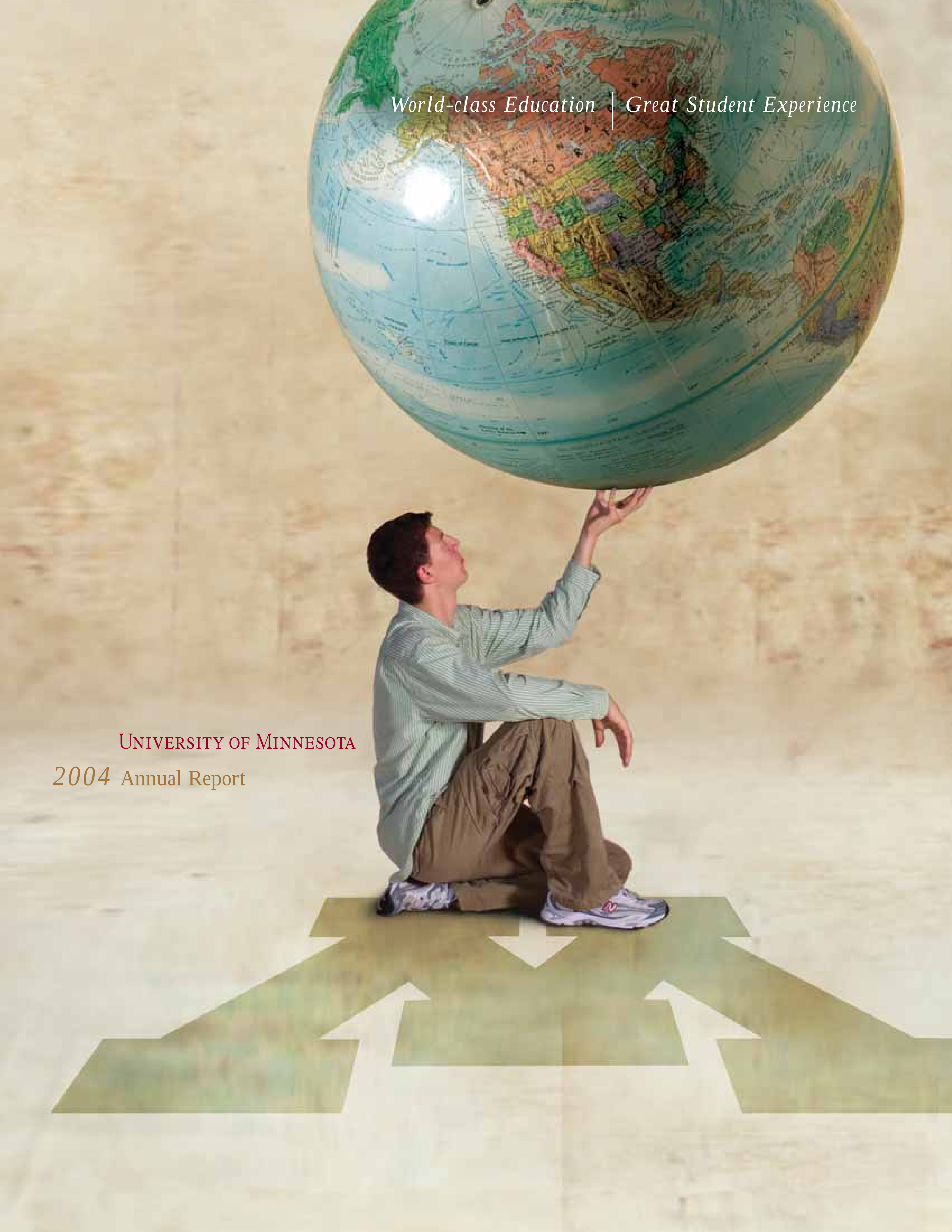


World-class Education | *Great Student Experience*

University of Minnesota

2004 Annual Report

LETTER FROM THE PRESIDENT

Dear Friends,

As the state's only research university, the University of Minnesota plays a unique role in the life and economy of Minnesota. Here, world-class scholars attract more than $500 million in research funding each year. The knowledge they create becomes the basis for everything from treatments for devastating diseases to foods like the Honeycrisp™ apple and public policy solutions for vexing social challenges. These scholars are also educating the young people who come to the University of Minnesota, and the opportunities available to these students at a research university are as varied and enriching as the products of its research.

Over the past 10 years, the University has renewed and revitalized the experience of its students. Better services for registration and financial aid; new and renovated residence halls, classrooms, and labs; freshman seminars; and increased undergraduate research, internship, service learning, and study-abroad opportunities have been just a few of the more visible elements of the University's commitment to improving the quality of student life. Innovations in teaching such as the Academy of Distinguished Teachers have also helped students with their most important pursuits on campus.

Today, the University is attracting students with higher credentials than ever before, and overall student progress toward graduation is headed in the right direction. Less tangibly, there is a renewed sense of student community on our campuses today, and student satisfaction rates reflect it. We are continuing to invest in technological innovations that help keep students informed and engaged in the broader University community and that keep them on track academically. We are also making a major push to raise scholarship funds so that the promise of a University education can be made possible for current and future students, just as it became a reality for students of the past.

You can read about our progress in this annual report, and I encourage you to spend some time on campus to get an even better sense of how we are serving students better and how they are responding with academic achievement and love for the U.

Sincerely,

Robert H. Bruininks
President

ONLY AT THE U

University of Minnesota students have the world at their fingertips. They're exposed to knowledge unlike that at any other higher education institution in Minnesota because the University is the state's only research institution. They're presented with unlimited opportunities for personal growth at four campuses, each offering a distinctive experience. And they can pursue scholarly or artistic endeavors beyond their expectations under the tutelage of stellar faculty, who themselves are explorers pushing the boundaries in their respective fields.

The University provides an outstanding academic education for Minnesota's citizens. Its dedication to quality is recognized near and far—the University consistently ranks within the top six U.S. public research universities, and it has more than 250 exchange agreements and many informal linkages with institutions around the world. Its commitment to excellence is reflected in its students. Over the past five years, University students have won every major national scholarship, including the Rhodes, Truman, Marshall, and Goldwater. They participate in research of local and global significance—studying senior housing options in rural Minnesota or AIDS prevention in Africa. The University's graduate and professional students are considered among the best-educated and most innovative scholars in their disciplines.

BETTER STUDENTS	*In fall 2003, the average high school percentile rank of freshmen on the Twin Cities campus was 79.9, up 10 percentage points since 1990. The average ACT score was 24.8, up from 22.8.*
COMMUNITY ENVIRONMENT	*On the Twin Cities campus, 77 percent of first-year students live on campus.*
CULTURAL EXCHANGE	*The University offers more than 250 study, work, and intern programs in 60 countries. And more than 4,500 people from more than 130 countries study, teach, or conduct research at the University.*
UNIQUE PROGRAMS	*The University and Guthrie Theater bachelor of fine arts actor-training program is one of the most coveted of its kind in the country, auditioning 400–500 people a year in cities across the United States for only 20 freshman spots.*
INCREASINGLY DIVERSE	*In particular, more Asian American and African American students are coming to the University. Freshmen of color on the Twin Cities campus increased from 18.1 percent in 1994 to 20.8 percent in 2003.*

Top-notch classroom and field education is undeniably a University priority. Over the past decade, the University has also invested in programs, services, and infrastructure that enhance the undergraduate experience. Today's University student is provided with better classrooms, enhanced online services, expanded

Students are presented with unlimited opportunities for personal growth at four campuses, each offering a distinctive experience.

living and learning communities, and increased honors and study-abroad opportunities. Moreover, the University has placed special emphasis on the first-year experience by reintroducing the annual new-student convocation, reorganizing orientation for students and parents, and offering freshman seminars and the Student Excellence in Academics and Multiculturalism Program, which helps to ensure that students of color succeed in their first year.

As a result, student satisfaction and retention rates are on a steady incline. Last year, the Twin Cities campus achieved a record first-year retention rate of 86 percent. The Carlson School of Management has a retention rate of 96 percent—5 percent higher than the national average. About 94 percent of freshmen are very satisfied or satisfied with their University experience. And in a recent survey of third-year students, 90.5 percent said they would still choose to attend the University if they could start over.

The University of Minnesota has also invested heavily in its infrastructure as a means of better serving its students. In the last decade alone, the University has undergone a physical transformation, with more than $1 billion in capital improvements for new buildings and renovations. In addition, over the past five years, the U has invested more than $8 million in classroom improvements.

LIMITLESS OPPORTUNITIES FOR PERSONAL AND ACADEMIC GROWTH

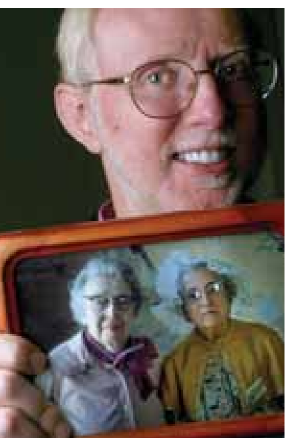
The University is among the nation's most comprehensive places of learning. Its Twin Cities campus is one of only five campuses in the country with both agricultural programs and a major medical school. It's the only higher education institution in the United States with all of its arts disciplines located in one district—the West Bank Arts Quarter in Minneapolis. The Morris campus ranks among the top five U.S. public liberal arts colleges. Freshwater research is a priority on the Duluth campus, a top regional university. The Crookston campus provides the only baccalaureate programs in natural resources aviation and law enforcement aviation in North America, and it's the only four-year polytechnic campus in Minnesota. The Rochester collaborative center serves southeastern Minnesota through partnerships with other universities and colleges.

The University is an academically compelling place that touches students on an intrinsic level. Students today want more than intellectual excitement; they desire an unforgettable college experience as well. And the University delivers.

AGING GRACEFULLY

In Robert Yahnke's freshman seminar "The Art of Aging," maturing means knowing how to grow old.

Throughout the semester, the University professor and his group of first-year students talk about their experiences—and those of characters in films and books—with regard to birth, death, and "everything in between," such as relationships, illness, and retirement. Yahnke's easy-going manner and creative exercises—from writing poems to making photo montages—give the students a chance to examine their attitudes about older people and to divulge their innermost fears about growing old. They even get to ask their 57-year-old professor what scares him the most as he enters his golden years.



The small-group setting is a perfect format. "The point of having a smaller class is really the luxury of getting to know each other in a deeper way," says Yahnke, who has been teaching and researching gerontology since 1978. "Last spring, I saw some friendships formed that are going to last beyond that class, and I got to share in some very important decisions being made by the students about their future."

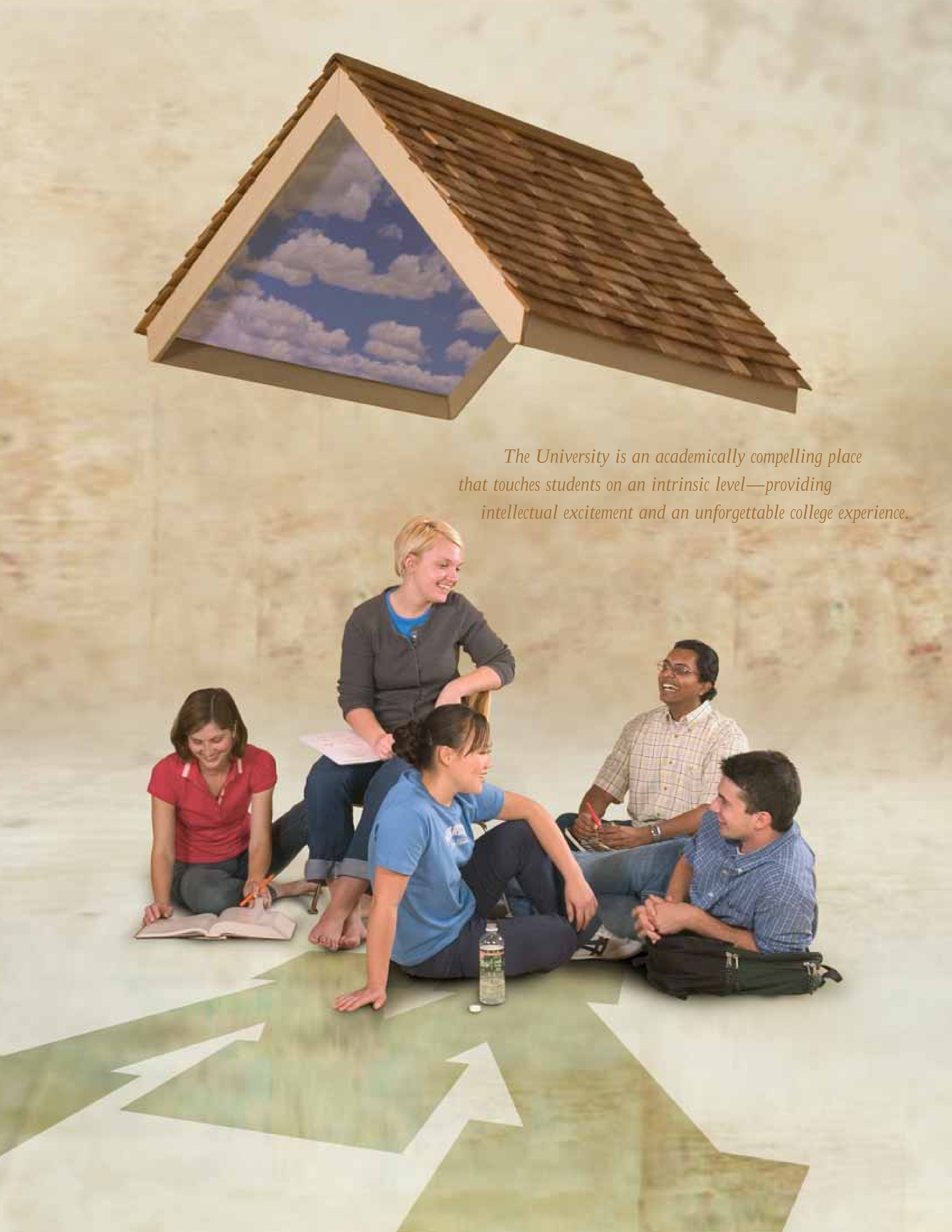
Yahnke's freshman seminar—offered through General College—and dozens like it transform the Twin Cities campus of nearly 50,000 students into smaller communities, making that first year at the U more friendly.

