UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM

Annual Financial Report

June 30, 2013

(With Independent Auditors' Report Thereon)

UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM

Annual Financial Report

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From the Vice President/Chief Financial Officer, Comptroller

UNIVERSITY OF ILLINOIS
Urbana-Champaign ● Chicago ● Springfield

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

December 20, 2013

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, 2013. This report supplements the financial statements of the University of Illinois presented in the Annual Financial Report.

The 2013 financial statements and accompanying notes appearing on pages 4 through 23 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, 2013, 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, 2013. 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
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report

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

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General of the State of Illinois, we have audited the accompanying financial statements of the University of Illinois Auxiliary Facilities System (the System), a segment of the University of Illinois, which comprise the statement of net position as of June 30, 2013, and the related statements of revenue, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

The System's management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

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, 2013, and the changes in its financial position and its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

Report on Summarized Comparative Information

We have previously audited the System's 2012 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 17, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Emphasis of Matter

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, 2013, 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. Our opinion is not modified with respect to this matter.

Other Matter

Management of the System has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2013, 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* in considering the System's internal control over financial reporting and compliance.

KPMG LLP

Chicago, Illinois
December 20, 2013

UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM

Statement of Net Position

June 30, 2013
(with comparative totals for June 30, 2012)

Assets		**2013**	**2012**
Current assets:			
Claim on cash and on pooled investments	$	160,680,185	140,232,609
Cash and cash equivalents		7,596,218	14,595,396
Investments		3,875,102	
Investments, restricted		1,356,564	4,532,100
Accrued investment income		444,486	630,510
Accounts receivable, net of allowance for uncollectible of $3,915,233 in 2013		6,924,243	6,337,798
Inventories		7,978,211	9,985,963
Prepaid expenses and deferred charges		685,475	593,279
Total current assets		189,540,484	176,907,655
Noncurrent assets:			
Cash and cash equivalents, restricted		20,226,156	7,032,323
Investments, restricted		24,205,078	70,067,357
Capital assets:			
Land		19,238,069	19,238,069
Buildings, net of accumulated depreciation		874,667,233	882,373,487
Improvements, net of accumulated depreciation		19,149,778	20,588,008
Equipment, net of accumulated depreciation		4,478,857	4,700,234
Construction in progress		68,245,934	45,375,876
Subtotal for capital assets		985,779,871	972,275,674
Prepaid expenses and deferred charges		7,594,210	6,744,342
Total noncurrent assets		1,037,805,315	1,056,119,696
Total assets	$	1,227,345,799	1,233,027,351
Liabilities and Net Position			
Current liabilities:			
Accounts payable	$	22,368,936	17,572,561
Accrued liabilities		4,539,375	3,781,493
Accrued compensated absences		740,487	687,754
Accrued interest		9,629,735	10,697,978
Deferred revenue		7,010,085	7,244,242
Notes payable to the University		2,502,017	2,033,369
Bonds and leaseholds payable		38,484,354	34,548,446
Total current liabilities		85,274,989	76,565,843
Noncurrent liabilities:			
Accrued compensated absences		5,225,752	5,122,069
Notes payable to the University		7,518,484	4,778,836
Bonds and leaseholds payable		961,498,855	990,626,166
Total noncurrent liabilities		974,243,091	1,000,527,071
Total liabilities		1,059,518,080	1,077,092,914
Net investment in capital assets		10,498,509	9,745,014
Restricted:			
Expendable for debt service		23,924,710	24,257,173
Unrestricted		133,404,500	121,932,250
Total net position		167,827,719	155,934,437
Total liabilities and net position	$	1,227,345,799	1,233,027,351

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM

Statement of Revenues, Expenses and Changes in Net Position

Year ended June 30, 2013
(with comparative totals for the year ended June 30, 2012)

