

**UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM**

Annual Financial Report

June 30, 2011

(With Independent Auditors' Report Thereon)

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UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Annual Financial Report

June 30, 2011

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From the Vice President/Chief Financial Officer, Comptroller

UNIVERSITY OF ILLINOIS
Urbana-Champaign • Chicago • Springfield

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

December 16, 2011

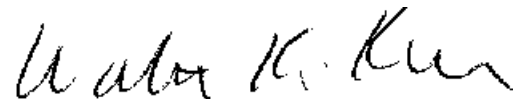
Holders of University of Illinois
Auxiliary Facilities System Revenue Bonds
and The Board of Trustees of the University of Illinois:

I am pleased to transmit the Annual Financial Report of the University of Illinois Auxiliary Facilities System for the fiscal year ended June 30, 2011. This report supplements the financial statements of the University of Illinois presented in the Annual Financial Report.

The 2011 financial statements and accompanying notes appearing on pages 4 through 22 have been audited by KPMG LLP, Independent Certified Public Accountants, as special assistants to the Auditor General of the State of Illinois, whose report on the financial statements appears on pages 2 and 3.

KPMG LLP will also prepare a report for the year ended June 30, 2011, containing special data requested by the Auditor General and another report covering their audit of the compliance of the University with applicable state and federal laws and regulations for the year ended June 30, 2011. These reports, which include some data related to the Auxiliary Facilities System, are not contained herein and are primarily for the use of the Auditor General and state and federal agencies.

Very truly yours,



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



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

Independent Auditors' Report

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

As Special Assistant Auditors for the Auditor General, we have audited the accompanying balance sheet of the University of Illinois Auxiliary Facilities System (System), a segment of the University of Illinois, as of June 30, 2011, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on the financial statements based on our audit. The 2010 comparative information has been derived from the System's 2010 financial statements, and in our report dated December 20, 2010, we expressed an unqualified opinion on those financial statements.

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

As discussed in note 1 to the financial statements, the financial statements of the System are intended to present the financial position, the changes in its financial position, and cash flows of only that portion of the business-type activities of the University of Illinois that are attributable to the transactions of the System relating to complying with the requirements of the indentures for the System's Revenue Bonds. The financial statements do not purport to, and do not, present fairly the financial position of the University of Illinois as of June 30, 2011 or the changes in its financial position or its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Illinois Auxiliary Facilities System as of June 30, 2011, and the changes in its financial position and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.



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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2011 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

Chicago, Illinois
December 16, 2011

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Balance Sheet

June 30, 2011

(with comparative totals for June 30, 2010)

Assets	2011	2010
Current assets:		
Claim on cash and on pooled investments	\$ 105,368,564	104,888,862
Cash and cash equivalents	24,928,655	5,223,601
Cash and cash equivalents, restricted	1,156,526	24,581,240
Investments, restricted	34,151,411	3,002,689
Accrued investment income	407,602	232,065
Accounts receivable, net of allowance for uncollectible of \$3,023,267 in 2011	7,687,386	7,962,468
Inventories	9,314,373	10,790,881
Prepaid expenses and deferred charges	628,524	808,289
Total current assets	<u>183,643,041</u>	<u>157,490,095</u>
Noncurrent assets:		
Investments, restricted	28,615,256	14,364,266
Capital assets:		
Land	19,238,069	19,238,069
Buildings, net of accumulated depreciation	870,233,285	888,067,909
Improvements, net of accumulated depreciation	21,442,755	19,658,310
Equipment, net of accumulated depreciation	4,713,417	5,425,692
Construction in progress	32,264,209	13,631,653
Subtotal for capital assets	<u>947,891,735</u>	<u>946,021,633</u>
Prepaid expenses and deferred charges	6,029,627	5,527,724
Total noncurrent assets	<u>982,536,618</u>	<u>965,913,623</u>
Total assets	<u>\$ 1,166,179,659</u>	<u>1,123,403,718</u>
Liabilities		
Current liabilities:		
Accounts payable	\$ 15,875,577	18,345,130
Accrued liabilities	3,582,773	3,714,420
Accrued compensated absences	662,396	602,244
Accrued interest	10,275,100	9,762,568
Deferred revenue	6,870,123	6,812,154
Notes payable to the University	1,980,084	3,431,500
Bonds and leaseholds payable	32,106,979	50,481,627
Total current liabilities	<u>71,353,032</u>	<u>93,149,643</u>
Noncurrent liabilities:		
Accrued compensated absences	5,253,732	5,874,508
Notes payable to the University	7,331,553	11,765,704
Bonds and leaseholds payable	945,650,813	889,705,045
Total noncurrent liabilities	<u>958,236,098</u>	<u>907,345,257</u>
Total liabilities	<u>1,029,589,130</u>	<u>1,000,494,900</u>
Net Assets		
Invested in capital assets, net of related debt	4,263,689	9,907,091
Restricted:		
Expendable for debt service	20,449,785	19,646,684
Unrestricted	111,877,055	93,355,043
Total net assets	<u>136,590,529</u>	<u>122,908,818</u>
Total liabilities and net assets	<u>\$ 1,166,179,659</u>	<u>1,123,403,718</u>