"I see this class as a means for students to take charge of their lives," says Yahnke. "It's not important where they go. It's important that they become themselves in a more well-defined and critical way that brings insight with it. [In other words,] to have had the experience and not miss the meaning."

FRESHMAN SEMINARS

With fewer than 20 students, freshman seminars—discussion-based courses on intriguing topics taught by distinguished University faculty—give first-year students the chance to connect with a senior faculty member. Students who participate acclimate to college life better and are more likely to graduate in four years than their peers who don't take a freshman seminar. Each year, the University offers more than 125 freshman seminars across a wide variety of disciplines—courses such as Bioterrorism (biology), Child Delinquency: Huck Finn or Pathway to Prison (education and human development), and Hmong: Life in America (Asian literatures and languages).

Freshman seminars transform the University into smaller communities, making the first year at the U more friendly.



The University is an academically compelling place that touches students on an intrinsic level—providing intellectual excitement and an unforgettable college experience.

Undergraduate research opportunities

The University has more than 3,000 faculty with expertise ranging from cheese production in the Midwest to lion behavior at the Serengeti National Park in Africa. These scholars and scientists of national and international renown, along with their students, have earned countless honors, including Nobel and Pulitzer Prizes. They are the same professors who teach the University's undergraduate students and work closely with graduate students. Through the Undergraduate Research Opportunities Program, first- to fourth-year students can discover and invent alongside these faculty; only at the University can Minnesota citizens get this type of experience. Since 1985, more than 6,800 students have participated in this program.

Learning and social communities

Last year, more than 900 University students took advantage of the U's 20-plus living and learning communities. These communities, such as a wing in a residential hall, offer incoming students with similar academic interests or common needs a friendly and supportive environment to further academic and personal development. In the American Indian Cultural House, students are learning more about past and present American Indian issues through study groups, movie screenings, and field trips. At the Women in Science and Engineering House, female students are exploring various aspects of the science and engineering fields through lab tours and visits with faculty mentors.

The University also has more than 600 registered student organizations—centered on interests such as a cappella singing and Japanese animation. These groups create opportunities for students to meet people from different parts of the world or to simply share common interests.

Civic engagement

The University's presence in different communities of various sizes makes it an ideal place for service learning. More than 70 programs in nine colleges on the Twin Cities campus offer students this chance to blend classroom learning with a community-based experience. Student volunteers provide important community services such as teaching English as a second language to immigrant families and saving sand dunes from the overgrowth of vegetation.

With the University's America Reads program, 650 student-tutors are serving more than 2,500 elementary students at 31 Twin Cities locations. On the Morris campus, students are helping rural communities plan development projects through the Center for Small Towns. Two major civic engagement projects on the Duluth campus—the Darland Connection and Students Engaged in Rewarding Volunteer Experiences—have more than 600 student volunteers each semester working at 114 sites and delivering more than 33,000 hours of service. And the Service Learning Center on the Crookston campus was selected as one of six finalists for the 2004 Minnesota Carter Partnership Award.

ALL SYSTEMS GO: INVESTING IN TECHNOLOGY

The University offers a physical infrastructure that maximizes student learning and the student experience. Wireless connectivity, which gives students convenient electronic access, abounds on the University's four campuses. There are more than 380 access points, providing Internet services in classrooms and common spaces in more than 80 University buildings. Two-thirds of classrooms on the Twin Cities campus are "projection-capable"—providing fixed-data projection, smart control systems, laptop interfaces, and Internet connectivity. Three-fourths of the classrooms have wireless networking in place.

Grades are now available online within 24 hours of being submitted to the registrar's office. In fall 2003, the University introduced e-bill and e-pay, eliminating paper bills and allowing students to pay their tuition with an electronic withdrawal from a bank account. About 50 percent of University student bills are now paid electronically. Students can purchase books, classroom supplies, and merchandise at University Bookstores with their student ID. They can check their financial aid status online and receive scholarship money in four days instead of six to eight weeks. And students in some colleges can also make appointments online with their advisers.

With a 21st-century learning environment, the University is helping its students to stay on top academically and to master computer skills vital in an increasingly high-tech world. The University is developing the online Grad Planner, which will give students better planning options for timely graduation. It recently introduced the MYU Web Portal (see sidebar). And the University's Electronic Learning Portfolio (e-Portfolio) allows more than 31,000 University students, faculty, and staff to safely store and conveniently access or share their educational records, artwork and writing samples, resumes, and other personal data in a secure, globally accessible computing environment.

MYU WEB PORTAL

Students in the Class of 2008 will be getting the most out of their college experience with their MYU Web Portal. The virtual desktop, which students can custom-design to fit their needs and interests, gives them access to a host of University Web pages, services, Web-based e-mail, and other sources of information such as helpful tips for that crucial first year and specific information relating to their individual college. A personal "tool kit" keeps students connected to class Web pages and assignments. Students can also check the weather and personalize information—such as receiving news feeds—as well as create their own discussion groups anytime and from anywhere, be it an Internet cafe in their neighborhood or a beach in Costa Rica.

The University is helping its students to stay on top academically and to master computer skills vital in an increasingly high-tech world.

INVESTING IN MINNESOTA'S FUTURE

Time and again, University of Minnesota graduates speak about how their University experiences prepared them to meet leadership challenges and helped them to develop skills that serve them well as citizens of the state, the nation, and the world. For the University of Minnesota, there is no greater obligation or greater reward. Students are the future.

And well-educated graduates are one of the University's greatest contributions to Minnesota's vitality and high quality of life. Alumni from the Institute of Technology have founded more than 3,000 companies—most of which are in Minnesota. The University educates 70 percent of Minnesota's health care professionals and trains a significant number to practice in rural Minnesota communities. Every year, approximately 40 percent of all nonresident University graduates stay in Minnesota to live and work.

To keep attracting the best and brightest students from Minnesota and elsewhere, the University will continue to invest in its programs, services, and infrastructure. In light of declining state support and higher tuition rates, however, the University has also made funding for student scholarships a top priority. This year, the University launched a major, multiyear drive to raise private scholarship money for students, which includes a new matching program to encourage more donors to make endowed scholarship gifts.

Currently, 4,500 students receive scholarships funded through private gifts to the University. The goal of the scholarship drive is to increase that figure by 50 percent. Under the President's Scholarship Match, income from new endowed scholarships will be matched by funds from the University, thereby doubling the impact of donors' gifts. A recent University report shows that students who receive scholarships graduate in four years at rates up to 35 percent higher than other students.

Over the years, the University of Minnesota has armed hundreds of thousands of people with knowledge and skills that contribute to the betterment of the state and beyond. It will continue this tradition; just as it will steadfastly maintain itself as a place where undergraduates can be proud to attend and alumni can be proud to have attended.

FINANCIAL REPORT

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, 2004 and 2003. 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 third largest campus in the country in terms of enrollment (approximately 50,000 students) and also one of the most comprehensive. It is the state's major research campus, with expenditures of approximately $422.3 million and $411.6 million in fiscal years 2004 and 2003, respectively, for research under various programs funded by governmental and private sources.

The Duluth campus (approximately 10,100 students) is a comprehensive regional university that offers instruction through the master's degree and has unique research strengths in natural and freshwater resources.

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

The Crookston campus (approximately 2,300 students; including 1,100 degree-seeking undergraduates) provides career-oriented education at the baccalaureate level, primarily in polytechnical disciplines.

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

Mission

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

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

Operations

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

- provides instruction for more than 64,300 students;
- graduates approximately 11,500 students, 41 percent with graduate or first professional degrees on the Twin Cities campus;
- conducts research sponsored by the National Institutes of Health, the National Science Foundation, other federal agencies, and numerous private companies and foundations;
- reaches out to more than one million Minnesotans through various outreach and public service activities.

CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements are prepared in accordance with generally accepted accounting principles prescribed by the Governmental Accounting Standards Board (GASB). 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, 2004 and 2003, are summarized below (in thousands of dollars).

	2004	2003
Current assets	$ 548,431	$ 626,710
Capital assets, net	1,862,746	1,837,689
Other noncurrent assets	1,178,258	981,964
Total assets	3,589,435	3,446,363
Current liabilities	665,640	846,435
Noncurrent liabilities	521,086	436,533
Total liabilities	1,186,726	1,282,968
Net assets		
Unrestricted	315,377	313,401
Restricted—expendable	687,461	515,079
Restricted—nonexpendable	199,369	192,604
Invested in capital assets, net of related debt	1,200,502	1,142,311
Net assets	$2,402,709	$2,163,395

Current assets at June 30, 2004, totaled $548.4 million, a decrease of 12.5 percent or $78.3 million over the prior year. Current assets consist primarily of cash and cash equivalents, securities lending collateral, and net receivables. Cash and cash equivalents decreased by $138.1 million or 52.6 percent to $124.5 million at June 30, 2004. The majority of this decrease is due to a change in the nature of the investments held, which reduced the amount classified as cash and cash equivalents. State and federal appropriations receivable increased $16.9 million or 15.5 percent to $126.0 million at June 30, 2004, from $109.1 million at June 30, 2003. The increase in the receivables was due to: a $17.0 million increase in capital appropriations receivable due to increased capital spending in fiscal year 2004; an $8.0 million increase in state special appropriations due mainly to increases in the tobacco settlement receipts, partially offset by reductions in other special appropriations; and an $8.1 million reduction in the state general fund appropriation receivable due to the $60.5 million decrease in the level of state support in fiscal year 2004 versus fiscal year 2003. Federal appropriations receivable remained consistent.

Receivables from students amounted to $35.5 million and $36.8 million at June 30, 2004 and 2003, respectively, net of estimated uncollectible amounts of $7.0 million and $2.5 million, at June 30, 2004 and 2003, respectively. The gross receivable balance did increase by $3.2 million or 8.2 percent to $42.5 million at June 30, 2004, from $39.3 million at June 30, 2003; however, the increase in the allowance for uncollectible amounts as a result of an increase in overdue balances, due in part to rising tuition and fees experienced during the past years, had the impact of decreasing the net student receivables. Sponsored receivables, net of allowances, were $63.0 million and $65.5 million at June 30, 2004 and 2003, respectively. The decrease of $2.5 million or 3.8 percent is mainly a result of more timely billings and collections of sponsored accounts. Trade and other receivables, net of allowances, increased $6.0 million or 9.7 percent to $66.3 million at June 30, 2004, from $60.3 million at June 30, 2003. Several increases in various departmental receivable accounts made up the change, the most significant of which was an increase of $4.7 million in the receivable 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 $70.2 million, net of allowances of $3.8 million, at June 30, 2004, compared with $67.8 million, net of allowances of $3.8 million, at June 30, 2003.

Capital assets, net of accumulated depreciation, totaled $1,862.7 million at June 30, 2004. Capital assets increased $25.1 million or 1.4 percent over the prior year. Fiscal year 2004 saw increased spending on capital projects as compared with the prior year. The majority of capital spending was funded by state capital appropriations, related to projects included in prior year capital requests, as well as capital gifts and grants. No significant spending was funded through bond proceeds in fiscal year 2004 because the Minnesota legislature failed to enact a bonding bill during the 2004 legislative session. The University had submitted a total capital request of $188.7 million in 2004, which included $155.5 million in state bonds and $33.2 million in University financing. The University intends to resubmit a capital request in fiscal year 2005. See Note 4 to the consolidated financial statements for more detailed information regarding capital assets.

Other noncurrent assets totaled $1,178.3 million and $982.0 million at June 30, 2004 and 2003, respectively, and include long-term endowment and other investments of $1,112.2 million and $844.8 million, respectively. The increase of $267.4 million or 31.7 percent in long-term endowment and other investments includes increases from net unrealized and realized gains on the endowment and other investments of $107.4 million; reinvested endowment earnings of $7.1 million; and a decrease of $30.1 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 $.4 million at June 30, 2004, and $78.1 million at June 30, 2003, which are earmarked for approved capital projects. Included in the June 30, 2003, balance was the $71.0 million Series 2003A bond issuance, which was used, along with additional University funds, to refund the Series 1993A debt in August 2004. Student loan receivables scheduled for collection beyond June 2004 and 2003, respectively, and prepaid expenses and deferred charges make up the majority of the remaining noncurrent assets.

Current liabilities totaled $665.6 million at June 30, 2004, down 21.4 percent or $180.8 million from $846.4 million at June 30, 2003. 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, 2004, were relatively consistent, increasing $3.0 million or 4.7 percent from $63.8 million at June 30, 2003. Securities lending collateral increased $24.0 million or 46.3 percent to $75.7 million at June 30, 2004, up from $51.7 million at June 30, 2003, due to increased investing activity in this area.