	2013	2012
Operating revenues:		
Room and board, net of waivers of $632,842 in 2013	$ 132,752,112	130,414,642
Merchandise and retail food sales	35,174,489	36,415,535
Student service fees	92,896,878	91,195,310
Public events and recreation fees	8,131,988	8,208,109
Parking income	25,639,299	25,192,338
Rental and lease income	20,022,277	19,531,287
Vending income	1,802,693	1,764,494
Other operating revenue	9,634,172	8,979,726
Total operating revenues	326,053,908	321,701,441
Operating expenses:		
Salaries and wages	87,887,020	83,799,604
Merchandise and food for resale	37,463,516	36,680,580
Repair and maintenance	5,256,655	3,756,261
Professional and other contractual services	35,566,607	38,005,205
Utilities	27,949,356	27,404,026
Supplies	11,586,743	10,710,374
Noncapitalized equipment and equipment rentals	1,782,889	1,828,653
Administrative services	15,167,503	14,673,730
Other operating expense	13,399,087	10,657,382
Depreciation	31,227,774	30,673,059
On-behalf payments for fringe benefits	45,845,260	33,649,533
Total operating expenses	313,132,410	291,838,407
Operating income	12,921,498	29,863,034
Nonoperating revenues (expenses):		
On-behalf payments for fringe benefits	45,845,260	33,649,533
Investment income (net of related expenses)	1,767,939	2,149,696
Interest on capital asset-related debt	(46,896,806)	(45,704,296)
Amortization of issuance costs	(375,741)	(338,393)
Loss on disposal of capital assets	(732,416)	(322,198)
Other nonoperating (expenses) revenues, net	(636,452)	46,532
Net nonoperating (expenses)	(1,028,216)	(10,519,126)
Increase in net position	11,893,282	19,343,908
Net position, beginning of year	155,934,437	136,590,529
Net position, end of year	$ 167,827,719	155,934,437

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2013
(with comparative totals for the year ended June 30, 2012)

		2013	2012
Cash flows from operating activities:			
Room and board	$	132,741,358	130,386,392
Merchandise and retail food sales		35,176,775	36,760,527
Student service fees		92,905,664	92,231,961
Public events and recreation fees		8,132,816	8,305,531
Parking income		25,425,833	25,203,295
Rental and lease income		20,020,226	19,686,165
Vending income		1,802,796	1,780,322
Other sources		9,616,526	9,070,954
Payments to employees and for benefits		(86,972,722)	(83,707,189)
Payments to suppliers		(145,963,332)	(144,552,438)
Net cash provided by operating activities		92,885,940	95,165,520
Cash flows from noncapital financing activities:			
Other (disbursements) receipts, net		(44,801)	26,623
Net cash (used in) provided by noncapital financing activities		(44,801)	26,623
Cash flows from capital and related financing activities:			
Proceeds from issuance of bonds		248,899,381	169,423,497
Purchase of capital assets		(37,559,046)	(47,650,651)
Principal paid on bonds and capital leases		(280,871,058)	(129,494,358)
Proceeds from notes payable to the University		4,273,287	
Repayment of notes payable to the University		(2,245,329)	(2,481,722)
Interest paid on bonds and notes payable		(43,068,731)	(42,973,590)
Payments of bond issuance costs		(2,744,089)	(1,702,735)
Net cash used in capital and related financing activities		(113,315,585)	(54,879,559)
Cash flows from investing activities:			
Loss (income) on claim on cash and on pooled investments		2,466,780	(615,963)
Proceeds from sales and maturities of investments		65,474,091	87,466,299
Purchase of investments		(20,824,194)	(96,756,337)
Net cash provided by (used in) investing activities		47,116,677	(9,906,001)
Net increase in cash and cash equivalents		26,642,231	30,406,583
Cash and cash equivalents, beginning of year		161,860,328	131,453,745
Cash and cash equivalents, end of year	$	188,502,559	161,860,328

(Continued)

UNIVERSITY OF ILLINOIS
AUXILIARY FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2013
(with comparative totals for the year ended June 30, 2012)

		2013	2012
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	12,921,498	29,863,034
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation		31,227,774	30,673,059
On-behalf payment of fringe benefits		45,845,260	33,649,533
Changes in assets and liabilities:			
Accounts receivable (net)		2,240	1,349,588
Inventories		2,007,752	(671,590)
Prepaid expenses and deferred charges		(13,733)	100,479
Accounts payable		215,007	(265,117)
Accrued liabilities		914,299	92,415
Deferred revenue		(234,157)	374,119
Net cash provided by operating activities	$	92,885,940	95,165,520
Noncash investing, capital and financing activities:			
On-behalf payments for fringe benefits	$	45,845,260	33,649,533
Change in fair value of investments		(512,817)	2,542,752
Capital assets acquisition through capital leases			113,365
Adjustments to notes payable to the University		5,453,625	(49,733)
Increase of capital assets obligations in accounts payable		4,581,369	1,962,101
Capital appreciation on bonds payable		8,959,170	9,475,501
Net interest capitalized		3,323,972	5,650,880
Other capital asset adjustments			2,200
Loss on disposal of capital assets		(732,416)	(322,198)

See accompanying notes to financial statements.

