NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

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, Michigan Health Corporation (a wholly-owned corporation created for joint venture and managed care initiatives), UM Health (a wholly-owned corporation created to hold and develop the University's statewide network of hospitals, hospital joint ventures and other hospital affiliations) 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.

On December 15, 2016, the University completed an affiliation with Metropolitan Health Corporation ("Metro Health"), a community health care provider in west Michigan, pursuant to which UM Health became the sole corporate member of Metro Health. In accordance with GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, this affiliation is included in the financial statements as if it occurred at the beginning of the earliest period presented. The University recognized, measured and combined the assets, deferred outflows, liabilities and net position of Metro Health based upon GASB accounting principles applied at July 1, 2016.

During 2017, the University adopted GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* ("GASB 75"). This statement supersedes GASB Statement No. 45 and establishes new requirements for calculating and reporting the University's postemployment benefits. The adoption of GASB 75 has been reflected as of the beginning of the earliest period presented in the financial statements, resulting in an increase in obligations for postemployment benefits and a decrease in unrestricted net position of $930,343,000 at July 1, 2016.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Net position as of July 1, 2016 was restated for the effects of the University's affiliation with Metro Health and the adoption of GASB 75 as follows (in millions):

	June 30, 2016 As Previously Reported*	Metro Health Affiliation	GASB 75 Adoption	July 1, 2016 As Restated
Current assets	$ 2,445	$ 100		$ 2,545
Noncurrent assets:				
Endowment, life income and other investments	10,046	63		10,109
Capital assets, net	5,709	239		5,948
Other	337	9		346
Total assets	18,537	411		18,948
Deferred outflows	30			30
Total assets and deferred outflows	18,567	411		18,978
Current liabilities	1,771	113	$ (3)	1,881
Noncurrent liabilities	3,795	218	933	4,946
Total liabilities	5,566	331	930	6,827
Net position	$ 13,001	$ 80	$ (930)	$ 12,151

*Certain balances as of June 30, 2016 have been reclassified to conform with current year presentations.

Net position is categorized as:

- Net investment in capital assets: Capital assets, net of accumulated depreciation, outstanding principal balances of debt and capital lease liabilities, unexpended bond proceeds and deferred outflows and inflows associated with 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.

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.

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 Statement No. 72, *Fair Value Measurement and Application*, ("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 to determine the fair value of nonmarketable investments if the NAV is calculated in a manner consistent with the Financial Accounting Standards Board's measurement principles for investment companies. 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, 2017. 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.

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

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 acquisition 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.

Deferred outflows represent the consumption of net assets attributable to a future period and are primarily associated with the University's obligations for postemployment benefits, as well as, debt and derivative activity, and Metro Health's defined benefit pension plan.

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.

Deferred inflows represent the acquisition of net assets attributable to a future period and are associated with Metro Health's defined benefit pension plan.

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 $1,828,744,000 at June 30, 2017, 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's health system, which includes the University of Michigan Hospitals, Metro Health, the University of Michigan Medical Group and 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 University's charity care policies 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 $52,986,000 in 2017.

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.

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.

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 primarily 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2—CASH AND INVESTMENTS, CONTINUED

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 entities that benefit from the endowment fund. The annual distribution rate is 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 $105,127,000 at June 30, 2017, 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 $61,583,000 at June 30, 2017. 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. At June 30, 2017, Level 1 securities, which primarily consist of money market funds and U.S. government securities, totaled $6,845,000, while Level 2 securities, which primarily consist of U.S. agencies, totaled $59,900,000.

Investments: At June 30, 2017, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows (in thousands):

Cash equivalents, noncurrent	$ 102,550
Equity securities	1,364,719
Fixed income securities	2,181,020
Commingled funds	3,255,747
Nonmarketable alternative investments	6,112,495
Other investments	9,054
	$ 13,025,585

GASB 72 establishes a hierarchy that prioritizes inputs to valuation techniques used to measure fair value. At June 30, 2017, the fair value of the University's investments based on the inputs used to value them is summarized as follows (in thousands):