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Statement of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2011

(with comparative totals for year ended June 30, 2010)

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Room and board, net of waivers of \$859,865 in 2011	\$ 125,497,448	121,897,163
Merchandise and food sales	31,823,331	31,850,997
Student service fees	89,015,513	88,193,121
Public events and recreation fees	7,814,351	8,256,358
Parking income	22,360,696	22,352,952
Rental and lease income	21,327,286	20,515,928
Vending income	1,342,045	1,342,674
Other operating revenue	11,993,993	11,880,089
	<u>311,174,663</u>	<u>306,289,282</u>
Operating expenses:		
Salaries and wages	82,032,536	82,470,032
Merchandise and food for resale	30,829,423	31,508,083
Repair and maintenance	3,331,307	3,521,268
Professional and other contractual services	37,935,429	33,430,926
Utilities	28,584,476	26,355,186
Supplies	10,503,425	12,496,674
Noncapitalized equipment and equipment rentals	1,884,290	1,788,554
Administrative services	14,747,704	14,377,333
Other operating expense	9,425,646	10,502,254
Depreciation	29,860,796	28,673,198
On behalf payments for fringe benefits	28,331,030	26,900,395
	<u>277,466,062</u>	<u>272,023,903</u>
Operating income	<u>33,708,601</u>	<u>34,265,379</u>
Nonoperating revenues (expenses):		
On behalf payments for fringe benefits	28,331,030	26,900,395
Investment income (net of related expenses)	2,425,812	3,507,810
Interest on capital asset-related debt	(49,672,498)	(46,277,554)
Amortization of issuance costs	(299,557)	(275,283)
Loss on disposal of capital assets	(630,786)	(164,055)
Other nonoperating expenses, net	(180,891)	(204,886)
	<u>(20,026,890)</u>	<u>(16,513,573)</u>
Net nonoperating expenses	<u>(20,026,890)</u>	<u>(16,513,573)</u>
Increase in net assets	13,681,711	17,751,806
Net assets, beginning of year	<u>122,908,818</u>	<u>105,157,012</u>
Net assets, end of year	<u>\$ 136,590,529</u>	<u>122,908,818</u>

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2011

(with comparative totals for year ended June 30, 2010)