Accrued liabilities and other increased $17.2 million or 10.3 percent to $185.3 million at June 30, 2004, from $168.1 million at June 30, 2003. 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 $9.4 million or 8.2 percent to $123.8 million at June 30, 2004. Of this increase, $9.0 million was due to higher payroll accruals resulting from two extra days of accrued payroll versus June 30, 2003. Trade liabilities of $14.7 million at June 30, 2004, were $6.7 million or 82.8 percent higher than June 30, 2003. Several increases, including increased capital spending, made up the change, the most significant of which was an increase of $2.6 million in the current portion of retainage accruals associated with construction in progress at the University. Accrued interest totaled $2.3 million and $5.7 million at June 30, 2004 and 2003, respectively. The $3.4 million or 59.4 percent decrease was the result of a payment related to arbitrage. Other accrued liabilities increased $3.8 million or 23.0 percent to $20.5 million at June 30, 2004. This change is mainly attributable to a $4.5 million increase in payables related to Minnesota for Medical Education and Research Costs (MERC) and the Prepaid Medical Assistance Program (PMAP), partially offset by decreases in several other accrued liabilities.

Unearned income of $86.2 million at June 30, 2004, consisted of revenue related to summer session tuition and fees deferred to fiscal year 2005, funds received in advance of expenditures on sponsored accounts, and deferred revenue related to contracts with outside corporations. This balance decreased $17.4 million or 16.8 percent from June 30, 2003, due to a decrease in sponsored deferred revenue of $23.8 million resulting from increased sponsored expenditures during fiscal year 2004. This was partially offset by an increase in summer session tuition and fees of $2.2 million due to increased enrollment rates and a $6.4 million deferral of an up-front payment from TCF related to a new U Card contract. Other smaller net decreases also impacted the unearned income account.

Four of the University's bond issuances totaling $345.9 million have demand provisions that require the University to repurchase the bonds upon notice from bondholders. As of June 30, 2004, 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 standby purchase agreement was no longer classified long-term as it was set to expire in June 2005, and the University did not renew this agreement. Although management believes that all of these bonds will continue to be paid according to the original noncurrent payment schedules, $237.3 million and $362.0 million was reported as current liabilities at June 30, 2004 and 2003, respectively. Included in current liabilities at June 30, 2004, were all of the outstanding obligations under the Series 1999A, 2001A, and 2001B bonds and a portion of the Series 2001C bonds that would be due within the next year if the standby purchase agreement were exercised for the year then ended. Included in current liabilities at June 30, 2003, were all of the outstanding obligations under the Series 1999A, 2001A, 2001B, and 2001C bonds.

Noncurrent liabilities, totaling $521.1 million and $436.5 million at June 30, 2004 and 2003, respectively, primarily included principal amounts due on University bonds and long-term vacation and other compensation-related liabilities. As discussed above, the portion of the University's Series 2001C bonds that was classified as current at June 30, 2003, has been moved to noncurrent liabilities at June 30, 2004. This change in classification was the primary cause of the increase in long-term debt at June 30, 2004, of $96.9 million or 30.6 percent. See Note 5 to the consolidated financial statements for more detailed information regarding long-term debt. Noncurrent accrued liabilities and other decreased to $102.4 million at June 30, 2004, from $119.4 million at June 30, 2003. This $17.0 million or 14.2 percent decrease was caused by several factors including: settlement of claims related to the University steam plant resulting in a $12.0 million decrease; a $9.0 million decrease in the liability to Fairview for the prior settlement of hospital claims due to payments as well as a reclassification of amounts to current liabilities; and a decrease in the accrued pension liability of $1.2 million. These decreases were partially offset by an increase of $2.2 million in accrued vacation liabilities; an increase in accrued severance liabilities of $1.7 million due to a larger number of employees than the prior year; and a $1.0 million increase in student loan advances from the federal government.

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

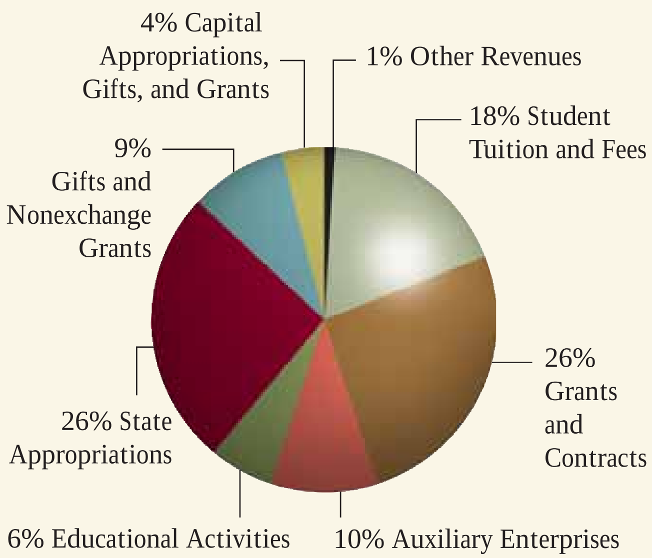
The Consolidated Statements of Revenues, Expenses, and Changes in Net Assets present the institution's operating, nonoperating, and capital- and endowment-related financial activity during the year. This statement differentiates between operating and nonoperating revenues and expenses, and displays the 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.

The University's consolidated revenues, expenses, and changes in net assets for the years ended June 30, 2004 and 2003, are summarized as follows (in thousands of dollars):

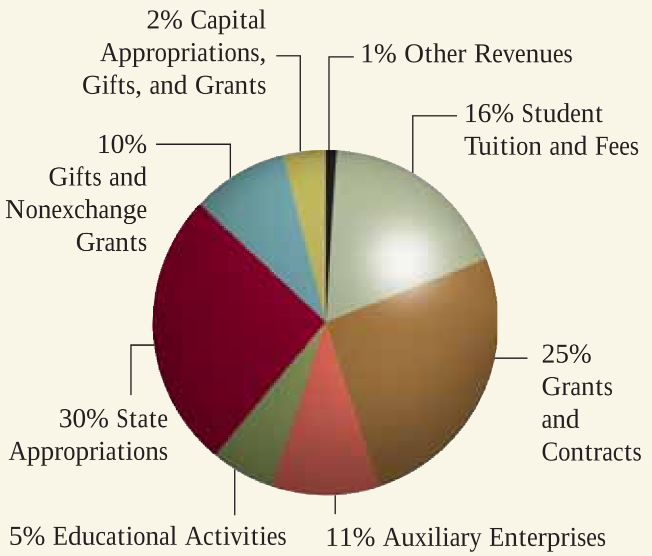
	2004	2003
Operating revenues		
Student tuition and fees, net	$ 407,631	$ 348,675
Grants and contracts	588,994	526,298
Auxiliary enterprises, net	238,275	229,367
Educational activities	127,149	113,746
Federal appropriations	16,657	15,562
Other revenues	2,069	3,710
Total operating revenues	1,380,775	1,237,358
Operating expenses	2,098,030	2,117,739
Operating loss	(717,255)	(880,381)
Nonoperating revenues (expenses)		
State appropriations	577,648	633,747
Grants and gifts	197,585	214,135
Net investment gain	115,272	17,723
Interest expense	(28,024)	(29,420)
Other nonoperating revenues (expenses), net	4,133	(1,022)
Income (loss) before other revenues	149,359	(45,218)
Capital appropriations	58,892	5,502
Capital and endowment gifts and grants	31,063	31,808
Total other revenues	89,955	37,310
Increase (decrease) in net assets	239,314	(7,908)
Net assets, beginning of year	2,163,395	2,171,303
Net assets, end of year	$2,402,709	$2,163,395

The following graphs illustrate the sources of the University's operating and nonoperating revenues, excluding investment-related revenues, for the years ended June 30, 2004, and June 30, 2003.

FY2004 Total Revenues



FY2003 Total Revenues



One of the University's strengths is that it has a diversified revenue base including: student tuition and fees, grants and contracts, sales by auxiliary and educational units, and state appropriations.

For the year ended June 30, 2004, student tuition and fees totaled $407.6 million, net of $88.9 million of scholarship allowances. This revenue represents an increase of $58.9 million or 16.9 percent over the year ended June 30, 2003, when student tuition and fees totaled $348.7 million, net of $81.4 million of scholarship allowances. The increase in student tuition and fees revenue was due to tuition and required fee increases ranging from 9 percent to 15 percent, depending on campus, student level, and residency status; combined with increased enrollment and average credit hours of 1.6 percent and 2.3 percent, respectively.

Grants and contracts from the federal government totaled $358.8 million in fiscal year 2004, up $35.3 million or 10.9 percent from $323.5 million in fiscal year 2003. The majority of this increase is due to increased spending of $21.5 million on federal grants and contracts as well as an increase in new grant activity. State and other governmental grants increased $8.0 million, or 20.9 percent, to $46.4 million for fiscal year 2004 from $38.4 million for fiscal year 2003. This increase is due in part to new grant activity, as well as a large grant of $5.0 million that was appropriately shifted from nonoperating to operating revenues, based on a change in the nature of the activities. Nongovernmental grants and contracts of $183.8 million for fiscal year 2004 increased by $19.3 million or 11.7 percent from $164.5 million in fiscal year 2003. The majority of this increase is due to a decrease in deferred revenue of $16.0 million as more expenses were incurred on existing sponsored projects, as well as an increase in new sponsored activity. These increases were partially offset by the shift, due to a change in the nature of the activities, of $5.8 million to nonexchange grant activity from exchange activity.

Auxiliary revenues increased slightly to $238.3 million, net of $9.7 million of scholarship allowances for the year ended June 30, 2004, up from $229.4 million, net of $8.6 million of scholarship allowances for the year ended June 30, 2003. This $8.9 million or 3.9 percent increase was the result of a blended increase in room and board rates of 5.2 percent, increases in contract parking rates of up to 2.4 percent, and an increase in event parking rates of $1.00. Other significant auxiliary rates were not increased during fiscal year 2004.

Revenues from sales and services of educational activities for fiscal year 2004 were $127.1 million, up $13.4 million or 11.8 percent from the prior year revenues of $113.7 million. Several factors contributed to this increase, including: $3.2 million in increased revenue from the Learning Abroad Center due to a 15 percent increase in enrollment; $2.6 million resulting from increases in royalty receipts from sales of products using University patents or technology; settlement funds received by the University of $2.6 million; and $2.1 million from the Dentistry Clinic due to increased patient volume.

State appropriations (excluding capital appropriations) totaled $577.6 million for fiscal year 2004, down $56.1 million or 8.9 percent from $633.7 million for fiscal year 2003. These totals include state general fund appropriations of $483.9 million and $544.4 million during fiscal years 2004 and 2003, respectively, as well as special appropriations designated by the state of $93.7 million and $89.3 million during the respective fiscal years.

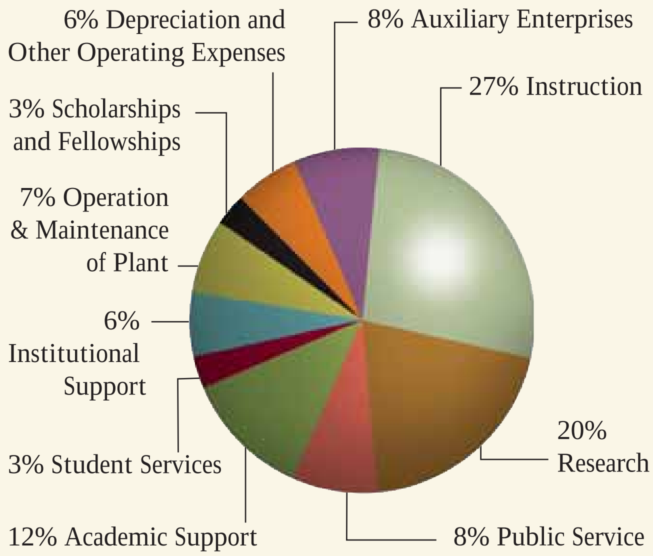
State appropriations, in addition to other sources of unrestricted revenue (tuition and educational and auxiliary activities) and nonoperating grants totaling $100.3 million, fund a number of University priorities, including competitive compensation plans for faculty and staff; various academic initiatives; 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 $97.3 million and $94.0 million, and gifts for capital purposes of $25.4 million and $29.9 million in fiscal years 2004 and 2003, respectively.

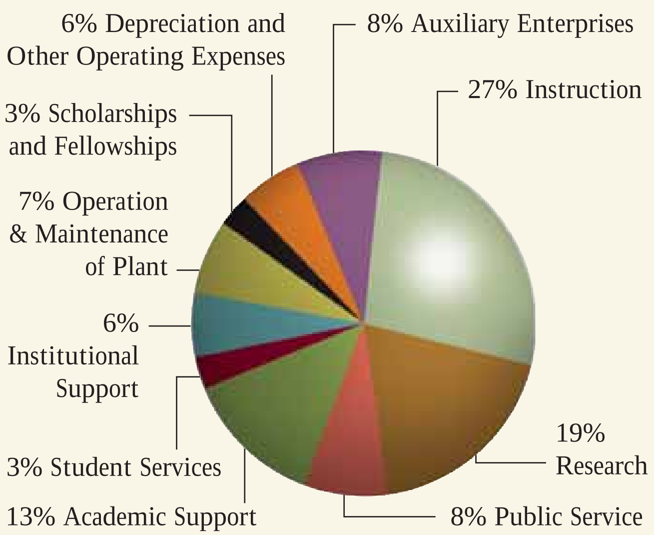
Capital appropriations are awarded biennially. The University requested $155.5 million in state capital appropriations in fiscal year 2004, but the Minnesota legislature failed to enact a bonding bill during the 2004 legislative session, so none of the University's 2004 capital appropriations request was funded. The University records state capital appropriation revenue only when approved capital expenditures have been incurred. Capital appropriations recorded in fiscal year 2004 were $58.9 million, an increase of $53.4 million over fiscal year 2003 capital appropriations of $5.5 million. This increase is due to increased spending on capital projects approved prior to 2004.

