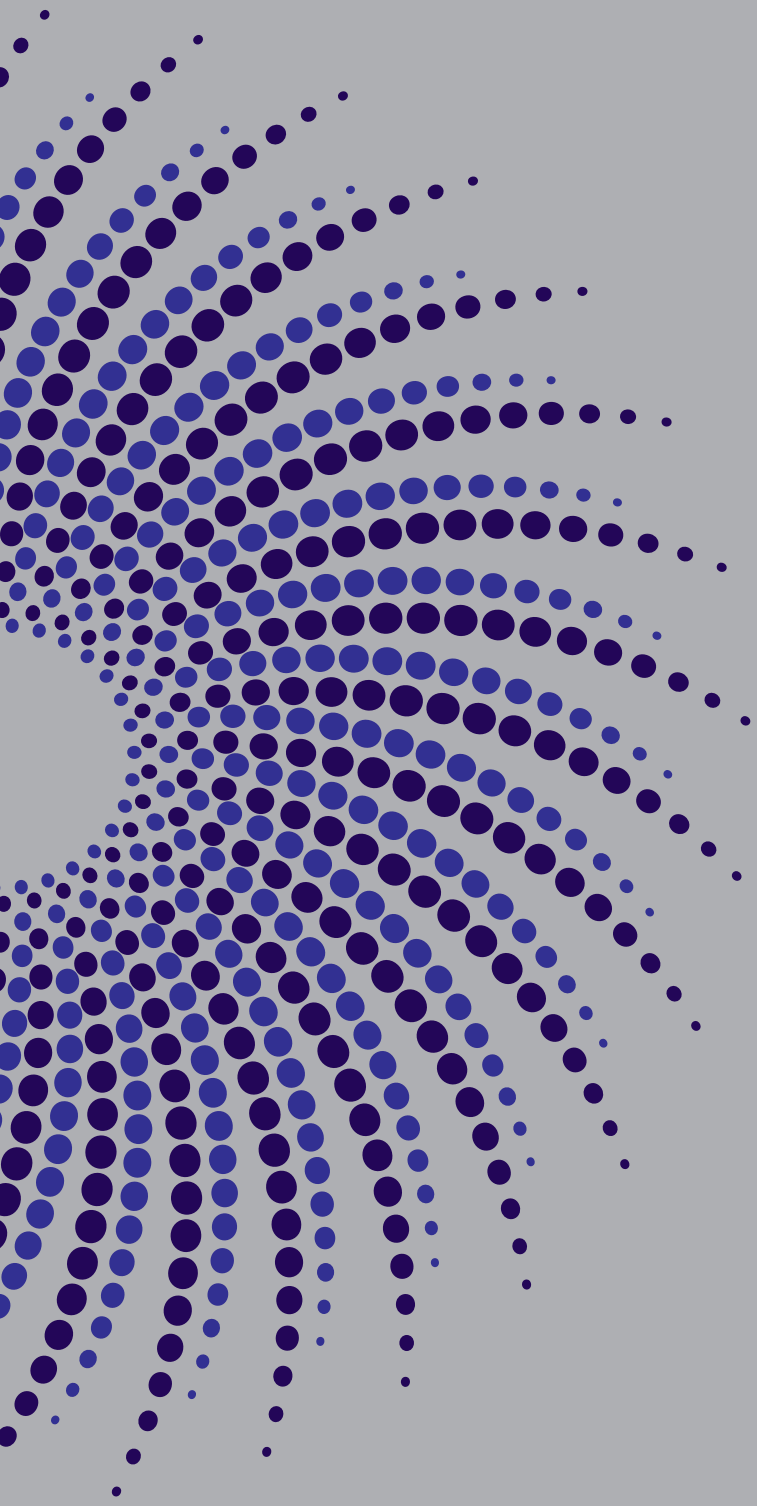


Research at Northwestern

NORTHWESTERN UNIVERSITY 2010 FINANCIAL REPORT

The growth in funding allows Northwestern researchers to do more to increase understanding of our world and improve the quality of lives.

Message from the President

In fiscal year 2010 Northwestern received more than a half billion dollars in research grants, the largest total in University history. The amount, $556.4 million, also set a record for the greatest increase from the previous year, 17 percent. Nearly all of our schools and colleges, as well as our research centers and institutes, shared in the growth in research awards.

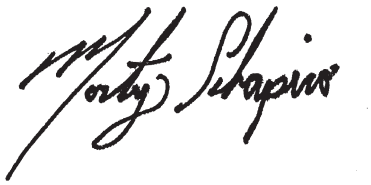
Funding of research at Northwestern has grown steadily in the past decade, testifying to the importance and the relevance of the scholarly work being done here. The growth in research funding helps Northwestern to do more to improve the human condition. That is the ultimate purpose of research. Our researchers' breakthroughs go on to be used in clinical and commercial applications that help make life better for people and meet society's needs.

Teaching and research are aspects of the same mission of education. We educate the larger society as our scholarly findings are published. We educate students in the classroom and also increasingly by involving them in faculty research. The best undergraduate educational experience comes from both classroom work and participation in scholarly investigations.

At Northwestern, where nearly all of our faculty teach undergraduates, and where hundreds of undergraduates participate in sponsored research projects, we know that lines drawn between teaching and research are artificial. And so are lines drawn between academic areas; Northwestern has a highly interdisciplinary culture, which serves us well in today's research environment, where complex questions require the input of many disciplines. Northwestern currently has more than 100 research centers bringing together faculty from various fields. Our faculty members team with colleagues in other departments, other schools of the University, other universities, and other institutions, such as the nearby Argonne National Laboratory and Fermi National Laboratory.

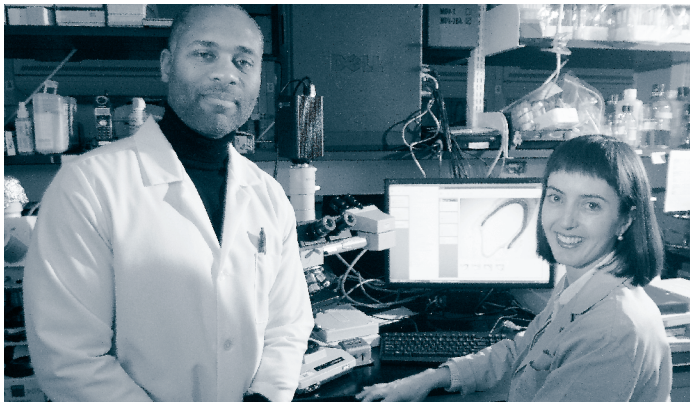
In the last decade Northwestern has demonstrated its commitment to research by adding buildings and state-of-the-art facilities for Northwestern investigators. These include the the Robert H. Lurie Medical Research Center (2005) on the Chicago campus and the Patrick G. and Shirley W. Ryan Hall for Nanofabrication and Molecular Self-Assembly (2002), the Arthur and Gladys Pancoe–NorthShore University HealthSystems Life Sciences Pavilion (2003), and the Richard and Barbara Silverman Hall for Molecular Therapeutics and Diagnostics (2009) on the Evanston campus.

Every day hundreds of important research projects are being conducted at Northwestern. Those featured on the following pages represent the range of research across the University, from science to the arts, economics to communication. Many people contribute to the success of research at Northwestern, and all of their work holds the potential to increase understanding of our world and to improve the quality of lives.



Morton Schapiro
President and Professor

Northwestern has a highly interdisciplinary culture, which serves us well in today's research environment, where complex questions require the input of many disciplines.



Can Biomaterials Replace Stents?

Guillermo Ameer (BIOMEDICAL ENGINEERING AND SURGERY) **and Melina Kibbe** (SURGERY)

Guillermo Ameer, associate professor of biomedical engineering and surgery, and Melina Kibbe, associate professor of vascular surgery, typify the collaboration occurring not just across departments but also across schools at Northwestern. His primary appointment is in the Robert R. McCormick School of Engineering and Applied Science, hers in the Feinberg School of Medicine. The pair had been research partners for several years when a conversation about the vascular stents Kibbe uses in surgery prompted an idea: Could injectable biomaterials replace the stents currently used?

Ameer and Kibbe theorize that a liquid polymer could form to the contours of an artery to provide a custom-made stent. And if that polymer were loaded with drugs that promote healing, the stent could disperse them in a targeted area before degrading, leaving behind a healthy artery.

A two-year grant from the National Institutes of Health, along with a supplemental grant from the Northwestern Memorial Foundation, are providing the team with the resources to develop a concept that could find its way to clinical trials. Ameer and Kibbe, both resident faculty of the Institute for Bionanotechnology in Medicine, are working to develop nitric oxide–eluting materials for use in a biodegradable stent. Nitric oxide is naturally produced by the thin layer of endothelial cells that line arteries and provides a host of cardiovascular benefits.

"It's my hope that I can eventually use in the operating room the techniques and devices that we've developed," says Kibbe.

Accounting for Both High Unemployment and High Job Vacancies

Dale Mortensen (ECONOMICS)

With today's stubborn high unemployment, the market analysis for which Dale Mortensen, Ida C. Cook Professor of Economics, won the 2010 Nobel Prize is especially pertinent.

The research recognized by the Nobel award focuses on the role of search and matching frictions in determining price and quantity traded in many markets. When applied to the labor market, in the simplest lay terms this means, Mortensen says, "It takes time for workers to find jobs and for employers to find workers."

Frictions characterize most real-world transactions. The search process takes time and money. Sellers and buyers have difficulty finding each other; some remain unmatched. In the labor market, employers who are looking for employees and workers who are trying to find jobs do not always make contact with one another immediately — and may not at all. Thus, there may be high unemployment even as job vacancies go unfilled.

It wasn't until Mortensen and the two men with whom he shared the Nobel Prize — Peter Diamond of Massachusetts Institute of Technology and Christopher Pissarides of the London School of Economics and Political Science — began publishing in the 1970s that economists brought search and matching frictions into formal models of trade. The Diamond-Mortensen-Pissarides (DMP) model about the determinants of unemployment became the leading technique for analysis of labor markets and the effects of labor market policy. The DMP model is used to estimate the effects of different labor market factors on unemployment, the average duration of unemployment, the number of vacancies, and the real wage.

Search and matching frictions theory has been most often applied to labor markets but is also used to analyze other markets, especially housing, where empty properties and people looking for suitable housing don't inevitably mesh in a timely fashion. The theory has even been applied to marriages.

Access Alone Won't Fix Digital Divide

Eszter Hargittai (COMMUNICATION STUDIES)

The term "digital divide" is usually understood to refer to inequitable access to the Internet between the haves and the have-nots. Eszter Hargittai, associate professor of communication studies and the 2010 recipient of the Outstanding Young Scholar Award of the International Communication Association, uses it in a broader sense, however. Her research suggests there are considerable differences in how groups of people with similar levels of access use the Internet.

Even among college freshmen and young adults who grew up with the Internet, higher-level Internet skills and more sophisticated Internet usage still strongly correspond to socioeconomic status.

"It's an erroneous assumption that once everyone has access to the Internet, issues of inequality are solved," Hargittai says. "Providing infrastructure without offering training is a bit like giving people cars without providing driver's education. Internet education, training, and support are needed for meaningful access."

A faculty associate at Northwestern's Institute for Policy Research, Hargittai has spent more than a decade researching the social and policy implications of information technologies, particularly as they relate to social inequality. Her studies of Internet usage have found that people from lower socioeconomic backgrounds and female, African American, and Hispanic users report significantly lower levels of web know-how than their higher socioeconomic and white male counterparts.

Hargittai's research has important implications for the ambitious National Broadband Plan sent to Congress by the Federal Communications Commission.

"A federal infrastructure approach alone will not address the discrepancies in the benefits people can gain from Internet access," Hargittai says.

Music as Anthropology

Drew Edward Davies (MUSICOLOGY)

Drew Edward Davies, assistant professor of musicology, is answering fundamental questions about music and its meaning in society and history. His dramatic discoveries of early Latin American musical gems not only have brought these works to the attention of scholars, musicians, and audiences for the first time but also have given rise to a reassessment of musical influences.

"I really want to understand how music was indicative of culture and how it intersected with culture," says Davies, a musicologist specializing in the liturgical and devotional music of New Spain (colonial Mexico). "I never saw myself as a passive consumer of music, but more of an anthropologist."