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Room and board	\$ 125,727,488	121,927,267
Merchandise and food sales	31,853,862	31,839,458
Student service fees	89,083,932	88,150,734
Public events and recreation fees	7,820,200	8,252,098
Parking income	22,328,878	22,354,027
Rental and lease income	21,347,185	20,508,792
Vending income	1,343,444	1,342,301
Other sources	12,002,725	11,877,184
Payments to employees and benefits	(82,724,807)	(81,906,567)
Payments to suppliers	<u>(136,916,763)</u>	<u>(132,883,124)</u>
Net cash provided by operating activities	<u>91,866,144</u>	<u>91,462,170</u>
Cash flows from noncapital financing activities:		
Other disbursements	<u>(202,363)</u>	<u>(271,831)</u>
Net cash used in noncapital financing activities	<u>(202,363)</u>	<u>(271,831)</u>
Cash flows from capital and related financing activities:		
Proceeds from issuance of bonds	59,333,965	
Purchase of capital assets	(32,107,979)	(38,748,163)
Principal paid on bonds and capital leases	(30,992,332)	(30,552,277)
Repayment of notes payable to the University	(5,881,605)	(5,012,301)
Interest paid on bonds and notes payable	(41,515,076)	(40,838,899)
Payments of bond issuance costs	<u>(591,276)</u>	
Net cash used in capital and related financing activities	<u>(51,754,303)</u>	<u>(115,151,640)</u>
Cash flows from investing activities:		
Interest on investments	4,088,204	3,613,607
Proceeds from sales and maturities of investments	62,274,577	21,416,248
Purchase of investments	<u>(109,512,217)</u>	<u>(14,914,309)</u>
Net cash (used in) provided by investing activities	<u>(43,149,436)</u>	<u>10,115,546</u>
Net decrease in cash and cash equivalents	(3,239,958)	(13,845,755)
Cash and cash equivalents, beginning of year	<u>134,693,703</u>	<u>148,539,458</u>
Cash and cash equivalents, end of year	<u>\$ 131,453,745</u>	<u>134,693,703</u>

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS AUXILIARY FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2011

(with comparative totals for year ended June 30, 2010)

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 33,708,601	34,265,379
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	29,860,796	28,673,198
On-behalf payment of fringe benefits	28,331,030	26,900,395
Changes in assets and liabilities:		
Accounts receivable (net)	275,082	324,957
Inventories	1,476,508	(2,883,500)
Prepaid expenses and deferred charges	(30,419)	(6,355)
Accounts payable	(1,121,152)	3,987,010
Accrued liabilities	(692,271)	563,465
Deferred revenue	57,969	(362,379)
Net cash provided by operating activities	\$ <u>91,866,144</u>	<u>91,462,170</u>
Noncash investing, capital and financing activities:		
On-behalf payments for fringe benefits	\$ 28,331,030	26,900,395
Change in fair value of investments	(1,837,928)	(5,257,592)
Capital assets acquisition via notes payable to the University		4,777,547
Adjustments to notes payable to the University	(1,427)	(92,280)
Decrease of capital assets obligations in accounts payable	(1,348,401)	(13,836,121)
Capital appreciation on bonds payable	9,955,300	10,390,180
Net interest capitalized	1,602,106	4,123,765
Other capital asset adjustments		35,788
Capital lease adjustments	17,509	
Loss on disposal of capital assets	(630,786)	(164,055)

See accompanying notes to financial statements.

**UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM**

Notes to Financial Statements

June 30, 2011

(1) Summary of Significant Accounting Policies

Organizational Background and Basis of Presentation

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

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

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

The financial statements include certain prior year comparative information, which has been derived from the System's 2010 financial statements. Such information does not include all of the information required to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2010.

Certain items in the June 30, 2010 comparative information have been reclassified to correspond to the June 30, 2011 financial statement presentation.

Significant Accounting Policies

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

The System prepared its financial statements as a Business Type Activity, as defined by GASB Statement No. 35, *Basic Financial Statements – and Management Discussion and Analysis – for Public Colleges and Universities*, using the economic resources measurement focus and the accrual basis of accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

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

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

(b) *Cash and Cash Equivalents*

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

(c) *Investments*

Investments are recorded at fair value. Fair value is determined by quoted market prices for most of the System's investments. Fair value for investments in limited partnerships and certain mutual funds is determined using net asset values as provided by external investment managers.

(d) *Inventories*

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

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

(e) *Capital Assets*

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

collection of works of art or historical treasures must be applied to the acquisition of additional items for the same collection.