	Level 1	Level 2	Level 3	NAV	Total Fair Value
Cash equivalents, noncurrent	$ 102,550	-	-	-	$ 102,550
Equity securities:					
Domestic	446,823		$ 28,358		475,181
Foreign	888,965		573		889,538
	1,335,788	-	28,931	-	1,364,719
Fixed income securities:					
U.S. Treasury	1,020,420				1,020,420
U.S. government agency		$ 301,634			301,634
Corporate and other		854,885	4,081		858,966
	1,020,420	1,156,519	4,081	-	2,181,020
Commingled funds:					
Absolute return				$ 2,036,001	2,036,001
Domestic equities	17,206			274,829	292,035
Global equities	8,896			862,070	870,966
U.S. fixed income	10,938			41,332	52,270
Other	4,475				4,475
	41,515	-	-	3,214,232	3,255,747
Nonmarketable alternative investments:					
Venture capital				1,430,158	1,430,158
Absolute return				1,299,022	1,299,022
Private equity			207,078	1,271,632	1,478,710
Real estate			8,033	968,849	976,882
Natural resources			176,294	751,429	927,723
	-	-	391,405	5,721,090	6,112,495
Other investments	1,302	(4,036)	11,788	-	9,054
	$ 2,501,575	$ 1,152,483	$ 436,205	$ 8,935,322	$ 13,025,585

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 debt investments with select venture funded University faculty start-ups. Nonmarketable alternative investments categorized as Level 3 primarily include direct investments which are valued using models that rely on inputs which are unobservable in the market.

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 5.0 years at June 30, 2017. 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, 2017, 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, 2017, along with credit quality and effective duration measures, is summarized as follows:

(in thousands)	U.S. Government	Investment Grade	Non-Investment Grade	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 791,194				$ 791,194	6.2
U.S. Treasury inflation protected	229,226				229,226	2.7
U.S. government agency	301,634				301,634	0.5
Mortgage backed		$ 64,229	$ 7,143	$ 5,159	76,531	1.0
Asset backed		71,441	650	126	72,217	0.7
Corporate and other		695,333	6,975	7,910	710,218	7.2
	$ 1,322,054	$ 831,003	$ 14,768	$ 13,195	$ 2,181,020	5.0

Of the University's fixed income securities, 99 percent were rated investment grade or better at June 30, 2017, and 69 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, 2017.

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.

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, 2017, 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, 2017 is summarized as follows (amounts in thousands):

	Fair Value	Remaining Life	Outstanding Commitments	Redemption Terms	Redemption Notice
Commingled funds	$ 3,255,747	N/A		Daily, monthly, quarterly, and annually, with varying notice periods	Lock-up provisions range from none to 3 years
Nonmarketable alternative investments	$ 6,112,495	1-12 years	$ 4,766,977	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, 2017, approximately 78 percent are redeemable within one year, with 61 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 14.

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.

NOTE 2—CASH AND INVESTMENTS, CONTINUED

The value of the University's non-U.S. dollar holdings, net of the value of the outstanding forward foreign exchange contracts, totaled $1,694,128,000 or 13 percent of total investments at June 30, 2017, and are summarized as follows (in thousands):

Euro	$ 954,456
British pound sterling	230,211
Japanese yen	230,547
Canadian dollar	69,764
Swedish krona	52,440
Swiss franc	45,640
Other	111,070
	$ 1,694,128

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 $90,638,000 in securities loans outstanding at June 30, 2017. 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, 2017, collateral of $95,679,000 (106 percent of securities on loan) includes invested cash of $44,130,000 and U.S. government securities of $51,549,000.

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, 2017 is summarized as follows (in thousands):

Patient care	$ 633,727
Sponsored programs	143,958
State appropriations, educational and capital	65,933
Student accounts	29,544
Other	33,602
	906,764
Less allowance for uncollectible accounts receivable:	
Patient care	258,847
All other	8,533
	$ 639,384

NOTE 4—NOTES AND PLEDGES RECEIVABLE

The composition of notes and pledges receivable at June 30, 2017 is summarized as follows (in thousands):

Notes:	
Federal student loan programs	$ 88,911
University student loan funds	17,563
Other	1,120
	107,594
Less allowance for uncollectible notes	3,100
Total notes receivable, net	104,494
Gift pledges:	
Capital	177,043
Operations	121,047
	298,090
Less:	
Allowance for uncollectible pledges	10,064
Unamortized discount to present value	3,894
Total pledges receivable, net	284,132
Total notes and pledges receivable, net	388,626
Less current portion	76,148
	$ 312,478

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, 2017 are expected to be received in the following years ended June 30 (in thousands):

2018	$ 61,113
2019	46,737
2020	37,136
2021	36,942
2022	22,200
2023 and after	93,962
	$ 298,090

