

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2016 AND 2015

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation: The University of Michigan (the “University”) is a state-supported institution with an enrollment of over 61,000 students on its three campuses. The financial statements include the individual schools, colleges and departments, the University of Michigan Hospitals and Health Centers, Michigan Health Corporation (a wholly-owned corporation created to pursue joint venture and managed care initiatives) and Veritas Insurance Corporation (a wholly-owned captive insurance company). While the University is a political subdivision of the state of Michigan, it is not a component unit of the State in accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*. The University is classified as a state instrumentality under Internal Revenue Code Section 115 and a charitable organization under Internal Revenue Code Section 501(c)(3), and is therefore exempt from federal income taxes. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514.

The University reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB, on the accrual basis. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The financial statements of all controlled organizations are included in the University’s financial statements; affiliated organizations that are not controlled by, and not dependent on the University, such as booster and alumni organizations, are not included.

Net position is categorized as:

- Net investment in capital assets: Capital assets, net of accumulated depreciation and outstanding principal balances of debt related to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable* – Net position subject to externally imposed stipulations that it be maintained permanently. Such net position includes the corpus portion (historical value) of gifts to the University’s permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.
 - Expendable* – Net position subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time. Such net position includes net appreciation of the University’s permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- Unrestricted: Net position not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. Substantially all unrestricted net position is designated for various academic programs, research initiatives and capital projects.

Adoption of New Accounting Standard: During 2016, the University adopted GASB Statement No. 72, *Fair Value Measurement and Application* (“GASB 72”). With the adoption of this statement, the University expanded disclosures to present cash equivalents, investments and derivative instruments across the hierarchy of valuation inputs.

Accounting Standard Issued But Not Yet Adopted: In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which establishes new accounting and financial reporting requirements for the University’s postemployment benefits. This statement is effective for fiscal years beginning after June 15, 2017 and the University is currently evaluating the potential impact to its financial statements and related disclosures.

Summary of Significant Accounting Policies: For purposes of the statement of cash flows, the University considers all highly liquid investments purchased with a maturity of three months or less, to be cash equivalents. Cash equivalents representing assets of the University’s endowment, life income and other investments are included in noncurrent investments as these funds are not used for operating purposes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Investments are reported in four categories in the statement of net position. Investments reported as endowment, life income and other investments are those funds invested in portfolios that are considered by management to be of a long duration. Investments for student loan and capital activities are those funds that are intended to be used for these specific activities. All other investments are reported as investments for operating activities.

GASB 72 defines fair value and establishes a framework for measuring fair value that includes a three tiered hierarchy of valuation inputs, placing a priority on those which are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the University's own assumptions about how market participants would value an asset or liability based on the best information available. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The three levels of inputs, of which the first two are considered observable and the last unobservable, are as follows:

- Level 1 – Quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date
- Level 2 – Other significant observable inputs, either direct or indirect, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; or market corroborated inputs
- Level 3 – Unobservable inputs

GASB 72 allows for the use of net asset value ("NAV") as a practical expedient for valuation purposes. Investments that use NAV in determining fair value are disclosed separately from the valuation hierarchy as presented in Note 2.

Investments in marketable securities are carried at fair value, as established by the major securities markets. Purchases and sales of investments are accounted for on the trade date basis. Investment income is recorded on the accrual basis. Realized and unrealized gains and losses are reported in investment income.

Investments in nonmarketable limited partnerships are carried at fair value, which is generally established using the NAV provided by the management of the investment partnerships as of June 30, 2016 and 2015. The University may also adjust the fair value of these investments based on market conditions, specific redemption terms and restrictions, risk considerations and other factors. As these investments are not readily marketable the estimated value is subject to uncertainty, and therefore, may differ from the value that would have been used had a ready market for the investments existed.

Investments denominated in foreign currencies are translated into U.S. dollar equivalents using year-end spot foreign currency exchange rates. Purchases and sales of investments denominated in foreign currencies and related income are translated at spot exchange rates on the transaction dates.

Derivative instruments such as financial futures, forward foreign exchange contracts and interest rate swaps held in investment portfolios, are recorded on the contract date and are carried at fair value using listed price quotations or amounts that approximate fair value. To facilitate trading in financial futures, the University is required to post cash or securities to satisfy margin requirements of the exchange where such futures contracts are listed. The University monitors the required amount of cash and securities on deposit for financial futures transactions and withdraws or deposits cash or securities as necessary.

Accounts receivable are recorded net of an allowance for uncollectible accounts receivable. The allowance is based on management's judgment of potential uncollectible amounts, which includes such factors as historical experience and type of receivable.

The University receives pledges and bequests of financial support from corporations, foundations and individuals. Revenue is recognized when a pledge representing an unconditional promise to pay is received and all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Permanent endowment pledges do not meet eligibility requirements, as defined by GASB, and are not recorded as assets until the related gift is received.

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are made, commensurate with expected future payments. An allowance for uncollectible pledges receivable is provided based on management's judgment of potential uncollectible amounts and includes such factors as prior collection history, type of gift and nature of fundraising.

Capital assets are recorded at cost or, if donated, at fair value at the date of donation. Depreciation of capital assets is provided on a straight-line method over the estimated useful lives of the respective assets, which generally range from four to forty years. The University does not capitalize works of art or historical treasures that are held for exhibition, education, research or public service. These collections are neither disposed of for financial gain nor encumbered in any way. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Unearned revenue consists primarily of cash received from grant and contract sponsors which has not yet been earned under the terms of the agreement. Unearned revenue also includes amounts received in advance of an event, such as student tuition and advance ticket sales related to future fiscal years.

Deposits of affiliates and others represent cash and invested funds held by the University as a result of agency relationships with various groups. Noncurrent deposits of affiliates represent the portion of endowment and similar funds held by the University on behalf of others.

The University holds life income funds for beneficiaries of the pooled income fund, charitable remainder trusts and the gift annuity program. These funds generally pay lifetime income to beneficiaries, after which the principal is made available to the University in accordance with donor intentions. All life income fund assets, including those held in trust, are recorded at fair value. The present value of estimated future payments due to life income beneficiaries is recorded as a liability.

For donor restricted endowments, the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate amounts for endowment spending rule distributions as is considered prudent. The University's policy is to retain net realized and unrealized appreciation with the endowment after spending rule distributions. Net appreciation of permanent endowment funds, which totaled \$1,519,149,000 and \$1,708,175,000 at June 30, 2016 and 2015, respectively, is recorded in restricted expendable net position. The University's endowment spending rule is further discussed in Note 2.

Student tuition and residence fees are presented net of scholarships and fellowships applied to student accounts, while stipends and other payments made directly to students are presented as scholarship and fellowship expenses.

Patient care revenues are reported net of contractual allowances and bad debt expenses. Contractual allowances are estimated based on agreements with third-party payers that provide payments for patient care services at amounts different from established rates. These allowances are subject to the laws and regulations governing the federal and state programs and post-payment audits, and adjusted in future periods as final settlements are determined. Patient care services are primarily provided through the University of Michigan Health System, which includes the Hospitals and Health Centers, the University of Michigan Medical Group and the Michigan Health Corporation. Patient care services are also provided through University Health Services, which provides health care services to students, faculty and staff, and Dental Faculty Associates, which provides dental care services performed by faculty dentists.

