consolidated financial statements.



Minnesota Landscape Arboretum Foundation		Minnesota 4-H Foundation		University of Minnesota Physicians		University of Minnesota Alumni Association		University Gateway Corporation	
2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
\$ 769	\$ 1,016	\$ 387	\$ 233	\$15,689	\$16,938	\$ 462	\$ 315	\$ 1,091	\$ 1,168
1,032	2,946	6,167	5,512	20,449	10,652	22,827	21,958	1,418	4,169
19,432	16,417								
					153				
2,250	5,700	1,249	96						
161	204	2	1	35,367	31,198	99	326	122	91
1,866	1,761	32	30						
								17,646	16,091
						76	93		
566	1,666	12	11	12,508	11,996	523	637	39,685	37,592
		5	9	1,939	2,840	256	208	677	722
26,076	29,710	7,854	5,892	85,952	73,777	24,243	23,537	60,639	59,833
61	36	943	904	43,897	35,961	945	784	7,781	975
376	364	30	20			3,712	3,943		
40	41								
				4,299	5,625			45,130	45,730
477	441	973	924	48,196	41,586	4,657	4,727	52,911	46,705
4,228	5,191	87	135	37,756	32,191	18,805	18,079	7,654	10,909
8,909	11,945	4,234	2,356			182	174	74	2,219
12,462	12,133	2,560	2,477			599	557		
25,599	29,269	6,881	4,968	37,756	32,191	19,586	18,810	7,728	13,128
\$26,076	\$29,710	\$7,854	\$5,892	\$85,952	\$73,777	\$24,243	\$23,537	\$60,639	\$59,833

University of Minnesota

Consolidated Statements of Revenues, Expenses, and Changes in Net Assets
(Excluding Component Units)

Years ended June 30, 2005 and 2004 (in thousands)

		2005	2004
Revenues			
Operating revenues	Student tuition and fees, net of scholarship allowances of \$96,273 in 2005; \$88,926 in 2004	\$ 463,417	\$ 407,631
	Federal appropriations	14,294	16,657
	Federal grants and contracts	363,335	358,840
	State and other government grants	47,979	46,389
	Nongovernmental grants and contracts	181,253	183,765
	Student loan interest income	1,558	1,484
	Sales and services of educational activities	132,401	127,149
	Auxiliary enterprises, net of scholarship allowances of \$10,204 in 2005; \$9,660 in 2004. Revenues of \$2,798 in 2005; \$2,865 in 2004 were pledged as security for various auxiliary revenue bonds	244,889	238,275
	Other operating revenues	4,050	585
Total operating revenues		1,453,176	1,380,775
Expenses			
Operating expenses	Education and general		
	Instruction	581,297	560,906
	Research	464,893	422,290
	Public service	173,830	165,200
	Academic support	265,531	251,602
	Student services	74,025	71,082
	Institutional support	108,902	116,481
	Operation and maintenance of plant	164,623	152,372
	Scholarships and fellowships	69,857	66,605
	Depreciation	127,091	126,930
	Auxiliary enterprises	170,543	164,218
	Other operating expenses, net	646	344
Total operating expenses		2,201,238	2,098,030
Operating Loss		(748,062)	(717,255)
Nonoperating Revenues (Expenses)			
State appropriations		573,392	577,648
Grants		111,783	100,256
Gifts		94,152	97,329
Investment income		32,835	29,405
Net increase in the fair market value of investments		116,012	85,867
Interest on capital asset-related debt		(27,470)	(28,024)
Other nonoperating revenues, net		164	4,133
Net nonoperating revenues		900,868	866,614
Income Before Other Revenues		152,806	149,359
Capital appropriations		50,936	58,892
Capital grants and gifts		14,719	25,440
Additions to permanent endowments		4,934	5,623
Total other revenues		70,589	89,955
Increase in Net Assets		223,395	239,314
Net assets at beginning of year		2,402,709	2,163,395
Net assets at end of year		\$2,626,104	\$2,402,709

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

University of Minnesota Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	2005	Total 2004
Revenues					
Contributions	\$ 41	\$ 39,668	\$ 15,963	\$ 55,672	\$ 75,461
Investment income, net	4,299	6,611	24	10,934	8,229
Net realized and unrealized gains (losses) on investments	6,095	80,493	(4)	86,584	124,913
Change in carrying value of investments	(104)	1,249	3,041	4,186	4,468
Support services revenue	2,764			2,764	3,130
Other revenue	659			659	613
Net assets released from restriction	75,271	(75,142)	(129)	–	–
Total revenues	89,025	52,879	18,895	160,799	216,814
Expenses					
Program services					
Distributions for educational purposes	72,883			72,883	76,775
Support services					
Management and general	6,174			6,174	6,011
Fund-raising	10,884			10,884	10,417
Total expenses	89,941	–	–	89,941	93,203
Increase (decrease) in net assets	(916)	52,879	18,895	70,858	123,611
Net assets at beginning of year	41,138	611,468	377,496	1,030,102	906,491
Net assets at end of year	\$40,222	\$664,347	\$396,391	\$1,100,960	\$1,030,102

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

Minnesota Medical Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	2005	Total 2004
Revenues					
Contributions	\$ 577	\$ 38,974	\$ 31,004	\$ 70,555	\$ 38,936
Net investment return	532	10,850	5,113	16,495	27,360
Change in carrying value of investments		868	1,693	2,561	655
Service charges	7,822	(3,920)	(3,768)	134	–
Receipts from affiliated parties	375	(5)	2,000	2,370	250
Net assets released from restriction	33,469	(37,543)	4,074	–	–
Total revenues	42,775	9,224	40,116	92,115	67,201
Expenses					
Program services					
Research and education grants	28,294			28,294	35,558
Communications	386			386	306
Student aid and scholarships	1,794			1,794	1,656
Honor and award grants	1,484			1,484	1,042
Alumni and sponsored events	1,441			1,441	1,080
Support services					
Management and general	3,339			3,339	2,686
Fund-raising	5,988			5,988	5,956
Total expenses	42,726	–	–	42,726	48,284
Increase in net assets	49	9,224	40,116	49,389	18,917
Net assets at beginning of year	8,538	124,879	120,121	253,538	234,621
Net assets at end of year	\$ 8,587	\$134,103	\$160,237	\$302,927	\$253,538

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

Minnesota Landscape Arboretum Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	2005	Total 2004
Revenues					
Contributions	\$1,698	\$1,171	\$ 303	\$ 3,172	\$ 5,852
Membership dues and fees	705			705	686
Investment income, net	3	76		79	191
Net realized and unrealized gains on investments	56	1,729		1,785	2,201
Change in carrying value of investments		144	29	173	254
Other revenue	384			384	668
Net assets released from restriction	6,159	(6,156)	(3)	–	–
Total revenues	9,005	(3,036)	329	6,298	9,852
Expenses					
Program services					
Other program services	8,231			8,231	13,830
Support services					
Management and general	1,154			1,154	752
Fund-raising	583			583	591
Total expenses	9,968	–	–	9,968	15,173
Increase (decrease) in net assets	(963)	(3,036)	329	(3,670)	(5,321)
Adjustment to net assets				–	131
Net assets at beginning of year	5,191	11,945	12,133	29,269	34,459
Net assets at end of year	\$4,228	\$8,909	\$12,462	\$25,599	\$29,269

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

Minnesota 4-H Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	2005	Total 2004
Revenues					
Contributions	\$ 90	\$ 139	\$ 32	\$ 261	\$ 196
Investment income, net	32	346	52	430	646
Change in carrying value of investments		1		1	3
Support services revenue				–	–
Other revenue	166	2,213		2,379	300
Net assets released from restriction	822	(821)	(1)	–	–
Total revenues	1,110	1,878	83	3,071	1,145
Expenses					
Program services					
Other program services	804			804	806
Support services					
Management and general	99			99	86
Fund-raising	255			255	199
Total expenses	1,158	–	–	1,158	1,091
Increase (decrease) in net assets	(48)	1,878	83	1,913	54
Adjustment to net assets					
Net assets at beginning of year	135	2,356	2,477	4,968	4,914
Net assets at end of year	\$ 87	\$4,234	\$2,560	\$6,881	\$4,968

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

University of Minnesota Physicians

	Total (Unrestricted) 2005	2004
Revenues		
Net patient service revenue	\$145,446	\$127,315
Contract revenue	62,012	52,261
Investment income, net	808	294
Other revenue	2,600	2,747
Total revenues	210,866	182,617
Expenses		
Program services		
Health care services	176,656	156,950
Support services		
Management and general	28,645	22,617
Total expenses	205,301	179,567
Increase in net assets	5,565	3,050
Net assets at beginning of year	32,191	29,141
Net assets at end of year	\$ 37,756	\$ 32,191

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

University of Minnesota Alumni Association

	Unrestricted	Temporarily Restricted	Permanently Restricted	2005	Total 2004
Revenues					
Contributions	\$ 134	\$ 1		\$ 135	\$ 148
Membership dues and fees	852			852	875
Investment income, net	91	3		94	48
Change in carrying value of investments	1,877	29	\$ 42	1,948	3,043
Other revenue	2,873			2,873	3,479
Net assets released from restriction	25	(25)		–	–
Total revenues	5,852	8	42	5,902	7,593
Expenses					
Program services					
Other program services	4,541			4,541	5,026
Support services					
Management and general	550			550	402
Fund-raising	35			35	12
Total expenses	5,126	–	–	5,126	5,440
Increase in net assets	726	8	42	776	2,153
Net assets at beginning of year	18,079	174	557	18,810	16,657
Net assets at end of year	\$18,805	\$182	\$599	\$19,586	\$18,810

See notes to consolidated financial statements.