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 $185,551,000 at June 30, 2017, are not recognized as assets in the accompanying financial statements. 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 year ended June 30, 2017 is summarized as follows (in thousands):

	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 124,207	$ 2,410		$ 126,617
Land improvements	125,953	12,152	$ 124	137,981
Infrastructure	255,921	2,528		258,449
Buildings	8,206,614	430,132	18,369	8,618,377
Construction in progress	456,391	19,733		476,124
Property held for future use	24,502	(24,502)		-
Equipment	2,068,851	167,252	185,255	2,050,848
Library materials	593,768	26,432		620,200
	11,856,207	636,137	203,748	12,288,596
Less accumulated depreciation	5,907,820	537,670	202,336	6,243,154
	$ 5,948,387	$ 98,467	$ 1,412	$ 6,045,442

The increase in construction in progress of $19,733,000 in 2017 represents the amount of capital expenditures for new projects of $563,683,000 net of assets placed in service of $543,950,000.

NOTE 6—LONG-TERM DEBT

Long-term debt at June 30, 2017 is summarized as follows (in thousands):

Commercial Paper:	
Tax-exempt, variable rate (.92%)*	$ 157,160
Taxable, variable rate (1.03%)*	3,885
General Revenue Bonds:	
Series 2017A, 4.00% to 5.00% through 2047	464,750
unamortized premium	84,172
Series 2015, 4.00% to 5.00% through 2046	304,615
unamortized premium	50,686
Series 2014A, 4.25% to 5.00% through 2044	77,825
Series 2014B, 1.771% to 3.516% through 2024	6,625
unamortized premium	6,963
Series 2013A, 2.50% to 5.00% through 2029	46,385
unamortized premium	1,885
Series 2012A, variable rate (.85%)* through 2036	50,000
Series 2012B, variable rate (.70%)* through 2042	65,000
Series 2012D-1, variable rate (.68%)* through 2025 with partial swap to fixed through 2025	63,635
Series 2012D-2, variable rate (.88%)* through 2030 with partial swap to fixed through 2026 and variable rate 2027 through 2030	66,990
Series 2012E**, variable rate (1.34%)* through 2033	95,500
Series 2010A, taxable-Build America Bonds, 4.926% to 5.593% through 2040	163,110
Series 2010C, 3.75% to 5.00% through 2027	61,570
unamortized premium	4,434
Series 2010D, taxable-Build America Bonds, 3.176% to 5.333% through 2041	173,560
Series 2009A, 3.00% to 5.00% through 2019	12,555
unamortized premium	2,991
Series 2009B, variable rate (.87%)* through 2039	118,710
Series 2009D, taxable-Build America Bonds, 5.155% to 6.172% through 2030	89,815
Series 2008A, variable rate (.75%)* through 2038	57,085
Series 2008B, variable rate (.89%)* through 2028 with swap to fixed through 2026	77,185
Series 2005A, 5.00% through 2018	1,065
unamortized premium	17
Series 2002, variable rate (.91%)* through 2018 with swap to fixed through 2018	7,595
Other	1,747
	2,317,515
Less:	
Commercial paper and current portion of bonds payable	237,243
Long-term bonds payable subject to remarketing, net	202,718
	$ 1,877,554

* Denotes variable rate at June 30, 2017

** Denotes variable rate bonds not subject to remarketing

NOTE 6—LONG-TERM DEBT, CONTINUED

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, 2017 is summarized as follows (in thousands):

Variable rate bonds payable subject to remarketing	$ 506,200
Less:	
Current principal maturities	21,615
Long-term liquidity agreements:	
Unsecured line of credit	150,000
Standby bond purchase agreements	131,867
Long-term bonds payable subject to remarketing, net	$ 202,718

The University's available line of credit and standby bond purchase agreements were entirely unused at June 30, 2017.

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 year ended June 30, 2017 is summarized as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
Commercial paper	$ 159,970	$ 23,420	$ 22,345	$ 161,045
Bonds	2,025,251	550,019	420,547	2,154,723
Other	4,175		2,428	1,747
	$ 2,189,396	$ 573,439	$ 445,320	$ 2,317,515

The University maintains a combination of variable and fixed rate debt supported by general revenues, with effective interest rates that averaged 2.7 percent in 2017, 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.