Patient care services are provided to patients who meet certain criteria under the Hospitals and Health Centers' charity care policy without charge or at amounts less than its established rates. Accordingly, charity care is not reported as revenue in the accompanying statement of revenues, expenses and changes in net position. Charges forgone for charity care services totaled \$48,203,000 and \$20,557,000 in 2016 and 2015, respectively.

Other auxiliary enterprise revenues primarily represent revenues generated by intercollegiate athletics, parking, student unions and student publications.

The University's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net position are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Nearly all of the University's expenses are from exchange transactions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Certain significant revenue streams relied upon for operations result from nonexchange transactions and are recorded as nonoperating revenues including state appropriations, federal Pell grants, gifts and investment income.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The most significant areas that require management estimates relate to self-insurance and benefits obligations.

Reclassifications: Certain prior year amounts have been reclassified to conform with current year presentations.

Subsequent Event: In September 2016, the University and Metropolitan Health Corporation signed a definitive, non-binding agreement to affiliate and consummate a member substitution where the University would become the parent organization. The signing of this agreement did not have a material impact on the University's financial statements.

NOTE 2—CASH AND INVESTMENTS

Summary: The University maintains centralized management for substantially all of its cash and investments.

Working capital of individual University units is invested in the University Investment Pool ("UIP"). Together with the University's short-term insurance and other benefits reserves, the UIP is invested in the Daily and Monthly Portfolios, which are principally invested in investment-grade money market securities, U.S. government and other fixed income securities and absolute return strategies.

The University collectively invests substantially all of the assets of its endowment funds along with a portion of its insurance and benefits reserves, charitable remainder trusts and gift annuity program in the Long Term Portfolio. The longer investment horizon of the Long Term Portfolio allows for an equity-oriented strategy to achieve higher expected returns over time, and permits the use of less liquid alternative investments, providing for equity diversification beyond the stock markets. The Long Term Portfolio includes investments in domestic and non-U.S. stocks and bonds, commingled funds and limited partnerships consisting of venture capital, private equity, real estate, natural resources and absolute return strategies.

The University also separately invests certain endowments and charitable remainder trusts, unexpended bond proceeds and other funds with investment restrictions outside of the Daily, Monthly and Long Term Portfolios.

Authorizations: The University's investment policies are governed and authorized by University Bylaws and the Board of Regents. The approved asset allocation policy for the Long Term Portfolio sets a general target of 80 percent equities and 20 percent fixed income securities, within a permitted range of 65 to 90 percent for equities and 10 to 35 percent for fixed income securities. Since diversification is a fundamental risk management strategy, the Long Term Portfolio is broadly diversified within these general categories.

The endowment spending rule provides for distributions from the University Endowment Fund to the University entities that benefit from the endowment fund. At June 30, 2016 and 2015, the annual distribution rate was 4.5 percent of the one-quarter lagged seven year moving average fair value of fund shares. To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. Distributions are also made from the UIP to University entities based on the 90-day U.S. Treasury Bill rate. The University's costs to administer and grow the University Endowment Fund and UIP are funded by investment returns.

Cash and Cash Equivalents: Cash and cash equivalents, which totaled \$285,838,000 and \$105,465,000 at June 30, 2016 and 2015, respectively, represent short-term money market investments in mutual funds, overnight collective funds managed by the University's custodian or short-term highly liquid investments registered as securities and held by the University or its agents in the University's name. Of its cash and cash equivalents, the University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation limits in the amount of \$9,687,000 and \$9,136,000 at June 30, 2016 and 2015, respectively. The University does not require its deposits to be collateralized or insured.

Cash and cash equivalents include certain securities that are subject to the leveling requirements defined by GASB 72. Level 1 securities, which primarily consist of money market funds and U.S. government securities, totaled \$63,433,000 and \$37,424,000 at June 30, 2016 and 2015, respectively. Level 2 securities, which primarily consist of U.S. agencies, totaled \$96,343,000 and \$39,993,000 at June 30, 2016 and 2015, respectively.

Investments: At June 30, 2016 and 2015, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows:

(in thousands)	2016	2015
Cash equivalents, noncurrent	\$ 161,500	\$ 52,461
Equity securities	1,396,023	1,300,173
Fixed income securities	1,868,581	2,301,472
Commingled funds	2,597,267	2,903,066
Nonmarketable alternative investments	5,308,968	4,997,621
Other investments	10,746	17,212
	\$ 11,343,085	\$ 11,572,005

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2—CASH AND INVESTMENTS, CONTINUED

GASB 72 establishes a hierarchy that prioritizes inputs to valuation techniques used to measure fair value. At June 30, 2016 and 2015, the fair value of the University's investments based on the inputs used to value them is summarized as follows:

2016					
(in thousands)	Level 1	Level 2	Level 3	NAV	Total Fair Value
Cash equivalents, noncurrent	\$ 161,500				\$ 161,500
Equity securities:					
Domestic	457,605		\$ 18,868		476,473
Foreign	918,992		558		919,550
	1,376,597	-	19,426	-	1,396,023
Fixed income securities:					
U.S. Treasury	537,988				537,988
U.S. government agency		\$ 287,098			287,098
Corporate and other		880,777	162,718		1,043,495
	537,988	1,167,875	162,718	-	1,868,581
Commingled funds:					
Absolute return				\$ 1,578,437	1,578,437
Domestic equities	16,094			246,522	262,616
Global equities	9,222			692,613	701,835
U.S. fixed income	5,817			43,222	49,039
Other	5,340				5,340
	36,473	-	-	2,560,794	2,597,267
Nonmarketable alternative investments:					
Venture capital				1,306,581	1,306,581
Absolute return				1,092,694	1,092,694
Private equity			162,878	1,130,422	1,293,300
Real estate			8,590	907,602	916,192
Natural resources			168,897	531,304	700,201
	-	-	340,365	4,968,603	5,308,968
Other investments	213	549	9,984		10,746
	\$ 2,112,771	\$ 1,168,424	\$ 532,493	\$ 7,529,397	\$ 11,343,085

2015					
(in thousands)	Level 1	Level 2	Level 3	NAV	Total Fair Value
Cash equivalents, noncurrent	\$ 52,461				\$ 52,461
Equity securities:					
Domestic	436,536		\$ 11,051		447,587
Foreign	852,570		16		852,586
	1,289,106	-	11,067	-	1,300,173
Fixed income securities:					
U.S. Treasury	844,161				844,161
U.S. government agency		\$ 396,594			396,594
Corporate and other		900,894	159,823		1,060,717
	844,161	1,297,488	159,823	-	2,301,472
Commingled funds:					
Absolute return				\$ 1,385,538	1,385,538
Domestic equities	15,387			314,652	330,039
Global equities	11,140			1,120,363	1,131,503
U.S. fixed income	6,424			43,633	50,057
Other	5,929				5,929
	38,880	-	-	2,864,186	2,903,066
Nonmarketable alternative investments:					
Venture capital				1,362,389	1,362,389
Absolute return				807,894	807,894
Private equity			89,252	1,208,261	1,297,513
Real estate			7,137	907,535	914,672
Natural resources			177,830	437,323	615,153
	-	-	274,219	4,723,402	4,997,621
Other investments	(1,725)	9,463	9,474		17,212
	\$ 2,222,883	\$ 1,306,951	\$ 454,583	\$ 7,587,588	\$ 11,572,005