University of Minnesota

Component Units – Statements of Activities

Years ended June 30, 2005 (with summarized information for the year ended June 30, 2004) (in thousands)

University Gateway Corporation

	Unrestricted	Temporarily Restricted	2005	Total	2004
Revenues					
Investment income, net	\$ 96		\$ 96		\$ 38
Receipts from affiliated parties					2,106
Other revenue	5,313	\$1,555	6,868		7,369
Net assets released from restriction	3,700	(3,700)	–		–
Total revenues	9,109	(2,145)	6,964		9,513
Expenses					
Program services					
Other program services	11,976		11,976		5,318
Support services					
Management and general	25		25		31
Payment to affiliated parties	363		363		291
Total expenses	12,364	–	12,364		5,640
Increase (decrease) in net assets	(3,255)	(2,145)	(5,400)		3,873
Net assets at beginning of year	10,909	2,219	13,128		9,255
Net assets at end of year	\$ 7,654	\$ 74	\$ 7,728		\$13,128

See notes to consolidated financial statements.

University of Minnesota

Consolidated Statements of Cash Flows (Excluding Component Units)

Years ended June 30, 2005 and 2004 (in thousands)

	2005	2004
Cash Flows from Operating Activities		
Student tuition and fees	\$ 465,438	\$ 405,732
Federal appropriations	13,312	16,963
Grants and contracts (federal, state, nongovernmental, other)	597,331	583,104
Sales and services of educational activities	129,654	130,343
Auxiliary enterprises	248,164	237,469
Other operating revenues	4,750	1,067
Payments to employees for services	(1,118,078)	(1,084,467)
Payments for fringe benefits	(317,668)	(298,431)
Payments to suppliers for goods and services	(559,933)	(530,057)
Payments for scholarships and fellowships	(65,704)	(62,217)
Loans issued to students	(13,460)	(16,638)
Collection of loans to students	15,384	15,465
Net cash used in operating activities	(600,810)	(601,667)
Cash Flows from Noncapital Financing Activities		
State appropriations	572,728	577,573
Grants for other than capital purposes	122,907	91,826
Gifts for other than capital purposes	95,121	97,407
Private gifts for endowment purposes	4,934	5,623
Other nonoperating revenues, net	1,330	4,681
Direct lending receipts	255,087	237,749
Direct lending disbursements	(254,785)	(238,040)
Agency transactions	(1,469)	(2,528)
Net cash provided by noncapital financing activities	795,853	774,291
Cash Flows from Capital and Related Financing Activities		
Capital appropriations	76,921	42,420
Capital grants and gifts	13,890	23,107
Proceeds from capital debt	21,491	-
Purchases of capital assets	(177,069)	(151,460)
Principal paid on capital debt	(26,466)	(112,763)
Interest paid on capital debt	(33,129)	(29,194)
Net cash used in capital and related financing activities	(124,362)	(227,890)
Cash Flows from Investing Activities		
Investment income, net	60,911	51,604
Proceeds from sales and maturities of investments	4,339,590	6,000,596
Purchase of investments	(4,464,374)	(6,212,768)
Net cash used in investing activities	(63,873)	(160,568)
Net Increase (Decrease) in Cash	6,808	(215,834)
Cash and Cash Equivalents at Beginning of Year	124,886	340,720
Cash and Cash Equivalents at End of Year	\$ 131,694	\$ 124,886

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows (Excluding Component Units) (concluded)

Years ended June 30, 2005 and 2004 (in thousands)

	2005	2004
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Used in Operating Activities		
Operating loss	\$(748,062)	\$(717,255)
Adjustments to reconcile net operating loss to net cash used in operating activities		
Depreciation expense	127,091	126,930
Changes in assets and liabilities		
Receivables, net	5,797	(13,701)
Inventories	640	(1,219)
Prepaid and other items	14,204	(14,532)
Accounts payable	2,981	(4,120)
Accrued liabilities	(3,134)	14,165
Unearned income	(327)	8,065
Net Cash Used in Operating Activities	\$(600,810)	\$(601,667)
Noncash Transactions		
Borrowing under capital lease	(712)	(516)
Equipment	\$ 712	\$ 516

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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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, as required under GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (GASB 39), its legally separate component units. The component units are included in the University's reporting entity because of the significance of their operational or financial relationships with the University or its other component units.

Blended Component Unit—RUMINCO, Ltd. is a wholly owned single parent captive insurance company. Although it is legally separate from the University, RUMINCO, Ltd. is reported as if it were part of the University because its sole purpose is to handle medical malpractice, general liability, directors and officers' liability, and automobile liability on behalf of the University.

Discretely Presented Component Units—The University's financial statements include the financial data of several tax-exempt component units. They are reported in separate columns on separate pages. GASB 39 requires discrete presentation of component units when either the resources held by these entities can only be used by, or for the

benefit of, the University or its component units; or the component units are closely related to, or financially integrated with, the University.

University of Minnesota Foundation

The University of Minnesota Foundation (UMF) is a legally separate, tax-exempt organization dedicated to raising and managing private gifts to benefit the University of Minnesota. The Board of Trustees of the UMF consists of between 30 and 45 members and includes the president of the University of Minnesota. One-fourth of the members of the Board of Trustees are appointed by the University. Although the UMF is an independent organization, the majority of resources that the UMF holds and invests, including income from its investments, are restricted to activities of the University by donors.

During the year ended June 30, 2005, the UMF distributed \$81,849, to the University. Complete financial statements for the University of Minnesota Foundation can be obtained from the UMF office, McNamara Alumni Center, 200 Oak Street S.E., Suite 500, Minneapolis, MN 55455.

Minnesota Medical Foundation

The Minnesota Medical Foundation (MMF) is a legally separate, tax-exempt organization dedicated to raising and managing private gifts in support of the advancement of health-related education, research, and service at the University of Minnesota. The Board of Trustees of the MMF consists of not less than 24 elected members, one-third of whom must be physicians. Although the MMF is an independent organization, the majority of resources that the MMF holds and invests, including income from its investments, are restricted to activities of the University by donors.

During the year ended June 30, 2005, the MMF distributed \$35,335 to the University. Complete financial statements for the Minnesota Medical Foundation can be obtained from the MMF office, McNamara Alumni Center, 200 Oak Street S.E., Suite 300, Minneapolis, MN 55455.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Minnesota Landscape Arboretum Foundation

The Minnesota Landscape Arboretum Foundation (Foundation) is a legally separate, tax-exempt organization dedicated to raising and managing private gifts for the benefit of the Minnesota Landscape Arboretum of the University of Minnesota. The Board of Trustees of the Foundation consists of between eight and 36 trustees, and the number of trustees must be divisible by four. One-fourth of the trustees are appointed by the University of Minnesota. Although the Foundation is an independent organization, the majority of resources that the Foundation holds and invests, including income from its investments, are restricted to activities of the University by donors.

During the year ended June 30, 2005, the Minnesota Landscape Arboretum Foundation distributed \$8,353 to the University. Complete financial statements for the Minnesota Landscape Arboretum Foundation can be obtained from the Foundation office, 3675 Arboretum Drive, Chaska, MN 55318.

Minnesota 4-H Foundation

The Minnesota 4-H Foundation is a legally separate, tax-exempt organization, organized to receive, hold, invest, and administer assets and to make expenditures to or for the benefit of the programs of the Center for 4-H Youth Development, including support of the University of Minnesota Extension Service. The Board of Trustees consists of not fewer than 18 and not more than 21 persons elected from a slate of candidates prepared by the Board of Trustees.