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

(f) *Compensated Absences*

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

<u>Changes in Compensated Absences Balance</u>	
Balance, beginning of year	\$ 6,476,752
Additions	279,833
Deductions	<u>(840,457)</u>
Balance, end of year	5,916,128
Less current portion	<u>662,396</u>
Balance, end of year – noncurrent portion	<u><u>\$ 5,253,732</u></u>

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

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

(h) *Net Assets*

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

(i) *Classification of Revenues*

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

Certain revenue sources that the System relies on for operations including on-behalf payments for fringe benefits and investment income are defined by GASB Statement No. 35, as nonoperating. In addition, certain transactions related to capital and financing activities are components of net nonoperating revenue.

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

(j) *Classification of Expenses*

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

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

In accordance with GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the System reported payments made by the State of Illinois on behalf of the System for contributions to State group insurance and retirement programs including postemployment benefits for System employees and its retirees of \$28,331,030 for the year ended June 30, 2011. On-behalf payments are classified as nonoperating revenues and the corresponding expenses are reported in on-behalf payments for fringe benefits of the System as operating expenses.

(l) *Use of Estimates*

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

(2) *Cash, Cash Equivalents and Investments*

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

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

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

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

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

The following details the carrying value of the System's cash, cash equivalents and investments as of June 30, 2011:

U.S. government securities	\$	35,716,653
U.S. government treasuries		23,073,805
Corporate bonds		693,183
Mutual funds – money market		22,870,976
Commercial paper		<u>6,497,231</u>
Subtotal		88,851,848
Claim on pooled cash and investments of University		<u>105,368,564</u>
Total	\$	<u><u>194,220,412</u></u>

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

Claim on pooled cash and investments	\$	105,368,564
Cash and cash equivalents		24,928,655
Cash and cash equivalents, restricted		1,156,526
Investments, restricted		<u>62,766,667</u>
Total	\$	<u><u>194,220,412</u></u>

(a) **Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University employs multiple investment managers, of which each has specific maturity assignments related to the operating funds. The funds are structured with different layers of liquidity. Funds expected to be used within one year are invested in money market instruments. Core operating funds are invested in longer maturity investments. Core operating funds investment manager's performance benchmarks are Barclays one to three-year Government Credit Bond Index and the Barclays Capital Intermediate Aggregate Bond Index. The University's manager guidelines provide that the average weighted duration of the portfolio, including option positions, not vary from that of their respective performance benchmarks by more than +/-20%. The System's nonpooled investments and maturities at June 30, 2011 are illustrated as follows:

	Maturities (in years)				Total
	Less than 1	1 – 5	6 – 10	Greater than 10	
Mutual funds – money markets	\$ 22,870,976				22,870,976
Corporate bonds				693,183	693,183
U.S. government treasuries	10,436,074	8,085,457		4,552,274	23,073,805
U.S. government securities	20,432,312	15,284,341			35,716,653
Commercial paper	6,497,231				6,497,231
Total cash equivalents and investments	\$ 60,236,593	23,369,798	—	5,245,457	88,851,848

Claim on cash and on pooled investments represents the System's share of participation in the University's operating internal investment pool. At June 30, 2011, the University's operating funds internal investment portfolio had an effective duration of 1 year. The operating internal investment pool consists of money market funds and other short-term investments (57%), stocks (11%) and long-term investments such as corporate bonds and government securities (32%).

(b) **Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's investment policy requires that operating funds be invested in fixed income securities and money market instruments. Fixed income securities shall be rated investment-grade or better by one or more nationally recognized statistical rating organizations. Securities not covered by the investment-grade standard are allowed if, in the manager's judgment, those instruments are of comparable credit quality. Securities which fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager's discretion. It is expected that the average credit quality of the operating funds will not fall below Standard & Poor's AA- or equivalent. At June 30, 2011, all of the System's nonpooled investments carried a AAA quality rating. At June 30, 2011, the University's operating internal investment pool primarily consisted of securities with quality ratings of AA or better.

(c) **Custodial Credit Risk**

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

investment policy does not limit the value of investments that may be held by an outside party. At June 30, 2011, the System's investments and deposits had no custodial credit risk exposure.