Investments categorized as Level 1 are valued using prices quoted in active markets for those securities. Equity securities categorized as Level 3 represent investments in start-up or venture companies. Fixed income securities categorized as Level 2 represent investments valued using a matrix pricing technique, which values debt securities based on their relationship to a benchmark and the relative spread to that benchmark. Fixed income securities categorized as Level 3 represent a note receivable associated with the sale of a portion of the University's nonmarketable alternative real estate investments. Certain assumptions about the appropriate yield curve and underlying credit rating of the issuer were made in determining the fair value of the note. Nonmarketable alternative investments categorized as Level 3 include direct investments and are primarily valued using models that rely on inputs which are unobservable in the market.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2—CASH AND INVESTMENTS, CONTINUED

The University's investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts recorded in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forwards, futures and commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counterparty to perform according to the terms of the contract. The University's risk of loss in the event of a counterparty default is typically limited to the amounts recognized in the statement of net position and is not represented by the contract or notional amounts of the instruments.

Fixed income securities have inherent financial risks, including credit risk and interest rate risk. Credit risk for fixed income securities is the risk that the issuer will not fulfill its obligations. Nationally recognized statistical rating organizations ("NSROs"), such as Moody's and Standard & Poor's, assign credit ratings to security issues and issuers that indicate a measure of potential credit risk to investors. Fixed income securities considered investment grade are those rated at least Baa by Moody's and BBB by Standard & Poor's. To manage credit risk, the University specifies minimum average and minimum absolute quality NSRO ratings for securities held pursuant to its management agreements.

The University minimizes concentration of credit risk, the risk of a large loss attributed to the magnitude of the investment in a single issuer of fixed income securities, by diversifying its fixed income issues and issuers and holding U.S. Treasury securities which are considered to have minimal credit risk. The University also manages this risk at the account level by limiting each fixed income manager's holding of any non-U.S. government issuer to 5 percent of the value of the investment account.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of fixed income securities. Effective duration, a commonly used measure of interest rate risk, incorporates a security's yield, coupon, final maturity, call features and other imbedded options into one number expressed in years that indicates how price-sensitive a security or portfolio of securities is to changes in interest rates. The effective duration of a security or portfolio indicates the approximate percentage change in fair value expected for a one percent change in interest rates. The longer the duration, the more sensitive the security or portfolio is to changes in interest rates. The weighted average effective duration of the University's fixed income securities was 5.9 years at June 30, 2016, compared to 3.4 years at June 30, 2015. The University manages the effective duration of its fixed income securities at the account level, where fixed income managers generally may not deviate from the duration of their respective benchmarks by more than 25 percent. The Monthly Portfolio held positions in bond futures at June 30, 2016 and 2015, which are used to adjust the duration of cash equivalents and the fixed income portion of the portfolios.

The composition of fixed income securities at June 30, 2016 and 2015, along with credit quality and effective duration measures, is summarized as follows:

(in thousands)	2016					Duration (in years)
	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	
U.S. Treasury	\$ 308,171				\$ 308,171	9.0
U.S. Treasury inflation protected	229,817				229,817	2.7
U.S. government agency	287,098				287,098	1.0
Mortgage backed		\$ 18,875	\$ 4,603	\$ 531	24,009	1.8
Asset backed		50,113	864		50,977	2.3
Corporate and other		949,218	12,326	6,965	968,509	7.4
	\$ 825,086	\$ 1,018,206	\$ 17,793	\$ 7,496	\$ 1,868,581	5.9

(in thousands)	2015					Duration (in years)
	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	
U.S. Treasury	\$ 617,218				\$ 617,218	1.3
U.S. Treasury inflation protected	226,943				226,943	3.1
U.S. government agency	396,594				396,594	0.8
Mortgage backed		\$ 42,578	\$ 11,738	\$ 7,738	62,054	1.6
Asset backed		31,509	1,553		33,062	3.5
Corporate and other		923,984	33,984	7,633	965,601	6.1
	\$ 1,240,755	\$ 998,071	\$ 47,275	\$ 15,371	\$ 2,301,472	3.4

Of the University's fixed income securities, 99 percent and 97 percent were rated investment grade or better at June 30, 2016 and 2015, and 51 percent and 59 percent of these securities consisted of either U.S. treasury and government agencies or non-U.S. government securities rated AAA/Aaa at June 30, 2016 and 2015, respectively. Corporate and other fixed income securities include a receivable associated with the sale of a portion of the University's real estate nonmarketable alternative investments which totaled \$160,305,000 and \$157,832,000 at June 30, 2016 and 2015, respectively.

Commingled (pooled) funds include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures which are generally unrated and unregulated. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy. These investments are structured to limit the University's risk exposure to the amount of invested capital.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2—CASH AND INVESTMENTS, CONTINUED

Nonmarketable alternative investments consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. There is not an active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner. The University's limited partnerships are diversified in terms of manager selection, industry and geographic focus. At June 30, 2016 and 2015, no individual partnership investment represented 5 percent or more of total investments.

Absolute return strategies in the commingled funds and nonmarketable alternative investments classifications include long/short stock programs, merger arbitrage, intra-capital structure arbitrage and distressed debt investments. The goal of absolute return strategies is to provide, in aggregate, a return that is consistently positive and uncorrelated with the overall market.

The University's investments in commingled funds and nonmarketable alternative investments are contractual agreements that may limit the ability to initiate redemptions due to notice periods, lock-ups and gates. Additional information about current redemption terms and outstanding commitments at June 30, 2016 is summarized as follows (amounts in thousands):

	Fair Value	Remaining Life	Outstanding Commitments	Redemption Terms	Redemption Notice
Commingled funds	\$ 2,597,267	N/A		Daily, monthly, quarterly, and annually, with varying notice periods	Lock-up provisions range from none to 3 years
Nonmarketable alternative investments	\$ 5,308,968	1-12 years	\$ 3,859,336	Ineligible for redemption	N/A

Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Of the University's commingled funds at June 30, 2016 and 2015, approximately 83 percent and 88 percent are redeemable within one year, with 58 and 64 percent redeemable within 90 days under normal market conditions. The remaining amounts are redeemable beyond one year, with redemption of certain funds dependent on disposition of the underlying assets. The University's committed but unpaid obligation to nonmarketable alternative investments is further discussed in Note 13.