During the year ended June 30, 2005, the Minnesota 4-H Foundation distributed \$553 to the University. Complete financial statements for the Minnesota 4-H Foundation can be obtained from the Minnesota 4-H Foundation office, McNamara Alumni Center, 200 Oak Street S.E., Suite 270B, Minneapolis, MN 55455.

University of Minnesota Alumni Association

The University of Minnesota Alumni Association (Association) is a legally separate, tax-exempt organization that serves alumni and the University of Minnesota with a mission to connect alumni to the University, advocating and supporting excellence in education, and building pride, spirit, and community. A volunteer board of 46 directors governs the Association. Members of the board

are elected as follows: officers (9) and an honorary director (1) by the Board of Directors; at-large and geographical representatives (18) by the Association's general membership; and collegiate/professional representatives (18) by their respective societies.

During the year ended June 30, 2005, the Association distributed \$1,066 to the University. Complete financial statements for the Association can be obtained from the University of Minnesota Alumni Association, McNamara Alumni Center, 200 Oak Street S.E., Suite 200, Minneapolis, MN 55455.

University Gateway Corporation

The University Gateway Corporation (Gateway) is a legally separate, tax-exempt entity that owns and operates a facility used to support three beneficiary organizations and the University of Minnesota in student recruiting, alumni relations, fund-raising activities, and general operations. The beneficiary organizations include the University of Minnesota Foundation, the University of Minnesota Alumni Association, and the Minnesota Medical Foundation. Gateway's six-member Board of Directors consists of three members from the University of Minnesota Foundation, two members from the University of Minnesota Alumni Association, and one member from the Minnesota Medical Foundation.

During the year ended June 30, 2005, Gateway distributed \$7,012 to the University. Complete financial statements for the University Gateway Corporation can be obtained from the McNamara Alumni Center Management Office, 200 Oak Street S.E., Suite 35, Minneapolis, MN 55455.

University of Minnesota Physicians

University of Minnesota Physicians (UMPhysicians) is a legally separate, tax-exempt clinical practice organization for the faculty of the University of Minnesota School of Medicine. The Board of UMPhysicians consists of 24 voting directors, including the UMPhysicians chief executive officer, the dean of the University of Minnesota Medical School, faculty and department heads of the University Medical School (18 members), and individuals from the community at-large (4 members); and two nonvoting directors.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

During the year ended June 30, 2005, UM Physicians distributed \$27,804 to the University. Complete financial statements for University of Minnesota Physicians can be obtained from Patti Andreini Arnold, Chief Financial Officer, 2550 University Avenue West, Suite 401, South St. Paul, MN 55114.

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

Component Units

The University's component units are private nonprofit organizations that report under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the component units' financial information in the University's financial report for these differences. The component units' financial data has, however, been aggregated into like categories for presentation purposes and is shown in these statements in thousands, although in all cases except the University of Minnesota Physicians, the separately issued component units' financial statements are not rounded.

Financial Statement Presentation

The financial statements have been prepared in accordance with accounting principles prescribed by the Governmental Accounting Standards Board. These statements are prepared on a consolidated, entity-wide basis. All significant interfund balances have been eliminated upon consolidation.

Effective July 1, 2004, the University adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. This statement, which amends GASB Statement No. 3, *Deposits with Financial Institutions, Investments (Including Repurchase Agreements) and Reverse Repurchase Agreements*, requires the University to address common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. This statement also requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. The University also has disclosed its deposit and investment policies.

Basis of Accounting

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 statement of cash flows, the University defines cash and cash equivalents as highly liquid, short-term (90 days or less) investments that bear little or 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 balances held at the date of the statements are due to the timing of reinvesting the proceeds within the funds.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Investments—Investments in securities are reported at market value as determined by the major securities markets. Alternative investment strategies involving thinly traded securities are determined by the most recent purchase or sale price publicly available for that security. Private investments including real estate, timber, and venture capital are independently appraised annually and reported by investment managers as an updated estimate to that appraisal. 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 and endowment income (interest earned on endowments but allocated to other funds). Realized and unrealized gains and losses are reported as a net increase (decrease) in the fair market value of investments.

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 and to enhance the investment returns of certain asset classes. 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 Board of Regents determines 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 \$1,046 at June 30, 2005, and \$356 at June 30, 2004, which 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 as these 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 \$27,470 and \$28,024 was incurred during construction for the years ended June 30, 2005 and 2004, respectively. No interest qualified for interest capitalization in fiscal years 2005 or 2004. 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	3–20	2,500
Library and reference books	10	N/A

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.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Unearned Income—Unearned income represents amounts received from 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 and institutional contributions to refundable loan programs.

- **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 Supplemental Educational Opportunity Grants), 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.

Expense Classification—The University has classified operating expenses based upon their functional classification. Operating expenses by natural classification are presented in Note 10.

During fiscal years 2005 and 2004, departmental research in nonsponsored accounts of \$104,534 and \$94,688, respectively, was recorded as research expense.

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.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Reclassifications—Certain prior year amounts have been reclassified to conform to the presentation used in the current year. These reclassifications had no impact on net assets as previously reported.

New Accounting Pronouncements

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement, which amends GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, is effective for the University for the year ending June 30, 2006. The University will be required to account for and report impairment losses of capital assets by writing the capital asset down to the lower of carrying value or fair value. In addition to impairments, the standard addresses the accounting treatment for insurance recoveries. The University has not yet determined the full impact of GASB Statement No. 42 on its consolidated financial statements.

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*. The University will be required to disclose a description of termination benefit arrangements, the cost of the termination benefits, and significant methods and assumptions used to determine termination benefit liabilities. This statement is effective in two parts. For termination benefits provided through an existing defined benefit (other postemployment benefits) OPEB plan, the provisions of this statement will be implemented simultaneously with the requirements of Statement No. 45 for the fiscal year ending 2008. For all other termination benefits, this statement is effective for the fiscal year ending June 30, 2006. The University has not yet determined the full impact of GASB Statement No. 47 on its consolidated financial statements.

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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, Ltd.—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 credit, concentration of credit, custodial credit, interest rate, and foreign currency. Although the objective of each investment pool is to control risk and preserve capital, it is likely that changes in the values of investment securities will occur in the near term, and possible that such changes could materially affect the amounts reported in the consolidated financial statements.

Authorizations

The Board of Regents establishes the University's 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 the TIP is to maximize current income while preserving principal and maintaining liquidity. The pool is invested primarily in commercial paper, money market funds, corporate obligations, and U.S. government and agency securities within the credit quality and term constraints of the portfolio.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

The TIP investments are guided by the following: the average duration of three years or less for the entire portfolio and maximum duration of seven years for any individual holding; average credit quality of A1/A- or better; no use of leverage; and security ratings of investment grade (defined as Baa2/BBB rating or better by Moody's or Standard & Poor's) unless the president or delegate specifically approves retention of a lower rated security. The TIP's average credit rating per Standard & Poor's Corporation is AAA- and is further broken down as follows:

Standard & Poor's rating	2005 Market value	2004 Market value
AAA	\$525,005	\$451,932
AA	15,137	18,796
A	19,169	47,783
BBB	41,374	18,084
BB	20,715	-
N/A	1,066	2,710
Total	\$622,466	\$539,305

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 35 percent investment in domestic equities, 15 percent investment in international equities, 20 percent in fixed-income related investments, and 30 percent investment in alternative investments including, but not limited to, private capital (such as private equity, venture capital, and distressed debt), real assets (such as real estate partnerships, timberlands, oil and gas partnerships, and other investable commodities), and marketable alternatives (such as hedge funds, mezzanine or high-yield debt). To maintain the allocation targets, the CEF may invest in various stock, bond, and currency futures contracts. The CEF's ratable credit risk, which was 8.6 percent of the pool in fiscal year 2005, compared to 10.9 percent in fiscal year 2004, consisted of debt securities that had an average Standard & Poor's rating of AA+.

The University distributes funds from the CEF 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.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (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 the GIP is invested in global, fixed-income securities through institutional mutual funds. The portfolio can invest up to 33 percent of the overall value in domestic equity securities.

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 \$11,000 and \$12,000 at June 30, 2005 and 2004, respectively.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the University of Minnesota's investment in a single issuer. The University has an established policy for CEF that limits the amount of funds that may be invested by any one investment management firm to 25 percent of the total endowment. A further policy limits any investment manager to holding more than 5 to 7 percent of the portfolio in a single issuer. As a result of these policies, the largest holding as of June 30, 2005 and June 30, 2004, was 0.38 percent and 0.55 percent of the endowment pool, respectively. The TIP's policy is to limit single issuer concentration to 7 percent. As of June 30, 2005 and June 30, 2004, no single issuer is above the 5 percent concentration threshold.