(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 University of Illinois Revenue Bond Financing Act for Auxiliary Facilities, 110 ILCS 405/1, which authorized the University's Board of Trustees (Board) to combine and consolidate facilities 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 State Farm Center (formerly 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, 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 considerations 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, 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 2012 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, 2012.

Certain items in the June 30, 2012 comparative information have been reclassified to correspond to the June 30, 2013 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's Discussion and Analysis – for Public Colleges and Universities*, using the economic resources measurement focus and the accrual basis of accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

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

(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 90 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 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 System's policy requires the capitalization of 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.

Estimated useful lives for capital assets are as follows:

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

(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.

Changes in Compensated Absences Balance

Balance, beginning of year	$	5,809,823
Additions		839,474
Deductions		(683,058)
Balance, end of year		5,966,239
Less current portion		740,487
Balance, end of year – noncurrent portion	$	5,225,752

(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 Position

The System's resources are classified into net position categories and reported in the Statement of Net Position. These categories are defined as (a) Net investment in capital assets – capital assets net of accumulated depreciation and related outstanding debt balances attributable to the acquisition, construction, or improvement of those assets, (b) Restricted – net position 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 position not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board. The System first applies resources included in restricted net position when an expense or outlay is incurred for purposes for which resources in both restricted and unrestricted net positions are available.

(i) Classification of Revenues

The Statement of Revenues, Expenses and Changes in Net Position 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 (State) on behalf of the System for contributions to State group insurance and retirement programs including postemployment benefits for System employees and its retirees of $45,845,260 for the year ended June 30, 2013. 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.

(m) New Accounting Pronouncements

The System adopted the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which was effective July 1, 2012. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: (1) Financial Accounting Standards Board (FASB) Statements and Interpretations, (2) Accounting Principles Board Opinions, and (3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. Implementation of this statement did not impact the System's financial statements.

The System adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which was effective July 1, 2012. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Certain transactions that result in the consumption or acquisition of resources in one period that are applicable to future periods are identified as deferred outflows of resources and deferred inflows of resources, respectively, and are distinguished from assets and liabilities. The difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources is identified as net position. The System's Statement of Net Position reports all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. The System's Statement of Revenues, Expenses, and Changes in Net Position reports all revenues and expenses, increases or decreases in net position, and beginning and ending net position. The new pronouncement required a change in the format of the System's financial statements, but did not have any quantitative impact.

(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:

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

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 and the State of Illinois Public Funds Investment Act when investing its funds.

The following details the carrying value of the System's cash, cash equivalents and investments as of June 30, 2013:

U.S. government securities	$	11,177,809
U.S. government treasuries		11,923,815
Corporate bonds		835,760
Mutual funds – money market		27,322,576
Commercial paper		5,999,158
Subtotal		57,259,118
Claim on cash and on pooled investments		160,680,185
Total	$	217,939,303

These cash, cash equivalents and investments are classified in the Statement of Net Position as follows:

Current assets:		
Claim on cash and on pooled investments	$	160,680,185
Cash and cash equivalents		7,596,218
Investments		3,875,102
Investments, restricted		1,356,564
Noncurrent assets:		
Cash and cash equivalents, restricted		20,226,156
Investments, restricted		24,205,078
Total	$	217,939,303

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the University employs multiple investment managers, of which each has specific maturity assignments related to the operating funds. The funds are structured with different layers of liquidity. Funds expected to be used within one year are invested in money market instruments. Core operating funds are invested in longer maturity investments. Core operating funds investment manager's performance benchmarks are the Barclays Capital one-year to three-year Government Bond Index, the Barclays Capital one-year to three-year Government Credit Bond Index, and the Barclays Capital Intermediate Aggregate Bond Index. The University's manager guidelines provide that the average weighted duration of the portfolio, including option positions, not vary from that of their respective performance benchmarks by more than +/-20%. The System's nonpooled investments and maturities at June 30, 2013 are illustrated as follows:

		Maturities (in years)				
		Less than 1	**1 – 5**	**6 – 10**	**Greater than 10**	**Total**
Mutual funds – money markets	$	27,322,576				27,322,576
Corporate bonds				835,760		835,760
U.S. government treasuries		2,259,877	4,954,845	4,709,093		11,923,815
U.S. government securities		11,177,809				11,177,809
Commercial paper		5,999,158				5,999,158
Total cash equivalents and investments	$	46,759,420	4,954,845	5,544,853	—	57,259,118

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, 2013, the University's operating funds internal investment portfolio had an effective duration of 1.4 years. The operating internal investment pool consists of money market funds and other short-term investments (45%), stocks (7%) and long-term investments such as corporate bonds and government securities (48%).

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's investment policy requires that operating funds be invested in fixed income securities and money market instruments. Fixed income securities shall be rated investment-grade or better by one or more nationally recognized statistical rating organizations.

Securities not covered by the investment grade standard are allowed if, in the manager's judgment, those instruments are of comparable credit quality. Securities that fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager's discretion. 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, 2013, all of the System's nonpooled investments carried an A or better quality rating. At June 30, 2013, 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, 2013, 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 investment policy provides that the total operating funds portfolio will be broadly diversified across securities in a manner that is consistent with fiduciary standards of diversification. This diversification is achieved by employing multiple investment managers and imposing maximum position limits for each manager. Within the University investment policy, the manager guidelines for operating investments provide that non-U.S. government obligations may not exceed 10% per issuer and private mortgage-backed and asset-backed securities may not exceed 10% per issuer (unless collateral is credit independent of the issuer and the security's credit enhancement is generated internally, in which case the limit is 25% per issuer). Obligations with other issuers, other than the U.S. government, U.S. agencies, or U.S. government sponsored corporations and agencies, may not exceed 5%. As of June 30, 2013, 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, the University loans securities to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. government securities and irrevocable bank letters of credit in an amount not less than 102% of the fair value of the securities loaned. Noncash collateral cannot be pledged or sold by the University unless the borrower defaults. Cash collateral is invested by the custodian bank in a short-term investment pool. As of June 30, 2013, the short-term investment pool has a weighted average maturity of eighty-eight days. The University receives interest and dividends during the loan period as well as a fee from the custodian. Marking to market is performed every business day and the borrower is required to deliver additional collateral when necessary so that the total collateral held by the custodian will equal at least the fair value plus accrued interest of the borrowed securities. All security loans can be terminated on demand by either the University or the borrowers. The University's pro rata share of cash received as securities lending collateral was approximately $25,545,000 at June 30, 2013, and is recorded as an asset and corresponding liability on the University's Statement of Net Position. As of June 30, 2013, approximately $24,978,000 of the investments reported on the University's Statement of Net Position was on loan, secured by collateral with a fair value of approximately $25,545,000. At June 30, 2013, 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 $3,323,972 was capitalized during the year ended June 30, 2013. 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, 2013 is summarized as follows:

	Capital assets				
	Beginning balance	Additions	Retirements	Transfers	Ending balance
Nondepreciable capital assets:					
Land	$ 19,238,069				19,238,069
Construction in progress	45,375,876	44,501,984		(21,631,926)	68,245,934
Total nondepreciable capital assets	64,613,945	44,501,984	—	(21,631,926)	87,484,003
Depreciable capital assets:					
Buildings	1,207,451,660		2,281,732	21,631,926	1,226,801,854
Improvements	53,187,425				53,187,425
Equipment	14,706,795	962,403	1,032,823		14,636,375
Total depreciable capital assets	1,275,345,880	962,403	3,314,555	21,631,926	1,294,625,654
Less accumulated depreciation:					
Buildings	325,078,173	28,765,372	1,708,924		352,134,621
Improvements	32,599,417	1,438,230			34,037,647
Equipment	10,006,561	1,024,172	873,215		10,157,518
Total accumulated depreciation	367,684,151	31,227,774	2,582,139	—	396,329,786
Total net depreciable capital assets	907,661,729	(30,265,371)	732,416	21,631,926	898,295,868
Total	$ 972,275,674	14,236,613	732,416	—	985,779,871