(d) *Concentration of Credit Risk*

Concentration of credit risk is the risk of loss attributed to the magnitude of the University's investment in a single issuer. The University's policy provides that the total operating funds portfolio will be broadly diversified across securities in a manner that is consistent with fiduciary standards of diversification. This diversification is achieved by employing multiple investment managers and imposing maximum position limits for each manager. The University's manager guidelines for operating investments provide that non-U.S. government obligations (other national governments) may not exceed 10% per issuer and private mortgage-backed and asset-backed securities may not exceed 10% per issuer (unless collateral is credit independent of the issuer and the security's credit enhancement is generated internally, in which case the limit is 25% per issuer). Obligations with other issuers, other than the U.S. government, U.S. agencies or U.S. government sponsored corporations and agencies, may not exceed 5%. As of June 30, 2011, not more than 5% of the University's total investments were invested in securities of any one issuer, excluding securities issued or guaranteed by the U.S. government, mutual funds, and external investment pools or other pooled investments.

(e) *Foreign Currency Risk*

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

(f) *Securities Lending*

To enhance the return on investments, the Board has authorized participation in a securities lending program. Through its custodian bank, Northern Trust, the University loans securities to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. government securities and irrevocable bank letters of credit in an amount not less than 102% of the fair value of the securities loaned. Noncash collateral cannot be pledged or sold by the University unless the borrower defaults. Cash collateral is invested by Northern Trust in a short-term investment pool. As of June 30, 2011, the short-term investment pool has a weighted average maturity of one hundred and two days. The University receives interest and dividends during the loan period as well as a fee from the custodian. Marking to market is performed every business day and the borrower is required to deliver additional collateral when necessary so that the total collateral held by the custodian will equal at least the fair value plus accrued interest of the borrowed securities. All security loans can be terminated on demand by either the University or the borrowers. The University's pro rata share of cash received as securities lending collateral was approximately \$92,895,000 at June 30, 2011, and is recorded as an asset and corresponding liability on the University's Balance Sheet. As of June 30, 2011, approximately \$92,005,000 of the investments reported on the University's Balance Sheet was on loan, secured by collateral with a fair value of approximately \$93,942,000. At June 30, 2011, the University has no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University. The System does not directly participate in this securities lending program, and hence, no amounts have been recorded in the accompanying financial statements related to securities lending transactions.

(3) Capital Assets

Net interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Net interest of \$1,602,106 was capitalized during the year ended June 30, 2011. The capital assets of the System are not pledged to secure outstanding indebtedness of the Board.

Capital asset activity for the year ended June 30, 2011 is summarized as follows:

	Capital assets				
	<u>Beginning balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers</u>	<u>Ending balance</u>
Nondepreciable capital assets:					
Land	\$ 19,238,069				19,238,069
Construction in progress	13,631,653	31,800,576		(13,168,020)	32,264,209
Total nondepreciable capital assets	32,869,722	31,800,576	—	(13,168,020)	51,502,278
Depreciable capital assets:					
Buildings	1,160,135,468		3,071,032	10,177,625	1,167,242,061
Improvements	49,569,278			2,990,395	52,559,673
Equipment	13,995,511	561,108	493,763		14,062,856
Total depreciable capital assets	1,223,700,257	561,108	3,564,795	13,168,020	1,233,864,590
Less accumulated depreciation:					
Buildings	272,067,559	27,605,206	2,663,989		297,008,776
Improvements	29,910,968	1,205,950			31,116,918
Equipment	8,569,819	1,049,640	270,020		9,349,439
Total accumulated depreciation	310,548,346	29,860,796	2,934,009	—	337,475,133
Total net depreciable capital assets	913,151,911	(29,299,688)	630,786	13,168,020	896,389,457
Total	\$ 946,021,633	2,500,888	630,786	—	947,891,735

(4) Bonds Payable

On July 21, 2010, the University issued Auxiliary Facilities System Revenue Bonds, Series 2010A, in the amount of \$56,675,000. The proceeds from the Series 2010A Bonds will be used to fund the costs of various improvements and additions to the System and fund all costs incidental to the issuance of the Series 2010A Bonds.