Davies has uncovered and pieced together hundreds of fragments of early Mexican works previously unknown to music scholarship. Granted unprecedented access to the archive of Durango Cathedral, he cataloged the cathedral's entire collection of 18th-century manuscripts — the only such project completed to date in Spanish America. He now serves as an adviser on similar projects in Mexico City and Guadalajara.

Asserting that New Spanish music must be understood in transatlantic contexts, Davis has used interdisciplinary approaches to show that early music was a multicontinental phenomenon that moved far beyond the cities, courts, and churches of Europe.

His discoveries have given centuries-old compositions new relevance, leading to scholarly publications and performance scores that have been featured in concerts by Northwestern's Early Music Ensemble, Chicago's Newberry Consort, Early Music New York, and the Dallas-based Orchestra of New Spain.

Keeping the Customer in Mind

Wei Chen (MECHANICAL ENGINEERING)

Wei Chen's research focuses on a critical component previously lacking in product design: methods to integrate consumer preferences into decision making.

Chen, Wilson-Cook Endowed Professor in Engineering Design, established the Integrated Design Automation Laboratory on the Evanston campus. It develops rational design methods to support engineering design and product realization based on advanced computational and statistical techniques.

"In order for engineers to create products with the power to compete in today's market, they need more than just strong technical skills," she says. "They need a strong understanding of consumer preferences."

In the laboratory's rational design methodology, mathematical optimization techniques and statistical methods are used to capture how the process of choosing a product is affected by consumer heterogeneity, perceptions, and emotions and by such factors as purchase history and the context in which the product will be used. The consumer information is integrated with technical requirements to produce an optimal decision-making framework in product design.

Chen and her research group collaborate with market research experts at J. D. Power & Associates, engineering design researchers at Ford Motor Company, and civil and environmental engineering professor Frank Koppelman. Their hierarchical choice-modeling approach for managing and analyzing consumer preference data from multiple sources was applied to configuring an efficient and cost-effective allocation of space for vehicle occupants. The research offers a general design approach that can also be applied to other engineered consumer goods, mobility/prosthetic devices, and large-scale systems.

The Gift of the Humanities

Barbara Newman (ENGLISH; RELIGIOUS STUDIES; CLASSICS)

While scientific and medical advances understandably receive a lot of media and funders' attention today, Barbara Newman, professor of English, religious studies, and classics and John Evans Professor of Latin, doesn't lack for recognition and grants for her humanistic studies.

The medieval scholar was one of only four recipients in the country of a 2008 Andrew W. Mellon Foundation Distinguished Achievement Award. She was the second recipient of Northwestern's Ver Steeg Distinguished Research Fellowship for excellence in research by a faculty member. She is a fellow of the Medieval Academy and of the American Academy of Arts and Sciences, the oldest learned society in academia.

The Mellon awards, amounting to up to $1.5 million each, underscore the contributions of the humanities to the nation's intellectual life. They support institutional initiatives as well as the individual's own research. Newman's three-year Mellon Award is supporting postdoctoral fellows, library acquisitions, dissertation-year fellowships, and summer symposia in medieval studies, among other things.

Newman is a leader in the field of medieval religious culture and has made pioneering contributions to the study of women in medieval Christianity in works such as *God and the Goddesses: Vision, Poetry, and Belief in the Middle Ages* (2003). She recently finished a paper on the exchange of hearts, a common motif in both sacred and secular medieval texts.

Hundreds of research projects are taking place at Northwestern. Studies in every field hold the potential to improve the human condition.

Reflecting on the social place of the humanities, Newman says, "While there are still diseases to be cured, starving people to be fed, and endangered species to be saved, when there is the dramatic urgency of war or catastrophe, humanistic pursuits may seem self-indulgent. Yet one of the most insidious evils of violence is its ability to make us think that only violence matters. It is the gift of humanistic studies to insist that after the next 2,000 or 2 million deaths, there will still be people who care about Greek verbs and Renaissance choral music, Captain Ahab's quest and Chaucer's pilgrims. Without poetry, the world would be a desperately impoverished place."

More Undergraduates Engaging in Research

Research, always a primary focus of graduate students, increasingly has become part of the undergraduate experience. Funding and opportunities for undergraduate research have grown exponentially at Northwestern.

Nearly two decades ago the Office of the Provost established a small grant program to encourage undergraduate research and funded the research of 24 students with $15,000. In 2010 the same program — the Undergraduate Research Grant Program — funded the research proposals of more than 150 undergraduates from every Northwestern school and college at a cost of $350,000. Moreover, numerous efforts beyond URG support undergraduate engagement in research today. Between the Provost's Office, the individual schools and academic programs, Residential Colleges, the Office of Fellowships, and sponsored research, an estimated $1.5 million supported Northwestern undergraduates engaged in research last year.

A comprehensive new website (undergradresearch.northwestern.edu) launched in October 2010 helps undergraduates find research possibilities. It includes links to undergraduate research funding opportunities across campus; offers guidance about topic choice, research proposal writing, funding applications, and more; and features videos of students from diverse fields discussing their research.

Research opportunities take many forms, involve students in just about every discipline, and take place on campus and at locations across the country and in distant parts of the globe. Some students stay on campus to work alongside faculty members, such as the sophomore who studied high-mass star formation with an astronomy professor. Others have gone far off campus — among other places, to Pittsburgh to research an oral history collection of interviews with former steel workers, to South Asia to learn about human trafficking, and to Russia to interview people who had spent time in forced labor camps as children.

The best undergraduate educational experience comes from both classroom work and participation in scholarly investigations.

"Research projects allow students to explore subjects outside the traditional academic structure of classes and grades and to transform from consumers of knowledge to producers of knowledge," says associate provost for undergraduate education Ronald Braeutigam. "It can help students determine whether they are interested in graduate work in a field involving research. And it will help students become better prepared for the workplace, graduate school, and prestigious fellowships."

Not surprisingly, Northwestern's increased undergraduate research opportunities coincide with a sharp increase in the numbers of undergraduates receiving prestigious competitive awards such as National Science Foundation and related science/engineering fellowships and international fellowships. For the past five years Northwestern has been in the top 10 producers of Fulbright scholars among 34 research universities and among the top 1 percent among 600 institutions nationwide. In recent years Northwestern has also had 3 Rhodes, 12 Marshall, 3 Mitchell, 5 Churchill, 32 Goldwater, and 14 Gates Cambridge scholars.

Report of the Senior Vice President for Business and Finance

To the Board of Trustees of Northwestern University:

The slow pace of recovery from the recession as well as continued uncertainty in US and international economies dominated the University's financial planning in the past fiscal year. Fortunately, the strength of its asset and liability profile enabled Northwestern to manage external pressures without extensive budget or programmatic cutbacks.

Prudent management of University resources and strong budget monitoring resulted in positive financial results for fiscal year 2010. Total assets increased 5.4 percent to nearly $8.4 billion, while liabilities decreased 1.3 percent to under $1.6 billion. The total net assets of the University grew 7.1 percent to over $6.8 billion, with unrestricted net assets of over $4 billion representing a growing percentage of total net assets. The University increased its cash and earned a 10.8 percent return on its long-term investments while issuing no additional debt. Its total excess of operating revenues over expenses was $90.2 million. Positive investment returns generated an excess of nonoperating revenues over expenses of $359.3 million.

The quality and value of a Northwestern education continued to be appreciated, as reflected in the record number of undergraduate applications for fall 2010. Increased resources were allocated to scholarship assistance as the University responded to the increased financial needs of families.

The strength of the University's research enterprise was evidenced by research expenditures increasing 12.9 percent to $441.9 million in fiscal year 2010, in large part due to University researchers receiving $140.9 million in federal stimulus funds through mid-November 2010.

Through its financial stewardship, the University is well positioned to plan a comprehensive fundraising campaign to finance strategic academic and facility initiatives that will enhance Northwestern's education and research mission. The support of alumni and friends is crucial to the University's future. Northwestern's continued financial strength provides evidence that this support will be carefully managed and preserved.

Eugene S. Sunshine
Senior Vice President for Business and Finance

Aggressive monetary easing by central banks worldwide provided liquidity after the recession of 2008–09. While this did not immediately translate into jobs and strength in the overall economy, it did positively affect financial assets. US equity and bond indices generally were up in the mid-to-high single digits. Riskier assets, such as emerging market investments and high-yield debt, had double-digit returns and were among the best-performing asset classes.

As a result, the University's overall portfolio experienced strong gains. At the close of the fiscal year on August 31, 2010, the University's investment assets, including cash and intra-University investments, had increased $395 million from August 31, 2009, and totaled $6.24 billion.

The University's Total Investment Pools

The University maintains three primary investment vehicles: The Long-Term Balanced Pool, treasury funds, and separately invested assets. Each investment category has a specific set of objectives.

The Long-Term Balanced Pool, the primary fund, is managed with the objective of long-term total return. Because of its size and long-term orientation, performance data and investment strategy information in the discussion that follows relate to the Long-Term Balanced Pool.

Treasury funds are money market funds used for cash reserves and to preserve principal and maintain liquidity; intermediate-term bond investments; and working capital funds held by the University, which are generated through the temporary differences between operating receipts and disbursements. These funds are not unitized. The income from investing them is used for general operating purposes. Working capital investments are held in a variety of money market instruments and guaranteed student loans or, if not needed within 90 days, are invested in the Long-Term Balanced Pool.

Separately invested funds are donated funds, including restricted investments and some life-income plans.

The table below illustrates the net asset values and unitized information for the University's investment pools for the past five years.

History of the Merged Pools as of August 31

	2006	*2007*	*2008*	*2009*	*2010*
Long-Term Balanced Pool					
Net asset value (in thousands of dollars)	$5,190,425	$6,380,194	$6,942,081	$5,639,701	$6,015,844
Number of units (in thousands)	26,519	27,753	31,378	32,524	33,301
Net asset value per unit	$195.73	$229.89	$221.24	$173.40	$180.65
Payout amount per unit					
Current earned income	$1.96	$3.25	($0.65)	($0.50)	($0.71)
Previously reinvested realized gains withdrawn	$4.85	$3.97	$8.45	$9.04	$9.25
Total payout per unit	$6.81	$7.22	$7.80	$8.54	$8.54
Summary of net asset values (in thousands of dollars)					
Treasury pool funds	$61,217	$84,430	$87,819	$73,001	$117,334
Separately invested funds	78,471	123,648	151,169	129,037	103,462
Total net asset value (in thousands of dollars)	**$5,330,113**	**$6,588,272**	**$7,181,069**	**$5,841,739**	**$6,236,640**

Asset Allocation for the Long-Term Balanced Pool

The Investment Committee of the University annually reviews asset allocation policy for the Long-Term Balanced Pool. In fiscal year 2010 the committee implemented modest changes to the allocation targets based on the Investment Office's optimization modeling of a more efficient portfolio that should generate higher returns with lower risk levels. For added protection from potential deflation and possible longer-term inflation, the committee decreased the target allocation for US and international equities by 1 percent each and increased the allocation for fixed income by 2 percent. In addition, the allocation for private investments was increased by 2 percent, and the allocation for real assets was decreased by 2 percent.

The next chart displays the current asset allocation policy for the University. Actual allocations vary from targeted levels by modest amounts, due to the illiquidity found in certain asset categories and the Investment Office's bias against market timing, or tactical asset allocation, as a primary driver of value added. The overweight of high-yield credit was, however, a conscious response to opportunities derived from the credit crisis.

Policy Portfolio Targets and Ranges				
	Range	*Target*	*August 31, 2010*	*Difference*
US equity securities	9–15%	12%	10.4%	-1.6%
International equity securities	13–19%	16%	15%	-1%
Fixed-income securities	9–15%	12%	8.7%	-3.3%
High-yield credit	0–10%	5%	8.9%	3.9%
Absolute return	14–22%	18%	15.5%	-2.5%
Private investments	16–24%	20%	23.2%	3.2%
Real assets	13–21%	17%	16.9%	-.1%
Cash		0%	1.4%	1.4%

Primary Investment Performance Objective: Preserving Purchasing Power and Growing Income

The principal objective for Northwestern's Long-Term Balanced Pool is to preserve purchasing power and to provide a growing stream of income to fund University programs. On average, the pool seeks to achieve an annual total rate of return (i.e., actual income plus appreciation) equal to inflation plus actual spending. This objective of preserving purchasing power emphasizes the need for a long-term perspective in formulating both spending and investment policies. A more detailed look at the University's spending guideline is on page 11 of this report.