Custodial Credit Risk

Deposits—Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to the University. The University does not have a deposit policy for custodial credit risk. As of June 30, 2005, \$20,521 of the University's bank balance of \$20,621 was uninsured and uncollateralized; compared to fiscal year ending June 30, 2004 when \$5,596 of the University's bank balance of \$5,696 was uninsured and uncollateralized.

Investments—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University's policy is to register investment securities in the name of the Board of Regents of the University of Minnesota.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates that will adversely affect the market value of the University's investments. The University's established TIP policy does limit investment duration as a means of managing its exposure to market value losses arising from increasing interest rates. The University's investment in securities subject to this risk as of June 30, 2005, was as follows:

Investment type	2005 Market value	Average duration (years)
Government issues — agencies	\$306,639	2.70
Corporate bonds	79,959	1.06
Mortgage backed securities	75,967	3.56
Other (primarily mutual funds)	39,535	4.02
Cash and cash equivalents	120,366	0.003
Total	\$622,466	

The University's investment in securities subject to interest rate risk as of June 30, 2004, was as follows:

Investment type	2004 Market value	Average duration (years)
Government issues — agencies	\$244,153	2.94
Corporate bonds	59,049	0.91
Mortgage backed securities	78,727	4.18
Commercial paper	29,834	0.20
Other (primarily mutual funds)	19,232	0.87
Cash and cash equivalents	108,310	0.003
Total	\$539,305	

Foreign Currency Risk

The University's exposure to foreign currency risk derives from its positions in foreign currency denominated investments. Changes in exchange rates can adversely affect the fair value of an investment. The University's established formal investment policy permits it to target allocations for publicly traded international securities at 15 percent with a range around this target of 10–20 percent. The University's exposure to foreign currency risk, stated in U.S. dollar equivalents, was as follows:

Investment type	Currency	2005 Market value	2004 Market value
Equity	Euro	\$ 42,695	\$ 36,137
Equity	Japanese yen	29,819	32,820
Equity	Great British pound sterling	27,263	23,925
Equity	Australian dollar	4,779	1,478
Equity	Canadian dollar	4,035	4,397
Equity	Swiss franc	3,514	4,033
Equity	Hong Kong dollar	2,648	4,111
Equity	Singapore dollar	2,388	1,094
Equity	Swedish krona	1,263	2,591
Equity	Danish krone	714	1,222
Equity	New Zealand dollar	584	–
Equity	South Korean won	236	1,442
Equity	Norwegian krone	164	1,681
Equity	Thailand baht	–	265
Futures	Euro	31	–
Total		\$120,133	\$115,196

As of June 30, 2005, the University had \$6,991 in open foreign currency purchase contracts and \$8,908 in open foreign currency sales contracts with a net market value of \$(4). This compares to \$7,980 in open foreign currency purchase contracts and \$14,242 in open foreign currency sales contracts with a net market value of \$(60) as of June 30, 2004. In addition, the University has entered into various hedge contracts to minimize interest rate risk in the debt markets.

University of Minnesota

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

The following summarizes cash, securities lending collateral, and investments, including the University's insurance subsidiary, at June 30, 2005:

	Temporary investment pool	Invested assets related to indebtedness	Securities lending program	Consolidated endowment fund	Group income pool	Separately invested funds	Insurance subsidiary	Total
Cash and cash equivalents*	\$122,133	\$ 1,278		\$ 4,539	\$ 605		\$ 2,093	\$ 130,648
Securities lending collateral			\$70,879					70,879
Short-term investments	34,744	905						35,649
Total current assets	156,877	2,183	70,879	4,539	605		2,093	237,176
Restricted cash and cash equivalents		1,046						1,046
Investments	467,356	7,680		757,033	35,422	\$42	26,632	1,294,165
Total noncurrent assets	467,356	8,726		757,033	35,422	42	26,632	1,295,211
	\$624,233	\$10,909	\$70,879	\$761,572	\$36,027	\$42	\$28,725	\$1,532,387
Unrestricted amounts included above	\$136,092	\$ -	\$19,208	\$ -	\$16,717	\$ -	\$28,725	\$ 200,742

The following summarizes cash, securities lending collateral, and investments, including the University's insurance subsidiary, at June 30, 2004:

	Temporary investment pool	Invested assets related to indebtedness	Securities lending program	Consolidated endowment fund	Group income pool	Separately invested funds	Insurance subsidiary	Total
Cash and cash equivalents*	\$122,396	\$ 2,037		\$ (1,138)	\$ 96		\$1,139	\$ 124,530
Securities lending collateral			\$75,696					75,696
Short-term investments	3,626	855						4,481
Total current assets	126,022	2,892	75,696	(1,138)	96		1,139	204,707
Restricted cash and cash equivalents		356						356
Investments	397,536	8,305		630,465	49,083	\$490	26,363	1,112,242
Total noncurrent assets	397,536	8,661		630,465	49,083	490	26,363	1,112,598
	\$523,558	\$11,553	\$75,696	\$629,327	\$49,179	\$490	\$27,502	\$1,317,305
Unrestricted amounts included above	\$232,498	\$ -	\$21,316	\$ -	\$16,284	\$ -	\$27,502	\$ 297,600

*Temporary investment pool includes cash-in-transit of \$1,767 and \$(15,747) on June 30, 2005 and June 30, 2004, respectively.

Unrestricted cash and investments include amounts that have not been restricted for specific purposes by grantors, donors, or law.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Securities Lending

To enhance the return on investments, the Board of Regents of the University has 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. The University had loaned securities with market values of approximately \$68,482 and \$73,592 at June 30, 2005 and 2004, respectively. These loaned securities were supported by collateral of approximately \$70,879 and \$75,696, which is included as securities lending collateral in the consolidated statements of net assets at June 30, 2005 and 2004, respectively. Of this collateral amount, approximately \$68,836 and \$73,754 was cash and approximately \$2,043 and \$1,942 was acceptable noncash collateral at June 30, 2005 and 2004, respectively.

In general, since the value of collateral received exceeded the market value of the securities on loan, the University's credit risk was minimal. 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 was 35 and 49 days as of June 30, 2005 and 2004, respectively. 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 \$1,531 and \$1,332, respectively, for the year ended June 30, 2005, and \$672 and \$486 at June 30, 2004, respectively.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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Other Asset and Liability Information

Receivables, net, and student loans receivable at June 30, 2005, consisted of the following:

	Current	Noncurrent	Total
State and federal appropriations	\$109,537		\$109,537
Sponsored grants and contracts	74,286		74,286
Notes receivable	78	\$ 1,337	1,415
Student receivables	39,096		39,096
Trade receivables	45,596		45,596
Accrued interest	4,802		4,802
Other	7,459		7,459
Allowance for uncollectible accounts	(9,285)		(9,285)
Total receivables, net	\$271,569	\$ 1,337	\$272,906
Student loans receivable	14,943	58,193	73,136
Allowance for uncollectible accounts	(2,625)	(582)	(3,207)
Student loans receivable, net	\$ 12,318	\$57,611	\$ 69,929

Accrued liabilities at June 30, 2005, consisted of the following:

	Current	Noncurrent	Total
Trade liabilities	\$ 14,414	\$ 3,290	\$ 17,704
Compensation and benefits	133,896	21,246	155,142
Self-insurance reserves	20,801	11,747	32,548
Accrued interest	2,499	332	2,831
Refundable advances		58,080	58,080
Other	20,634	-	20,634
Total accrued liabilities	\$192,244	\$94,695	\$286,939

Activity for certain liabilities with long-term components consisted of the following at June 30, 2005:

	Beginning balance	Additions	Reductions	Ending balance	Current portion
Compensated balances (excluding pensions, see Note 6)	\$69,818	\$ 59,854	\$ (58,646)	\$71,026	\$59,314
Self-insurance reserves (see Note 9)	36,878	144,128	(149,789)	31,217	19,470
Refundable advances	57,548	532		58,080	
Other	19,748	4,525	(8,840)	15,433	11,811

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Receivables, net, and student loans receivable at June 30, 2004, consisted of the following:

	Current	Noncurrent	Total
State and federal appropriations	\$125,973		\$125,973
Sponsored grants and contracts	65,970		65,970
Notes receivable	258	\$ 1,451	1,709
Student receivables	42,540		42,540
Trade receivables	62,075		62,075
Accrued interest	4,028		4,028
Other	4,150		4,150
Allowance for uncollectible accounts	(11,945)		(11,945)
Total receivables, net	\$293,049	\$ 1,451	\$294,500
Student loans receivable	16,748	57,229	73,977
Allowance for uncollectible accounts	(3,242)	(572)	(3,814)
Student loans receivable, net	\$ 13,506	\$56,657	\$ 70,163