Total expenses by functional category are illustrated below.

FY2004 Functional Expenses



FY2003 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 66.3 percent of operating expenses in 2004. 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, 2004 and 2003 are summarized below (in thousands of dollars).

	2004	2003
Cash (used in) provided by		
Operating activities	$(601,667)	$(715,127)
Noncapital financing activities	774,291	856,125
Capital and related financing activities	(227,890)	(126,959)
Investing activities	(160,568)	88,059
Net (decrease) increase in cash	(215,834)	102,098
Cash, beginning of the year	340,720	238,622
Cash, end of the year	$ 124,886	$ 340,720

The University's cash and cash equivalents decreased $215.8 million due to the use of funds for operating activities, capital and related financing activities, and investing activities, partially offset by the inflow of funds provided by noncapital financing activities. The most significant sources of cash provided by noncapital financing activities, included state appropriations totaling $577.6 million, grants of $91.8 million, and gifts of $97.4 million in fiscal year 2004. Cash inflows for capital acquisitions from state appropriations, gifts and grants, and bonds issued during the year funded the University's equipment needs and ongoing renovation and construction initiatives.

Investment Activities

The endowment funds of the University are invested to preserve the inflation-adjusted value of the endowment and to maximize total return within acceptable risk parameters. These objectives are meant to be achieved over three- to five-year periods.

During fiscal year 2004, the value of the University's endowment funds increased significantly. This increase was due to new contributions to the endowment fund as well as market value and realized gains of $93.5 million and $1.6 million, respectively, and $7.1 million in reinvested earnings. These increases were partially offset by distributions of $30.1 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 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 $164.6 million in fiscal year 2004. Total additions were down from the prior year's total additions of $180.9 million as several significant projects were in the final stages of completion in fiscal 2003 and moved from construction in progress to capital additions. These completed projects include the Molecular and Cellular Biology building, Coffman Memorial Union remodeling, and the Art Teaching and Research building. Fiscal year 2004 spending included Duluth's Swenson Science building, the Cargill building, Duluth's Kirby Plaza renovation, the Arboretum Visitor Center, and the Translational Research Facility. Although there was an overall decrease in capital spending, cash provided by capital appropriations increased by $13.0 million to $42.4 million in fiscal year 2004, as more capital appropriation funding was used to fund capital expenditures.

Bonds and other debt payable totaled $665.0 million at June 30, 2004, and included proceeds from capital leases and debt service obligations related to state of Minnesota infrastructure development bonds of $3.3 million. During fiscal year 2003, the University issued $71.0 million in General Obligation Refunding Bonds. These bonds were used, along with additional funds provided by the University, to refund the University's $84.0 million Series 1993A General Obligation Bonds in fiscal year 2004. 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

In the course of the last fiscal year, the University has successfully faced significant financial challenges stemming primarily from a reduction in state support brought about by continued economic challenges facing the nation and the state of Minnesota. As evidenced in the annual consolidated financial statements, state appropriations declined by approximately $56.1 million or 8.9 percent compared with the prior fiscal year. As a result of this reduction, the University initiated an aggressive effort to reduce costs and increase revenues in order to ensure overall continued financial strength. As part of this effort, the University undertook a one-year wage freeze, modified its employer/employee cost responsibility for health care benefits, reduced administrative and operating costs, and increased tuition revenue.

As a result of strong management actions to control costs, increase operating revenues, and focus on reshaping short- and long-term investment strategies, net assets of the University increased approximately $239.3 million or 11.1 percent compared with the prior fiscal year.

Looking toward the future, management believes that the University is well positioned to maintain its strong financial position and level of excellence in service to students, faculty, staff, and the citizens of the state of Minnesota. The University's strong financial position, strong leadership, and responsive management decision making has served to ease recent financial challenges brought about by the economic downturn and its impact on state revenues. The University is engaged in ongoing efforts toward revenue diversification and cost containment that will assist the University in continuing to provide the necessary resources to support excellence in its teaching, research, and public service missions.

The University has implemented more broadly diversified investment strategies for both the endowment and reserve pools, intended to enhance the total returns while reducing the overall levels of risk. In the endowment pool, these strategies often involve owning assets that are much less liquid but have more stable returns than stocks or bonds. In addition, the University is in the process of installing new technologies that will enhance its ability to evaluate new investment opportunities and monitor more sophisticated portfolios. The value of all funds managed by the University, including the consolidated endowment fund, long-term reserves, and short-term reserves, totaled approximately $1.31 billion on June 30, 2004, compared with $1.24 billion the prior year, net of investment gains and losses and the impact of distribution to the academic units of the institution. The University plans to continue its present spending policy for the endowment pool, which is intended to insulate the University's operation units from market volatility.

In light of higher tuition rates and declining state support, the University now more than ever needs to place the highest priority on fiscal resourcefulness, institutional efficiency, and quality student services to remain competitive. With capabilities now available through new technologies and a history of strong working partnerships among faculty, staff, and administration, this is an opportune time to think creatively about ways the University can seize natural opportunities to enhance service and productivity while at the same time reducing unnecessary costs across the entire University of Minnesota system.

The University has recently initiated a concentrated effort to improve service and productivity in both academic and support units; and it expects to capture significant financial benefits through changes in operational practices, such as smarter purchasing practices. The new service and productivity initiative has been designed to serve as a catalyst and guide for sustainable improvement throughout the University, to work with leadership and the University community to energize and enable a culture of continuous improvement, and to work collaboratively with units to help identify and realize sustainable improvements in value, service, and productivity.

The University has begun preliminary planning to replace its enterprisewide financial system. The new financial system is the final component of the University's very successful enterprise system projects, which have included replacement of student, human resource, libraries, and grants management systems. The new financial system is intended to provide users with more control and access to financial information; automate and streamline business processes such as purchasing, vendor payments, and cash management; provide more robust financial analysis and reporting capabilities; and provide enhanced policy-level financial information for decision making by the University's Board of Regents and administration. Based on preliminary planning, the project is expected to begin in July 2005, last 24 to 30 months, and cost between $22.0 and $26.0 million.

Private gifts are an important supplement to the fundamental support from the state of Minnesota and student tuition and represent a crucial 'tipping point' in the advancement of the quality of academic units. A record number of donors made gifts and pledges totaling $145 million to the University of Minnesota during fiscal year 2004. This included gifts from 81,979 donors, the largest number of individual donors in the University's history. Most of the new donors are the result of a 6 percent increase in the number of alumni making gifts. The 42,379 alumni who pledged funds to the University account for 52 percent of all donors to the University.

The number of faculty and staff contributions also increased by 9 percent to more than 5,000 in 2004. The increase came in a year when state appropriation reductions produced a one-year salary freeze at the University.

Fiscal year 2004 marked the first full year of fund-raising at the University since the close of Campaign Minnesota, the hugely successful seven-year effort by the University and its related foundations that raised $1.66 billion in current and future resources for the University. Nevertheless, gift production in 2004 showed continued strength, even after the highly successful capital campaign, and was about double the level of new gift commitments in the years prior to Campaign Minnesota.

The University is now focused on raising funds specifically for scholarships. October 2004 has been designated Scholarship Month at the University, as part of the fund-raising drive.

A crucial element for the University's future will be to strengthen its financial partnership with the state of Minnesota. The biennial budget proposal for fiscal years 2006 and 2007 calls for a "50-50 partnership" with the state of Minnesota, in which the state would contribute $84 million in new funding to the University over the two-year period. In return, the University would generate its share of new funding through tuition increases of 5.5 percent each year (generating $27 million per year) plus internal reallocations of $15 million each year.

The proposed state contribution of $42 million each year would fund three broad categories: investing in biosciences; attracting and retaining talent—students, faculty, and staff—for Minnesota's future; and sustaining the University's research and technology infrastructure.

As a result of the 2004 Minnesota Legislature's failure to enact a capital appropriation bill, the University will be seeking action on its original 2004 capital appropriation request of approximately $186.5 million from the state of Minnesota in the 2005 legislative session. The University will also be updating its six-year capital plan in November 2004. The updated six-year capital plan 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 be centered on outlining projects that will be requested from the state of Minnesota. Approximately 82 percent of the six-year capital plan reflects the renewal and renovation of existing facilities, while the remaining 18 percent is targeted for the construction of critical new facilities in support of academic programs.

The University's outstanding debt totaled $665.0 million on June 30, 2004. The weighted average cost of capital was 4.33 percent per the original bond agreements, and the average life of debt was 12.3 years, with 96 percent fixed and 4 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.

As disclosed in Note 6 of the accompanying financial statements, most of the University's contributions to fund pension plans are for a defined-contribution plan, and the remaining defined-benefit plans do not have significant unfunded accrued liabilities.

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

University of Minnesota

Independent Auditors' Report

To the Board of Regents
University of Minnesota

We have audited the accompanying consolidated statements of net assets of the University of Minnesota (the University) as of June 30, 2004 and 2003 and the related consolidated statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We did not audit the financial statements of the discretely presented component units (see Note 11 and pages 24, 25, and 27 to 33 of the financial statements) which statements reflect total assets constituting 32 percent of combined total assets at June 30, 2004, and total revenues constituting 18 percent of combined total revenues for the year then ended. Those statements and the prior-year comparative information were audited by other auditors whose report has 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 unit's June 30, 2003 financial statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the consolidated financial statements, the University adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, as of July 1, 2003.

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 consolidated financial position of the University as of June 30, 2004 and 2003, and the consolidated changes in revenues, expenses, and net assets and of cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 12 to 21 is not a required part of the financial statements but is supplemental information required by the GASB. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards,* we will issue a separate report, dated October 15, 2004, on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte + Touche LLP

Deloitte and Touche, LLP
October 15, 2004

Consolidated Statements of Net Assets

June 30, 2004 and 2003 (in thousands)

			2004	2003
Assets				
Current assets	Cash and cash equivalents		$ 124,530	$ 262,618
	Securities lending collateral		75,696	51,742
	Short-term investments		4,481	805
	Receivables, net		293,049	272,065
	Inventories		18,968	17,593
	Current portion of student loan receivables, net		13,506	12,879
	Current portion of prepaid expenses and deferred charges		18,001	8,808
	Other assets		200	200
	Total current assets		548,431	626,710
Noncurrent assets	Restricted cash and cash equivalents		356	78,102
	Investments		1,112,242	844,780
	Receivables, net		1,451	1,706
	Student loan receivables, net		56,657	54,921
	Prepaid expenses and deferred charges		7,448	2,355
	Other assets		104	100
	Capital assets, net		1,862,746	1,837,689
	Total noncurrent assets		3,041,004	2,819,653
Total assets			3,589,435	3,446,363
Liabilities				
Current liabilities	Accounts payable		66,794	63,819
	Accrued liabilities and other		185,305	168,069
	Securities lending collateral		75,696	51,742
	Unearned income		86,230	103,649
	Long-term debt—current portion		251,615	459,156
	Total current liabilities		665,640	846,435
Noncurrent liabilities	Accrued liabilities and other		102,447	119,391
	Unearned income		5,300	700
	Long-term debt		413,339	316,442
	Total noncurrent liabilities		521,086	436,533
Total liabilities			1,186,726	1,282,968
Net Assets				
	Unrestricted		315,377	313,401
	Restricted	Expendable	687,461	515,079
		Nonexpendable	199,369	192,604
	Invested in capital assets, net of related debt		1,200,502	1,142,311
Total net assets			$2,402,709	$2,163,395

See notes to consolidated financial statements.