The University participates in non-U.S. developed and emerging markets through commingled funds invested in non-U.S./global equities and absolute return strategies. Although substantially all of these funds are reported in U.S. dollars, price changes of the underlying securities in local markets as well as changes to the value of local currencies relative to the U.S. dollar are embedded in investment returns. In addition, a portion of the University's equity securities and nonmarketable alternative investments are denominated in foreign currencies, which must be settled in local (non-U.S.) currencies.

Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. Forward foreign currency contracts are typically used to manage the risks related to fluctuations in currency exchange rates between the time of purchase or sale and the actual settlement of foreign securities. Various investment managers acting for the University use forward foreign exchange contracts in risk-based transactions to carry out their portfolio strategies and are subject to agreements that provide minimum diversification and maximum exposure limits by country and currency.

The value of the University's non-U.S. dollar holdings net of outstanding forward foreign exchange contracts totaled \$940,947,000 or 8 percent of total investments at June 30, 2016, and \$624,515,000 or 5 percent of total investments at June 30, 2015. Non-U.S. dollar exposures at June 30, 2016 and 2015 are summarized as follows:

(in thousands)	2016	2015
Euros	\$ 602,240	\$ 574,210
British pounds sterling	142,091	(93,105)
Canadian dollar	113,689	8,771
Japanese yen	105,989	166,751
New Zealand dollar	(69,991)	(145,909)
Singapore dollar	(110,707)	(141,793)
Other	157,636	255,590
	\$ 940,947	\$ 624,515

The Long Term Portfolio and the Monthly Portfolio participate in a short-term, fully collateralized, securities lending program administered by the University's master custodian. Together, the Portfolios had \$95,505,000 and \$91,157,000 in securities loans outstanding at June 30, 2016 and 2015, respectively. At loan inception, an approved borrower must deliver collateral of cash, securities or letters of credit to the University's lending agent equal to 102 percent of fair value for domestic securities and 105 percent for foreign securities. Collateral positions are monitored daily to ensure that borrowed securities are never less than 100 percent collateralized. At June 30, 2016, collateral of \$99,200,000 (104 percent of securities on loan) includes invested cash of \$63,292,000 and U.S. government securities of \$35,908,000, while at June 30, 2015, collateral of \$98,820,000 (108 percent of securities on loan) includes invested cash of \$83,203,000 and U.S. government securities of \$15,617,000.

Cash collateral held by the University's lending agent, along with the offsetting liability to return the collateral at loan termination, are recorded in the statement of net position. Neither the University nor its securities lending agent has the ability to pledge or sell securities received as collateral unless a borrower defaults. Securities loans may be terminated upon notice by either the University or the borrower.

NOTE 3—ACCOUNTS RECEIVABLE

The composition of accounts receivable at June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016	2015
Patient care	\$ 573,339	\$ 584,311
Sponsored programs	133,196	113,594
State appropriations, educational and capital	86,795	65,701
Student accounts	28,935	29,580
Other	44,878	49,002
	867,143	842,188
Less allowance for uncollectible accounts receivable	251,174	261,897
	\$ 615,969	\$ 580,291

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4—NOTES AND PLEDGES RECEIVABLE

The composition of notes and pledges receivable at June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016	2015
Notes:		
Federal student loan programs	\$ 89,644	\$ 89,839
University student loan funds	17,586	17,495
Other	851	673
	108,081	108,007
Less allowance for uncollectible notes	3,100	3,100
Total notes receivable, net	104,981	104,907
Gift pledges:		
Capital	179,712	184,184
Operations	122,932	121,938
	302,644	306,122
Less:		
Allowance for uncollectible pledges	11,411	5,581
Unamortized discount to present value	3,978	4,364
Total pledges receivable, net	287,255	296,177
Total notes and pledges receivable, net	392,236	401,084
Less current portion	73,958	79,445
	\$ 318,278	\$ 321,639

The principal repayment and interest rate terms of federal and university loans vary considerably. The allowance for uncollectible notes only applies to University funded notes and the University portion of federal student loans, as the University is not obligated to fund the federal portion of uncollected student loans. Federal loan programs are funded principally with federal advances to the University under the Perkins and various health professions loan programs.

Payments on pledges receivable at June 30, 2016 are expected to be received in the following years ended June 30 (in thousands):

2017	\$ 60,537
2018	47,157
2019	35,048
2020	26,225
2021	27,063
2022 and after	106,614
	\$ 302,644

As discussed in Note 1, permanent endowment pledges do not meet eligibility requirements, as defined by GASB, until the related gift is received. Accordingly, permanent endowment pledges totaling \$168,434,000 and \$154,133,000 at June 30, 2016 and 2015, respectively, are not recognized as assets in the accompanying financial statements. In addition, bequest intentions and other conditional promises are not recognized as assets until the specified conditions are met due to uncertainties with regard to their realizability and valuation.

NOTE 5—CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016			
	Beginning Balance	Additions	Retirements	Ending Balance
Land	\$ 112,400	\$ 1,366	\$ 50	\$ 113,716
Land improvements	123,003	3,166	1,117	125,052
Infrastructure	248,047	7,132		255,179
Buildings	7,486,312	490,954	20,777	7,956,489
Construction in progress	528,728	(76,581)		452,147
Property held for future use	24,502			24,502
Equipment	1,861,266	142,607	112,006	1,891,867
Library materials	567,461	26,306		593,767
	10,951,719	594,950	133,950	11,412,719
Less accumulated depreciation	5,329,333	501,631	126,821	5,704,143
	\$ 5,622,386	\$ 93,319	\$ 7,129	\$ 5,708,576

(in thousands)	2015			
	Beginning Balance	Additions	Retirements	Ending Balance
Land	\$ 112,011	\$ 389		\$ 112,400
Land improvements	116,677	8,564	\$ 2,238	123,003
Infrastructure	241,528	6,519		248,047
Buildings	7,283,237	245,727	42,652	7,486,312
Construction in progress	270,963	257,765		528,728
Property held for future use	30,779	(6,277)		24,502
Equipment	1,879,237	122,262	140,233	1,861,266
Library materials	542,672	24,789		567,461
	10,477,104	659,738	185,123	10,951,719
Less accumulated depreciation	5,010,433	493,629	174,729	5,329,333
	\$ 5,466,671	\$ 166,109	\$ 10,394	\$ 5,622,386

The decrease in construction in progress of \$76,581,000 in 2016 represents the amount of capital expenditures for new projects of \$504,099,000 net of assets placed in service of \$580,680,000. The increase in construction in progress of \$257,765,000 in 2015 represents the amount of capital expenditures for new projects of \$585,979,000 net of assets placed in service of \$328,214,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6—LONG-TERM DEBT