Accrued liabilities at June 30, 2004, consisted of the following:

	Current	Noncurrent	Total
Trade liabilities	\$ 14,702	\$ 7,015	\$ 21,717
Compensation and benefits	123,843	24,597	148,440
Self-insurance reserves	23,923	12,955	36,878
Accrued interest	2,312	332	2,644
Refundable advances		57,548	57,548
Other	20,525		20,525
Total accrued liabilities	\$185,305	\$102,447	\$287,752

Activity for certain liabilities with long-term components consisted of the following at June 30, 2004:

	Beginning balance	Additions	Reductions	Ending balance	Current portion
Compensated balances (excluding pensions, see Note 6)	\$ 63,562	\$ 59,807	\$ (53,551)	\$69,818	\$55,357
Self-insurance reserves (see Note 9)	37,124	128,345	(128,591)	36,878	23,923
Refundable advances	56,580	968		57,548	
Other	39,142	4,224	(23,618)	19,748	12,401

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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Capital Assets

Capital assets, net at June 30, 2005, consisted of the following:

	Beginning balance	Additions	Transfers	Retirements	Ending balance
Depreciable capital assets					
Buildings and improvements	\$2,212,809		\$ 134,580	\$ (1,103)	\$2,346,286
Leasehold improvements	1,126		183		1,309
Equipment	539,608	\$ 52,594	11,210	(42,171)	561,241
Infrastructure	291,852		13,958	(314)	305,496
Library and reference books	101,610	11,583		(9,079)	104,114
Total depreciable capital assets	3,147,005	64,177	159,931	(52,667)	3,318,446
Non-depreciable capital assets					
Land	39,467	5,934	770	(5)	46,166
Museums and collections	35,601	1,203			36,804
Construction in progress	107,170	108,215	(160,701)	(418)	54,266
Total non-depreciable capital assets	182,238	115,352	(159,931)	(423)	137,236
Accumulated depreciation					
Buildings and improvements	929,645	62,622		(1,103)	991,164
Leasehold improvements	350	170			520
Equipment	364,189	44,759		(39,045)	369,903
Infrastructure	123,344	9,254			132,598
Library and reference books	48,969	10,286		(9,079)	50,176
Total accumulated depreciation	1,466,497	127,091		(49,227)	1,544,361
Net capital assets	\$1,862,746	\$ 52,438	\$ –	\$ (3,863)	\$1,911,321
Summary					
Depreciable capital assets	\$3,147,005	\$ 64,177	\$ 159,931	\$(52,667)	\$3,318,446
Non-depreciable capital assets	182,238	115,352	(159,931)	(423)	137,236
Total capital assets	3,329,243	179,529	–	(53,090)	3,455,682
Less accumulated depreciation	1,466,497	127,091	–	(49,227)	1,544,361
Capital assets, net	\$1,862,746	\$ 52,438	\$ –	\$ (3,863)	\$1,911,321

University of Minnesota

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Capital assets, net at June 30, 2004, consisted of the following:

	Beginning balance	Additions	Transfers	Retirements	Ending balance
Depreciable capital assets					
Buildings and improvements	\$2,177,121		\$ 37,669	\$ (1,981)	\$2,212,809
Leasehold improvements	617		509		1,126
Equipment	537,495	\$ 50,432	(7,203)	(41,116)	539,608
Infrastructure	298,198		5,571	(11,917)	291,852
Library and reference books	98,851	10,753		(7,994)	101,610
Total depreciable capital assets	3,112,282	61,185	36,546	(63,008)	3,147,005
Non-depreciable capital assets					
Land	35,590	3,877			39,467
Museums and collections	33,988	1,613			35,601
Construction in progress	45,970	97,917	(36,546)	(171)	107,170
Total non-depreciable capital assets	115,548	103,407	(36,546)	(171)	182,238
Accumulated depreciation					
Buildings and improvements	869,142	62,458		(1,955)	929,645
Leasehold improvements	191	159			350
Equipment	358,178	46,636		(40,625)	364,189
Infrastructure	115,689	7,655			123,344
Library and reference books	46,941	10,022		(7,994)	48,969
Total accumulated depreciation	1,390,141	126,930		(50,574)	1,466,497
Net capital assets	\$1,837,689	\$ 37,662	\$ -	\$(12,605)	\$1,862,746
Summary					
Depreciable capital assets	\$3,112,282	\$ 61,185	\$ 36,546	\$(63,008)	\$3,147,005
Non-depreciable capital assets	115,548	103,407	(36,546)	(171)	182,238
Total capital assets	3,227,830	164,592	-	(63,179)	3,329,243
Less accumulated depreciation	1,390,141	126,930	-	(50,574)	1,466,497
Capital assets, net	\$1,837,689	\$ 37,662	\$ -	\$(12,605)	\$1,862,746

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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Long-term Debt

Long-term debt at June 30, 2005, consisted of the following:

	Interest rate	Due at various dates through	Beginning balance	Additions	Reductions	Ending balance	Current portion
General obligation bonds							
Series 2004A	4.86%	2010		\$22,231	\$ 240	\$ 21,991	\$ 3,184
Series 2003A	4.39%	2031	\$ 71,000		1,050	69,950	1,450
Series 2001C	4.40%	2008	155,100		5,050	150,050	42,871
Series 2001B	4.33%	2004	2,955		310	2,645	2,645
Series 2001A	3.08%	2004	12,370		2,285	10,085	10,085
Series 1999A	4.16%	2005	175,450		9,050	166,400	166,400
Series 1996A	4.50% – 5.75%	2021	171,669		6,039	165,630	165,630
Obligations to the State of Minnesota pursuant to infrastructure development bonds							
Auxiliary revenue bonds	3.00%	2013	9,260	11,359	5,567	67,716	5,549
Capital leases and other	1.72% – 8.00%	2011	5,226	712	1,859	4,079	1,300
Total			\$664,954	\$34,302	\$32,305	\$666,951	\$400,019

Long-term debt at June 30, 2004, consisted of the following:

	Interest rate	Due at various dates through	Beginning balance	Additions	Reductions	Ending balance	Current portion
General obligation bonds							
Series 2003A	4.39%	2031	\$ 71,000			\$ 71,000	\$ 1,050
Series 2001C	4.40%	2008	159,950		\$4,850	155,100	46,530
Series 2001B	4.33%	2004	3,250		295	2,955	2,955
Series 2001A	3.08%	2004	14,565		2,195	12,370	12,370
Series 1999A	4.16%	2005	184,200		8,750	175,450	175,450
Series 1996A	4.50% – 5.75%	2021	177,708		6,039	171,669	6,039
Series 1993A	4.80%	2003	84,000		84,000		
Obligations to the State of Minnesota pursuant to infrastructure development bonds							
Auxiliary revenue bonds	3.00%	2013	10,066		806	9,260	855
Capital leases and other	1.29% – 8.00%	2011	6,578	880	2,232	5,226	1,451
Total			\$775,598	\$3,302	\$113,946	\$664,954	\$251,615

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

General Obligation Bonds

In November 2001, the Board of 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, and \$71,000 was issued for the 2003A bonds for the refunding of the Series 1993A bonds and \$20,720 was issued for the Series 2004A bonds, with \$28,680 remaining unissued.

On July 21, 2004 the University issued \$20,720 in General Obligation Intermediate Term Financing Program Bonds, Series 2004A. The bond proceeds were applied to certain capital projects of the University including the purchase of equipment and related services in connection with the upgrade of the University's Twin Cities campus data network, as well as a portion of the acquisition cost of certain property operated as an office building on the Twin Cities campus. The bonds were issued at coupon rates of 4–5 percent, with a premium of \$1,511.

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 standby bond purchase agreements, the University has classified the entire obligation of the Series 2001A and 2001B bonds as current liabilities. As of the date of this report, none of the bondholders had 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 December 2003, the University entered into a standby bond purchase agreement to provide liquidity support for the Series 2001C bonds. The agreement requires the banks to provide funds for the purchase 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 \$155,100, but is reduced annually in the same amount as the annual principal reduction on the bonds. The agreement, which expires on December 16, 2008, provides for 10 equal semiannual installments 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, 2005.

In June 2004, the University entered into a standby bond purchase agreement to provide liquidity support for the Series 1999A bonds. The available principal commitment was initially the aggregate principal amount of the Series 1999A bond outstanding of \$175,450, but is reduced annually in the same amount as the annual principal reduction on the bonds. The agreement provides for four equal semiannual installment payments on June 1 and December 1. No amounts have been drawn under this agreement through June 30, 2005. In May 2004, this agreement was extended for an additional 364-day term. Since the agreement expires on June 12, 2006, the entire obligation of the Series 1999A bonds has been classified as a current liability.