Component Units — Statements of Financial Position

June 30, 2004 and 2003 (in thousands)

	University of Minnesota Foundation		Minnesota Medical Foundation	
	2004	2003	2004	2003
Assets				
Cash and cash equivalents	$ 7,463	$ 5,276	$ 2,449	$ 6,643
Investments, substantially at fair market value	876,214	749,539	181,514	208,056
Investments held for unitrusts, annuity trusts, and gift annuities			11,165	10,688
Investments designated for endowments				
Investments loaned to broker	95,302	102,471	40,136	
Investments collateral	97,437	105,518	41,100	
Assets limited as to use				
Pledges receivable, net	49,726	54,321	24,478	20,284
Accounts and other receivables	3,899	3,273	1,866	2,133
Interest in charitable lead trusts, unitrusts, pooled income and trusts	52,111	45,087	6,184	5,876
Gift annuities	25,295	21,731		
Interest in the net assets of related parties				
Due from affiliated parties	19	129		
Property and equipment, net	1,024	1,252	371	518
Other assets			313	800
Total assets	1,208,490	1,088,597	309,576	254,998
Liabilities				
Accounts payable and accrued liabilities	3,806	4,484	4,803	10,558
Deferred revenue				
Gift annuities payable	14,243	13,039		
Split-interest agreement liabilities			7,437	6,604
Unitrusts, pooled income and annuity trusts payable	11,436	8,372		
Investments held for custody of others	51,466	50,693	2,698	3,215
Payable under investment loan agreement	97,437	105,518	41,100	
Notes and bonds payable				
Total current liabilities	178,388	182,106	56,038	20,377
Net Assets				
Unrestricted	41,138	36,534	8,538	8,648
Temporarily restricted	611,468	516,629	124,879	121,788
Permanently restricted	377,496	353,328	120,121	104,185
Total net assets	1,030,102	906,491	253,538	234,621
Total liabilities and net assets	$1,208,490	$1,088,597	$309,576	$254,998

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	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	$ 1,016	$ 476	$ 233	$ 295	$16,938	$11,358	$ 315	$ 368	$ 1,168	$ 1,217
	2,946	11,172	5,512	4,904	10,652	11,564	21,958	19,415	4,169	2,028
	16,417	13,103								
					153	4,453				
	5,700	7,563	96	147						
	204	6	1	319	31,198	28,457	326	179	91	95
	1,761	1,577	30	27						
									16,091	13,823
							93	114		
	1,666	1,100	11	12	11,996	9,018	637	736	37,592	38,561
			9	11	2,840	1,745	208	181	722	745
	29,710	34,997	5,892	5,715	73,777	66,595	23,537	20,993	59,833	56,469
	36	132	904	147	35,961	30,554	784	279	975	914
	364	363	20	25			3,943	4,057		
	41	43								
					5,625	6,900			45,730	46,300
	441	538	924	172	41,586	37,454	4,727	4,336	46,705	47,214
	5,191	4,021	135	81	32,191	29,141	18,079	16,010	10,909	9,058
	11,945	21,113	2,356	2,977			174	173	2,219	197
	12,133	9,325	2,477	2,485			557	474		
	29,269	34,459	4,968	5,543	32,191	29,141	18,810	16,657	13,128	9,255
	$29,710	$34,997	$5,892	$5,715	$73,777	$66,595	$23,537	$20,993	$59,833	$56,469

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

Years ended June 30, 2004 and 2003 (in thousands)

			2004	2003
Revenues				
Operating revenues	Student tuition and fees, net of scholarship allowances of $88,926 in 2004; $81,379 in 2003		$ 407,631	$ 348,675
	Federal appropriations		16,657	15,562
	Federal grants and contracts		358,840	323,467
	State and other government grants		46,389	38,368
	Nongovernmental grants and contracts		183,765	164,463
	Student loan interest income		1,484	1,719
	Sales and services of educational activities		127,149	113,746
	Auxiliary enterprises, net of scholarship allowances of $9,660 in 2004; $8,628 in 2003. Revenues of $2,865 in 2004; $2,893 in 2003 were pledged as security for various auxiliary revenue bonds		238,275	229,367
	Other operating revenues		585	1,991
Total operating revenues			1,380,775	1,237,358
Expenses				
Operating expenses	Education and general	Instruction	560,906	569,375
		Research	422,290	411,568
		Public service	165,200	158,913
		Academic support	251,602	271,990
		Student services	71,082	68,140
		Institutional support	116,481	118,340
		Operation and maintenance of plant	152,372	160,240
		Scholarships and fellowships	66,605	67,461
		Depreciation	126,930	129,191
	Auxiliary enterprises		164,218	161,625
	Other operating expenses, net		344	896
Total operating expenses			2,098,030	2,117,739
Operating Loss			(717,255)	(880,381)
Nonoperating Revenues (Expenses)				
State appropriations			577,648	633,747
Grants			100,256	120,124
Gifts			97,329	94,011
Investment income			29,405	24,472
Net increase (decrease) in the fair market value of investments			85,867	(6,749)
Interest on capital asset-related debt			(28,024)	(29,420)
Other nonoperating revenues (expenses), net			4,133	(1,022)
Net nonoperating revenues			866,614	835,163
Income (Loss) Before Other Revenues			149,359	(45,218)
Capital appropriations			58,892	5,502
Capital grants and gifts			25,440	29,869
Additions to permanent endowments			5,623	1,939
Total other revenues			89,955	37,310
Increase (Decrease) in Net Assets			239,314	(7,908)
Net assets at beginning of year			2,163,395	2,171,303
Net assets at end of year			$2,402,709	$2,163,395

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

University of Minnesota Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2004	Total 2003
Revenues					
Contributions	$ 29	$ 50,573	$ 24,859	$ 75,461	$ 63,587
Investment income, net	3,784	4,425	20	8,229	12,316
Net realized and unrealized gains (losses) on investments	9,074	115,852	(13)	124,913	37,288
Change in carrying value of investments	(132)	4,693	(93)	4,468	9,832
Support services revenue	3,130			3,130	3,469
Other revenue	613			613	621
Net assets released from restriction	81,309	(80,704)	(605)	–	–
Total revenues	97,807	94,839	24,168	216,814	127,113
Expenses					
Program services					
Distributions for educational purposes	76,775			76,775	79,380
Support services					
Management and general	6,011			6,011	5,633
Fundraising	10,417			10,417	10,244
Total expenses	93,203			93,203	95,257
Increase in net assets	4,604	94,839	24,168	123,611	31,856
Net assets at beginning of year	36,534	516,629	353,328	906,491	874,635
Net assets at end of year	$41,138	$611,468	$377,496	$1,030,102	$906,491

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

Minnesota Medical Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2004	Total 2003
Revenues					
Contributions	$ 764	$ 31,634	$ 6,538	$ 38,936	$ 43,623
Net investment return	765	15,714	10,881	27,360	5,256
Change in carrying value of investments		971	(316)	655	(466)
Service charges	6,579	(3,827)	(2,752)	–	–
Receipts from affiliated parties	250			250	214
Net assets released from restrictions	39,816	(41,401)	1,585	–	–
Total revenues	48,174	3,091	15,936	67,201	48,627
Expenses					
Program services					
Research and education grants	35,558			35,558	31,645
Other program services	4,084			4,084	4,446
Support services					
Management and general	2,686			2,686	2,773
Fundraising	5,956			5,956	5,744
Total expenses	48,284			48,284	44,608
(Decrease) increase in net assets	(110)	3,091	15,936	18,917	4,019
Net assets at beginning of year	8,648	121,788	104,185	234,621	230,602
Net assets at end of year	$ 8,538	$124,879	$120,121	$253,538	$234,621

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

Minnesota Landscape Arboretum Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2004	Total 2003
Revenues					
Contributions	$ 2,486	$ 1,654	$ 1,712	$ 5,852	$ 9,681
Membership dues and fees	686			686	620
Investment income, net	8	183		191	360
Net realized and unrealized gains on investments	47	2,154		2,201	977
Change in carrying value of investments		223	31	254	(238)
Other revenue	368	300		668	667
Net assets released from restriction	12,617	(13,682)	1,065	–	–
Total revenues	16,212	(9,168)	2,808	9,852	12,067
Expenses					
Program services					
Other program services	13,830			13,830	8,391
Support services					
Management and general	752			752	1,091
Fundraising	591			591	518
Total expenses	15,173			15,173	10,000
Increase (decrease) in net assets	1,039	(9,168)	2,808	(5,321)	2,067
Adjustment to net assets	131			131	–
Net assets at beginning of year	4,021	21,113	9,325	34,459	32,392
Net assets at end of year	$ 5,191	$ 11,945	$12,133	$29,269	$34,459

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

Minnesota 4-H Foundation

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2004	Total 2003
Revenues					
Contributions	$ 126	$ 53	$ 17	$ 196	$ 294
Investment income, net	46	510	90	646	29
Change in carrying value of investments		3		3	227
Support services revenue				–	39
Other revenue	136	164		300	318
Net assets released from restriction	850	(850)		–	–
Total revenues	1,158	(120)	107	1,145	907
Expenses					
Program services					
Other program services	888			888	959
Support services					
Management and general	125			125	164
Fundraising	78			78	102
Total expenses	1,091			1,091	1,225
Increase (decrease) in net assets	67	(120)	107	54	(318)
Adjustment to net assets	(13)	(501)	(115)	(629)	–
Net assets at beginning of year	81	2,977	2,485	5,543	5,861
Net assets at end of year	$ 135	$2,356	$2,477	$4,968	$5,543

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

University of Minnesota Physicians

	Total (Unrestricted) 2004	2003
Revenues		
Net patient service revenue	$127,315	$114,622
Contract revenue	52,261	41,457
Investment income, net	294	280
Other revenue	2,747	3,796
Total revenues	182,617	160,155
Expenses		
Program services		
Health care services	156,950	137,039
Support services		
Management and general	22,617	18,369
Total expenses	179,567	155,408
Increase in net assets	3,050	4,747
Net assets at beginning of year	29,141	24,394
Net assets at end of year	$ 32,191	$ 29,141

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

University of Minnesota Alumni Association

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2004	Total 2003
Revenues					
Contributions	$ 146	$ 2		$ 148	$ 77
Membership dues and fees	875			875	908
Investment income, net	47	1		48	167
Change in carrying value of investments	2,930	30	$ 83	3,043	884
Other revenue	3,479			3,479	3,256
Net assets released from restriction	32	(32)		–	–
Total revenues	7,509	1	83	7,593	5,292
Expenses					
Program services					
Other program services	5,026			5,026	4,250
Support services					
Management and general	402			402	428
Fundraising	12			12	16
Total expenses	5,440			5,440	4,694
Increase in net assets	2,069	1	83	2,153	598
Net assets at beginning of year	16,010	173	474	16,657	16,059
Net assets at end of year	$18,079	$174	$557	$18,810	$16,657

See notes to consolidated financial statements.

Component Units—Statements of Activities

Year ended June 30, 2004 (with summarized information for the year ended June 30, 2003) (in thousands)

University Gateway Corporation

	Unrestricted	Temporarily Restricted	Total 2004	Total 2003
Revenues				
Investment income, net	$ 38		$ 38	$ 56
Receipts from affiliated parties		$2,106	2,106	
Other revenue	5,101	2,268	7,369	5,772
Net assets released from restriction	2,352	(2,352)	–	–
Total revenues	7,491	2,022	9,513	5,828
Expenses				
Program services				
Other program services	5,318		5,318	5,301
Support services				
Management and general	31		31	22
Payments to affiliated parties	291		291	–
Total expenses	5,640		5,640	5,323
Increase in net assets	1,851	2,022	3,873	505
Net assets at beginning of year	9,058	197	9,255	8,750
Net assets at end of year	$10,909	$2,219	$13,128	$9,255

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended June 30, 2004 and 2003 (in thousands)

	2004	2003
Cash Flows from Operating Activities		
Student tuition and fees	$ 405,732	$ 348,875
Federal appropriations	16,963	17,988
Grants and contracts (federal, state, nongovernmental, other)	583,104	530,990
Sales and services of educational activities	130,343	113,228
Auxiliary enterprises	237,469	235,900
Other operating revenues	1,067	1,770
Payments to employees for services	(1,084,467)	(1,087,142)
Payments for fringe benefits	(298,431)	(303,864)
Payments to suppliers for goods and services	(530,057)	(513,555)
Payments for scholarships and fellowships	(62,217)	(61,807)
Loans issued to students	(16,638)	(16,194)
Collection of loans to students	15,465	18,684
Net cash used in operating activities	(601,667)	(715,127)
Cash Flows from Noncapital Financing Activities		
State appropriations	577,573	642,711
Grants for other than capital purposes	91,826	115,725
Gifts for other than capital purposes	97,407	94,655
Private gifts for endowment purposes	5,623	1,939
Other nonoperating revenues, net	4,681	735
Direct lending receipts	237,749	206,691
Direct lending disbursements	(238,040)	(206,639)
Agency transactions	(2,528)	308
Net cash provided by noncapital financing activities	774,291	856,125
Cash Flows from Capital and Related Financing Activities		
Capital appropriations	42,420	29,445
Capital grants and gifts	23,107	26,345
Proceeds from capital debt	–	70,823
Purchases of capital assets	(151,460)	(197,090)
Principal paid on capital debt	(112,763)	(25,230)
Interest paid on capital debt	(29,194)	(31,252)
Net cash used in capital and related financing activities	(227,890)	(126,959)
Cash Flows from Investing Activities		
Investment income, net	51,604	28,709
Proceeds from sales and maturities of investments	6,000,596	2,203,278
Purchase of investments	(6,212,768)	(2,143,928)
Net cash (used in) provided by investing activities	(160,568)	88,059
Net (Decrease) Increase in Cash	(215,834)	102,098
Cash and Cash Equivalents at Beginning of Year	340,720	238,622
Cash and Cash Equivalents at End of Year	$ 124,886	$ 340,720

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows (concluded)

Years ended June 30, 2004 and 2003 (in thousands)

	2004	2003
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Used in Operating Activities		
Operating loss	$(717,255)	$(880,381)
Adjustments to reconcile net operating loss to net cash used in operating activities		
Depreciation expense	126,930	129,191
Changes in assets and liabilities		
Receivables, net	(13,701)	4,964
Inventories	(1,219)	408
Prepaid and other items	(14,532)	(1,683)
Accounts payable	(4,120)	1,575
Accrued liabilities	14,165	20,688
Unearned income	8,065	10,111
Net Cash Used in Operating Activities	$(601,667)	$(715,127)
Noncash Transactions		
Borrowing under capital lease	$ (516)	$ (1,663)
Equipment	516	1,663

See notes to consolidated financial statements.

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

Organization

The University of Minnesota 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 thirty and forty-five 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, 2004, the UMF distributed $74,139 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 twenty-four 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, 2004, the MMF distributed $31,332 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.

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 thirty-six 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, 2004, the Minnesota Landscape Arboretum Foundation distributed $14,617 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, 2004, the Minnesota 4-H Foundation distributed $658 to the University. Complete financial statements for the Minnesota 4-H Foundation can be obtained from the 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, 2004, the Association distributed $531 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 is composed 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.

Complete financial statements for the University Gateway Corporation can be obtained from the McNamara Alumni Center Management Office, 200 Oak Street S.E., Suite 035, 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 twenty-four 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.

During the year ended June 30, 2004, UMPhysicians distributed $26,289 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. As an integral part of the state, the University is generally exempt from federal income taxes, although certain activities are subject to federal unrelated business income tax.