Long-term debt at June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016	2015
Commercial Paper:		
Tax-exempt, variable rate (.467%)*	\$ 155,085	\$ 132,625
Taxable, variable rate (.549%)*	4,885	5,865
General Revenue Bonds:		
Series 2015, 4.00% to 5.00% through 2046	306,715	
unamortized premium	53,754	
Series 2014A, 4.00% to 5.00% through 2044	79,560	81,310
Series 2014B, 0.597% to 3.516% through 2024	7,505	8,370
unamortized premium	7,433	7,914
Series 2013A, 2.75% to 5.00% through 2029	47,820	49,710
unamortized premium	2,133	2,395
Series 2012A, variable rate (.39%)* through 2036	50,000	50,000
Series 2012B, variable rate (.31%)* through 2042	65,000	65,000
Series 2012C, 5.00% through 2017	68,120	73,175
unamortized premium	2,590	5,373
Series 2012D-1, variable rate (.36%)* to fixed via swap through 2025	66,885	69,980
deferred amount on refunding	(12,335)	(14,409)
Series 2012D-2, variable rate (.41%)* to fixed via swap through 2026		
and variable rate 2027 through 2030	71,110	75,085
deferred amount on refunding	(4,618)	(5,529)
Series 2012E**, variable rate (.84%)* through 2033	95,970	95,970
Series 2012F**, variable rate through 2016		100,970
Series 2010A, taxable-Build America Bonds, 4.926% to 5.593% through 2040	163,110	163,110
Series 2010C, 3.75% to 5.00% through 2027	138,970	149,970
unamortized premium	8,228	9,650
Series 2010D, taxable-Build America Bonds, 2.738% to 5.333% through 2041	181,190	189,095
Series 2009A, 3.00% to 5.00% through 2029	56,105	63,870
Series 2009B, variable rate (.43%)* through 2039	118,710	118,710
unamortized premium	5,040	5,430
Series 2009D, taxable-Build America Bonds, 5.155% to 6.172% through 2030	89,815	89,815
Series 2008A, variable rate (.37%)* through 2038	57,085	105,810
Series 2008B, variable rate (.39%)* to fixed via swap through 2026		
and variable rate 2027 through 2028	83,590	89,725
Series 2005A, 5.00% through 2018	2,080	3,045
unamortized premium	50	98
Series 2002, variable rate (.44%)* to fixed via swap through 2018		
and variable rate through 2016	14,785	76,285
	1,986,370	1,868,417
Less:		
Commercial paper and current portion of bonds payable	292,021	201,146
Long-term bonds payable subject to remarketing, net	217,637	336,374
	\$ 1,476,712	\$ 1,330,897

* Denotes variable rate at June 30, 2016

** Denotes variable rate bonds not subject to remarketing

Certain variable rate bonds have remarketing features which allow bondholders to put debt back to the University. Accordingly, variable rate bonds payable is classified as current unless supported by liquidity agreements, such as lines of credit or standby bond purchase agreements, which can refinance the debt on a long-term basis. The classification of the University's variable rate bonds payable at June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016	2015
Variable rate bonds payable subject to remarketing	\$ 527,165	\$ 650,595
Less:		
Current principal maturities	20,965	20,075
Long-term liquidity agreements:		
Unsecured line of credit	150,000	150,000
Standby bond purchase agreements	138,563	144,146
Long-term bonds payable subject to remarketing, net	\$ 217,637	\$ 336,374

The University's available line of credit and standby bond purchase agreements were entirely unused at June 30, 2016.

In connection with certain issues of variable rate debt, the University has entered into various floating-to-fixed interest rate swaps to convert all or a portion of the associated variable rate debt to synthetic fixed rates to protect against the potential of rising interest rates. The fair value, significant terms and other information about the University's interest rate swaps is discussed in Note 7.

Long-term debt activity for the years ended June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016			
	Beginning Balance	Additions	Reductions	Ending Balance
Commercial paper	\$ 138,490	\$ 196,885	\$ 175,405	\$ 159,970
Bonds	1,729,927	361,364	264,891	1,826,400
	\$ 1,868,417	\$ 558,249	\$ 440,296	\$ 1,986,370
(in thousands)	2015			
	Beginning Balance	Additions	Reductions	Ending Balance
Commercial paper	\$ 41,090	\$ 136,915	\$ 39,515	\$ 138,490
Bonds	1,793,569		63,642	1,729,927
	\$ 1,834,659	\$ 136,915	\$ 103,157	\$ 1,868,417

The University maintains a combination of variable and fixed rate debt supported by general revenues, with effective interest rates that averaged 2.3 percent and 2.1 percent in 2016 and 2015, respectively, including federal subsidies for interest on taxable Build America Bonds. The University utilizes commercial paper to provide interim financing for its capital improvement program. The Board of Regents has authorized the issuance of up to \$300,000,000 in commercial paper backed by a general revenue pledge. Outstanding commercial paper debt is converted to long-term debt financing, as appropriate, within the normal course of business.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6—LONG-TERM DEBT, CONTINUED

During 2016, the University issued \$306,715,000 of fixed rate General Revenue Bonds Series 2015 with a net original issue premium of \$54,649,000. Total bond proceeds of \$361,364,000 were utilized to convert \$71,425,000 of commercial paper to long-term debt and refund \$204,325,000 of existing bonds, as well as provide \$84,685,000 for capital projects and \$929,000 for debt issuance costs.

Debt obligations are generally callable by the University and mature at various dates through fiscal 2046. Principal maturities, including amortization of deferred amounts on refunding and interest on debt obligations, based on scheduled bond maturities, for the next five years and in subsequent five-year periods are as follows:

(in thousands)	Principal	Interest*	Total
2017	\$ 283,915	\$ 58,676	\$ 342,591
2018	56,675	53,813	110,488
2019	56,030	52,148	108,178
2020	57,615	50,291	107,906
2021	60,920	48,269	109,189
2022-2026	338,480	212,561	551,041
2027-2031	351,105	149,596	500,701
2032-2036	368,845	92,782	461,627
2037-2041	283,210	40,403	323,613
2042-2046	67,300	7,440	74,740
	1,924,095	\$ 765,979	\$ 2,690,074
Plus unamortized premiums, net	79,228		
Less deferred amount on refunding	16,953		
	\$ 1,986,370		

* Interest on variable rate debt is estimated based on rates in effect at June 30, 2016; amounts do not reflect federal subsidies to be received for Build America Bonds interest

If all variable rate bonds were put back to the University and existing unsecured lines of credit and standby bond purchase agreements were not extended upon their current expiration dates, the total principal payments due in 2017 would increase to \$501,552,000, total principal payments due in 2018 would increase to \$256,081,000, total principal payments due in 2019 would increase to \$87,288,000 and total principal payments due in 2020 would increase to \$65,764,000. Accordingly, principal payments due in subsequent years would be reduced to \$45,920,000 in 2021; \$228,755,000 in 2022 through 2026; \$282,645,000 in 2027 through 2031; \$230,005,000 in 2032 through 2036; \$169,860,000 in 2037 through 2041; and \$56,225,000 in 2042 through 2046. There would not be a material impact on annual interest payments due to the low variable rate of interest on these bonds.

NOTE 7—DERIVATIVE INSTRUMENTS

Derivatives held by the University are recorded at fair value in the statement of net position in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* ("GASB 53"). For hedging derivative instruments that are effective in significantly reducing an identified financial risk, as defined by GASB 53, the corresponding change in fair value is deferred and included in the statement of net position. For all other derivative instruments, changes in fair value are reported as net investment income (loss).