The University's investments historically have grown at a rate exceeding the objective. As of August 31, 2010, the Long-Term Balanced Pool's assets were $6.02 billion, up almost $400 million from the previous year. For the 12-month period ending August 31, 2010, the portfolio increased 10.8 percent, which was 4.9 percent above the objective. For the 15-year period ending August 31, 2010, the objective was exceeded by 3.3 percent.

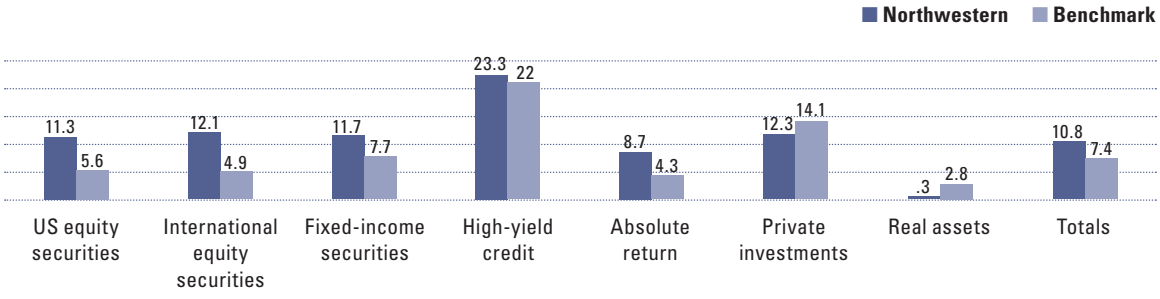
Annualized Returns: Exceeding the Objective					
	1-year	**3-year**	**5-year**	**10-year**	**15-year**
*Annual total return**	10.8%	-2.6%	5.4%	5.3%	9.4%
– Spending	4.7%	4.1%	3.9%	4.1%	3.8%
– Inflation	1.2%	1.6%	2.1%	2.4%	2.3%
= Above or below objective	**4.9%**	**-8.3%**	**-.6%**	**-1.2%**	**3.3%**

**Total returns are net of fees and are calculated on annual changes in net asset value. They may differ from payout distributions.*

Secondary Investment Performance Objective: Benchmark Comparisons

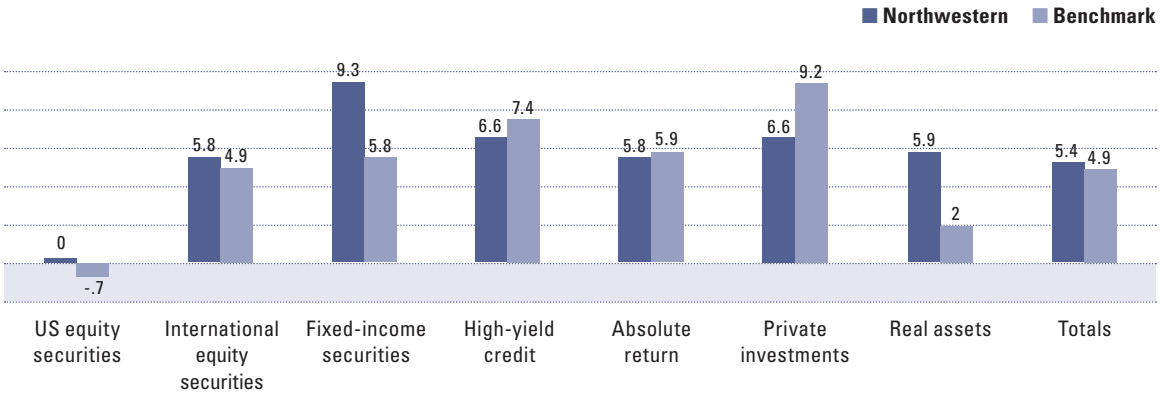
The pool's 10.8 percent gain for the 12-month period exceeded the 7.4 percent gain of the composite benchmark, a blend of the benchmark returns for each asset class weighted by the policy allocation targets. Outperformance resulted primarily from the relative strong performance of marketable portfolios, including US and international equity securities. Fixed income also enjoyed outstanding absolute and relative performance for the third year in a row. High-yield credit was the best portfolio in absolute terms and also outperformed on a relative basis. The absolute-return portfolio was very strong on a relative basis. Private investments and real assets were weak on a relative basis, although the private investments portfolio had a strong absolute performance for the fiscal year. The following chart shows returns and benchmarks for all asset classes for the fiscal year. A more detailed explanation of activity and performance follows the five-year performance chart below.

Long-Term Balanced Pool: Fiscal 2010 Net Performance Relative to Benchmarks (in percentages)



For the five-year period ended August 31, 2010, the pool outperformed the composite benchmark (5.4 percent versus 4.9 percent), as shown in the next chart. Four of the seven categories exceeded their benchmarks over five years. Single-digit returns in all asset classes for the past five years reflect the damage from the financial crisis. The worst-performing asset class, US equities, produced a 0 percent return. In contrast, fixed income, the least-risky asset class, had outstanding performance and was the best asset class over five years.

Long-Term Balanced Pool: Five-Year Net Performance Relative to Benchmarks (in percentages)



Marketable Securities Categories

The domestic equity portfolio rose 11.3 percent for the fiscal year, outperforming the 5.6 percent gain of the benchmark Russell 3000. A number of active managers outperformed their respective benchmarks during the fiscal year. Over five years, the portfolio exceeded its benchmark by 70 basis points (0 percent versus -.7 percent). It has outperformed in eight of the last ten fiscal years.

The international equity portfolio gained 12.1 percent and in relative terms was the best-performing asset class, outperforming the benchmark by 7.2 percent for the fiscal year. For the last five years the international program returned 5.8 percent, compared with the benchmark's return of 4.9 percent. A heavier weight to smaller-cap foreign stocks and to emerging markets has helped this portfolio over the five-year period. It has outperformed in eight of the last ten fiscal years.

Bonds continued to be one of the best-performing asset classes in both absolute and relative terms in the past fiscal year. The portfolio gained 11.7 percent, compared with 7.7 percent for the Barclays Government Index. The bond portfolio has also outperformed the index for the five-year period by 350 basis points (9.3 percent versus 5.8 percent). Superior active management and exposure to global and inflation-protected bonds contributed to the outperformance in both one- and five-year periods.

High-Yield Credit Category

The high-yield credit portfolio includes investments in distressed debt, emerging market debt, and other credit instruments with fixed-income characteristics but more specific risk tied to the securities and their underlying cash flows. During the fiscal year the portfolio was the best-performing asset class on an absolute basis, increasing 23.3 percent, ahead of the 22 percent increase of the benchmark Merrill Lynch High-Yield Master II Index. Relative returns from distressed managers, a few high-yield hedge funds, and emerging market debt investments accounted for a larger increase for this asset class relative to its benchmark. For the five-year period the high yield credit portfolio returned 6.6 percent, lagging the index's 7.4 percent because it concentrates on bank debt rather than the more subordinated high-yield bonds in the benchmark.

Absolute-Return Category

Made up of 22 different hedge funds, this portfolio aims to provide equity-like returns with low correlation to the equity markets. For the year it gained 8.7 percent, surpassing the 4.3 percent return of its benchmark (80 percent, Treasury bills plus 400 basis points; 20 percent, MSCI All-Country World Index). The portfolio's return for the five-year period of 5.8 percent was positive on both an absolute and a risk-adjusted basis but on a relative basis was slightly behind the benchmark, which gained 5.9 percent. Northwestern's absolute-return portfolio is weighted toward long-short equity managers (57 percent). The remaining hedge funds (43 percent) are more market neutral or represent diversifying event-driven strategies.

Private Investments Category

The private investments portfolio includes investments in global buyout funds as well as venture capital. In fiscal year 2010 this portfolio rose 12.3 percent, compared with the Cambridge Associates' universe pooled mean return of private investments' 14.1 percent gain. Increased merger and acquisition activity significantly bolstered the portfolio's returns. In addition, the IPO (initial public offering) environment reversed the previous year's gloom with marked improvement in both domestic and international markets.

Cash flows were stronger than in fiscal year 2009. An increase in trade sales, recapitalizations, and IPOs resulted in more distributions from the portfolios. Private investment distributions were $144.2 million for fiscal year 2010, compared with $82.5 million the previous year. The University's manager relationships and reputation in the marketplace remain strong.

Real Assets Category

The real assets portfolio includes the University's investments in energy, timber, real estate, and public investments in some commodity funds. This portfolio had weak absolute and relative results in fiscal year 2010, gaining .3 percent. The real estate portfolio continued to realize markdowns as a result of weak fundamentals. There was, however, a counterbalance from significantly higher realizations in private energy investments and increased global demand for commodities.

Long-Term Balanced Pool Spending Guideline

The University's Investment and Budget Committees annually review the Long-Term Balanced Pool's spending guideline, based on a formula established by the Board of Trustees in fiscal year 2006 that blends two elements:

- Market element adjusts annual endowment spending to the long-term sustainable target spending of 4.35 percent of the average actual market value of the endowment for the 12 months ending the October following the latest fiscal year. This component of the spending rate receives a 30 percent weighting in the spending rate calculation.
- Spending element increases the previous year's spending rate by actual inflation plus budget growth (1.5 percent). This element of the spending rate receives a weight of 70 percent.

For fiscal year 2011, the Board of Trustees, in conjunction with the Investment Committee and the Budget Committee, set the spending rate per unit at $8.28 in order to sustain the fund's long-term earning ability and provide adequate resources to the University. The payout rate for fiscal year 2010 was 4.6 percent.

Payout Determined by Spending Guideline

	2006	*2007*	*2008*	*2009*	*2010*
Spending per unit	$6.81	$7.22	$7.80	$8.54	$8.54
Net asset value per unit	$195.73	$229.89	$221.24	$173.40	$180.65
Payout rate*	3.53%	3.28%	3.35%	4.16%	4.6%
Total (in millions)	$176.21	$197.50	$233.50	$272.95	$281.91
Growth in total spending	9.15%	12.08%	18.23%	16.90%	3.28%

* Payout rate is calculated as spending per unit divided by the two-year average net asset value per unit before distribution of the annual contribution to the budget.

The Long-Term Balanced Pool: In Conclusion

Northwestern's portfolio weathered a difficult period in good condition and is poised to continue to grow and support the University's needs. Its success is based on the diversification of the Long-Term Balanced Pool and the skill of outstanding money managers worldwide in meeting investment objectives. Northwestern's leadership continues to maintain a long-term investment focus and remains confident in the portfolio's prospects.

William H. McLean
Vice President and Chief Investment Officer

Independent Auditors' Report

To the Board of Trustees of Northwestern University:

We have audited the accompanying consolidated statements of financial position of Northwestern University and subsidiaries (the "University") as of August 31, 2010 and 2009, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 University'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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University as of August 31, 2010 and 2009, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 5 to the consolidated financial statements, in 2009, the University adopted Accounting Standards Codification 958-205 Not-for-Profit Entities — Presentation of Financial Statements (formerly Financial Accounting Standards Board Staff Position 117-1, Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds), which required the reclassification of certain unrestricted net assets to temporarily restricted net assets.

Chicago, Illinois

January 18, 2011

Consolidated Statements of Financial Position

As of August 31, 2010, and August 31, 2009

(in thousands of dollars)	*2010*	*2009*
Assets		
Cash and cash equivalents	$227,352	$161,610
Accounts receivable	318,613	284,671
Notes receivable	48,637	52,718
Contributions receivable	85,689	153,886
Investments	6,148,291	5,759,604
Land, buildings, and equipment	1,481,292	1,436,227
Bond proceeds held by trustees	21,597	58,506
Other assets	65,746	61,953
Total assets	**$8,397,217**	**$7,969,175**
Liabilities		
Accounts payable and accrued expenses	$224,486	$237,171
Deferred revenue	319,149	303,352
Deposits payable and actuarial liability of annuities payable	72,166	75,484
Reserves for self-insurance	16,880	26,207
Government advances for student loans	39,143	38,821
Asset retirement obligations	115,326	109,810
Bonds, notes, and other debt payable	808,412	826,166
Total liabilities	**$1,595,562**	**$1,617,011**
Net assets		
Unrestricted	$4,064,966	$3,721,731
Temporarily restricted	1,698,125	1,621,873
Permanently restricted	1,038,564	1,008,560
Total net assets	**$6,801,655**	**$6,352,164**
Total liabilities and net assets	**$8,397,217**	**$7,969,175**

See Notes to the Consolidated Financial Statements, beginning on page 16.