Financial Statement Presentation

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

Effective July 1, 2003, the University adopted GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. This statement, which amends GASB Statement No. 14, *The Financial Reporting Entity*, requires the University to present the financial results of its component units, either in a discrete or blended presentation, within the University's financial statements, depending on the nature and significance of their relationship to the University or its other component units.

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.

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.

Years ended June 30, 2004 and 2003 (amounts in thousands)

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 $356 at June 30, 2004, and $78,102 at June 30, 2003, 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 to be consistent with the purpose for which the funds are required to be used—for long-term capital projects.

Capital Assets—Land, buildings, and other property are recorded at cost if purchased or constructed, or at market value on the date of gift, if received by gift or bequest. Interest expense of $28,022 and $31,156 was incurred during construction for the years ended June 30, 2004 and 2003, respectively. No interest qualified for interest capitalization in 2004; however, $1,736 was capitalized in 2003 as a cost of the assets constructed. Depreciation is determined using the straight-line method, based on the estimated useful lives of the assets.

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

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

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

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

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

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

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

  Nonexpendable—Net assets that are required to be retained permanently by the University. These assets represent the principal portion (historical value) of gifts to the University's true and life endowment funds 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 SEOG), and other nonexchange grants and contracts. Although the institution relies upon these revenue sources to fund the cost of operations, the grantor or donor is not the direct recipient of the goods or services delivered under the grant or gift terms.

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 year 2004 and 2003, separately budgeted departmental research in nonsponsored accounts of $94,688 and $79,570, 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.

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 March 2003, the GASB issued 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*, is effective for the University for the year ending June 30, 2005. The University will be required 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 is also required to disclose its deposit and investment policies. The University has not yet determined the full impact of GASB Statement No. 40 on its consolidated financial statements.

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. In all cases, except the University of Minnesota Physicians, the separately issued component units' financial statements are not rounded.

2. Cash and Investments

Summary

The University maintains centralized management for substantially all of its cash and investments. With the exception of insurance reserves maintained by RUMINCO, 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 interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term, and that such changes could materially affect the amounts reported in the consolidated financial statements.

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.

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, 20 percent investment in international equities, 25 percent investment in alternative investments, and 20 percent in fixed-income related investments. To maintain the allocation targets, the CEF may invest in various bond and stock index futures contracts. The University has deposited U.S. government securities with a market value of $2,114 at June 30, 2004, and $3,675 at June 30, 2003, as collateral for these future commitments.

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.

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 an institutional mutual fund. All income received from these investments is available for spending.

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

Invested Assets Related to Indebtedness (IARI)—Included in investments are the invested assets related to indebtedness that are held by the bond trustee primarily in the debt-service reserve funds of the outstanding University bond issuances. In addition, unspent bond proceeds held by the University are invested for short-term income until needed for the capital projects for which the bonds were issued. The market value of debt-related investments held by the bond trustee and internally managed was $12,000 and $91,000 at June 30, 2004 and 2003, respectively.

Years ended June 30, 2004 and 2003 (amounts in thousands)

Custodial Credit Risk

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

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

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

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

Cash and Cash Equivalents

The University had cash deficits in its bank accounts of $(12,185) and $(10,486) at June 30, 2004 and 2003, respectively. Balances in excess of Federal Deposit Insurance Corporation limits were $5,596 and $3,210 for the same periods. The University held risk category 1 cash equivalents of $137,071 at June 30, 2004, and $351,206 at June 30, 2003. At certain times during the year, deposits (cash) temporarily fell into risk category 3, due to higher cash flows arising from state appropriations, tuition receipts, and various state or federal draws.

Investments

The University investment pools hold risk category 1 and uncategorized investments. Investments held at June 30, 2004 and 2003, which include amounts held by the University's insurance subsidiary, are summarized in the following table:

	2004	2003
Risk Category 1 Investments		
Cash equivalents, noncurrent	$ 59,982	$ 75,598
Government agency securities	332,920	228,874
Corporate bonds and preferred stock	102,924	75,864
Common stock and convertibles	369,786	200,662
Total risk category 1 investments	865,612	580,998
Noncategorized Investments		
Securities lending collateral	75,696	51,742
Mutual funds	99,460	170,791
Alternative investments	137,624	93,796
Other miscellaneous	14,027	–
Total noncategorized investments	326,807	316,329
Total investments	$1,192,419	$897,327

The University has entered into various forward contracts, through its international equity managers, to manage its exposure against foreign currency exchange-rate fluctuations. As of June 30, 2004, the University had $7,980 in open foreign currency purchase contracts and $14,242 in open foreign currency sales contracts with a net market value of $(60). This compares to $3,376 in open foreign currency purchase contracts and $24,579 in open foreign currency sales contracts with a net market value of $388 as of June 30, 2003. In addition, the University has entered into various hedge contracts to minimize interest rate risk in the debt markets.

Years ended June 30, 2004 and 2003 (amounts in thousands)

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

The following summarizes cash, securities lending collateral, and investments, including the University's insurance subsidiary, at June 30, 2003:

	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	$257,542	$ 1,002		$ 3,207	$ 90		$ 777	$ 262,618
Securities lending collateral			$51,742					51,742
Short-term investments		805						805
Total current assets	257,542	1,807	51,742	3,207	90		777	315,165
Restricted cash and cash equivalents		78,102						78,102
Investments	236,102	11,177		525,696	46,780	$561	24,464	844,780
Total noncurrent assets	236,102	89,279	–	525,696	46,780	561	24,464	922,882
	$493,644	$91,086	$51,742	$528,903	$46,870	$561	$25,241	$1,238,047
Unrestricted amounts included above	$227,198	$ –	$14,200	$ –	$16,230	$ –	$25,241	$ 282,869

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

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 $73,592 and $49,621 at June 30, 2004 and 2003, respectively.

These loaned securities were supported by collateral of approximately $75,696 and $51,742, which is included as securities lending collateral in the consolidated statements of net assets at June 30, 2004 and 2003, respectively. Of this collateral amount, approximately $73,754 and $43,901 was cash and approximately $1,942 and $7,841 was acceptable noncash collateral at June 30, 2004 and 2003, 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 were 49 and 57 days as of June 2004 and 2003, 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 $672 and $486, respectively, for the year ended June 30, 2004, and $574 and $422 at June 30, 2003, respectively.

Years ended June 30, 2004 and 2003 (amounts in thousands)

3. Other Asset and Liability Information

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	$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

Years ended June 30, 2004 and 2003 (amounts in thousands)

Receivables, net, and student loans receivable at June 30, 2003, consisted of the following:

	Current	Noncurrent	Total
State and federal appropriations	$109,098		$109,098
Sponsored grants and contracts	68,582		68,582
Notes receivable	325	$ 1,706	2,031
Student receivables	39,319		39,319
Trade receivables	57,610		57,610
Accrued interest	2,612		2,612
Other	2,736		2,736
Allowance for uncollectible accounts	(8,217)		(8,217)
Total receivables, net	$272,065	$ 1,706	273,771
Student loans receivable	16,138	55,476	71,614
Allowance for uncollectible accounts	(3,259)	(555)	(3,814)
Student loans receivable, net	$ 12,879	$ 54,921	$ 67,800

Accrued liabilities at June 30, 2003, consisted of the following:

	Current	Noncurrent	Total
Trade liabilities	$ 8,042	$ 27,742	$ 35,784
Compensation and benefits	114,449	20,811	135,260
Self-insurance reserves	23,198	13,926	37,124
Accrued interest	5,692	332	6,024
Refundable advances		56,580	56,580
Other	16,688		16,688
Total accrued liabilities	$168,069	$119,391	$287,460

Activity for certain liabilities with long-term components consisted of the following at June 30, 2003:

	Beginning balance	Additions	Reductions	Ending balance	Current portion
Compensated balances	$61,679	$53,640	$(51,757)	$63,562	$54,044
Self-insurance reserves (see Note 9)	28,989	121,520	(113,385)	37,124	23,198
Refundable advances	55,166	1,414		56,580	
Other	40,439	19,911	(21,208)	39,142	11,068

Years ended June 30, 2004 and 2003 (amounts in thousands)

4. CAPITAL ASSETS

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					
Technology	180,786	$ 20,517	(7,535)	(21,917)	171,851
Other equipment	356,709	29,915	332	(19,199)	367,757
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
Nondepreciable 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 nondepreciable 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					
Technology	126,982	20,427		(22,520)	124,889
Other equipment	231,196	26,209		(18,105)	239,300
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
Nondepreciable 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

Years ended June 30, 2004 and 2003 (amounts in thousands)

Capital assets, net at June 30, 2003, consisted of the following:

	Beginning balance	Additions	Transfers	Retirements	Ending balance
Depreciable capital assets					
Buildings and improvements	$1,933,018		$261,619	$(17,516)	$2,177,121
Leasehold improvements	617				617
Equipment					
Technology	198,521	$ 13,652		(31,387)	180,786
Other equipment	353,566	31,365	(2,366)	(25,856)	356,709
Infrastructure	278,158	631	19,409		298,198
Library and reference books	96,935	10,508		(8,592)	98,851
Total depreciable capital assets	2,860,815	56,156	278,662	(83,351)	3,112,282
Nondepreciable capital assets					
Land	34,852	856		(118)	35,590
Museums and collections	29,913	4,076		(1)	33,988
Construction in progress	204,965	119,796	(278,662)	(129)	45,970
Total nondepreciable capital assets	269,730	124,728	(278,662)	(248)	115,548
Accumulated depreciation					
Buildings and improvements	824,987	61,322		(17,167)	869,142
Leasehold improvements	119	72			191
Equipment					
Technology	133,674	24,168		(30,860)	126,982
Other equipment	229,543	24,927		(23,274)	231,196
Infrastructure	106,784	8,914		(9)	115,689
Library and reference books	45,743	9,789		(8,591)	46,941
Total accumulated depreciation	1,340,850	129,192		(79,901)	1,390,141
Net capital assets	$1,789,695	$ 51,692	$ –	$ (3,698)	$1,837,689
Summary					
Depreciable capital assets	$2,860,815	$ 56,156	$278,662	$(83,351)	$3,112,282
Nondepreciable capital assets	269,730	124,728	(278,662)	(248)	115,548
Total capital assets	3,130,545	180,884		(83,599)	3,227,830
Less accumulated depreciation	1,340,850	129,192		(79,901)	1,390,141
Capital assets, net	$1,789,695	$ 51,692	$ –	$ (3,698)	$1,837,689

Years ended June 30, 2004 and 2003 (amounts in thousands)

5. LONG-TERM DEBT

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% to 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	4.00% to 6.90%	2022	64,281	$2,422	4,779	61,924	4,915
Auxiliary revenue bonds	3.00%	2013	10,066		806	9,260	855
Capital leases and other	1.29% to 8.00%	2011	6,578	880	2,232	5,226	1,451
Total			$775,598	$3,302	$113,946	$664,954	$251,615

Long-term debt at June 30, 2003, 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	
Series 2001C	4.40%	2004	$159,950			159,950	$159,950
Series 2001B	4.33%	2004	3,500		$ 250	3,250	3,250
Series 2001A	3.08%	2004	16,500		1,935	14,565	14,565
Series 1999A	4.16%	2004	192,600		8,400	184,200	184,200
Series 1996A	4.50% to 5.75%	2021	184,748		7,040	177,708	6,039
Series 1993A	4.80%	2003	84,000			84,000	84,000
Obligations to the state of Minnesota pursuant to Infrastructure Development Bonds	4.00% to 6.90%	2022	60,003	9,033	4,755	64,281	4,761
Auxiliary revenue bonds	3.00%	2013	10,816		750	10,066	805
Capital leases and other	1.56% to 8.00%	2011	7,156	1,663	2,241	6,578	1,586
Total			$719,273	$81,696	$ 25,371	$775,598	$459,156

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. Subsequent to year-end, on July 13, 2004, an additional, $20,720 was issued for the 2004A bonds, with $28,680 remaining unissued.

On May 20, 2003, the University issued $71,000 General Obligation Refunding Bonds, Series 2003A. The bond proceeds were applied, along with certain additional funds provided by the University, to the refunding on August 15, 2003, of the University's $84,000 General Obligation Bonds, Series 1993A.

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 have 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. The agreement, expiring on December 16, 2008, provides for ten equal semi-annual 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, 2004.

In June 2004, the University entered into a standby bond purchase agreement to provide liquidity support for the Series 1999A bonds. The agreement provides for four equal semi-annual installment payments on June 1 and December 1. No amounts have been drawn under this agreement through June 30, 2004. Since the agreement expires on June 13, 2005, 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 $171,669 at June 30, 2004, and $177,708 at June 30, 2003, of Series 1996A University bonds or eligible AAA-rated governmental or municipal securities to the University. This option may be exercised at any time. At the date of this report, the counterparty has not exercised the put option.

Subsequent to year-end, on July 13, 2004, the University issued $20,720 General Obligation Intermediate Term Financing Program Bonds, Series 2004A. The bond proceeds are to be applied for certain capital projects of the University to include 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 to be 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.

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 $1,217 at June 30, 2004, and $1,301 at June 30, 2003, for future debt service. An additional $9,979 and $11,481 was set aside for building replacement reserves for June 30, 2004 and 2003, respectively. These mandatory reserves are included in restricted expendable net assets in the financial statements.

Years ended June 30, 2004 and 2003 (amounts in thousands)

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 $185,771 as of June 30, 2004, and $192,845 as of June 30, 2003.