Derivative instruments held by the University at June 30, 2016 and 2015 are summarized as follows:

(in thousands)	2016		2015	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Investment Derivative Instruments:				
Investment portfolios:				
Futures	\$ 252,104	\$ 241	\$ 571,891	\$ (2,238)
Foreign currency forwards	1,714,843	11,139	2,173,950	(977)
Other	177,750	14,084	28,763	9,546
	\$ 2,144,697	\$ 25,464	\$ 2,774,604	\$ 6,331
Effective Cash Flow Hedges:				
Floating-to-fixed interest rate swap on debt	\$ 14,785	\$ (648)	\$ 21,655	\$ (971)
Floating-to-fixed interest rate swaps on debt	\$ 180,420	\$ (29,938)	\$ 193,615	\$ (27,377)

The University utilizes bond futures in its investment portfolios to adjust the duration of cash equivalents and fixed income securities, while foreign currency forward contracts are utilized to settle securities and transactions denominated in foreign currencies and manage foreign exchange risk. Other derivative instruments in the University's investment portfolios consist primarily of interest rate swaps, credit default swaps and total return swaps used to carry out investment and portfolio strategies.

In connection with certain issues of variable rate debt, the University has entered into various floating-to-fixed interest rate swaps to convert all or a portion of the associated variable rate debt to synthetic fixed rates to protect against the potential of rising interest rates. The fair value generally represents the estimated amount that the University would pay to terminate the swap agreements at the statement of net position date, taking into account current interest rates and creditworthiness of the underlying counterparty. The valuation inputs used to determine the fair value of these instruments are considered Level 2, as they rely on observable inputs other than quoted market prices. The notional amount represents the underlying reference of the instrument and does not represent the amount of the University's settlement obligations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7—DERIVATIVE INSTRUMENTS, CONTINUED

In accordance with GASB 53, an interest rate swap is considered an effective cash flow hedge if the swap payments received substantially offset the payments made on the associated debt. An interest rate swap that is not considered an effective cash flow hedge is deemed to be an investment derivative instrument and changes in fair value are recorded as net investment income (loss).

At June 30, 2016 and 2015, the fair value of floating-to-fixed interest rate swaps associated with the University's variable rate debt is a liability of \$30,586,000 and \$28,348,000, respectively, and is included in the statement of net position as part of noncurrent other liabilities. The deferred outflow of resources for the fair value of swaps deemed effective cash flow hedges totaled \$12,985,000 and \$7,439,000, at June 30, 2016 and 2015, respectively, and is included in the statement of net position as part of noncurrent other assets. Three bond issues were refunded in 2013 and the deferred outflow of resources related to the effective cash flow hedges associated with these bonds was reclassified to deferred amount on refunding and net against bonds payable. The deferred amount on refunding is being amortized into interest expense over the remaining term of the refunding bonds and totaled \$16,953,000 and \$19,938,000 at June 30, 2016 and 2015, respectively.

The change in fair value of derivative instruments, which includes realized gains and losses on positions closed, for the years ended June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016	2015
Investment Derivative Instruments:		
Investment portfolios:		
Futures	\$ (31,031)	\$ 18,584
Foreign currency forwards	23,683	(3,836)
Other	1,992	(82)
	\$ (5,356)	\$ 14,666
Floating-to-fixed interest rate swap on debt	\$ 323	\$ 509
Effective Cash Flow Hedges:		
Floating-to-fixed interest rate swaps on debt	\$ (2,561)	\$ 1,835

The University's interest rate swaps, along with their associated variable rate debt and significant terms, are summarized below.

The floating-to-fixed interest rate swap associated with the Series 2008B General Revenue Bonds has a notional amount of \$66,875,000 and \$73,010,000 at June 30, 2016 and 2015, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective April 1, 2008, the University makes payments based on a fixed rate of 3.105 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, until the swap terminates in April 2026. The University has the option to terminate the swap upon five business days written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2016 and 2015 and has a fair value of (\$9,064,000) and (\$7,766,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2005B Hospital Revenue Bonds has a notional amount of \$46,795,000 and \$50,765,000 at June 30, 2016 and 2015, respectively. The Series 2005B Hospital Revenue Bonds were refunded on February 1, 2013, and the swap is now associated with the Series 2012D-2 General Revenue Bonds. Effective December 1, 2005, the University makes payments based on a fixed rate of 3.229 percent and receives variable rate payments from the swap counterparty based on 68 percent of the One-Month USD LIBOR, until the bonds mature in December 2025. The University has the option to terminate the swap upon five business days written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2016 and 2015 and has a fair value of (\$5,874,000) and (\$5,258,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2002 General Revenue Bonds has a notional amount of \$14,785,000 and \$21,655,000 at June 30, 2016 and 2015, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. Effective June 1, 2007, the University makes payments based on a fixed rate of 3.5375 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, through April 1, 2009, and 63 percent of the Five-Year USD LIBOR Swap Rate for the balance of the term, through April 2018. The University has the option to terminate the swap upon five business days written notice and payment of the fair market compensation for the value of the swap. This swap is not considered an effective hedge at June 30, 2016 and 2015 and has a fair value of (\$648,000) and (\$971,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 1998A-2 Hospital Revenue Refunding Bonds has a notional amount of \$44,670,000 at both June 30, 2016 and 2015 tied to the outstanding balance of the bonds. The Series 1998A-2 Hospital Revenue Refunding Bonds were refunded on January 4, 2013, and the swap is now associated with the Series 2012D-1 General Revenue Bonds. Effective May 14, 1998, the University makes payments based on a fixed rate of 4.705 percent and receives variable rate payments from the swap counterparty based on the floating Securities Industry and Financial Markets Association ("SIFMA") Municipal Index through the final maturity dates of the underlying bonds in December 2024. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2016 and 2015 and has a fair value of (\$12,230,000) and (\$11,016,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds has a notional amount of \$22,080,000 and \$25,170,000 at June 30, 2016 and 2015, respectively, tied to the outstanding balance of the bonds. The Series 1998A-1 Medical Service Plan Revenue Refunding Bonds were refunded on January 4, 2013, and the swap is now associated with the Series 2012D-1 General Revenue Bonds. Effective May 14, 1998, the University makes payments based on a fixed rate of 4.685 percent and receives variable rate payments based on the floating SIFMA Municipal Index through the final maturity dates of the underlying bonds in December 2024. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2016 and 2015 and has a fair value of (\$2,770,000) and (\$3,337,000), respectively.