Bonds payable activity for the year ended June 30, 2011 was as follows:

Bonds payable							
Series	Rate on June 30 outstanding debt	Fiscal year maturity dates	Beginning balance	Additions	Deductions	Ending balance	Current portion
1991	7.30% – 7.35%	2012 – 2021	\$ 178,970,000		16,270,000	162,700,000	16,270,000
1996	—		225,000		225,000		
1999A	6.05% – 6.33%	2015 – 2030	39,820,000			39,820,000	
1999B	7.56%	2012 – 2015	3,695,000		875,000	2,820,000	1,050,000
2001A	5.00% – 5.50%	2012 – 2030	98,330,000		1,410,000	96,920,000	1,490,000
2001B	4.60% – 5.50%	2012 – 2032	37,520,000		585,000	36,935,000	745,000
2001C	6.41% – 7.00%	2012 – 2021	11,655,000		1,220,000	10,435,000	1,225,000
2003A	4.25% – 5.50%	2012 – 2034	59,310,000		1,335,000	57,975,000	1,380,000
2005A	4.625% – 5.50%	2012 – 2031	151,245,000		5,650,000	145,595,000	6,125,000
2006	4.00% – 5.00%	2012 – 2036	313,595,000		2,295,000	311,300,000	2,690,000
2008	variable	2012 – 2038	20,120,000		380,000	19,740,000	395,000
2009A	3.00% – 5.75%	2012 – 2038	83,435,000		720,000	82,715,000	740,000
2010A	4.00% – 5.25%	2012 – 2030		56,675,000		56,675,000	115,000
			997,920,000	56,675,000	30,965,000	1,023,630,000	32,225,000
Unaccreted appreciation			(78,564,291)	9,955,300		(68,608,991)	(849,359)
			919,355,709	66,630,300	30,965,000	955,021,009	31,375,641
Unamortized debt premium			32,951,085	2,658,965	1,464,254	34,145,796	1,471,625
Unamortized deferred loss on refunding			(12,180,626)		(755,950)	(11,424,676)	(755,950)
Total bonds payable			\$ 940,126,168	69,289,265	31,673,304	977,742,129	32,091,316

Capital appreciation bonds (Series 1991 and 1999A) of \$202,520,000 outstanding at June 30, 2011 do not require current interest payments and have a net unappreciated value of \$133,911,000. The University records the annual increase in the principal amount of these bonds as interest expense and accretion on bonds payable.

Costs associated with the issuance of the Series 1991, 1999A, 1999B, 2001A, 2001B, 2001C, 2003A, 2005A, 2006, 2008, 2009A and 2010A Bonds have been recorded as a prepaid expense and are being amortized over the life of the related bond issue.

Certain bonds of the System (Series 1991) have debt service reserve requirements. The Maximum Annual Net Debt Service for those bonds, as defined, is \$14,926,605.

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

The resolutions authorizing the University of Illinois Auxiliary Facilities System Revenue Bonds provide for the establishment of separate funds as follows: Current Unrestricted Fund, Unexpended Fund, Repair and Replacement Reserve, Equipment Reserve, Bond and Interest Sinking Fund, Debt Service Reserve, and Development Reserve. All System revenues, including student tuition and fees as provided for by the Bond Resolutions are to be deposited in the Current Unrestricted Fund and used to pay necessary operation and maintenance expenses of the System. The Bond Resolutions also require transfers to funds as follows:

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

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

Equipment Reserve – an amount approved by the Board for the acquisition of movable equipment to be installed in the facilities constituting the System. The reserve may not exceed 20% of the book value of the movable equipment of the System. Additions of \$3,156,204 were made to the Equipment Reserve during the year ended June 30, 2011. No expenditures were made to replace movable equipment during the year ended June 30, 2011. The fund balance of the Equipment Reserve was \$7,107,276 at June 30, 2011.