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 1.29 percent and 1.63 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, 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, and the University's swap agreements contain scheduled reductions to outstanding notional amounts, which match scheduled reductions in the associated bond issuance, except for the non-integrated swaps associated with the 1996A bond issue. The terms, fair values, and credit rating of the outstanding swaps as of June 30, 2004 are as follows.

Associated bond issue	Nature of association	Notional amounts	Effective date	Fixed rate	Variable rate	Swap type	Fair value	Swap termination date
2003A	Integrated	$ 71,000	12/04/02	4.39%	WAR*	Pay fixed and receive variable	$ (5,675)	08/15/31
2001C	Integrated	155,100	01/09/02	4.40%	WAR*	Pay fixed and receive variable	(12,816)	12/01/36
2001B	Non-integrated	2,955	11/13/01	4.33%	WAR*	Pay fixed and receive variable	(22)	07/01/11
2001A	Integrated	12,370	11/13/01	3.08%	WAR*	Pay fixed and receive variable	(149)	07/01/08
1999A	Non-integrated	175,450	02/17/99	4.16%	WAR*	Pay fixed and receive variable	(10,625)	01/01/34
1996A	Integrated	171,000	01/08/97	4.45% to 5.43%	BMA Index **	Pay variable and receive fixed	21,895	07/01/21
1996A	Non-integrated	70,000	08/27/97	4.98%	BMA Index **	Pay fixed and receive variable	(8,498)	08/27/17
1996A	Non-integrated	37,500	08/28/97	4.88%	BMA Index **	Pay fixed and receive variable	(4,267)	08/28/12
1996A	Non-integrated	37,500	09/01/97	4.90%	BMA Index **	Pay fixed and receive variable	(4,519)	07/01/12
		$732,875					$(24,676)	

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

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

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, 2004.

The University has swap transactions with three separate counterparties. The percentage of the notional amount of swaps outstanding at June 30, 2004 for each counterparty is 57, 28, and 15 percent, respectively, 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 $21,895 at June 30, 2004 represents the University's credit risk exposure to the counterparty as of June 30, 2004. Should the counterparty to this transaction fail to perform according to the terms of the swap contract, the University faces a maximum possible loss equivalent of $21,895. As of June 30, 2004, the counterparty was rated Aa3 by Moody's Investors Service. In addition, this swap increases the University's exposure to variable interest rates. As the BMA Index increases, the University's net payment on the swap increases.

The other swap contracts are not exposed to credit risk because these swaps have negative fair values. However, should interest rates change and the fair values of the swaps become positive, the University would be exposed to credit risk in the amount of the derivative's fair value.

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 two of the swaps associated with the 1996A bond issue. The integrated swap provides either party with the option to terminate the swap agreement each January 1 and July 1, commencing January 1, 2007. The non-integrated 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 non-integrated 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 non-integrated swaps that terminate on August 27, 2017; August 28, 2012; and July 1, 2012; respectively.

Using rates as of June 30, 2004, 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.

Years ended June 30, 2004 and 2003 (amounts in thousands)

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

	Bonds and obligations	Capital lease and other	Total principal	Interest	Net interest rate swaps	Total obligations
Fiscal year ending June 30						
2005	$250,164	$1,451	$251,615	$ 23,307	$10,637	$285,559
2006	44,413	1,325	45,738	20,594	9,232	75,564
2007	44,354	1,086	45,440	17,636	8,030	71,106
2008	44,164	719	44,883	14,693	6,824	66,400
2009	28,118	428	28,546	11,803	5,855	46,204
2010-2014	66,853	217	67,070	46,094	20,892	134,056
2015-2019	79,560		79,560	27,616	6,231	113,407
2020-2024	71,552		71,552	8,660	4,897	85,109
2025-2029	17,700		17,700	1,346	4,345	23,391
2030-2034	12,850		12,850	193	875	13,918
	$659,728	$5,226	$664,954	$171,942	$77,818	$914,714

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, 2004
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 that plan. Those reports may be obtained by writing or calling the plan, as follows:

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

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

Years ended June 30, 2004 and 2003 (amounts in thousands)

FUNDING POLICY AND ANNUAL PENSION COST

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

	FRP	SERF	PEPFF	SBP
University contributions—fiscal year ended June 30				
2004	$56,713	$13,661	$310	$425
2003	57,575	14,151	272	416
2002	53,331	13,672	257	528
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	$14,151	$272	$541
2003	N/A	13,672	257	315
2002	N/A	12,773	232	878
Actuarial valuation date	N/A	6/30/03	6/30/03	7/01/03
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% to 6.75%	5.25% to 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 statute. The University makes all contributions to the SBP using a variable rate.

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

	2003	2002	2001
Pension benefit obligation	$11,741	$12,980	$14,133
Net assets available for benefits	7,047	7,842	8,695
Unfunded accrued liability	$ 4,694	$ 5,138	$ 5,438
Funded ratio (net assets as a percentage of the pension benefit obligation)	60.02%	60.42%	61.52%

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

Years ended June 30, 2004 and 2003 (amounts 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 fifteen-member Board of Directors of UCare Minnesota, a licensed nonprofit HMO that provides medical services for its members, however, the University's accountability for this organization 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 2004, UCare Minnesota contributed $500 to the University.

8. Commitments and Contingencies

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

The University also provides certain services to Fairview, and Fairview provides certain services to the University, to be reimbursed at negotiated rates. These services include items such as utilities, mailing and addressing services, police protection, printing services, miscellaneous services related to telecommunications, and such other items as are necessary to support the relationship, for which $7,745 and $7,577 was billed to Fairview in fiscal years 2004 and 2003, respectively. Fairview billed the University $724 and $396 in fiscal years 2004 and 2003, respectively, for pharmaceuticals, medical professionals, and transcription services.

Construction projects in progress, principally buildings, approximate $107,169 at June 30, 2004. The estimated cost to complete these facilities is $228,832, which is to be funded from plant fund assets and $106,194 in appropriations available from the state of Minnesota at June 30, 2004.

The University owns certain 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 the agreement, the University must make minimum fixed payments for certain operating and maintenance costs, as well as contingent payments based on monthly usage.

The University is obligated under various operating leases for the use of real property and equipment. Total operating lease expenditures for the years ended June 30, 2004 and 2003 were $15,009 and $13,448, respectively, of which $11,807 and $10,347 was for real property and $3,202 and $3,101 was for equipment, respectively.

The future commitments at June 30, 2004, are as follows:

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

	Steam plant	Operating leases	Total
Fiscal year ending June 30			
2005	$ 879	$ 7,952	$ 8,831
2006	879	7,858	8,737
2007	867	5,761	6,628
2008	779	4,790	5,569
2009	683	4,657	5,340
2010–2014		18,112	18,112
Total commitments	4,087	49,130	53,217
Less current portion	(879)	(7,952)	(8,831)
Long-term commitments	$3,208	$41,178	$44,386

Years ended June 30, 2004 and 2003 (amounts in thousands)

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

9. SELF-INSURANCE PROGRAMS

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

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

Effective December 31, 2001, the University changed its medical (health) coverage for faculty and staff from the State of Minnesota's State Employees Group Insurance Program (SEGIP) to a self-insured program (UPlan). Under the 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 continuation (COBRA) rights expire. The University also carries stop-loss coverage, which protects the University against the risk that an individual participant will incur medical expenses greater than $500,000 in a single year. An annual actuarial estimate of the University's liability for medical claims, including IBNR, is recorded.

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.

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

Years ended June 30, 2004 and 2003 (amounts in thousands)

Changes in reported liabilities since June 30, 2002, are shown below:

	Liability, beginning of year	New claims	Claim payments	Other adjustments	Liability, end of year
RUMINCO, Ltd.	$6,492	$ 2,057	$ (1,032)	$ 140	$ 7,657
Workers' compensation	9,000	3,148	(3,489)	3,341	12,000
UPlan medical	13,497	111,943	(108,864)	891	17,467

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

10. OPERATING EXPENSES BY NATURAL CLASSIFICATION

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

Operating expenses by natural classification for June 30, 2003, are summarized as follows:

Function	Compensation and benefits	Supplies and services	Scholarships and fellowships	Depreciation	Total
Instruction	$ 490,983	$ 78,392			$ 569,375
Research	292,360	119,208			411,568
Public service	111,532	47,381			158,913
Academic support	191,724	80,266			271,990
Student services	55,573	12,567			68,140
Institutional support	105,235	13,105			118,340
Operation and maintenance of plant	82,715	77,525			160,240
Scholarships and fellowships	3,883	291	$63,287		67,461
Depreciation				$129,191	129,191
Auxiliary enterprises	66,018	95,607			161,625
Other operating expense		896			896
	$1,400,023	$525,238	$63,287	$129,191	$2,117,739

11. 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 and the Minnesota Medical Foundation; as well as disclosures for guarantee agreements and financing agreements for the University Gateway Corporation, 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 of 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 $786 of indirect support received by the Foundation.

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. The Foundation 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 the Foundation in accordance with the donor's trust agreement.

Gift Annuity Agreements

UMF has entered into gift annuity agreements that provide that the Foundation 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. The Foundation 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.

Years ended June 30, 2004 and 2003 (amounts in thousands)

INVESTMENTS

University of Minnesota Foundation

Marketable securities, mutual funds, and derivative instruments are recorded at fair value using public market quotations. Limited partnerships are recorded at the fair value determined by the partnership. Contract for deed is recorded at the remaining outstanding principal balance. Land is recorded at the fair market value at the date of the donation.

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, 2004 are summarized as follows:

Marketable securities	
Cash and cash equivalents	$ 74,944
Corporate stocks and bonds	211,275
U.S. government obligations	107,976
Equity mutual funds and other investments	170,496
Total marketable securities	564,691
Limited partnerships	427,308
Contract for deed	33
Land	1,488
Total investments	993,520
Less investments loaned to broker	95,302
Less charitable gift annuities reported separately	22,004
Total	$876,214

The Foundation's investment in limited partnerships includes approximately $1,437 invested in a limited partnership with an objective to earn a total rate of return in excess of the *Standard and Poor's 500 Index*. The investment approach of the partnership is to trade directly and indirectly in common stock, derivative stock index instruments, other stock derivatives, debt securities, and other fixed income securities.

Minnesota Medical Foundation

Investments are reported at fair value based on quoted market prices. Investments as of June 30, 2004 consist of the following:

	Cost	Fair value
Cash and cash equivalents	$ 40,464	$ 40,464
U.S. Treasury and government securities	30,674	30,320
Fixed-income corporate bonds	13,974	13,723
Equity securities	124,352	137,143
Total investments	$209,464	221,650
Less investments loaned to broker		40,136
Total		$181,514

SECURITIES LENDING

University of Minnesota Foundation

UMF participates in securities lending transactions. Under terms of its securities lending agreement, the Foundation 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 the Foundation 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, 2004, are summarized as follows:

Investments loaned to broker	$95,302
Investments collateral	97,437
Income from securities lending	181

Minnesota Medical Foundation

MMF participates in securities lending transactions. Under terms of its securities lending agreement, the Foundation 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 the Foundation of securities lending are that the borrower may not provide additional collateral when required or return the securities when due.

Years ended June 30, 2004 and 2003 (amounts in thousands)

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, 2004, are summarized as follows:

Investments loaned to broker	$40,136
Investments collateral	41,100
Income from securities lending	22

NET ASSETS

University of Minnesota Foundation

Net assets of UMF are classified into three categories. Unrestricted net assets represent the portion of expendable funds that are available for support of the operations of the Foundation. Temporarily restricted net assets and permanently restricted net assets are discussed below.

Temporarily Restricted Net Assets
Temporarily restricted net assets consist of contributions that have been restricted by the donor for specific purposes or are time-restricted. Temporarily restricted net assets are available as of June 30, 2004, for the following purposes:

Capital improvement/facilities	$ 55,825
Faculty support	12,304
Scholarships and fellowships	141,539
Leaderships, professorships, and chairs	155,780
College program support	196,670
Research	25,763
Trusts	19,454
Other	4,133
	$611,468

Permanently Restricted Net Assets
Permanently restricted net assets consist of contributions that have been restricted by the donor that stipulate the resources be maintained permanently, but permit the Foundation to use or expend part or all of the income derived from the donated assets for either specified or unspecified purposes. The permanently restricted net asset balances and purposes the income is expendable to support, as of June 30, 2004, are as follows:

Capital improvement/facilities	$ 3,493
Faculty support	9,420
Scholarships and fellowships	140,435
Leaderships, professorships, and chairs	145,108
College program support	37,104
Research	7,784
Trusts	32,503
Other	1,649
	$377,496

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 5.5 percent payout of the average endowment balance over twelve trailing quarters. Such net assets are retained until expended as provided by the donor. Temporarily restricted net assets are available as of June 30, 2004, for the following purposes:

Medical School—Twin Cities	$ 62,039
Medical School program/student support	23,341
Academic Health Center	30,799
Biomedical Library	712
School of Public Health	2,526
Medical School—Duluth	1,756
Trusts, annuities, and other miscellaneous	3,706
	$124,879

Permanently Restricted Net Assets
This classification includes net assets that have been restricted by donors that stipulate the resources be maintained permanently by the Foundation. Earnings and growth in excess of the 5.5 percent payout, for donor-designated endowments, are reinvested to hedge against inflation and are maintained permanently by the Foundation. Permanently restricted net assets are

Years ended June 30, 2004 and 2003 (amounts in thousands)

restricted to investments in perpetuity. The permanently restricted net asset balances and purposes the income is expendable to support, as of June 30, 2004, are as follows:

Medical School—Twin Cities	$ 67,454
Medical School program/student support	27,324
Academic Health Center	15,094
Biomedical Library	1,803
School of Public Health	5,226
Medical School—Duluth	431
Trusts, annuities, and other miscellaneous	2,789
	$120,121

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 and $218, respectively, of bond guarantee fee expense paid to the University of Minnesota Foundation for each of the years ended June 30, 2004 and 2003.