Using rates in effect at June 30, 2016, the projected cash flows for the floating-to-fixed interest rate swaps deemed effective cash flow hedges, along with the debt service requirements of the associated variable rate debt, are summarized as follows:

(in thousands)	Variable Rate Bonds		Swap	Total
	Principal	Interest	Payments, Net	Payments
2017	\$ 13,775	\$ 834	\$ 5,846	\$ 20,455
2018	14,020	781	5,416	20,217
2019	13,770	727	4,970	19,467
2020	14,365	673	4,530	19,568
2021	15,000	615	4,051	19,666
2022-2026	109,725	1,865	8,798	120,388
2027-2030	40,930	251		41,181
	\$ 221,585	\$ 5,746	\$ 33,611	\$ 260,942

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7—DERIVATIVE INSTRUMENTS, CONTINUED

By using derivative financial instruments to hedge exposures to changes in interest rates, the University is exposed to termination risk and basis risk. There is termination risk with floating-to-fixed interest rate swaps because the University or swap counterparty may terminate a swap if the other party fails to perform under the terms of the contract or its credit rating falls below investment grade. Termination risk is the risk that the associated variable rate debt no longer carries a synthetic fixed rate and if at the time of termination a swap has a negative fair value, the University is liable to the counterparty for payment equal to the swap's fair value. The University is also exposed to basis risk as some of the variable payments paid to the University by the counterparties are based on a percentage of LIBOR. Basis risk is the risk that changes in the relationship between SIFMA and LIBOR may impact the synthetic fixed rate of the variable rate debt. The University is not exposed to credit risk because the swaps have negative fair values.

The University is subject to collateral requirements with its counterparties on certain derivative instrument positions. To meet trading margin requirements for bond futures, the University had cash and U.S. government securities with a fair value of \$17,003,000 and \$12,220,000 at June 30, 2016 and 2015, respectively, on deposit with its futures broker as collateral.

NOTE 8—SELF-INSURANCE

The University is self-insured for medical malpractice, workers' compensation, directors' and officers' liability, property damage, auto liability and general liability through Veritas Insurance Corporation. The University is also self-insured for various employee benefits through internally maintained funds.

Claims and expenses are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported and the future costs of handling claims. These liabilities are generally based on actuarial valuations and are reported at present value, discounted at a rate of 6 percent.

Changes in the total reported liability for insurance and benefits obligations for the years ended June 30, 2016 and 2015 are summarized as follows:

(in thousands)	2016	2015
Balance, beginning of year	\$ 192,905	\$ 194,664
Claims incurred and changes in estimates	588,653	533,182
Claim payments	(578,355)	(534,941)
Balance, end of year	203,203	192,905
Less current portion	90,791	84,634
	\$ 112,412	\$ 108,271

NOTE 9—POSTEMPLOYMENT BENEFITS

The University provides retiree health and welfare benefits, primarily medical, prescription drug, dental and life insurance coverage, to eligible retirees and their eligible dependents. Substantially all of the approximately 40,000 full-time regular University employees may become eligible for these benefits if they reach retirement age while working for the University. For employees retiring on or after January 1, 1987, contributions toward health and welfare benefits are shared between the University and the retiree and can vary based on date of hire, date of retirement, age and coverage elections.

The University also provides income replacement benefits, retirement savings contributions and health and life insurance benefits to substantially all regular University employees that are enrolled in a University sponsored long-term disability plan and qualify, based on disability status while working for the University, to receive basic or expanded long-term disability benefits. Contributions toward the expanded long-term disability plan are shared between the University and employees and vary based on years of service, annual base salary and coverage elections. Contributions toward the basic long-term disability plan are paid entirely by the University.

These postemployment benefits are provided through single-employer plans administered by the University. The Executive Vice Presidents of the University have the authority to establish and amend benefit provisions of the plans.

The University's annual postemployment benefits expense is actuarially determined in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* ("GASB 45"). Projections of benefits are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided and announced future changes at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

The University implemented GASB 45 in 2008 and elected to amortize its initial unfunded actuarial accrued liability over one year, the minimum period allowed by the Statement. The University also elected to amortize subsequent changes in actuarial assumptions, plan design and experience gains and losses over a ten-year closed period. Therefore, the liability for net postemployment benefits obligations recorded in the statement of net position may differ from the actuarial accrued liability due to the unamortized portion of these changes. At June 30, 2016, the recorded liability for net postemployment benefits obligations and the actuarial accrued liability totaled \$1,840,583,000 and \$1,844,785,000, respectively.

Changes in the total reported liability for postemployment benefits obligations for the years ended June 30, 2016 and 2015 are summarized as follows:

2016			
(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	\$ 1,588,838	\$ 164,025	\$ 1,752,863
Service cost	59,550	10,918	70,468
Amortization of assumption changes, plan changes and net actuarial (gains) losses	(28,671)	12,747	(15,924)
Interest cost	88,657	12,105	100,762
Payments of current premiums and claims	(47,893)	(19,693)	(67,586)
Balance, end of year	1,660,481	180,102	1,840,583
Less current portion	51,237	23,648	74,885
	\$ 1,609,244	\$ 156,454	\$ 1,765,698

2015			
(in thousands)	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	\$ 1,580,898	\$ 150,556	\$ 1,731,454
Service cost	40,987	9,300	50,287
Amortization of assumption changes, plan changes and net actuarial (gains) losses	(86,474)	10,741	(75,733)
Interest cost	96,119	11,864	107,983
Payments of current premiums and claims	(42,692)	(18,436)	(61,128)
Balance, end of year	1,588,838	164,025	1,752,863
Less current portion	45,479	19,693	65,172
	\$ 1,543,359	\$ 144,332	\$ 1,687,691

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9—POSTEMPLOYMENT BENEFITS, CONTINUED

Since a portion of retiree medical services will be provided by the University's Health System, the liability for postemployment benefits obligations is net of the related margin and fixed costs of providing those services which totaled \$393,541,000 and \$331,473,000 of actuarial accrued liability at June 30, 2016 and 2015, respectively. In accordance with GASB 45, the University's liability for postemployment benefits obligations at June 30, 2016 is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods of approximately \$219,000,000 on an actuarial accrued liability basis.

The annual required contribution represents a level of funding that an employer is projected to need in order to prefund its obligations for postemployment benefits over its employees' years of service and totals \$190,334,000 and \$112,864,000 at June 30, 2016 and 2015, respectively. The University has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently pays for postemployment benefits on a pay-as-you-go basis. The University's postemployment benefits obligations at June 30, 2016, 2015 and 2014 as a percentage of covered payroll of \$3,392,614,000, \$3,228,997,000 and \$3,083,357,000, was 54, 54 and 56 percent, respectively.

The University's recorded liability for postemployment benefits obligations was calculated using the projected unit credit method. Significant actuarial methods and assumptions used in the valuation for the years ended June 30, 2016 and 2015 are as follows:

2016		
	Retiree Health and Welfare	Long-term Disability
Discount Rate	5.58%	7.38%
Immediate/Ultimate Administrative Trend Rate	0.0%/3.0%	0.0%/3.0%
Immediate/Ultimate Medical Trend Rate	5.5%-7.0%/4.5%	5.5%-7.0%/4.5%
Immediate/Ultimate Rx Trend Rate	10.5%/4.5%	10.5%/4.5%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2014 Generational	2005 SOA Life Waiver (Modified)

2015		
	Retiree Health and Welfare	Long-term Disability
Discount Rate	6.08%	7.88%
Immediate/Ultimate Administrative Trend Rate	0.0%/3.0%	0.0%/3.0%
Immediate/Ultimate Medical Trend Rate	6.0%-7.0%/4.5%	6.0%-7.0%/4.5%
Immediate/Ultimate Rx Trend Rate	6.5%/4.5%	6.5%/4.5%
Expected Retirement Age (Faculty/Staff/Union)	66/62/61	Not Applicable
Mortality/Termination Table	RP-2000 Generational	2005 SOA Life Waiver (Modified)

The actuarial accrued liability is determined using current assumptions as of the valuation date, which may differ from those used to calculate the recorded liability.