(4) Bonds Payable

On May 15, 2013, the University issued $212,540,000 of Auxiliary Facilities System (AFS) Revenue Bonds, Series 2013A. The proceeds from the Series 2013A were used to provide for the partial refunding of the outstanding principal of three different Series of AFS Revenue Bonds, Series 2003A, Series 2005A and Series 2006. Proceeds were also used to fund all costs incidental to the issuance of the Series 2013A Bonds. The refunding resulted in a projected saving of $22,921,361 over the life of the issue at a present value of $17,971,609. The difference between the reacquisition price and the net carrying amount of the old debt, (gain) loss on refunding for each Series, was $(282,658), $2,737,124 and $18,870,181 respectively. This (gain) loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Bonds payable activity for the year ended June 30, 2013 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%	2014 – 2021	$ 146,430,000		16,270,000	130,160,000	16,270,000
1999A	6.05% – 6.33%	2015 – 2030	39,820,000			39,820,000	
1999B	7.56%	2014 – 2015	1,770,000		875,000	895,000	565,000
2001A	5.50%	2014 – 2024	48,995,000		1,570,000	47,425,000	4,580,000
2001B	5.50%	2014 – 2019	12,645,000		1,485,000	11,160,000	1,570,000
2003A	5.25% – 5.50%	2018 – 2034	42,500,000		4,215,000	38,285,000	
2005A	4.625% – 5.50%	2014 – 2031	139,470,000		61,905,000	77,565,000	5,070,000
2006	4.00% – 5.00%	2014 – 2036	308,610,000		163,335,000	145,275,000	3,085,000
2008	variable	2014 – 2038	19,345,000		420,000	18,925,000	430,000
2009A	3.00% – 5.75%	2014 – 2038	81,975,000		755,000	81,220,000	770,000
2010A	4.00% – 5.25%	2014 – 2030	56,560,000		1,050,000	55,510,000	1,095,000
2011A	3.00% – 5.50%	2014 – 2041	81,075,000			81,075,000	1,185,000
2011B	2.11% – 4.52%	2014 – 2021	9,300,000		810,000	8,490,000	895,000
2011C	2.00% – 5.00%	2014 – 2032	71,900,000		180,000	71,720,000	1,700,000
2013A	3.00% – 5.00%	2014 – 2032	—	212,540,000		212,540,000	960,000
			1,060,395,000	212,540,000	252,870,000	1,020,065,000	38,175,000
Unaccreted appreciation			(59,133,490)	8,959,170		(50,174,320)	(849,327)
			1,001,261,510	221,499,170	252,870,000	969,890,680	37,325,673
Unamortized debt premium			34,783,325	36,359,381	11,563,770	59,578,936	3,055,865
Unamortized deferred loss on refunding			(10,976,428)	(21,324,647)	(2,729,229)	(29,571,846)	(1,918,991)
Total bonds payable			$ 1,025,068,407	236,533,904	261,704,541	999,897,770	38,462,547

Capital appreciation bonds (Series 1991 and 1999A) of $169,980,000 outstanding at June 30, 2013 do not require current interest payments and have a net unappreciated value of $119,805,680. 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, 2003A, 2005A, 2006, 2008, 2009A, 2010A, 2011A, 2011B, 2011C and 2013A Bonds have been recorded as deferred charges 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 $281,347 were made to the Equipment Reserve during the year ended June 30, 2013. Expenditures of $7,506 were made to replace movable equipment during the year ended June 30, 2013. The fund balance of the Equipment Reserve was $6,920,371 at June 30, 2013.

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, 2013, 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, 2013, and there was no balance in the reserve at June 30, 2013.

The System made all required transfers for the year ended June 30, 2013.