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 at left). 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 2004. Advances on the line of credit bear interest at the bank's reference rate, less 1 percent (reference rate at June 30, 2004, was 4.00 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, 2004 and 2003.

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, 2004 and 2003, consisted of the following:

	2004	2003
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	$23,380	$23,950
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
	45,730	46,300
Less current portion	613	583
	$45,117	$45,717

University of Minnesota

Independent Auditors' Report on Supplemental Schedules

To the Board of Regents
University of Minnesota

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The combining schedules on pages 63-68 are presented for the purpose of additional analysis of the basic consolidated financial statements rather than to present the financial position, results of operations, and changes in net assets of the individual campuses and are not a required part of the basic consolidated financial statements. These schedules are the responsibility of the University's management. Such schedules have been subjected to the auditing procedures applied in our audit of the basic consolidated financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic consolidated financial statements taken as a whole.

Deloitte + Touche LLP

Deloitte and Touche, LLP
October 15, 2004

Statement of Net Assets by Campus

June 30, 2004 (amounts in thousands)

		Crookston	Duluth	Morris	Twin Cities	Total
Assets						
Current assets	Cash and cash equivalents	$ 5,219	$ 26,630	$ 3,352	$ 89,329	$ 124,530
	Securities lending collateral	478	5,915	277	69,026	75,696
	Short-term investments	35	220	95	4,131	4,481
	Receivables, net	1,713	9,956	2,805	278,575	293,049
	Inventories	63	1,247	364	17,294	18,968
	Current portion of student loan receivables, net	163	2,227	347	10,769	13,506
	Current portion of prepaid expenses and deferred charges		107		17,894	18,001
	Other assets				200	200
	Total current assets	7,671	46,302	7,240	487,218	548,431
Noncurrent assets	Restricted cash and cash equivalents				356	356
	Investments	3,182	47,496	4,060	1,057,504	1,112,242
	Receivables, net				1,451	1,451
	Student loan receivables, net	694	9,338	1,453	45,172	56,657
	Prepaid expenses and deferred charges				7,448	7,448
	Other assets				104	104
	Capital assets, net	21,230	159,339	45,511	1,636,666	1,862,746
	Total noncurrent assets	25,106	216,173	51,024	2,748,701	3,041,004
Total assets		32,777	262,475	58,264	3,235,919	3,589,435
Liabilities						
Current liabilities	Accounts payable	832	3,593	1,358	61,011	66,794
	Accrued liabilities and other	943	7,413	1,467	175,482	185,305
	Securities lending collateral	478	5,915	277	69,026	75,696
	Unearned income	29	5,366	370	80,465	86,230
	Long-term debt—current portion	35	220	95	251,265	251,615
	Total current liabilities	2,317	22,507	3,567	637,249	665,640
Noncurrent liabilities	Accrued liabilities and other	771	11,572	1,616	88,488	102,447
	Unearned income				5,300	5,300
	Long-term debt	260	1,600	650	410,829	413,339
	Total noncurrent liabilities	1,031	13,172	2,266	504,617	521,086
Total liabilities		3,348	35,679	5,833	1,141,866	1,186,726
Net Assets						
Unrestricted		(809)	12,800	(6,154)	309,540	315,377
Restricted	Expendable	8,351	46,904	12,417	619,789	687,461
	Nonexpendable	1,131	26,088	1,227	170,923	199,369
Invested in capital assets, net of related debt		20,756	141,004	44,941	993,801	1,200,502
Total net assets		$29,429	$226,796	$52,431	$2,094,053	$2,402,709

Statement of Net Assets by Campus

June 30, 2003 (amounts in thousands)

		Crookston	Duluth	Morris	Twin Cities	Total
Assets						
Current assets	Cash and cash equivalents	$4,173	$33,738	$3,024	$221,683	$262,618
	Securities lending collateral	322	3,937	164	47,319	51,742
	Short-term investments	35	200	90	480	805
	Receivables, net	964	11,032	2,309	257,760	272,065
	Inventories	65	1,076	241	16,211	17,593
	Current portion of student loan receivables, net	161	2,135	318	10,265	12,879
	Current portion of prepaid expenses and deferred charges		564		8,244	8,808
	Other assets				200	200
	Total current assets	5,720	52,682	6,146	562,162	626,710
Noncurrent assets	Restricted cash and cash equivalents				78,102	78,102
	Investments	3,324	40,155	3,430	797,871	844,780
	Receivables, net				1,706	1,706
	Student loan receivables, net	691	8,969	1,361	43,900	54,921
	Prepaid expenses and deferred charges				2,355	2,355
	Other assets				100	100
	Capital assets, net	20,792	130,554	45,801	1,640,542	1,837,689
	Total noncurrent assets	24,807	179,678	50,592	2,564,576	2,819,653
Total assets		30,527	232,360	56,738	3,126,738	3,446,363
Liabilities						
Current liabilities	Accounts payable	520	4,580	738	57,981	63,819
	Accrued liabilities and other	1,269	6,812	1,596	158,392	168,069
	Securities lending collateral	322	3,937	164	47,319	51,742
	Unearned income	380	6,214	286	96,769	103,649
	Long-term debt—current portion	35	200	90	458,831	459,156
	Total current liabilities	2,526	21,743	2,874	819,292	846,435
Noncurrent liabilities	Accrued liabilities and other	784	11,305	1,601	105,701	119,391
	Unearned income				700	700
	Long-term debt	295	1,820	745	313,582	316,442
	Total noncurrent liabilities	1,079	13,125	2,346	419,983	436,533
Total liabilities		3,605	34,868	5,220	1,239,275	1,282,968
Net Assets						
Unrestricted		(626)	19,687	(4,061)	298,401	313,401
Restricted	Expendable	6,559	34,169	9,048	465,303	515,079
	Nonexpendable	1,133	23,220	1,213	167,038	192,604
Invested in capital assets, net of related debt		19,856	120,416	45,318	956,721	1,142,311
Total net assets		$26,922	$197,492	$51,518	$1,887,463	$2,163,395

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

Year ended June 30, 2004 (amounts in thousands)

			Crookston	Duluth	Morris	Twin Cities	Total
Revenues							
Operating revenues	Student tuition and fees, net of scholarship allowances of $88,926		$ 4,145	$ 54,241	$ 8,782	$ 340,463	$ 407,631
	Federal appropriations					16,657	16,657
	Federal grants and contracts		898	8,550	375	349,017	358,840
	State and other government grants		60	1,460	101	44,768	46,389
	Nongovernmental grants and contracts		502	2,783	160	180,320	183,765
	Student loan interest income		14	188	36	1,246	1,484
	Sales and services of educational activities		724	2,378	239	123,808	127,149
	Auxiliary enterprises, net of scholarship allowances of $9,660. Revenues of $2,865 were pledged as security for various auxiliary revenue bonds		3,668	27,375	5,209	202,023	238,275
	Other operating revenues		120	66	38	361	585
Total operating revenues			10,131	97,041	14,940	1,258,663	1,380,775
Expenses							
Operating expenses	Education and general	Instruction	5,724	47,839	10,777	496,566	560,906
		Research	538	11,531	106	410,115	422,290
		Public service	668	3,500	893	160,139	165,200
		Academic support	1,765	10,924	3,880	235,033	251,602
		Student services	1,576	6,679	2,849	59,978	71,082
		Institutional support	1,835	7,812	1,811	105,023	116,481
		Operation and maintenance of plant	2,327	12,637	4,098	133,310	152,372
		Scholarships and fellowships	939	5,935	1,640	58,091	66,605
		Depreciation	1,462	8,482	2,095	114,891	126,930
	Auxiliary enterprises		4,278	26,537	5,587	127,816	164,218
	Other operating expenses (income), net		(26)	(76)	(32)	478	344
Total operating expenses			21,086	141,800	33,704	1,901,440	2,098,030
Operating loss			(10,955)	(44,759)	(18,764)	(642,777)	(717,255)
Nonoperating Revenues (Expenses)							
	State appropriations		8,542	38,727	13,768	516,611	577,648
	Grants		2,056	11,057	4,041	83,102	100,256
	Gifts		552	2,692	406	93,679	97,329
	Investment income		70	930	94	28,311	29,405
	Net increase in fair value of investments		361	6,319	419	78,768	85,867
	Interest on capital asset-related debt		(3)	(14)	(3)	(28,004)	(28,024)
	Other nonoperating revenues (expenses), net		(2)	266	14	3,855	4,133
Net nonoperating revenues			11,576	59,977	18,739	776,322	866,614
Income (Loss) before Other Revenues			621	15,218	(25)	133,545	149,359

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

Year ended June 30, 2004 (amounts in thousands) (concluded)

	Crookston	Duluth	Morris	Twin Cities	Total
Capital appropriations	$ 2,687	$ 18,337	$ 1,364	$ 36,504	$ 58,892
Capital grants and gifts		135		25,305	25,440
Additions to permanent endowments		2	5	5,616	5,623
Indirect cost recovery	(6)	(47)	(4)	57	–
University assessment	(1,214)	(8,517)	(1,778)	11,509	–
Net mandatory transfers in (out)	(12)	(20)	46	(14)	–
Net nonmandatory transfers in (out)	431	4,196	1,305	(5,932)	–
Total other revenues	1,886	14,086	938	73,045	89,955
Increase in Net Assets	2,507	29,304	913	206,590	239,314
Net assets at beginning of year	26,922	197,492	51,518	1,887,463	2,163,395
Net assets at end of year	$29,429	$226,796	$52,431	$2,094,053	$2,402,709

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

Year ended June 30, 2003 (amounts in thousands)

			Crookston	Duluth	Morris	Twin Cities	Total
Revenues							
Operating revenues	Student tuition and fees, net of scholarship allowances of $81,379		$ 2,971	$ 45,140	$ 7,498	$ 293,066	$ 348,675
	Federal appropriations					15,562	15,562
	Federal grants and contracts		820	7,061	347	315,239	323,467
	State and other government grants		104	3,000	20	35,244	38,368
	Nongovernmental grants and contracts		843	1,604	162	161,854	164,463
	Student loan interest income		20	234	46	1,419	1,719
	Sales and services of educational activities		236	2,491	210	110,809	113,746
	Auxiliary enterprises, net of scholarship allowances of $8,628. Revenues of $2,893 were pledged as security for various auxiliary revenue bonds		3,625	25,661	5,083	194,998	229,367
	Other operating revenues		10	117		1,864	1,991
Total operating revenues			8,629	85,308	13,366	1,130,055	1,237,358
Expenses							
Operating expenses	Education and general	Instruction	5,594	45,610	11,549	506,622	569,375
		Research	531	12,135	65	398,837	411,568
		Public service	779	3,111	729	154,294	158,913
		Academic support	2,146	12,150	3,860	253,834	271,990
		Student services	1,550	6,034	3,151	57,405	68,140
		Institutional support	1,773	8,257	1,796	106,514	118,340
		Operation and maintenance of plant	2,143	13,179	4,354	140,564	160,240
		Scholarships and fellowships	945	6,180	1,561	58,775	67,461
		Depreciation	1,505	9,085	2,161	116,440	129,191
	Auxiliary enterprises		4,888	26,336	6,447	123,954	161,625
	Other operating expenses (income), net		(4)	116	(55)	839	896
Total operating expenses			21,850	142,193	35,618	1,918,078	2,117,739
Operating loss			(13,221)	(56,885)	(22,252)	(788,023)	(880,381)
Nonoperating Revenues (Expenses)							
	State appropriations		9,218	49,665	15,081	559,783	633,747
	Grants		2,201	11,424	4,103	102,396	120,124
	Gifts		714	2,559	358	90,380	94,011
	Investment income		80	703	91	23,598	24,472
	Net decrease in fair value of investments		(53)	(747)	(59)	(5,890)	(6,749)
	Interest on capital asset-related debt		(7)	(27)	(9)	(29,377)	(29,420)
	Other nonoperating revenues (expenses), net		94	160	55	(1,331)	(1,022)
Net nonoperating revenues			12,247	63,737	19,620	739,559	835,163
Income (Loss) before Other Revenues			(974)	6,852	(2,632)	(48,464)	(45,218)

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

Year ended June 30, 2003 (amounts in thousands) (concluded)

	Crookston	Duluth	Morris	Twin Cities	Total
Capital appropriations	$ 2,829	$ 4,165	$ 907	$ (2,399)	$ 5,502
Capital grants and gifts		105	437	29,327	29,869
Additions to permanent endowments		1	4	1,934	1,939
Indirect cost recovery	(2)	3	(4)	3	–
University assessment	(1,056)	(8,149)	(1,822)	11,027	–
Net mandatory transfers in (out)	(15)	(66)	(76)	157	–
Net nonmandatory transfers in (out)	814	5,564	1,651	(8,029)	–
Total other revenues	2,570	1,623	1,097	32,020	37,310
Increase (Decrease) in Net Assets	1,596	8,475	(1,535)	(16,444)	(7,908)
Net assets at beginning of year	25,326	189,017	53,053	1,903,907	2,171,303
Net assets at end of year	$26,922	$197,492	$51,518	$1,887,463	$2,163,395

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

Photo of Robert Yahnke by Scott Cohen.

Design by Lisa Haines at juju.

Printing by Printing Services, University of Minnesota.

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