Consolidated Statements of Activities

For the fiscal years ended August 31, 2010, and August 31, 2009

(in thousands of dollars)	*2010*				*2009*			
Operating revenues	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	**Total**	**Unrestricted**	**Temporarily restricted**	**Permanently restricted**	**Total**
Tuition and fees	$726,246			$726,246	$690,817			$690,817
(less scholarships and fellowships)	(232,857)			(232,857)	(218,207)			(218,207)
Net tuition and fees	493,389			493,389	472,610			472,610
Auxiliary services	74,842			74,842	69,625			69,625
Grants and contracts	484,503			484,503	421,324			421,324
Private gifts	96,789			96,789	30,964			30,964
Investment return designated for operations	227,481	$114,430		341,911	242,631	$112,227		354,858
Sales and services	136,277			136,277	134,751			134,751
Professional fees	28,733			28,733	26,635			26,635
Royalties and trademarks	95,531			95,531	87,155			87,155
Other income	9,446			9,446	7,830			7,830
Total operating revenues	**1,646,991**	**114,430**	**—**	**1,761,421**	**1,493,525**	**112,227**	**—**	**1,605,752**
Operating expenses								
Instruction	575,966			575,966	574,231			574,231
Research	441,906			441,906	391,481			391,481
Academic support	167,501			167,501	176,266			176,266
Student services	132,850			132,850	137,906			137,906
Institutional support	243,162			243,162	189,685			189,685
Auxiliary services	109,812			109,812	118,574			118,574
Total operating expenses	**1,671,197**	**—**	**—**	**1,671,197**	**1,588,143**	**—**	**—**	**1,588,143**
Excess (deficit) of operating revenues over expenses	**(24,206)**	**114,430**	**—**	**90,224**	**(94,618)**	**112,227**	**—**	**17,609**
Nonoperating revenues and expenses								
Private gifts and grants for buildings and equipment	4,286			4,286	14,698			14,698
Restricted private gifts		71,591	$35,632	107,223		74,390	$74,426	148,816
Net (loss) gain on annuity obligations		(1,187)	(5,628)	(6,815)		8,490	(222)	8,268
Investment returns, reduced by operating distribution	161,341	90,991		252,332	(983,305)	(596,861)		(1,580,166)
Nonoperating investment returns		2,241		2,241		2,322		2,322
Excess (deficit) of nonoperating revenues over expenses	**165,627**	**163,636**	**30,004**	**359,267**	**(968,607)**	**(511,659)**	**74,204**	**(1,406,062)**
Net assets released from restrictions	**201,814**	**(201,814)**		**—**	**161,132**	**(161,132)**		**—**
Change in net assets before reclassifications	**343,235**	**76,252**	**30,004**	**449,491**	**(902,093)**	**(560,564)**	**74,204**	**(1,388,453)**
Net asset reclassifications					**(2,051,623)**	**2,051,623**		**—**
Change in net assets	**343,235**	**76,252**	**30,004**	**449,491**	**(2,953,716)**	**1,491,059**	**74,204**	**(1,388,453)**
Beginning net assets	**3,721,731**	**1,621,873**	**1,008,560**	**6,352,164**	**6,675,447**	**130,814**	**934,356**	**7,740,617**
Ending net assets	**$4,064,966**	**$1,698,125**	**$1,038,564**	**$6,801,655**	**$3,721,731**	**$1,621,873**	**$1,008,560**	**$6,352,164**

See Notes to the Consolidated Financial Statements, beginning on page 16.

Consolidated Statements of Cash Flows

For the fiscal years ended August 31, 2010, and August 31, 2009

(in thousands of dollars)	*2010*	*2009*
Cash flows from operating activities		
Change in net assets	**$449,491**	**($1,388,453)**
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities		
Depreciation	99,448	91,264
Accretion for asset retirement obligations	5,516	5,277
Loss on retirement of equipment	167	932
Gain on sale of land and building	(53)	—
Amortization of discount on bonds payable	73	73
Accretion of premium on bonds payable	(152)	(151)
Net realized and unrealized (gains) losses on investments	(557,689)	1,290,361
Private gifts and grants for long-term investments	(4,286)	(14,698)
Changes in assets and liabilities		
Accounts receivable	(33,866)	(16,011)
Contributions receivable	68,197	(37,188)
Other assets	(3,793)	(666)
Accounts payable and accrued expenses	(2,884)	12,489
Deferred revenue	15,797	41,968
Reserves for self-insurance	(9,327)	(21,468)
Government advances for student loans	322	(115)
Net cash provided by (used in) operating activities	**26,961**	**(36,386)**
Cash flows from (used in) investing activities		
Purchases of investments	(1,266,804)	(2,005,229)
Proceeds from sales of investments	1,440,771	2,091,992
(Increase) decrease in trusts held by others	(76)	802
Increase in investments held for others	(4,965)	(1,350)
Acquisitions of land, buildings, and equipment	(154,615)	(177,865)
Proceeds from sale of plant assets	187	339
Student loans disbursed	(41,738)	(66,704)
Principal collected on student loans	45,819	101,474
Net cash from (used in) investing activities	**18,579**	**(56,541)**
Cash flows from (used in) financing activities		
Net proceeds from issuance of notes, bonds, and other debt payable	—	15,000
Principal payments on notes, bonds, and other debt payable	(17,675)	(2,580)
Decrease in bond proceeds held by trustees	36,909	60,031
Proceeds from private gifts and grants for long-term investments	4,286	14,698
(Decrease) increase in deposits payable and annuities payable	(3,318)	9,616
Net cash provided by financing activities	**20,202**	**96,765**
Increase in cash and cash equivalents	**65,742**	**3,838**
Cash and cash equivalents at beginning of year	**161,610**	**157,772**
Cash and cash equivalents at end of year	**$227,352**	**$161,610**
Supplemental disclosure of cash flow information		
Accrued liabilities for construction in progress	$10,997	$20,798
Capitalized interest	10,639	1,638
Cash paid for interest	29,621	27,116

See Notes to the Consolidated Financial Statements, beginning on page 16.

1. Summary of Significant Accounting Policies

UNIVERSITY ACTIVITIES

Northwestern University (the University) is a major private research university with more than 17,000 students enrolled in 11 academic divisions on two lakefront campuses in Evanston and Chicago and an international campus in Doha, Qatar.

Northwestern's mission is to provide the highest-quality education for its students, to develop innovative programs in research, and to sustain an academic community that embraces these enterprises. Activities supporting its mission may be classified as either operating or nonoperating.

BASIS OF ACCOUNTING

General

The University maintains its accounts and prepares its consolidated financial statements on the accrual basis of accounting in conformity with generally accepted accounting principles in the United States of America (GAAP). The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) is the source of authoritative GAAP. These statements include all wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated.

Contributions

The University prepares its consolidated financial statements in accordance with the Not-for-Profit Entities Topic of the FASB ASC. Under its revenue recognition provisions, contributions received, including unconditional promises to give (pledges), are recognized by the University as revenues at their fair values. Private gifts, including unconditional promises to give, are recognized as revenues in the period received. Conditional promises to give are not included in revenue until the conditions are substantially met. Pledges receivable due in more than one year are recorded at the present value of the estimated future cash flows.

Net Asset Classifications

Under the FASB ASC requirements for external financial reporting by not-for-profit organizations, net assets and the flow of those assets are classified in three net asset categories according to the existence or absence of donor-imposed restrictions. In addition, in fiscal year 2009 the University implemented net asset classification of endowment funds subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and enhanced disclosures for all endowment funds. For further discussion of the classification of donor-restricted endowment funds and disclosures about both donor-restricted and board-designated endowment funds, see note 5 to the consolidated financial statements.

The category *Permanently Restricted Net Assets* applies to gifts, trusts, and pledges whose donors required that the principal be held in perpetuity and that only the income be available for stipulated program operations.

The category *Temporarily Restricted Net Assets* includes gifts for which donor-imposed restrictions have not been met (these are primarily future capital projects) and trust activity and pledges receivable whose ultimate use is not permanently restricted. In addition, the excess of the current market value over the historical cost of permanently restricted endowments is classified as temporarily restricted net assets.

The category *Unrestricted Net Assets* describes funds that are legally available for any purpose and have no donor-imposed restrictions. All revenues, expenses, gains, and losses are classified as unrestricted net assets unless they are changes in temporarily or permanently restricted net assets. Net unrealized losses on permanently restricted endowment funds for which the historical cost exceeds market value are recorded as a reduction to unrestricted net assets.

Revenue from temporarily restricted sources is reclassified as unrestricted revenue when the circumstances of the restriction have been fulfilled. Donor-restricted revenues whose restrictions are met within the same fiscal year are reported as unrestricted income. The expiration of a donor-imposed restriction on a contribution is recognized in the period in which the restriction expires. All expenditures are reported in the unrestricted class of net assets, since the use of restricted contributions in accordance with the donor's stipulations causes the release of the restriction.

FAIR VALUE MEASUREMENTS

Since fiscal year 2009, the University has made fair measurements and enhanced disclosures about fair value measurements as required by the Fair Value Measurements and Disclosures Topic of the FASB ASC. For further discussion, see note 4 to the consolidated financial statements.

The University also implemented provisions of the FASB ASC Financial Instruments Topic, which provides the option of reporting selected financial assets at fair value and includes presentation and disclosure requirements to facilitate comparisons between entities using different measurement attributes for similar kinds of assets and liabilities. The University has not elected the fair value option under this guidance.

CASH AND CASH EQUIVALENTS

Cash reflects currency and deposits or other accounts with financial institutions that may be deposited or withdrawn without restriction or penalty. *Cash equivalents* represent short-term and highly liquid investments that convert readily to cash and carry little risk of change in value at maturity due to interest rate changes.

INVESTMENTS

Investments are recorded at fair value, determined on the following basis:

- Equity securities with readily determinable fair values and debt securities are valued at the last sale price (if quotations are readily available) or at the closing bid price in the principal market in which such securities are normally traded (if no sale price is available). Certain fixed-income securities are valued based on dealer-supplied valuations.
- The estimated fair values of equity securities that do not have readily determined fair values, and of other investments, are based on estimates provided by external investment managers and are examined through a valuation review process performed by management. After this review, management may determine that an adjustment to the external managers' valuations is appropriate in recording the securities' fair value at August 31. The aggregate carrying value of these securities included within fixed income, high-yield credit, absolute return, private investments, and real assets was $3,957.5 million (47.1 percent of total assets) and $3,611.9 million (45.3 percent of total assets) at August 31, 2010, and 2009, respectively. These investments are generally less liquid than other investments.

During the examination process, management reviewed the valuation policies for all partnerships in which Northwestern University is invested and deemed those policies appropriate. In addition to receiving the most recent available audited and unaudited financial statements from the external managers, management contacted the majority of general partners regarding the aggregate carrying value of the respective investments at August 31, 2010.

A range of possible values exists for these partnership investments, and therefore the estimated values may be materially different from the values that would have been used had a ready market for these partnerships existed. In the absence of another basis, management has determined that cost represents an approximation of the fair value of such investments. A small number of investments within certain partnerships may have holdings at a carrying value of cost, and management has determined this to be appropriate for these specific investments.

Investment income is recorded on the accrual basis, and purchases and sales of investment securities are reflected on a trade-date basis.

DERIVATIVE FINANCIAL INSTRUMENTS

The University uses various financial instruments to hedge equity market exposure (e.g., equity price risk) of an underlying investment strategy; if applicable, these have a reference index (e.g., S&P 500) that is the same, or highly correlated with, the reference index of the investment strategy. Such instruments are not designated as hedges for accounting purposes and are recorded at fair value.

In fiscal years 2010 and 2009, the University entered into swap agreements to hedge future interest rate movements. It also added various interest-rate options to hedge the overall portfolio and used an interest-rate swap agreement to hedge variable interest rate exposure.

FAIR VALUES OF FINANCIAL INSTRUMENTS OTHER THAN INVESTMENTS

The fair values of financial instruments other than investments are based on a variety of factors. In some cases, fair values represent quoted market prices for identical or comparable instruments. In other cases, fair values have been estimated based on assumptions about the amount and timing of estimated future cash flows and assumed discount rates reflecting varying degrees of risk. Accordingly, the fair values may not represent actual values that could have been realized at year-end or that will be realized in the future. At August 31, 2010, the fair value of the University's fixed rate debt of $364.5 million exceeded the carrying value of $342.9 million by $21.6 million. At August 31, 2009, the fair value of the University's fixed rate debt of $356.1 million exceeded the carrying value of $345.6 million by $10.5 million.