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

Pledged revenues						
Bond issue(s)	Purpose	Source of revenue pledged		Future revenues pledged[1]	Term of commitment	Debt service to pledged revenues (current year)
Auxiliary facilities system (AFS)	Refundings, various improvements and additions to the System	Net AFS revenue, student tuition and fees	$	1,569,754	2041	7.17%

[1] Total 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, 2013 are as follows:

Debt service requirements				
		Principal		Interest
Years:				
2014	$	38,175,000		39,733,801
2015		38,595,000		39,978,689
2016		39,945,000		39,062,201
2017		41,275,000		38,005,434
2018		42,810,000		36,927,511
2019 – 2023		241,225,000		163,908,902
2024 – 2028		225,080,000		113,472,920
2029 – 2033		222,605,000		61,889,350
2034 – 2038		117,585,000		15,346,990
2039 – 2041		12,770,000		1,363,688
Total debt service		1,020,065,000	$	549,689,486
Unaccreted appreciation		(50,174,320)		
Unamortized debt premium		59,578,936		
Unamortized deferred loss on refunding		(29,571,846)		
Total bonds payable	$	999,897,770		

(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, 2013

Bond issue	Interest rate at June 30, 2013	Remarketing agent	Remarketing fee	Liquidity facility			
				Bank	Expiration	Insured by	Fee
AFS, Series 2008	0.06%	Loop Capital	0.075%	JPMorgan Chase	5/19/2016	None	0.525%

(c) Advanced Refunded Bonds Payable

The System has defeased bonds through advanced funding in the current year, and accordingly, they are not reflected in the accompanying financial statements. The amount of bonds that have been defeased as of June 30, 2013 consists of the following:

Advanced Refunded Bonds

Series	Outstanding at June 30, 2013
2005A	$ 54,950,000
2006	160,460,000
Total	$ 215,410,000

(5) Leaseholds Payable

Leaseholds payable activity for the year ended June 30, 2013 consisted of the following:

Leaseholds payable

Beginning balance	Additions	Deductions	Ending balance	Current portion
$ 106,205		20,766	85,439	21,807

The capital lease obligation matures in 2017 and has an interest rate of 4.9%. As of June 30, 2013, future minimum lease payments are as follows:

		Principal	Interest
2014	$	21,807	3,701
2015		22,899	2,608
2016		24,047	1,461
2017		16,686	308
Total minimum payments	$	85,439	8,078

(6) Related-Party Transactions

The University charged the System administrative service charges totaling $15,167,503 in 2013, 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 $8,351,109 in 2013 to fund the operations not covered by student fees. This transfer has been recorded as rental and lease income on the Statement of Revenues, Expenses and Changes in Net Position.

At June 30, 2013, the System had borrowings of $10,020,501 under multiple internal financing notes with the University for the 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	2015 – 2023	$	6,812,205	5,453,625	2,245,329	10,020,501	2,502,017

Future debt service requirements for the outstanding notes payable as of June 30, 2013 are as follows:

Notes payable to the University
Debt service requirements

		Principal	Interest
Years:			
2014	$	2,502,017	321,449
2015		2,584,675	238,792
2016		2,146,822	153,389
2017		1,162,669	83,463
2018		603,326	48,730
2019 -2023		1,020,992	84,483
Total	$	10,020,501	930,306

(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 on 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 full time 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 35.2% 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, 2013, 2012 and 2011 were $622,664,000, $439,316,000 and $350,480,000, respectively, equal to the required contributions for each year. The calculated allocation of these contributions that relate to the System was $25,189,593 for the year ended June 30, 2013, 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 stand-alone financial report but is included as a part of the State's financial statements. A copy of the financial statements of the State can be obtained at www.ioc.state.il.us.

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

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

Annuitants may be required to contribute toward health, dental, and vision benefits with the amounts based on factors such as date of retirement, years of credited service with the State or a university, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed healthcare plan. For fiscal year 2013, the annual cost of health, dental, and vision benefits before the State's contribution was $8,397 ($4,485 if Medicare eligible) if the annuitant chose benefits provided by a health maintenance organization (HMO) and $11,913 ($4,322 if Medicare eligible) if the annuitant chose other benefits. Additional contributions by annuitants for dependents ranging from $960 to $2,814 ($900 to $2,538 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

For current employees, contributions are dependent upon annual salary and whether or not the employee chooses to receive benefits through an HMO. Current employee contribution amounts to the plan for fiscal year 2013 are shown as follows:

Annual Employee Health, Dental, and Vision Contribution Requirements

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

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

(8) Commitments

At June 30, 2013, the System had commitments on various construction projects and contracts for repairs and renovation of auxiliary facilities of $26,260,384. These projects will be funded from the unexpended bond proceeds of Series 2009A, Series 2010A and 2011A along with certain renewal and replacement funds set aside for construction costs.