Bond and Interest Sinking Fund and Debt Service Reserve – amounts are transferred into the Bond and Interest Sinking Fund sufficient to pay principal and interest as it becomes due on the outstanding bonds and amounts fund a Debt Service Reserve at least equal to the Maximum Annual Net Debt Service, as defined. At June 30, 2011, the Debt Service Reserve was funded in excess of the Maximum Annual Net Debt Service. If at any time the Debt Service Reserve is less than the Maximum Annual Net Debt Service, the System is required to restore the Debt Service Reserve to the Maximum Annual Net Debt Service by the end of the next fiscal year.

Development Reserve – an amount approved by the Board for System development. No transfers were authorized by the Board during the year ended June 30, 2011, and there was no balance in the reserve at June 30, 2011.

The System made all required transfers for the year ended June 30, 2011.

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

Bond issue(s)	Purpose	Pledged revenues			Debt service to pledged revenues (current year)
		Source of revenue pledged	Future revenues pledged¹	Term of commitment	
Auxiliary facilities system (AFS)	Refundings, various improvements and additions to the System	Net AFS revenue, student tuition and fees	\$ 1,619,640	2038	7.77%

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

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

(a) **Debt Service Requirements**

Future debt service requirements for all bonds outstanding at June 30, 2011 are as follows:

Debt service requirements		
	Principal	Interest
Years:		
2012	\$ 32,225,000	41,109,416
2013	34,365,000	40,329,005
2014	35,725,000	39,434,643
2015	37,145,000	38,460,050
2016	38,525,000	37,506,921
2017 – 2021	219,330,000	170,564,306
2022 – 2026	224,875,000	127,943,411
2027 – 2031	226,490,000	76,073,992
2032 – 2036	170,260,000	24,383,989
2037 – 2038	4,690,000	204,697
Total debt service	1,023,630,000	\$ 596,010,430
Unaccreted appreciation	(68,608,991)	
Unamortized debt premium	34,145,796	
Unamortized deferred loss on refunding	(11,424,676)	
Total bonds payable	\$ 977,742,129	

(b) **Auxiliary Facilities System Variable-Rate Debt**

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

The System, in the event a liquidity facility is utilized, has a reimbursement agreement with different financial entities. Generally, the payback period is five to seven years, at an interest rate initially set at slightly above prime or the federal funds rate. The required future interest payments for these variable-rate bonds have been calculated using the current interest rate, based upon short-term tax-exempt rates, or the synthetic fixed rate, as illustrated in the table below:

Variable-rate bonds at June 30, 2011							
Bond issue	Interest rate at June 30, 2011	Remarketing agent	Remarketing fee	Liquidity facility			
				Bank	Expiration	Insurer	Fee
AFS, Series 2008	0.09%	Loop Capital	0.075%	JPMorgan Chase	5/19/2016	None	0.525%

(5) **Leaseholds Payable**

Leaseholds payable activity for the year ended June 30, 2011 consisted of the following:

Leaseholds payable				
Beginning balance	Additions	Deductions	Ending balance	Current portion
\$ 60,504	—	44,841	15,663	15,663

Capital lease obligations mature in 2012 and have interest rates at 4.3%. As of June 30, 2011, future minimum lease payments are as follows:

	Principal	Interest
2012	\$ 15,663	311
Total minimum payments	\$ 15,663	311

(6) **Related Party Transactions**

The University charged the System administrative service charges totaling \$14,747,704 in 2011, based upon the gross expenditures and debt service transfers of various operations of the System. These charges represent a portion of estimated administrative and other service costs incurred by the University in support of the System and are recorded as administrative services expense in the accompanying financial statements.

The System includes certain athletic facilities and office space utilized by the Division of Intercollegiate Athletics. Student fees provide the primary funding for the operation of these athletic facilities and office space. The Division of Intercollegiate Athletics transferred funds to the System of \$11,678,693 in 2011, to fund the operations not covered by student fees. This transfer has been recorded as rental and lease income on the statement of revenue, expenses and changes in net assets.