ACCOUNTS AND NOTES RECEIVABLE

Student accounts receivable arising from tuition and fees are carried net of an allowance for doubtful accounts of $494,000 and $446,000 as of August 31, 2010, and 2009, respectively. Notes receivable resulting from student loans are carried net of an allowance for doubtful accounts of $395,000 and $381,000 as of August 31, 2010, and 2009, respectively.

Receivables from Northwestern Medical Faculty Foundation, a related party (see page 19), arose out of operational activities. They totaled $12.7 million and $12.1 million as of August 31, 2010, and 2009, respectively.

CONTRIBUTIONS RECEIVABLE

Contributions receivable arising from unconditional promises to give are carried net of an allowance for uncollectible pledges that totaled $18 million and $20.5 million at August 31, 2010, and 2009, respectively. Additionally, unconditional promises expected to be collected in periods from more than one year are discounted to present value. The discount rates for pledges made in fiscal years 2010 and 2009 were 3.1 and 2.9 percent, respectively; the discount rate for pledges made in prior fiscal years ranged from 3.6 to 6.5 percent. There were no significant conditional promises to give as of August 31, 2010, and August 31, 2009.

LAND, BUILDINGS, AND EQUIPMENT

The value of land, buildings, and equipment is recorded at cost or, if received as gifts, at fair value at the date of the gift. Significant renewals and replacements are capitalized. The cost of repairs and maintenance is expensed as incurred. Purchases of library books are also expensed.

Depreciation is calculated using the straight-line method over the useful lives of the buildings and equipment, which are estimated to be 3 to 20 years for equipment and a maximum of 40 years for buildings. In accordance with the requirements of the Property, Plant, and Equipment Topic of the FASB ASC , the University reviews long-lived assets for impairment by comparing the future cash flows expected from the asset to the carrying value of the asset. If the carrying value of an asset exceeds the sum of estimated undiscounted future cash flows, an impairment loss is recognized for the difference between estimated fair value and carrying value. In management's opinion, no impairment existed as of August 31, 2010.

CHARITABLE REMAINDER TRUSTS

Charitable remainder trusts are classified as permanently restricted net assets if, upon termination of the trust, the donor permanently restricts the remaining trust assets. If the remainder is temporarily restricted or unrestricted by the donor, the charitable remainder trust assets are recorded as temporarily restricted net assets.

ANNUITIES PAYABLE

Annuities payable consist of annuity payments currently due and the actuarial amount of annuities payable. The actuarial amount of annuities payable is the present value of the aggregate liability for annuity payments over the expected lives of the beneficiaries (based on the 2000CM mortality tables in the Internal Revenue Code, Publication 1459, May 2009, and in Publication 939, April 2003).

SELF-INSURANCE RESERVES

The University maintains a self-insurance program for general liability, professional liability, and certain employee and student insurance coverages. This program is supplemented with commercial excess insurance above the University's self-insurance retention.

ASSET RETIREMENT OBLIGATIONS

The University records a liability if the fair value of the obligation to retire an asset can be reasonably estimated in accordance with the provisions of FASB ASC Asset Retirement and Environmental Obligations. Asset retirement obligations covered include those for which an entity has a legal obligation to perform an asset retirement activity; however, the timing and/or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. The University records all known asset retirement obligations for which the fair value of the liability can be reasonably estimated, including certain obligations relating to regulatory remediation.

REVENUE RECOGNITION

Revenues from tuition and fees are reported in the fiscal year in which they are earned, including pro-rata adjustments for educational programs crossing over fiscal years. Fiscal year 2011 fall-quarter tuition and fees, billed in fiscal year 2010, are reported as deferred revenue in fiscal year 2010. Similarly, fiscal year 2010 fall-quarter tuition and fees, billed in fiscal year 2009, are reported as deferred revenue in fiscal year 2009.

Revenues from auxiliary services, such as residence and food services, represent fees for goods and services furnished to University students, faculty, and staff; these revenues are recognized in the fiscal year in which the goods and services are provided. Grants and contracts revenue is recognized as expenses are incurred on a project. Professional fees arise from faculty and department services provided to external institutions such as hospitals. Sales and services revenues represent fees for services and goods provided to external parties in the course of educational activities and also include revenues from the provision of physical plant services and goods to external institutions contiguous to the University campuses. Trademark and royalty revenues arise from licensing of innovative technologies, copyrights, and other intellectual property; these revenues are recognized in the fiscal year in which they are earned. Other income includes revenues not otherwise categorized, such as rental revenues from property not held for investment, reimbursements for goods and services, and sundry payments to the University; these revenues are also recognized in the fiscal year in which they are earned.

INCOME TAXES

The Internal Revenue Service has determined that the University is exempt from income taxes under Section 501(c)(3) of the US Internal Revenue Code, except with regard to unrelated business income, which is taxed at corporate income tax rates. The University files federal and various state and local tax returns. The statute of limitations on the University's federal tax returns remains open for fiscal years 2007 through 2010.

In accordance with the requirements of the FASB ASC Income Taxes Topic, the University makes an assessment of individual tax positions and follows a process for recognition and measurement of uncertain tax positions. Tax positions are evaluated on whether they meet the "more likely than not" standard for sustainability on examination by tax authorities.

RELATED PARTIES

Northwestern Medical Faculty Foundation (NMFF) is a multispecialty physician organization committed to providing clinical care to patients and to supporting the research and academic endeavors of Northwestern's Feinberg School of Medicine. An independent not-for-profit organization, NMFF is governed by a board of directors. NMFF physicians are full-time faculty members or researchers at Feinberg and attending physicians at Northwestern Memorial Hospital. Under the terms of an agreement with the University, NMFF contributes a percentage of its revenue to a research and education fund, medical education programs, basic and applied biomedical research facilities and programs, and research and educational support services. NMFF also contributes funds to Feinberg's teaching and research activities on a discretionary basis. These contributions totaled $43.6 million in fiscal year 2010 and $26.3 million in fiscal year 2009 and are included in private gifts on the consolidated statements of activities.

USES OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the consolidated financial statements; and the reported amounts of revenues and expenses during the relevant period. Actual results could differ from those estimates.

At August 31, 2010, and 2009, reserves were established for uncollectible accounts, student loans, and pledges receivable. These reserves were estimated based on historical collection and allowance practices as well as on management's evaluation of current trends.

The reserves for self-insurance and postretirement medical and life insurance benefits were based on actuarial studies and management estimates.

The reserves for asset retirement obligations were based on analyses of University assets, review of applicable regulatory and other guidance, and management estimates.

The University believes that the methods and assumptions used in computing these reserves and liabilities are appropriate.

ACCOUNTING PRONOUNCEMENTS

The FASB ASC 815 Derivatives and Hedging Topic was effective in fiscal year 2010 for the University. This guidance improves financial reporting by requiring enhanced disclosures about the effects of derivative instruments and hedging activities on an entity's financial position, financial performance, and cash flows. The implementation had no effect on the University's consolidated financial statements.

The University also implemented the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. This guidance identifies the sources of accounting principles and the framework for selecting the principles used in preparing financial statements presented in conformity with GAAP, and arranged the sources of GAAP in a hierarchy of two levels, authoritative and nonauthoritative. The implementation had no effect on the University's consolidated financial statements.

In September 2009, Accounting Standards Update (ASU) 2009-12 was issued to amend the FASB ASC 820 Fair Value Measurements and Disclosures Topic and to provide guidance on fair value measurements and disclosures of investments in certain entities, such as investment companies and entities with attributes similar to an investment company's, that calculate net asset value (NAV) per share, or its equivalent. The guidance permits an entity, as a practical expedient, to measure the fair value of such investments based on the NAV per share, or its equivalent, without adjustment. This guidance also requires disclosure of the attributes of investments by major category, including the nature of any restrictions on an investor's ability to redeem its investments at the measurement date, any unfunded commitments, and the investment strategies of the investees. Additional guidance is provided on the classification of investments for which NAV is used to measure fair value within the fair-value hierarchy. If an entity has the ability to redeem its investment at NAV at the measurement date or near term (defined by the University as within three months of the financial statement date), the category will be Level 2 fair value measurement. If an entity does not know when it will have the ability to redeem its investment or cannot do so in the near term, the category will be Level 3 fair value measurement. This guidance was effective for the University in fiscal year 2010, and implementation required additional disclosures incorporated in note 4.

In January 2010, ASU 2010-06 was issued to amend FASB ASC 820. The amendment requires new disclosures for increased transparency and disaggregation. These include new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements related to Level 3 measurements. It also clarifies existing fair value disclosures regarding the level of disaggregation and the inputs and valuation techniques used to measure fair value. This guidance was effective for the University in fiscal year 2010, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective in fiscal year 2012. Implementation in fiscal year 2010 required additional disclosures incorporated in note 4; the University is evaluating the impact of future implementation on the consolidated financial statements.

2. Bonds, Notes, and Other Debt Payable

Bonds, notes, and other debt payable are as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Demand revenue bonds		
IEFA–Series 1993	$12,760	$15,435
Less unamortized discount on IEFA–Series 1993	(292)	(365)
IEFA–Series 2003	185,010	185,010
IFA–Series 2004	135,800	135,800
IFA–Series 2006	145,130	145,130
Plus unaccreted premium on IFA–Series 2006	5,004	5,156
IFA–Series 2008	125,000	125,000
Bonds payable subtotal	**608,412**	**611,166**
Notes payable — commercial paper, taxable	180,000	165,000
Other debt payable — lines of credit	20,000	50,000
Total bonds, notes, and other debt payable	**$808,412**	**$826,166**

Debt issuance	**Interest rate mode**	**Interest rate**	**Maturity**
IEFA–Series 1993	Fixed	5.5%*	December 1, 2010, to December 1, 2013
IEFA–Series 2003	Fixed	5%*	December 1, 2014, to December 1, 2038
IFA–Series 2004	Variable, annual rate	.4% and .32%†	December 1, 2034
IFA–Series 2006	Fixed	5%*	December 1, 2042
IFA–Series 2008	Variable, annual rate	.4% and .32%†	December 1, 2046
Notes payable —commercial paper, taxable	Fixed	.3%*	September 15, 2010, to November 2, 2010
Other debt payable — lines of credit	Fixed	.98%	September 7, 2010

** Weighted average interest rate at August 31, 2010* † *Annual variable rates at August 31, 2010*

Total obligations including notes and other debt payable at August 31, 2010, are scheduled to mature through August 31 of each period as noted at right. The schedule has been prepared based on the contractual maturities of the debt outstanding at August 31, 2010. Accordingly, if remarketing of bonds fails in future periods, debt repayments may become more accelerated than presented here.

(in thousands of dollars)	
2011	$202,954
2012	3,149
2013	3,344
2014	3,629
2015	3,622
2016–2020	22,163
2021–2025	10,893
2026–2030	758
2031–2035	158,538
Thereafter	399,362
Total	**$808,412**

BONDS PAYABLE

The IEFA–Series 1993 Revenue Refunding Bonds operate in a fixed mode until maturity, bearing interest at fixed rates ranging from 3 percent to 5.55 percent. Proceeds of the refunding bonds were invested in United States government securities with a cost of $75.4 million and placed in escrow to satisfy scheduled payments of $66.4 million of the IEFA–Series 1985 bonds and related interest until maturity.

The IEFA–Series 2003 Fixed Rate Revenue Bonds were issued to acquire, construct, or renovate certain University facilities and to refund $35 million of the University's outstanding IEFA–Series 1993 bonds, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Facilities Authority.

The IFA–Series 2004 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects on both the Evanston and the Chicago campuses, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode. In fiscal year 2010, the revenue bonds were remarketed from an annual rate mode to an adjustable rate period of 393 days.

The IFA–Series 2006 Revenue Bonds were issued to refund the University's outstanding IEFA–Series 1997 Adjustable Medium-Term Revenue Bonds totaling $145 million. The refunding bonds are subject to conditions set forth in a trust indenture and loan agreement between the University and the authority.