The University has sold a put option, which allows the counterparty to put up to \$165,000 at June 30, 2005, and \$171,000 at June 30, 2004, of Series 1996A University bonds or eligible AAA rated governmental or municipal securities to the University. This option may be exercised at any time. On July 5, 2005, the counterparty exercised this put option. On October 4, 2005, the University issued \$159,100 in tax-exempt Commercial Paper Notes, Series A, to refund the General Obligation Bonds, Series 1996A, and to pay costs of issuance thereof. The proceeds are to be used for the purchase of the portfolio of AAA rated securities delivered by Goldman Sachs for deposit to an irrevocable trust in an amount

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

sufficient to pay future debt service on the remaining outstanding Series 1996A bonds. In addition, the integrated fixed to floating interest-rate swap agreement on these bonds was also terminated.

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 Series 2001B bonds.

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 U.S. 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 set aside \$1,182 at June 30, 2005, and \$1,217 at June 30, 2004, for future debt service. An additional \$8,682 and \$9,979 was set aside for building replacement reserves for June 30, 2005 and 2004, respectively. 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 issued by the state for University capital projects. The amount of outstanding debt issued by the state on behalf of the University was \$203,148 as of June 30, 2005, and \$185,771 as of June 30, 2004.

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 1.72 percent and 3.60 percent with none extending beyond 2011. 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.

Interest Rate Swaps

In order to protect against future interest rate fluctuations on the University's general obligation bonds and for budgeting purposes, the University has entered into nine separate interest rate swaps. All but one of these are pay fixed and receive variable interest rate swaps, which effectively changes the University's variable interest rate bonds to synthetic fixed-rate bonds.

The University treats the integrated swaps associated with the issuance of the 1996A, 2001A, 2001C, and 2003A variable-rate bonds as qualified hedges with respect to these bonds.

The notional amounts of the swaps match the principal amounts of the associated bond issuance. The University's swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled reductions in the associated bond issuance, except for the nonintegrated swaps associated with the 1996A bond issue. The terms, fair values, and credit rating of the outstanding swaps as of June 30, 2005 are as follows.

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Years ended June 30, 2005 and 2004 (in thousands)

Associated bond issue	Nature of association	Notional amounts	Effective date	Fixed rate	Variable rate	Swap type	Fair value	Swap termination date
2003A	Integrated	\$ 69,950	12/04/02	4.39%	BMA Index**	Pay fixed and receive variable	\$ (9,650)	08/15/31
2001C	Integrated	150,050	01/09/02	4.40%	WAR*	Pay fixed and receive variable	(18,012)	12/01/36
2001B	Nonintegrated	2,645	11/13/01	4.33%	WAR*	Pay fixed and receive variable	(22)	07/01/11
2001A	Integrated	10,085	11/13/01	3.08%	WAR*	Pay fixed and receive variable	(41)	07/01/08
1999A	Nonintegrated	166,400	02/17/99	4.16%	WAR*	Pay fixed and receive variable	(13,847)	01/01/34
1996A ***	Integrated	165,000	01/08/97	4.45-5.43%	BMA Index**	Pay variable and receive fixed	23,260	07/01/21
1996A	Nonintegrated	70,000	08/27/97	4.98%	BMA Index**	Pay fixed and receive variable	(11,045)	08/27/17
1996A	Nonintegrated	37,500	08/28/97	4.88%	BMA Index**	Pay fixed and receive variable	(4,834)	08/28/12
1996A	Nonintegrated	37,500	09/01/97	4.90%	BMA Index**	Pay fixed and receive variable	(4,943)	07/01/12
							\$709,130	\$(39,134)

* WAR refers to the weighted average rate paid on the associated bond issue.

** BMA Index refers to the Bond Market Association Municipal Swap Index.

*** Swap has been terminated subsequent to year-end.

The fair value was developed by the pricing service of the counterparties by computing the net present value of forecasted expected cash flows. Because interest rates have declined, all the pay fixed receive variable interest rate swaps had negative fair values as of June 30, 2005.

The University has swap transactions with three separate counterparties. The percentage of the notional amount of swaps outstanding at June 30, 2005 for each counterparty is 57, 28, and 15 percent, while these counterparties are rated A1, Aa3, and Aa3, respectively, by Moody's Investors Service.

The integrated swap associated with the 1996A bond issue with a positive fair value of \$23,260 at June 30, 2005 was terminated on October 4, 2005 in connection with the exercise of the put option related to the 1996A bonds by the same counterparty. The University received \$22,236 representing the value of the swap as of that date. The remaining swap contracts are not exposed to credit risk because these swaps have negative fair values. Should interest rates change, however, and the fair values of the swaps become positive, the University faces a maximum possible loss equivalent to the amount of the derivative's fair value.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

The University or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. In addition, the University is exposed to termination risk on one of the nonintegrated swaps associated with the 1996A bond issue. The nonintegrated swap with a notional amount of \$70,000 allows the counterparty to terminate the swap agreement if the variable rate paid by the counterparty to the University averages above 7 percent for any rolling consecutive 90-day period. If any of the swaps are terminated, other than the nonintegrated 1999A swaps, the associated variable rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap had a negative fair value, the University would be liable to the counterparty for a payment equal to the fair value of the swap.

The University is exposed to rollover risk on swaps that mature or may terminate prior to the maturity of the associated debt. When these swaps terminate, or in the case of a termination option that is exercised by the counterparty, the University does not realize the synthetic interest rate offered by the swaps on the underlying bond issue. The 1996A general obligation bonds that have a final maturity date of July 1, 2021, are subject to rollover risk from the nonintegrated swaps that terminate on August 27, 2017; August 28, 2012; and July 1, 2012.

Using rates as of June 30, 2005, debt service requirements of the University's outstanding long-term debt obligations and net swap payments are as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

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

Fiscal year ending June 30	Bonds and obligations	Capital lease and other	Total principal	Interest	Net interest rate swaps
2006	\$398,719	\$1,300	\$400,019	\$22,876	\$10,633
2007	54,195	1,085	55,280	14,691	9,570
2008	54,170	783	54,953	10,162	8,505
2009	33,374	523	33,897	5,872	7,672
2010	11,807	267	12,074	4,384	7,288
2011–2015	39,358	122	39,480	15,715	27,506
2016–2020	25,142		25,142	9,122	11,974
2021–2025	18,806		18,806	4,953	4,490
2026–2030	18,550		18,550	2,331	2,371
2031–2035	8,750		8,750	153	270
	\$662,871	\$4,080	\$666,951	\$90,259	\$90,279

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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, 2005
General obligation bonds		
1982 Series A	\$112,635	\$29,600

Neither the outstanding indebtedness nor the related trust account assets for the defeased 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 each plan. These reports may be obtained by writing or calling the plan(s), as follows:

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

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

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (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				
2005	\$62,472	\$14,555	\$326	\$416
2004	56,713	13,661	310	425
2003	57,575	14,151	272	416
Current contribution rates				
University	13.0%	4.0%	9.3%	
Plan members	2.5%	4.0%	6.2%	
Annual pension cost – fiscal year ended June 30				
2004	N/A	\$13,661	\$310	\$603
2003	N/A	14,151	272	(10)
2002	N/A	13,672	257	228
Actuarial valuation date	N/A	6/30/04	6/30/04	7/01/04
Actuarial cost method	N/A	Entry age	Entry age	Entry age
Amortization method	N/A	Level percentage of salary, open	Level percent, closed	Level dollar amount by 6/30/21, closed
Remaining amortization period	N/A	30 years	30 years	30 years
Asset valuation method	N/A	Fair market value, smoothed over 5 years	Fair market value, smoothed over 5 years	Fair market value, smoothed over 4 years
Actuarial assumptions				
Investment rate of return	N/A	8.5%	8.5%	5.0%
Projected salary increase	N/A	5.25%–6.75%	5.25%–11.5%	3.5%
Assumed inflation rate	N/A	No assumption	5.0%	2.5%
Cost of living adjustment	N/A	2.5%	No assumption	Determined by formula, varies

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

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

	2004	2003	2002
Pension benefit obligation	\$11,118	\$11,741	\$12,980
Net assets available for benefits	6,245	7,047	7,842
Unfunded accrued liability	\$ 4,873	\$ 4,694	\$ 5,138
Funded ratio (net assets as a percentage of the pension benefit obligation)	56.17%	60.02%	60.42%

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

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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 Organization

The University is responsible for appointing nine members of the 15-member Board of Directors of UCare Minnesota, a licensed non-profit HMO that provides medical services for its members. The University's accountability for this organization, however, does not extend beyond making board appointments. The dean of the University of Minnesota School of Medicine and the head of the University's Department of Family Medicine appoint six board members; and three members are automatically appointed by virtue of the University positions that they hold. During fiscal year 2005, UCare Minnesota contributed \$2,750 to the University's Department of Family Medicine and Community Health.