NOTE 10—RETIREMENT PLAN

The University has a defined contribution retirement plan for all qualified employees through the Teachers Insurance and Annuity Association - College Retirement Equities Fund ("TIAA-CREF") and Fidelity Management Trust Company ("FMTC") mutual funds. All regular and supplemental instructional and primary staff are eligible to participate in the plan based upon age and service requirements. Participants maintain individual contracts with TIAA-CREF, or accounts with FMTC, and are fully vested.

For payroll covered under the plan, eligible employees generally contribute 5 percent of their pay and the University generally contributes 10 percent of employees' pay to the plan. Effective January 1, 2015, the plan was modified for certain employees of the University's health system who now generally contribute 4.5 percent of their pay, with the University contributing 9 percent of those employees' pay to the plan. The University contribution commences after an employee has completed one year of employment. Participants may elect to contribute additional amounts to the plans within specified limits that are not matched by University contributions. Contributions and covered payroll under the plan (excluding participants' additional contributions) for the three years ended June 30, 2016 are summarized as follows:

(in thousands)	2016	2015	2014
University contributions	\$ 259,268	\$ 251,614	\$ 245,973
Employee contributions	\$ 135,829	\$ 131,545	\$ 127,815
Payroll covered under plan	\$ 3,392,614	\$ 3,228,997	\$ 3,083,357
Total payroll	\$ 3,543,959	\$ 3,385,973	\$ 3,230,004

NOTE 11—NET POSITION

The composition of net position at June 30, 2016 and 2015 is summarized as follows:

(in thousands)	2016	2015
Net investment in capital assets	\$ 3,820,905	\$ 3,782,130
Restricted:		
Nonexpendable:		
Permanent endowment corpus	1,815,575	1,673,996
Expendable:		
Net appreciation of permanent endowments	1,519,149	1,708,175
Funds functioning as endowment	1,942,388	2,061,089
Restricted for operations and other	657,482	602,343
Unrestricted	3,245,756	3,468,074
	\$ 13,001,255	\$ 13,295,807

Unrestricted net position, as defined by GASB, is not subject to externally imposed stipulations; however, it is subject to internal restrictions. For example, unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. At June 30, 2016 and 2015, substantially all of the unrestricted net position has been designated for various academic programs, research initiatives and capital projects.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12—FEDERAL DIRECT LENDING PROGRAM

The University distributed \$292,106,000 and \$303,638,000 for the years ending June 30, 2016 and 2015, respectively, for student loans through the U.S. Department of Education (“DoED”) federal direct lending program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements. The statement of net position includes a receivable of \$7,871,000 and a payable of \$2,337,000 at June 30, 2016 and 2015, respectively, for DoED funding received subsequent or prior to distribution.

NOTE 13—COMMITMENTS AND CONTINGENCIES

Authorized expenditures for construction and other projects unexpended as of June 30, 2016 were \$1,072,287,000. Of these expenditures, the University expects that \$1,009,952,000 will be funded by internal sources, gifts, grants and future borrowings, \$25,910,000 by the State Building Authority and the remaining \$36,425,000 will be funded using unexpended debt proceeds.

Under the terms of various limited partnership agreements approved by the Board of Regents or by University officers, the University is obligated to make periodic payments for advance commitments to venture capital, private equity, real estate, natural resources and absolute return strategies. As of June 30, 2016, the University had committed, but not paid, a total of \$3,859,336,000 in funding for these alternative investments. Based on historical capital calls and discussions with those managing the limited partnerships, outstanding commitments for such investments are anticipated to be paid in the following years ended June 30 (in thousands):

2017	\$ 1,352,188
2018	880,157
2019	667,404
2020	337,750
2021	231,254
2022 and beyond	390,583
	<u>\$ 3,859,336</u>

These commitments are generally able to be called prior to an agreed commitment expiration date and therefore may occur earlier or later than estimated.

The University has entered into capital and operating leases for certain space and equipment, which expire at various dates through 2039. Outstanding commitments for these leases are expected to be paid in the following years ended June 30:

(in thousands)	Capital	Operating
2017	\$ 4,473	\$ 30,670
2018	4,473	24,754
2019	4,473	20,709
2020	3,735	18,013
2021	3,045	16,673
2022-2026	14,913	46,649
2027-2031	15,322	368
2032-2036	16,089	150
2037-2039	9,936	
	76,459	<u>\$ 157,986</u>
Less amount representing interest	38,386	
Present value of net minimum capital lease payments	<u>\$ 38,073</u>	

Operating lease expenses totaled \$32,929,000 and \$35,821,000 in 2016 and 2015, respectively.

Substantial amounts are received and expended by the University under federal and state programs and are subject to audit by cognizant governmental agencies. This funding relates to research, student aid, patient care and other programs. The University believes that any liabilities arising from such audits will not have a material effect on its financial position.

The University is a party to various pending legal actions and other claims in the normal course of business, and is of the opinion that the outcome of these proceedings will not have a material adverse effect on its financial position.

NOTE 14—OPERATING EXPENSES BY FUNCTION

Operating expenses by functional classification for the years ended June 30, 2016 and 2015 are summarized as follows:

(in thousands)	2016				
	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	\$ 891,703	\$ 139,307			\$ 1,031,010
Research	494,907	259,907			754,814
Public service	117,025	65,120			182,145
Academic support	224,841	61,999			286,840
Student services	84,728	25,151			109,879
Institutional support	172,634	53,669			226,303
Operations and maintenance of plant	37,018	269,935			306,953
Auxiliary enterprises	2,604,559	1,016,431			3,620,990
Depreciation			\$ 501,631		501,631
Scholarships and fellowships				\$ 132,228	132,228
	<u>\$ 4,627,415</u>	<u>\$ 1,891,519</u>	<u>\$ 501,631</u>	<u>\$ 132,228</u>	<u>\$ 7,152,793</u>

(in thousands)	2015				
	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	\$ 844,505	\$ 138,924			\$ 983,429
Research	469,871	236,257			706,128
Public service	128,604	60,794			189,398
Academic support	207,878	58,304			266,182
Student services	79,609	24,447			104,056
Institutional support	161,661	49,570			211,231
Operations and maintenance of plant	35,588	242,159			277,747
Auxiliary enterprises	2,403,193	925,467			3,328,660
Depreciation			\$ 493,629		493,629
Scholarships and fellowships				\$ 132,758	132,758
	<u>\$ 4,330,909</u>	<u>\$ 1,735,922</u>	<u>\$ 493,629</u>	<u>\$ 132,758</u>	<u>\$ 6,693,218</u>