The IFA–Series 2008 Adjustable Rate Revenue Bonds were issued to acquire, construct, renovate, remodel, improve, and equip capital projects, subject to conditions set forth in a trust indenture and loan agreement between the University and the Illinois Finance Authority. The bonds may operate in a daily, weekly, adjustable, or auction-rate mode. In fiscal year 2010, the revenue bonds were remarketed from an annual rate mode to an adjustable rate period of 393 days.

DERIVATIVE FINANCIAL INSTRUMENTS

The University entered into interest-rate swap agreements to hedge variable interest rate exposure. The agreements effectively fix the interest rate from 4.2 percent to 4.38 percent and expire on December 1, 2046. The notional value is $262.1 million through December 1, 2034, and reduces to $125 million effective December 2, 2034, through expiration. The University recognized unrealized losses on the swap investment totaling $31.1 million at August 31, 2010, and $17.9 million at August 31, 2009. The fair values of the swap position were ($72.6) million and ($41.5) million as of August 31, 2010, and 2009, respectively, and are included in accounts payable and accrued expenses on the consolidated statements of financial position.

NOTES PAYABLE

The University places commercial paper under a $200 million Taxable Commercial Paper Note.

OTHER DEBT PAYABLE

During the fiscal year, the University held or had the ability to draw $350 million in standby lines of credit to supplement working capital requirements as follows: $100 million renewed July 22, 2010, expires July 22, 2011; $50 million amended March 26, 2010, renewed August 19, 2010, expires August 18, 2011; $50 million renewed March 26, 2010, expires March 25, 2011; $50 million established April 24, 2009, expired April 22, 2010; $75 million renewed June 16, 2010, expires June 15, 2011; and $25 million established August 19, 2010, expires August 19, 2011.

3. Contributions Receivable

Contributions receivable consisted of the following:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Unconditional promises expected to be collected in		
Less than one year	$52,683	$124,449
One year to five years	51,107	54,896
More than five years	3,887	1,619
Less discount to present value and other reserves		
Discount to present value	(3,994)	(6,606)
Other reserves	(17,994)	(20,472)
Total	**$85,689**	**$153,886**

Contributions receivable are discounted based on the weighted average borrowing rates for short-term and long-term bonds, notes, and other debt payable to correspond to the terms of the pledges receivable. The University deems these yields to be a Level 3 input in accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC. See note 4 for further discussion of this topic.

The table at right summarizes the change in contributions receivable for the year ended August 31, 2010.

(in thousands of dollars)	
Balance — beginning of year	$153,886
New pledges	25,891
Collections on pledges	(60,178)
Adjustments to pledges	(39,000)
Decrease in discount to present value	2,612
Decrease in other reserves	2,478
Balance — end of year	**$85,689**

4. Investments

The University's investments are overseen by the Investment Committee of the Board of Trustees. Guided by the policies established by the Investment Committee, the University's Investment Office or external equity investment managers, external and internal fixed-income and cash managers, and various limited partnership managers direct the investment of endowment and trust assets, certain working capital, temporarily invested expendable funds, and commercial real estate.

Substantially all of these assets are merged into internally managed investment pools on a market-value basis. Each holder of units in the investment pools subscribes to or disposes of units on the basis of the market value per unit at the beginning of each month.

INVESTMENT MARKET VALUE

The University has valued its investments in accordance with the provisions of the Fair Value Measurements and Disclosures Topic of the FASB ASC. This guideline establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity; unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or a liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The fair-value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the University for financial instruments measured at fair value on a recurring basis.

Level 1: Quoted prices in active markets for identical assets or liabilities. Market price data are generally obtained from relevant exchanges or dealer markets.

Level 2: Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities. Inputs are obtained from various sources, including market participants, dealers, and brokers.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following charts show the estimated fair value of investments and derivatives held by the University, grouped by the valuation hierarchy as defined above, for the fiscal years ending August 31, 2010, and 2009:

(in thousands of dollars) *August 31, 2010*

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
US equity securities	$218,504	$158,231	$303,894	$680,629
International equity	259,948	331,600	315,522	907,070
Fixed income	18,564	562,143	450	581,157
High-yield credit	—	15,179	523,884	539,063
Absolute return	—	173,241	767,199	940,440
Private investments	241	—	1,433,845	1,434,086
Real assets	71,723	(30)	964,388	1,036,081
Other investments	—	2,553	37,519	40,072
Subtotal investment assets	**568,980**	**1,242,917**	**4,346,701**	**6,158,598**
Interest-rate derivatives	—	—	(10,307)	(10,307)
Subtotal investments	**568,980**	**1,242,917**	**4,336,394**	**6,148,291**
Interest-rate swaps	—	—	(72,620)	(72,620)
Total	**$568,980**	**$1,242,917**	**$4,263,774**	**$6,075,671**

(in thousands of dollars)				*August 31, 2009*
	Quoted prices in active markets (Level 1)	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total fair value**
US equity securities	$177,466	$166,060	$278,138	$621,664
International equity	258,873	294,176	181,004	734,053
Fixed income	79,998	532,700	173,121	785,819
High-yield credit	—	—	490,098	490,098
Absolute return	—	49,139	889,401	938,540
Private investments	16,985	—	1,177,180	1,194,165
Real assets	39,869	787	889,178	929,834
Other investments	—	1,455	49,431	50,886
Subtotal investment assets	**573,191**	**1,044,317**	**4,127,551**	**5,745,059**
Interest-rate derivatives	—	—	14,545	14,545
Subtotal investments	**573,191**	**1,044,317**	**4,142,096**	**5,759,604**
Interest-rate swaps	—	—	(41,518)	(41,518)
Total	**$573,191**	**$1,044,317**	**$4,100,578**	**$5,718,086**

Investments included in Level 3 primarily consist of the University's ownership in alternative investments (principally limited partnership interests in hedge, private equity, real estate, and other similar funds).

Interest-rate swaps are valued using observable inputs, such as quotations received from the counterparty, dealers, or brokers, whenever available and considered reliable. In instances where models are used, the value of the interest-rate swap depends on the contractual terms of, and specific risks inherent in, the instrument as well as the availability and reliability of observable inputs. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, and correlations of such inputs. The interest-rate swap arrangements have inputs that are unobservable and have little or no market activity and therefore are classified within Level 3.

Perpetual trusts held by third parties are valued at the present value of the future distributions expected to be received over the term of the agreement and are included in other investments in the summary of changes in investments within Level 3.

The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the University believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following tables summarize changes in the investments and derivatives classified by the University in Level 3 of the fair value hierarchy for the fiscal years ended August 31, 2010, and 2009:

(in thousands of dollars)	*August 31, 2009*					*August 31, 2010*
	Fair value	**Transfers into Level 3**	**Transfers out of Level 3**	**Realized/ unrealized gains (losses)**	**Net purchases, sales, and settlements**	**Fair value**
US equity securities	$278,139	—	—	35,767	(10,012)	$303,894
International equity	181,004	—	(14,451)	29,971	118,998	315,522
Fixed income	173,121	—	—	8,786	(181,457)	450
High-yield credit	490,097	—	(12,363)	97,925	(51,775)	523,884
Absolute return	889,401	—	(87,433)	42,884	(77,653)	767,199
Private investments	1,177,180	—	—	126,181	130,484	1,433,845
Real assets	889,178	—	—	(44,487)	119,697	964,388
Other investments	49,431	—	—	706	(12,618)	37,519
Total investment assets	**4,127,551**	—	**(114,247)**	**297,733**	**35,664**	**4,346,701**
Interest-rate derivatives	14,545	—	—	(10,836)	(14,016)	(10,307)
Subtotal investments	**4,142,096**	—	**(114,247)**	**286,897**	**21,648**	**4,336,394**
Interest-rate swaps	(41,518)	—	—	(31,102)	—	(72,620)
Total	**$4,100,578**	—	**(114,247)**	**255,795**	**21,648**	**$4,263,774**

(in thousands of dollars)	August 31, 2008					August 31, 2009
	Fair value	Transfers into Level 3	Transfers out of Level 3	Realized/ unrealized gains (losses)	Net purchases, sales, and settlements	Fair value
US equity securities	$405,738	—	—	(77,472)	(50,127)	$278,139
International equity	101,767	—	—	(16,656)	95,893	181,004
Fixed income	161,851	—	—	28,698	(17,428)	173,121
High-yield credit	494,406	—	—	(65,175)	60,866	490,097
Absolute return	1,213,836	—	—	(168,622)	(155,813)	889,401
Private investments	1,383,444	—	—	(306,513)	100,249	1,177,180
Real assets	1,121,775	—	—	(358,524)	125,927	889,178
Other investments	69,035	—	—	(4,153)	(15,451)	49,431
Total investment assets	**4,951,852**	—	—	**(968,417)**	**144,116**	**4,127,551**
Interest-rate derivatives	—	—	—	13,998	547	14,545
Subtotal investments	**4,951,852**	—	—	**(954,419)**	**144,663**	**4,142,096**
Interest-rate swaps	(23,654)	—	—	(17,864)	—	(41,518)
Total	**$4,928,198**	—	—	**(972,283)**	**144,663**	**$4,100,578**

The next table presents significant liquidity and redemption terms of investment funds by asset class. The University is obligated under certain partnership fund agreements to advance additional funding up to specified levels over a period of several years. These commitments have fixed expiration dates and other termination clauses, and the contractual agreements of these partnerships may limit the University's ability to initiate redemptions due to notice periods, lock-ups, and gates. At August 31, 2010, the University was committed to making future capital contributions in other investments in the amount of $1,274 million, primarily in the next five years, as detailed in the next table.

(in thousands of dollars)					
	Fair value	Remaining life	Unfunded commitments	Redemption terms	Redemption restrictions
US equity securities	$680,629	No limit	$7,000	Daily to annually, with 1–90-day notice periods	Lock-up provisions ranging from none to 2 years
International equity	907,070	No limit	15,000	Daily to annually, with 1–93-day notice periods	Lock-up provisions ranging from none to 3 years
Fixed income	581,157	No limit	—	Daily to monthly, with 1–10-day notice periods	None
High-yield credit	539,063	No limit to 8 years	61,773	Distressed partnerships ineligible for redemption; other funds monthly to annually, with 30–90-day notice periods	Distressed partnerships not redeemable; lock-up provisions on all other funds ranging from none to 2 years
Absolute return	940,440	No limit	—	Monthly to annually, with 5–120-day notice periods	Lock-up provisions ranging from none to 5 years; side pockets on many funds
Private investments	1,434,086	1–12 years	626,845	Partnerships ineligible for redemption	Not redeemable
Real assets	1,036,081	No limit to 14 years	563,187	Partnerships ineligible for redemption; commodity funds daily to annually, with 3–30-day notice periods	Partnerships not redeemable; no restrictions on commodity funds

INVESTMENT RETURN

The components of total investment return were as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Investment income	$38,719	$68,177
Net realized gains (losses)	216,364	(226,384)
Change in net unrealized gains (losses) on investments reported at fair value	341,401	(1,064,779)
Total investment return	**$596,484**	**($1,222,986)**

Investment return designated for operations is defined as the investment payout, according to the spending guideline for the Long-Term Balanced Pool and the actual investment income for all other investments. Other investment returns are categorized as nonoperating. As reflected in the consolidated statements of activities, investment return was as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Changes in unrestricted net assets		
Operating: investment return	$227,481	$242,631
Nonoperating: investment returns, reduced by operating distribution	161,341	(983,305)
Changes in temporarily restricted net assets		
Operating: investment return	114,430	112,227
Nonoperating: investment returns, reduced by operating distribution	90,991	(596,861)
Investment return	2,241	2,322
Total investment return	**$596,484**	**($1,222,986)**

DERIVATIVE FINANCIAL INSTRUMENTS

The University entered into hedging transactions via various interest-rate swaps and options in fiscal years 2010 and 2009. The swaps and options had a realized gain of $33.7 million during fiscal year 2010 and a realized gain of $800,000 during fiscal year 2009. The positions carried an unrealized loss of $10.3 million as of August 31, 2010, and an unrealized gain of $26.1 million as of August 31, 2009. These swaps and options had a notional value of $400 million million and $3,000 million at August 31, 2010, and August 31, 2009, respectively. These instruments are held in the fixed-income asset class in the summary of changes in investments within Level 3.

In fiscal year 2009, the University entered into a swap agreement to gain equity exposure to a subindex of the S&P 500 index and terminated exposure to various subindices as well as a commodities index. The notional value of these swaps outstanding at August 31, 2009, was $26.2 million. The equity index swap had an unrealized gain of $144,000 at August 31, 2009. The swaps had a realized loss of $38.7 million during fiscal year 2009. This swap agreement was terminated in fiscal year 2010 and had a realized gain of $1.4 million.