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 University of Minnesota Medical Center, 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 \$6,040 and \$7,745 was billed to Fairview in fiscal years 2005 and 2004, respectively. Fairview billed the University \$429 and \$724 in fiscal years 2005 and 2004, respectively, for pharmaceuticals, medical professionals, and transcription services.

Construction projects in progress, principally buildings, approximate \$54,266 at June 30, 2005. The estimated cost to complete these facilities is \$106,321, which is to be funded from plant fund assets and \$137,656 in appropriations available from the State of Minnesota at June 30, 2005.

The University owns steam production facilities, which produce steam for heating and cooling the Twin Cities campus and which, by agreement, are managed, operated, and maintained by an unaffiliated company. The term of the agreement is for five years and commenced May 17, 2004. Under this agreement, the University must make minimum fixed payments for certain operating and maintenance costs, as well as contingent payments based on performance requirements.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

The University is obligated under various operating leases for the use of real property and equipment. Total operating lease expenditures for the years ended June 30, 2005 and 2004 was \$16,294 and \$15,009, respectively, of which \$13,688 and \$11,807 was for real property and \$2,606 and \$3,202 was for equipment, respectively.

The future commitments at June 30, 2005, are as follows:

Steam plant and operating lease commitments are listed for the next five years and in subsequent five-year periods.

	Steam plant	Operating leases	Total
Fiscal year ending June 30			
2006	\$ 803	\$ 8,356	\$ 9,159
2007	791	8,222	9,013
2008	703	5,804	6,507
2009	616	4,736	5,352
2010	–	3,593	3,593
2011–2015	–	14,624	14,624
Total commitments	2,913	45,335	48,248
Less current portion	(803)	(8,356)	(9,159)
Long-term commitments	\$ 2,110	\$36,979	\$39,089

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 medical 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 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 \$500,000 in a single year. An annual actuarial estimate of the University's liability for medical claims, including IBNR, is recorded.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Effective January 1, 2004, the University changed its dental coverage for faculty and staff from a fully insured program to a self-insured program (UPlan). Under the dental UPlan, the University pays claims and establishes reserves. The administration of the program is handled by two independent administrators, Delta Dental and HealthPartners. An annual actuarial estimate of the University's liability for dental claims, including IBNR, is recorded.

Effective September 1, 2004, the University changed its medical coverage for eligible graduate assistants from a fully insured program to a self-insured program. Under

the graduate assistant medical plan, the University pays claims and establishes reserves. The program is administered by Blue Cross Blue Shield of Minnesota. An annual actuarial estimate of the University's liability for medical claims, including IBNR, is recorded.

Effective September 1, 2005, the University negotiated a new student health plan for the Academic Health Center. The plan is self-insured and the health carrier for the plan is Blue Cross Blue Shield of Minnesota. This estimated reserve is to ensure that funds are available to cover claims up to the point where stop-loss coverage begins.

Changes in reported liabilities since June 30, 2004, are shown below:

	Liability beginning of year	New claims	Claim payments	Other adjustments	Liability end of year
RUMINCO, Ltd.	\$ 7,459	\$ 1,860	\$ (3,059)	\$ 46	\$ 6,306
Workers' compensation	11,000	2,918	(3,229)	(1,689)	9,000
UPlan medical	17,950	126,625	(123,928)	(5,762)	14,885
UPlan dental	469	12,679	(12,073)	(49)	1,026
Graduate assistant health plan		9,314	(9,314)	757	757
Student health plan				574	574

Changes in reported liabilities since June 30, 2003, are shown below:

	Liability beginning of year	New claims	Claim payments	Other adjustments	Liability end of year
RUMINCO, Ltd.	\$ 7,657	\$ 1,296	\$ (1,650)	\$ 156	\$ 7,459
Workers' compensation	12,000	3,183	(3,601)	(582)	11,000
UPlan medical	17,467	117,650	(115,215)	(1,952)	17,950
UPlan dental		5,591	(5,591)	469	469

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

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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Operating Expenses by Natural Classification

Operating expenses by natural classification for June 30, 2005, are summarized as follows:

Function	Compensation and benefits	Supplies and services	Scholarships and fellowships	Depreciation	Total
Instruction	\$ 506,485	\$ 74,812			\$ 581,297
Research	311,521	153,372			464,893
Public service	112,233	61,597			173,830
Academic support	203,102	62,429			265,531
Student services	60,605	13,420			74,025
Institutional support	96,479	12,423			108,902
Operation and maintenance of plant	82,043	82,580			164,623
Scholarships and fellowships	3,386	363	\$66,108		69,857
Depreciation				\$127,091	127,091
Auxiliary enterprises	68,981	101,562			170,543
Other operating expense		646			646
	\$1,444,835	\$563,204	\$66,108	\$127,091	\$2,201,238

Operating expenses by natural classification for June 30, 2004, are summarized as follows:

Function	Compensation and benefits	Supplies and services	Scholarships and fellowships	Depreciation	Total
Instruction	\$488,350	\$ 72,556			\$560,906
Research	288,481	133,809			422,290
Public service	108,068	57,132			165,200
Academic support	190,402	61,200			251,602
Student services	58,794	12,288			71,082
Institutional support	105,262	11,219			116,481
Operation and maintenance of plant	79,961	72,411			152,372
Scholarships and fellowships	4,154	47	\$62,404		66,605
Depreciation				\$126,930	126,930
Auxiliary enterprises	67,216	97,002			164,218
Other operating expense		344			344
	\$1,390,688	\$518,008	\$62,404	\$126,930	\$2,098,030

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

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Component Units

The significant accounting policies and related note disclosures for investments, securities lending, temporarily restricted net assets, and permanently restricted net assets, as reported in the separately issued financial statements of the University of Minnesota Foundation (UMF) and the Minnesota Medical Foundation (MMF); as well as disclosures for guarantee agreements and financing agreements for the University Gateway Corporation (Gateway) are presented below.

Summary of Significant Accounting Policies

University of Minnesota Foundation

Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions to be received after one year are discounted at rates from 2.65 to 5.00 percent based on when the contribution was made. Amortization of discounts is recorded as additional contribution revenue. An allowance for uncollectible contributions receivable is provided based upon management's judgment including such factors as prior collection history.

Contributions as stated in the Statement of Activities include \$914 of indirect support received by UMF.

Unitrusts, Pooled Income, and Annuity Agreements

UMF has entered into unitrust, pooled income, and annuity agreements that provide, among other matters, that the trustee shall pay to the beneficiaries an annual income payment until the income obligation is completed in accordance with the donor's trust agreement. UMF records its interest in these trusts at the current market value of the related assets and a corresponding liability recorded for the actuarially determined present value of payments to be made to the designated beneficiaries with the residual amount recorded for the purposes designated when the gift is received. Upon termination of the income obligation, property in the trust or pooled income fund is held by UMF in accordance with the donor's trust agreement.

Gift Annuity Agreements

UMF has entered into gift annuity agreements that provide that UMF shall pay to the designated beneficiaries an annual amount until the death of the designated beneficiaries. The payments continue even if the assets of the gift annuity fund have been exhausted. UMF records these gift annuities at market value and a corresponding liability is recorded for the actuarially determined present value of payments to be made to the designated beneficiaries, with the residual amount recorded for the purposes designated when the gift is received. Upon the death of the beneficiaries, property in the gift annuity fund is held by UMF in accordance with the agreements.

Minnesota Medical Foundation

Contributions

Contributions, which include pledges, are recognized as revenues in the period received. All contributions are available for unrestricted use unless specifically restricted by the donor.

Pledges are recorded as pledges receivable using discount rates ranging from 3.50 to 5.00 percent. Additionally, an allowance for uncollectible pledges is provided based on management's judgment, including factors such as aging schedules, prior collection history, and the nature of fund-raising activity.

Investments, fixed assets, and contributed materials are initially recorded at fair value when received.

Contributions with donor-imposed conditions, such as time or purpose restrictions, are recorded as temporarily restricted net assets. When donor-imposed time conditions expire, or a donor-imposed purpose restriction is fulfilled, the temporarily restricted net assets are reclassified to unrestricted net assets. This reclassification is reported as net assets released from restriction on the Statement of Activities.