At June 30, 2011, the System had borrowings of \$9,311,637 under multiple internal financing notes with the University for construction of System facilities. The notes have varying repayment terms and interest rates of 3.0% to 3.5%.

Notes payable to the University						
	Maturity date	Beginning balance	New debt	Principal paid/debt refunded	Ending balance	Current portion
Payable to the University	2012 – 2017	\$ 15,197,204	—	5,885,567	9,311,637	1,980,084

Future debt service requirements for the outstanding notes payable as of June 30, 2011 are as follows:

Notes payable to the University debt service requirements		
	Principal	Interest
Years:		
2012	\$ 1,980,084	323,263
2013	2,032,730	254,238
2014	2,087,170	183,419
2015	1,853,185	110,744
2016	1,175,064	46,230
2017	183,404	5,460
Total	<u>\$ 9,311,637</u>	<u>923,354</u>

(7) Retirement and Postemployment Benefits

(a) Retirement Benefits

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

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

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

Plan members are required to contribute 8.0% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 24.21% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The University's contributions to SURS for the years ended June 30, 2011, 2010 and 2009, were \$350,480,000, \$319,047,000 and \$219,441,000, respectively, equal to the required contributions for each year. The calculated allocation of these contributions that relate to the System was \$13,444,632 for the year ended June 30, 2011, and is reflected within the accompanying financial statements as on-behalf payments for fringe benefits expense.

(b) *Postemployment Benefits*

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

The health, dental, and vision benefits provided to and contribution amounts required from annuitants are the result of collective bargaining between the State and various unions that represent the State's and the university's employees in accordance with limitations established in the Act. Therefore, the benefits provided and contribution amounts are subject to periodic change. The Act requires the State to provide life insurance benefits for annuitants equal to their annual salary as of the last day of employment until age 60, at which time the benefit amount becomes \$5,000.

The State makes substantially all of the contributions for OPEB on-behalf of the State universities. Since the State contributes substantially all of the employer contributions, the single-employer provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, have been followed for reporting the plan. The State is not required to and does not fund the plan other than the pay-as-you-go amount necessary to provide the current benefits.

Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State or a university, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in one of the State's sponsored pension plans, do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with 20 or more years of credited service to not have to contribute towards health, dental, and vision benefits. For fiscal year 2011, the annual cost of health, dental, and vision benefits before the State's contribution was \$7,538 (\$3,949 if Medicare eligible) if the annuitant chose benefits provided by a health maintenance organization (HMO) and \$10,697 (\$4,483 if Medicare eligible) if the annuitant chose other benefits. Additional contributions by annuitants for dependents ranging from \$1,068 to \$2,814 (\$1,020 to \$2,538 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

For current employees, contributions are dependent upon annual salary and whether or not the employee chooses to receive benefits through an HMO. Current employee contribution amounts to the plan for fiscal year 2011 are shown as follows:

	Annual Employee Health, Dental, and Vision Contribution Requirements	
	Benefits provided through	
	HMO	Others
Employee annual salary:		
\$29,500 and below	\$ 696	996
\$29,501 – \$44,600	756	1,056
\$44,601 – \$59,300	786	1,086
\$59,301 – \$74,300	816	1,116
\$74,301 and above	846	1,146

Additional contributions by employees for dependents ranging from \$996 to \$2,712 (\$948 to \$2,436 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

(8) Construction and Commitments

At June 30, 2011, the System had commitments on various construction projects and contracts for repairs and renovation of auxiliary facilities of \$65,750,851. These projects will be funded from the proceeds of the Series 2010A and 2011A Bonds Unexpended Fund.

(9) Subsequent Event

On July 7, 2011, the University issued Auxiliary Facilities System Revenue Bonds, Series 2011A and Series 2011B, in the amount of \$81,970,000 and \$10,875,000, respectively. The proceeds from the Series 2011A and the Series 2011B Bonds will be used to (i) pay a part of the costs of various improvements and additions to the System, (ii) currently refund certain outstanding obligations of the Board, (iii) pay certain capitalized interest on the Series 2011A Bonds and (iv) pay costs of issuing the Series 2011 Bonds.