In addition, the University terminated a euro-dominated foreign currency swap during fiscal year 2009 as an economic hedge against a portion of future capital commitments on foreign currencies. The swap had a realized loss of $13.5 million.

The University bought and sold futures contracts on a domestic equity index during fiscal year 2009 and incurred realized losses of $12.4 million. As of August 31, 2010 and 2009, the University had no S&P 500 index futures contracts outstanding.

The University also bought and sold futures contracts on international equity indices during 2009 and incurred realized losses of $11.5 million. As of August 31, 2010 and 2009, there were no international equity index contracts outstanding. Such equity instruments are not designated as hedges for accounting purposes and are recorded at fair value and included in investments on the consolidated statements of financial position.

Credit exposure represents the University's potential loss if all the counterparties fail to perform under the terms of the contracts, and if all collateral, if any, becomes worthless. This exposure is measured by the fair value of the cash collateral held at the counterparties at the reporting date. The University manages its exposure to credit risk by using highly rated counterparties, establishing risk control limits, and obtaining collateral where appropriate. As a result, the University has limited credit risk. In fiscal year 2009, the University entered into a margin collateral agreement with a major counterparty that imposes a $1 million threshold on both parties. As of August 31, 2010, the collateral account at the counterparty held $9.7 million in cash to support the University's unrealized loss at fiscal year end. As of August 31, 2009, the collateral account at the University's custodian bank held $32.7 million of treasury securities pledged by the counterparty to support the University's unrealized gains at fiscal year end. To date, the University has not incurred any losses on derivative financial instruments due to counterparty nonperformance.

The University regularly reviews the use of derivative financial instruments by each of the managers of alternative investment funds in which it participates. While these outside managers generally use such instruments for hedging purposes, derivative financial instruments are employed for trading purposes by 32 independent asset managers of the University funds totaling approximately $1,640 million and $1,650 million at August 31, 2010, and 2009, respectively.

5. Endowments

The FASB ASC Not-for-Profit Entities Presentation of Financial Statements Subtopic (ASC Subtopic 958-205) provides guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to an enacted version of UPMIFA and improves disclosure about an organization's endowment funds, both donor-restricted and board-designated, regardless of whether the organization is subject to UPMIFA. Illinois adopted UPMIFA effective for institutional funds existing on or established after June 30, 2009; the University implemented the provisions for the year ended August 31, 2009.

The University interprets UPMIFA as requiring that the fair value of the original donor-restricted endowment gift be preserved as of the gift date unless there are explicit donor stipulations to the contrary. Therefore, the University classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts, and accumulations to the permanent endowment made in accordance with the applicable donor gift instrument at the time the accumulation was added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for University expenditure in a manner consistent with UPMIFA's standard of prudence. In accordance with UPMIFA, the University considers the following factors in determining to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the endowment fund
- The purposes of the institution and of the endowment fund
- General economic conditions
- The possible effects of inflation or deflation
- The expected total return from income and appreciation of investments
- Other resources of the institution
- The institutional investment policy

The University's endowment consists of about 2,000 individual donor-restricted endowment funds and about 800 funds it designates to function as endowments. The net assets associated with endowment funds, including funds designated by the University to function as endowments, are classified and reported based on whether there are donor-imposed restrictions. Institution-designated endowment funds include quasi-endowments established by specific Board of Trustees approval as well as endowments created by management under general guidelines and policies approved by the Board of Trustees.

As a result of the implementation of the enhanced endowment classification at the beginning of fiscal year 2009, the portion of donor-restricted net assets not classified as permanently restricted in the amount of $2,052 million was reclassified from unrestricted net assets to temporarily restricted net assets to conform with the prescribed reporting requirements.

The following tables present the endowment net asset composition by type of fund at fair value for the years ended August 31, 2010, and 2009:

(in thousands of dollars) *August 31, 2010*

Endowment net asset composition by type of fund	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds		$1,561,568	$934,903	$2,496,471
Institution-designated endowment funds	$2,230,469			2,230,469
Total endowment funds	**$2,230,469**	**$1,561,568**	**$934,903**	**$4,726,940**

(in thousands of dollars) *August 31, 2009*

Endowment net asset composition by type of fund	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds		$1,470,149	$865,525	$2,335,674
Institution-designated endowment funds	$2,062,526			2,062,526
Total endowment funds	**$2,062,526**	**$1,470,149**	**$865,525**	**$4,398,200**

INVESTMENT AND SPENDING POLICIES

The University's endowment is primarily invested in the Long-Term Balanced Pool, which is managed with the objective of long-term total return. The Investment Committee of the Board of Trustees annually reviews asset allocation policy for the pool.

The principal objective for the Long-Term Balanced Pool is to preserve purchasing power and to provide a growing stream of income to fund University programs. On average, the pool seeks to achieve an annual total rate of return (i.e., actual income plus appreciation) equal to inflation plus actual spending. This objective of preserving purchasing power emphasizes the need for a long-term perspective in formulating both spending and investment policies.

The Board of Trustees has adopted a guideline for the annual spending rate from the University's Long-Term Balanced Pool. The calculation blends market and spending elements for the total annual spending rate.

The market element is an amount equal to 4.35 percent of the market value of a unit in the pool, averaged for the 12 months ending October 31 of the prior fiscal year. It is weighted at 30 percent in determining the total. The spending element is an amount equal to the current fiscal year's spending amount increased by 1.5 percent plus the actual rate of inflation. It is weighted at 70 percent in determining the total.

For the year ended August, 31,2010, it was decided that the endowment spending payout would remain at the 2009 rate of $8.54 per unit. If investment income received is not sufficient to support the total-return objective, the balance is provided from realized and unrealized gains. If the income received is in excess of the objective, the balance is reinvested in the Long-Term Balanced Pool on behalf of the unit holders.

The University's Policy is to allocate the current income of all other investment pools.

CHANGE IN ENDOWMENT NET ASSETS

The following tables represent the changes in endowment net assets for the year ended August 31, 2010, and 2009:

(in thousands of dollars) *August 31, 2010*

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, beginning of year	$2,062,526	$1,470,149	$865,525	$4,398,200
Investment income	(4,792)	(5,333)		(10,125)
Net appreciation (realized and unrealized)	200,285	210,754		411,039
Total investment return	195,493	205,421	—	400,914
Contributions		414	60,623	61,037
Appropriation of endowment assets for expenditure	(102,546)	(115,610)		(218,156)
Other changes				
Transfers to create institutional funds	113,444			113,444
Transfers of institutional funds per donor requirement		2,855	8,970	11,825
Spending of institution-designated endowment fund	(41,468)			(41,468)
Other reclassifications	3,020	(1,661)	(215)	1,144
Endowment net assets, end of year	**$2,230,469**	**$1,561,568**	**$934,903**	**$4,726,940**

(in thousands of dollars) *August 31, 2009*

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, September 1, 2008	$4,538,656	$20,395	$819,091	$5,378,142
Reclassification due to adoption of ASC Subtopic 958-205	(2,051,623)	2,051,623		—
Endowment net assets, beginning of year	2,487,033	2,072,018	819,091	5,378,142
Investment return				
Investment income	6,130	7,928		14,058
Net depreciation (realized and unrealized)	(420,752)	(496,189)		(916,941)
Total investment return	(414,622)	(488,261)	—	(902,883)
Contributions	8,670	898	39,888	49,456
Appropriation of endowment assets for expenditure	(98,770)	(114,056)		(212,826)
Other changes				
Transfers to create institutional funds	98,478			98,478
Transfers of institutional funds per donor requirement		402	5,694	6,096
Spending of institution-designated endowment fund	(18,263)			(18,263)
Other reclassifications		(852)	852	—
Endowment net assets, end of year	**$2,062,526**	**$1,470,149**	**$865,525**	**$4,398,200**

UNDERWATER ENDOWMENT FUNDS

The University monitors endowment funds to identify those for which historical cost was more than fair value. As of August 31, 2010, and 2009, respectively, the historical cost for such accounts was approximately $218 million and $197.7 million, and the fair value totaled $198 million and $172 million. Associated unrealized losses are recorded in the unrestricted net assets classification.

6. Retirement Plans

The University maintains two contributory retirement plans for its eligible faculty and staff. The plans offer employees the choice of two investment company options, Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF), and the mutual funds offered by Fidelity Investments. The measurement date for plans is August 31. Participating employee and University contributions are immediately vested. The University contributed $54.3 million and $47.7 million to the two plans in 2010 and 2009, respectively. It expects to contribute $57 million to the two plans in 2011.

The University currently sponsors a health care plan permitting retirees to continue participation on a "pay-all" basis. The retiree contribution is based on the average per-capita cost of coverage for the plan's entire group of active employees and retirees rather than the per-capita cost for retirees only. Retirees are also eligible to participate in certain tuition reimbursement plans and may receive a payment for sick days accumulated at retirement. The accrued cost for postemployment benefits was $7.2 million and $7.7 million at August 31, 2010, and 2009, respectively, and is included in accounts payable and accrued expenses on the consolidated statements of financial position.

Guidance under the Compensation — Retirement Benefits Topic of the FASB ASC requires an employer sponsoring one or more single-employer defined-benefit plans to recognize an asset or a liability in the statements of financial position for the plans' overfunded or underfunded status. The asset or liability is the difference between the fair value of plan assets and the related benefit obligation, defined as the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for other postretirement benefit plans such as a retiree health care plan. An employer also must recognize actuarial gains or losses and prior service costs or credits in the statements of activities that arise during the period but are not components of net periodic benefit cost. In addition, an employer must measure defined-benefit plan assets and obligations as of the date of its fiscal year-end and make specified disclosures for the upcoming fiscal year.

The University funds the benefit costs as they are incurred. The accumulated postretirement benefit obligation (APBO) was as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Active employees not yet eligible	$5,924	$4,955
Active employees eligible	6,629	5,710
Retirees	2,311	2,308
Total	**$14,864**	**$12,973**

The following table sets forth the plan's change in benefit obligation:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Benefit obligation at beginning of year	$12,973	$9,450
Service cost (benefits attributed to employee service during the year)	679	439
Interest cost on accumulated postretirement benefit obligation	696	642
Actuarial loss	1,160	3,001
Benefits paid	(1,438)	(1,242)
Contributions from participants	794	683
Benefit obligation at end of year	**$14,864**	**$12,973**

The following table sets forth the change in plan assets:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Fair value of plan assets at beginning of year	—	—
Employer contribution	$644	$559
Benefits paid	(1,438)	(1,242)
Contributions from participants	794	683
Fair value of plan assets at end of year	**—**	**—**

The accrued benefit cost recognized in the consolidated statements of financial position, which is included in accounts payable and accrued expenses, was $14.9 million and $13 million at August 31, 2010, and 2009, respectively.

The components of the net periodic postretirement benefit cost were as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Service cost (benefits attributed to employee service during the year)	$679	$439
Interest cost on accumulated postretirement benefit obligation	696	642
Amortization of prior service cost	109	109
Amortization of unrealized loss	231	92
Total	**$1,715**	**$1,282**

The following tables present key actuarial assumptions used in determining APBO as of August 31, 2010, and 2009. First, the assumptions used to determine benefit obligations:

	August 31, 2010	*August 31, 2009*
Settlement (discount) rate	4.4%	6%
Weighted average rate of increase in future compensation levels	4%	4%
Current pre-65 health cost trend rate	6%	7%
Current post-64 health cost trend rate	6%	7%
Ultimate health care cost trend rate	5%	5%
Year when trend rate will reach ultimate trend rate	2011	2011

Next, the assumptions used to define net periodic benefit cost:

	August 31, 2010	*August 31, 2009*
Discount rate	5.5%	7%
Weighted average rate of increase in future compensation levels	4%	4%
Current pre-65 health cost trend rate	7%	8%
Current post-64 health cost trend rate	7%	8%
Ultimate health care cost trend rate	5%	5%
Year when trend rate will reach ultimate trend rate	2011	2011

A one-percentage-point change in assumed health care cost trend rates would have had these effects in fiscal year 2010:

(in thousands of dollars)	*1% point increase*	*1% point decrease*
Increase (decrease) in total of service and interest cost	$129	($111)
Increase (decrease) in postretirement benefit obligation	1,069	(935)

Estimated future benefit payments reflecting anticipated service, as appropriate, are expected to be paid as shown at right.