Investments

University of Minnesota Foundation

Investments in marketable securities are carried at fair value as established by the major securities markets. Fair values for certain investments held in alternative structures including limited partnerships, commingled funds, and limited liability corporations are estimated by the

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

respective investment managers as market values are not readily determinable. These valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information. The estimated values as determined by the general partners and investment managers may differ from the values that would have been used had ready markets for the investments existed and the differences could be significantly higher or lower for any specific holding.

Donated investments are recorded at their fair values, as determined on the date of donation. Investment income and gains and losses are recorded in the period incurred.

For management efficiency, investments of the unrestricted and restricted net assets are pooled, except for certain net assets that the Board of Trustees or the donors have designated to be segregated and maintained separately.

The investments at June 30, 2005 are summarized as follows:

Investments

Cash and cash equivalents	\$ 63,548
Fixed Income	
U.S. bonds	94,683
Common Stocks	
U.S. stocks	199,693
Non-U.S. stocks	174,234
Total common stocks	373,927

Alternative assets

Hedge funds	202,988
Private equity	197,646
Real estate	40,641
Natural resources	43,365
TIPS	50,163
Total alternative assets	534,803

Miscellaneous

Total investments	1,073,525
Less investments loaned to broker	99,332
Less charitable gift annuities reported separately	23,194
Total	\$ 950,999

Investments include funds held for the custody of others of \$51,623 at June 30, 2005.

Minnesota Medical Foundation

Investments are reported at fair value based on quoted market prices. Investments as of June 30, 2005 consist of the following:

	Cost	Fair value
Cash and cash equivalents	\$ 41,754	\$ 41,754
U.S. Treasury and government securities	26,466	26,813
Fixed-income corporate bonds	20,932	20,987
Equity securities, including \$31,098 held in collective trusts managed by Barclays Global Investors	126,794	149,274
Total investments	\$215,946	238,828
Less investments loaned to broker		33,057
Total		\$205,771

Net investment return for the year ended June 30, 2005 consists of the following:

Interest and dividend income	\$ 4,101
Other investment income	1,827
Net realized and unrealized investment gains	11,308
	17,236
Less external investment manager and consultant fees	741
	\$16,495

Securities Lending

University of Minnesota Foundation

UMF participates in securities lending transactions. Under terms of its securities lending agreement, UMF requires collateral of value at least equal to 102 percent of the then fair value of the loaned securities and accrued interest, if any. The risks to UMF of securities lending are that the borrower may not provide additional collateral when required or return the securities when due. The securities lending transactions at and for the year ended June 30, 2005, are summarized as follows:

Investments loaned to broker	\$ 99,332
Investments collateral	101,920
Income from securities lending	147

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Minnesota Medical Foundation

MMF participates in securities lending transactions. Under terms of its securities lending agreement, MMF requires collateral of value at least equal to 102 percent of the then fair value of the loaned securities and accrued interest, if any. The risks to MMF of securities lending are that the borrower may not provide additional collateral when required or return the securities when due.

Investments held as collateral consist of cash and cash equivalents, U.S. Treasury and government securities, and short-term corporate debt instruments. The securities lending transactions at and for the year ended June 30, 2005, are summarized as follows:

Investments loaned to broker	\$33,057
Investments collateral	34,270
Income from securities lending	63

Net Assets

University of Minnesota Foundation

Net assets of UMF are classified into the following three categories:

1. Unrestricted net assets represent the portion of expendable funds that are available for support of the operations of UMF.
2. Temporarily restricted net assets consist of contributions that have been restricted by the donor for specific purposes or are time-restricted.
3. Permanently restricted net assets consist of contributions that have been restricted by the donor that stipulate the resources be maintained permanently, but permit UMF to use or expend part or all of the income derived from the donated assets for either specified or unspecified purposes.

Temporarily Restricted Net Assets

Temporarily restricted net assets are available as of June 30, 2005, for the following purposes:

Capital improvement/facilities	\$ 53,061
Faculty support	15,094
Scholarships and fellowships	161,572
Lectureships, professorships, and chairs	176,308
College program support	215,241
Research	28,114
Trusts	10,986
Other	3,971
	<u>\$664,347</u>

Permanently Restricted Net Assets

The permanently restricted net asset balances and purposes the income is expendable to support, as of June 30, 2005, are as follows:

Capital improvement/facilities	\$ 3,520
Faculty support	10,536
Scholarships and fellowships	153,241
Lectureships, professorships, and chairs	146,054
College program support	38,473
Research	7,808
Trusts	35,108
Other	1,651
	<u>\$396,391</u>

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Minnesota Medical Foundation

Net assets of MMF are classified based on the existence or absence of donor-imposed restrictions.

Temporarily Restricted Net Assets

This classification contains net assets that have been restricted by donors for specific purposes or are not available for use until a specific time. These consist principally of gifts and grants for designated purposes, investment return, and distributed earnings from permanent endowments calculated as a 4.75 percent payout of the average endowment balance over 12 trailing quarters. Such net assets are retained until expended as provided by the donor. Temporarily restricted net assets are available as of June 30, 2005, for the following purposes:

Medical School – Twin Cities	\$ 58,990
Medical School program/student support	23,049
Academic Health Center	34,434
Biomedical Library	494
School of Public Health	2,590
Medical School – Duluth	1,454
Trusts, annuities, and other miscellaneous	13,092
	<u>\$134,103</u>

Permanently Restricted Net Assets

This classification includes net assets that have been restricted by donors that stipulate the resources be maintained permanently by MMF. Earnings and growth in excess of the 4.75 percent payout, for donor-designated endowments, are reinvested to hedge against inflation and are maintained permanently by MMF. Permanently restricted net assets are restricted to investments in perpetuity. The permanently restricted net asset balances and purposes the income is expendable to support, as of June 30, 2005, are as follows:

Medical School – Twin Cities	\$ 75,155
Medical School program/student support	30,010
Academic Health Center	16,424
Biomedical Library	1,785
School of Public Health	5,388
Medical School – Duluth	438
Trusts, annuities, and other miscellaneous	31,037
	<u>\$160,237</u>

Guarantee Agreement and Financing Agreements

University Gateway Corporation

Guarantee Agreement

The University of Minnesota Foundation guarantees both the Series 1997 and Series 2002 bonds. Gateway pays a credit enhancement fee equal to one-quarter of 1 percent of the amount of the bonds outstanding on each June 1 and December 1.

Gateway recorded \$229 of bond guarantee fee expense paid to the University of Minnesota Foundation for each of the years ended June 30, 2005 and 2004.

Financing Agreements

Bonds payable: The City of Minneapolis revenue bonds, Series 1997-A and -B and Series 2002, are collateralized by substantially all the assets of Gateway, and repayment of the revenue bonds will be made through lease payments of the occupants.

To minimize interest cost, the University of Minnesota Foundation has guaranteed the revenue bonds (see Guarantee Agreement above). In addition, Gateway's Board of Directors' resolutions require mandatory capital contributions from the beneficiary organizations should the cash flow of Gateway be insufficient to meet the debt service obligations of Gateway.

Pursuant to a mortgage between Gateway and the trustee, the obligations to pay the principal and interest on the bonds have been collateralized by the mortgage on the property and equipment and an assignment of rents.

Line of credit: Gateway has a \$1 million, unsecured line of credit through November 2005. Advances on the line of credit bear interest at the bank's reference rate, less 1 percent (reference rate at June 30, 2005, was 6.00 percent), with interest payable monthly. The line is guaranteed by the University of Minnesota Foundation, a related entity. There were no borrowings under the line of credit during the years ended June 30, 2005 and 2004.

Notes to Consolidated Financial Statements

Years ended June 30, 2005 and 2004 (in thousands)

Capital lease agreement: Gateway entered into a capital lease agreement with Wells Fargo for security equipment in June 2003. The lease provides for a bargain purchase

option of \$1.00 at the end of the five-year term expiring June 2008. Payments of \$7 are due semiannually and bear a fixed interest rate of 4.25 percent.

Bonds payable and line-of-credit obligations at June 30, 2005 and 2004, consisted of the following:

	2005	2004
City of Minneapolis revenue bonds, Series 1997-A, with interest ranging from 4.8 percent to 5.25 percent, maturing serially from December 2001 through December 2024	\$22,780	\$23,380
City of Minneapolis revenue bonds, Series 1997-B, with interest at a variable rate, principal due in December 2027	15,000	15,000
City of Minneapolis revenue bonds, Series 2002, with interest at a variable rate, principal due in June 2032	7,350	7,350
Capital lease payable, interest at 4.25 percent, maturing in June 2008	39	52
	45,169	45,782
Less current portion	648	613
	\$44,521	\$45,169

Aggregate annual maturities are approximately as follows:

Fiscal years ending:

2006	\$ 648
2007	688
2008	723
2009	755
2010	795
Thereafter	41,560
	\$45,169

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