(in thousands of dollars)	
2011	$717
2012	733
2013	840
2014	969
2015	1,098
2016–2020	7,046
Total	**$11,403**

The University offers a deferred compensation plan under Internal Revenue Code 457(b) to a select group of management and highly compensated employees. There is no University contribution related to this deferred compensation plan. The University has recorded both an asset and a liability related to the deferred compensation plan that totaled $23.1 million and $18.2 million in fiscal years 2010 and 2009, respectively; these are included in investments and actuarial liability of annuities payable and deposits payable on the consolidated statements of financial position.

In accordance with the FASB ASC Compensation — Retirement Benefits Topic, the University is required to disclose the effects of the act and assess the impact of the Medicare Part D subsidy on the accumulated postretirement benefit obligation and net periodic postretirement benefit cost. Since the University chose not to pursue the subsidy, measures of the APBO or net periodic postretirement benefit cost do not reflect any amount associated with it in 2010 or prior years.

7. Land, Buildings, and Equipment

Land, buildings, and equipment consisted of the following:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Land	$28,360	$27,355
Construction in progress	111,191	162,319
Buildings and leasehold improvements	1,895,137	1,744,632
Equipment	431,126	388,733
Accumulated depreciation	(984,522)	(886,812)
Total	**$1,481,292**	**$1,436,227**

The estimated cost to complete construction in progress at August 31, 2010, is $279.5 million. Costs included in construction in progress are future leasehold improvements and building and equipment capitalizations. Building costs are funded by loans, gifts (received or pledged), grants, and unrestricted funds.

Under the University's interest capitalization policy, actual interest incurred during the period of construction of an asset for University use is capitalized until that asset is substantially completed and ready for use. The capitalized cost is reflected in the total cost of the asset and depreciated over the useful life of the asset. Assets may include buildings and major equipment.

ASSET RETIREMENT OBLIGATIONS

In accordance with the provisions of the FASB ASC Asset Retirement and Environmental Obligations Topic, the University records all known asset retirement obligations and changes to those obligations. Asset retirement obligations at August 31, 2009, were adjusted during 2010 as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Balance at beginning of year	$109,810	$104,533
Accretion expense	5,516	5,277
Balance at end of year	**$115,326**	**$109,810**

At August 31, 2010, the depreciation and accretion expenses were $408,000 and $5.5 million, respectively. At August 31, 2009, they were $408,000 and $5.3 million, respectively.

LEASE OBLIGATIONS

The University is obligated under numerous operating leases to pay base rent through the lease expiration dates. Operating leases consist primarily of leases for the use of real property and have terms expiring in various years through fiscal year 2025. Noncancelable real estate lease expenses allocated on a straight-line basis over the term of the leases totaled $7.8 million at August 31, 2010, and $8.4 million at August 31, 2009. The future minimum lease payments under noncancelable operating leases through August 31 of each period are as shown at right.

(in thousands of dollars)	
2011	$8,396
2012	9,215
2013	8,972
2014	9,037
2015	9,143
2016 and thereafter	49,240
Total	**$94,003**

8. Allocation of Expenses

The University allocated depreciation, plant maintenance expenditures, and interest on indebtedness to the various functional expense categories in the consolidated statements of activities for the fiscal years ended August 31, 2010, and 2009. Those expenses have been distributed to the functional areas of the University as follows:

(in thousands of dollars)				*August 31, 2010*
	Accretion for ARO	**Depreciation**	**Plant maintenance**	**Interest on bond indebtedness**
Instruction	$709	$12,787	$16,277	$3,722
Research	1,369	24,682	31,420	7,185
Academic support	1,044	18,824	23,962	5,479
Student services	718	12,937	16,468	3,766
Institutional support	286	5,153	6,560	1,500
Auxiliary services	1,390	25,065	31,906	7,296
Total	**$5,516**	**$99,448**	**$126,593**	**$28,948**

(in thousands of dollars)				*August 31, 2009*
	Accretion for ARO	**Depreciation**	**Plant maintenance**	**Interest on bond indebtedness**
Instruction	$746	$12,895	$19,807	$3,991
Research	1,249	21,615	33,203	6,690
Academic support	964	16,665	25,598	5,157
Student services	802	13,875	21,312	4,294
Institutional support	272	4,706	7,228	1,456
Auxiliary services	1,244	21,508	33,037	6,656
Total	**$5,277**	**$91,264**	**$140,185**	**$28,244**

The allocations were based on the functional use of space on the University's campuses.

9. Self-Insurance Reserves and Other Contingencies

Reserves for losses under the University's self-insurance program, aggregating $16.9 million and $26.2 million at August 31, 2010, and 2009, respectively, include reserves for known losses and for losses incurred but not yet reported. A portion of the reserves pertaining to professional liability has been determined on a discounted present-value basis. The discount rate was 7.5 percent in fiscal years 2010 and 2009. Self-insurance reserves are based on estimates of historical loss experience, and while management believes that the reserves are adequate, the ultimate liabilities may be more or less than the amounts provided.

Under an agreement between the University and Northwestern Medical Faculty Foundation, a proportionate share of primary medical professional liability costs that arise out of events prior to November 1, 2004, is borne by NMFF. As of November 1, 2004, NMFF obtained excess medical liability coverage through another institution for all events after October 1, 2002, and reported after November 1, 2004. As of August 31, 2010, and 2009, there were no accounts receivable from NMFF related to professional liability insurance costs.

The University has contracted to service student loans sold to a lending agency prior to fiscal year 2009; these totaled $145.9 million and $178.1 million at August 31, 2010, and 2009, respectively. Service revenues are the excess of the actual interest collected above the agreed-upon warehouse fees on the serviced loans. The University manages the program to break even and generates no servicing assets or liabilities through these activities. The University guarantees these loans against default up to 10 percent of the original domestic loan portfolio and 30 percent of the original international amounts. The maximum future total payments were $17 million as of August 31, 2010. At August 31, 2010, and 2009, $234,000 and $265,000, respectively, were reserved in anticipation of future defaults. Notes receivable on the consolidated statements of position are shown net of these reserves in fiscal years 2010 and 2009.

In August 2009, the University, as originating lender, began participation in a student loan securitization program. It sold $65 million of student loans to a school trust; the University issued University guaranteed notes, which were purchased by a funding trust that procures financing to support the lending program. The University sold an additional $19.8 million of student loans in a student loan securitization program in fiscal year 2010. The programs are managed to break even and generate no servicing assets or liabilities. Guaranteed notes under these programs totaled $76.5 million and $65 million as of August 31, 2010, and 2009, respectively. Reserves in anticipation of future defaults totaled $122,000 and $97,000 at

August 31, 2010, and 2009, respectively. Notes receivable on the consolidated statements of position are shown net of this reserve in fiscal years 2010 and 2009.

From time to time, various claims and suits generally incidental to the conduct of normal business are pending or may arise against the University. It is the opinion of management of the University, after taking into account insurance coverage, that any losses from the resolution of pending litigation should not have a material effect on the University's financial position or results of operations.

All funds expended in connection with government grants and contracts are subject to audit by government agencies. While any ultimate liability from audits of government grants and contracts by government agencies cannot be determined at present, management believes that it should not have a material effect on the University's financial position or results of operations.

10. Natural Classification of Expenses

Operating expenses incurred in the fiscal years ended August 31, 2010, and 2009, were as follows:

(in thousands of dollars)	*August 31, 2010*	*August 31, 2009*
Salaries, wages, and benefits	$865,173	$804,594
Services and professional fees	282,880	268,253
Supplies	94,934	99,871
Travel and promotion	75,506	75,527
Trademark and royalty fees	33,268	34,725
Other expenses	70,134	26,094
Maintenance, utilities, and equipment	115,390	154,294
Accretion for asset retirement obligations	5,516	5,277
Interest on bond indebtedness	28,948	28,244
Depreciation	99,448	91,264
Total	**$1,671,197**	**$1,588,143**

11. Subsequent Event

The University has evaluated subsequent events in accordance with the FASB ASC Subsequent Event Topic through January 18, 2011, the date when the consolidated financial statements were issued. The following events were identified: On January 13, 2011, the University executed an amendment to one of its interest-rate swap agreements, with a notional value of $45.2 million, that shortened the maturity date of these swaps from December 1, 2034, to August 29, 2014, at no cost. On January 14, 2011, the University executed an amendment to another of its interest-rate swap agreements, with a notional value of $46.6 million, that shortened the maturity date of these swaps from December 1, 2034, to August 29, 2014, at a cost of $60,000. On January 18, 2011, the University executed an amendment to another of its interest-rate swap agreements, with a notional value of $45.3 million, that shortened the maturity date of these swaps from December 1, 2034, to August 29, 2014, receiving $115,000 to do so.

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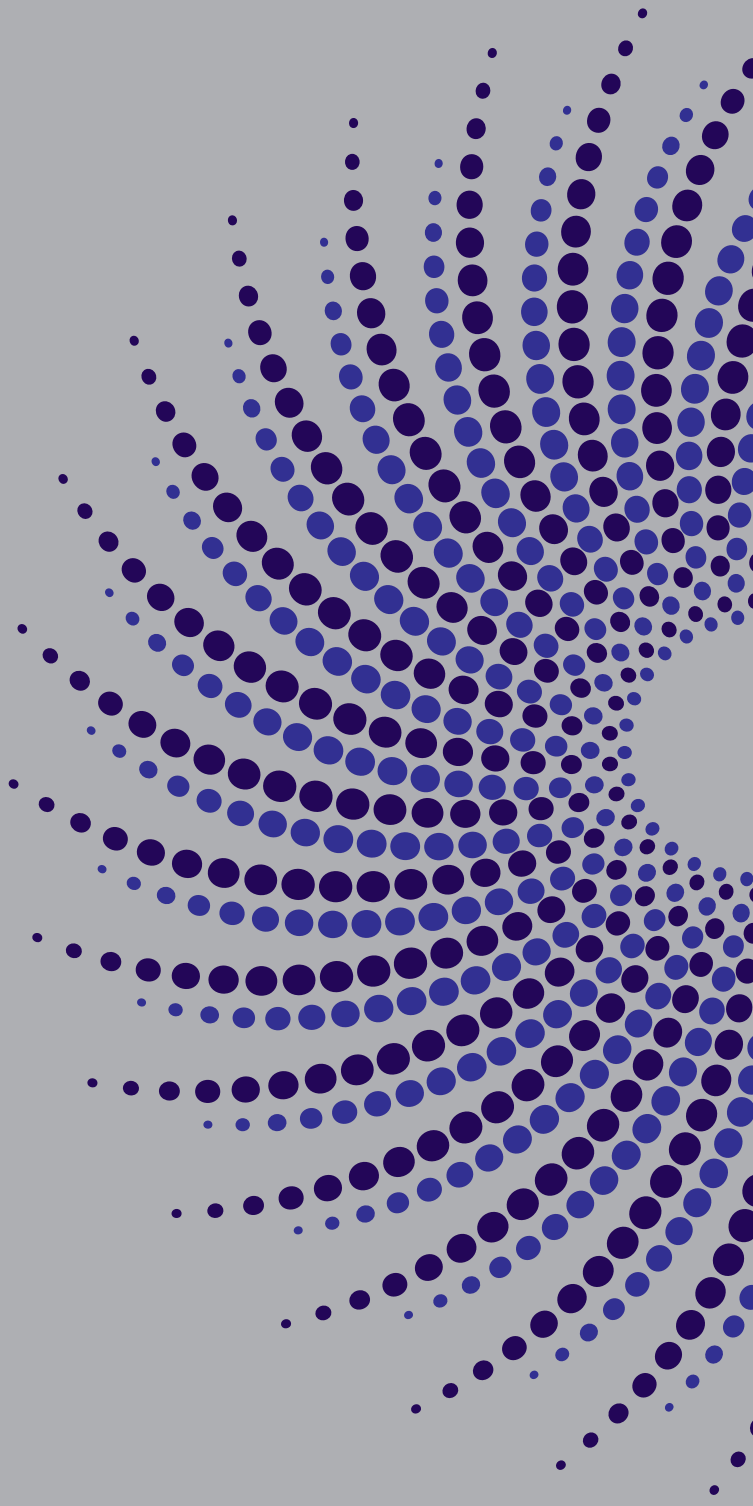

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