During 2017, the University issued $464,750,000 of fixed rate General Revenue Bonds Series 2017A with a net original issue premium of $85,269,000. Total bond proceeds of $550,019,000 together with amounts held by trustees under bond indenture of $12,019,000 were utilized to convert $12,285,000 of commercial paper to long-term debt, refund $237,540,000 of existing bonds, and establish an escrow of $111,752,000 to advance refund existing bonds, as well as provide $199,014,000 for capital projects and $1,447,000 for debt issuance costs.

Bond proceeds of $162,376,000 along with amounts held by trustees under bond indenture of $12,019,000 were used to refund Metro Health's Series 2005A Revenue Bonds of $122,945,000 and Series 2012 Variable Rate Demand Revenue and Revenue Refunding Bonds of $51,450,000, which had average interest rates of 5.99 percent and 3.08 percent, respectively. As a result of these refundings, the University reduced its aggregate debt service payments over the next 24 years by $68,469,000, resulting in an economic gain with present value savings of $39,171,000.

Bond proceeds of $63,145,000 were used to refund a portion of General Revenue Bonds Series 2012C which had an average interest rate of 5.00 percent and a final bullet maturity due April 1, 2017. As a result of the refunding, the University's aggregate debt service payments increased over the next 15 years by $11,125,000, resulting in an economic gain with present value savings of $600,000.

The University established an escrow with bond proceeds of $111,752,000 to advance refund $35,440,000 of General Revenue Bonds Series 2009A and $65,915,000 of General Revenue Bonds Series 2010C which had average interest rates of 4.51 percent and 4.64 percent, respectively. These bonds are considered legally defeased as funds were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result of these advance refundings, the University reduced its aggregate debt service payments over the next 12 years by $9,490,000, resulting in an economic gain with present value savings of $8,078,000.

During 2017, the University deferred $10,397,000 in connection with its refunding activity, which will be amortized into interest expense over the remaining life of the refunded bonds. At June 30, 2017, a total of $17,011,000 has been deferred in connection with the University's refunding activity.

Debt obligations are generally callable by the University and mature at various dates through fiscal 2047. Principal maturities, including 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
2018	$ 227,778	$ 72,567	$ 300,345
2019	64,968	71,006	135,974
2020	66,596	69,236	135,832
2021	70,190	67,241	137,431
2022	73,325	65,300	138,625
2023-2027	411,050	286,402	697,452
2028-2032	419,130	200,904	620,034
2033-2037	437,005	126,492	563,497
2038-2042	304,820	53,563	358,383
2043-2047	91,505	12,285	103,790
Total payments	2,166,367	$ 1,024,996	$ 3,191,363
Plus unamortized premiums	151,148		
	$ 2,317,515		

* Interest on variable rate debt is estimated based on rates in effect at June 30, 2017; 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 2018 would increase to $288,841,000, total principal payments due in 2019 would increase to $123,517,000, total principal payments due in 2020 would increase to $105,590,000 and total principal payments due in 2021 would increase to $86,384,000. Accordingly, principal payments due in subsequent years would be reduced to $66,725,000 in 2022; $373,480,000 in 2023 through 2027; $410,585,000 in 2028 through 2032; $376,455,000 in 2033 through 2037; $243,285,000 in 2038 through 2042; and $91,505,000 in 2043 through 2047. 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, 2017 are summarized as follows (in thousands):

	Notional Amount	Fair Value
Investment Derivative Instruments:		
Investment portfolios:		
Futures	$ 242,854	$ (6,371)
Foreign currency forwards:		
Chinese yuan	332,080	(8,633)
New Zealand dollar	51,891	(4,891)
South African rand	71,852	3,453
Euro	144,951	3,190
Czech koruna	27,072	(2,103)
Swedish krona	82,727	(2,019)
All other currencies	1,057,651	2,066
	1,768,224	(8,937)
Other	2,089,063	12,723
	$ 4,100,141	$ (2,585)
Floating-to-fixed interest rate swap on debt	$ 7,595	$ (186)
Effective Cash Flow Hedges:		
Floating-to-fixed interest rate swaps on debt	$ 166,660	$ (19,312)

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.

At June 30, 2017, the fair value of floating-to-fixed interest rate swaps associated with the University's variable rate debt is a liability of $19,498,000, respectively, and is included in the statement of net position as a component of Deposits of affiliates and other. The deferred outflows for the fair value of swaps deemed effective cash flow hedges totaled $5,181,000, at June 30, 2017.

The change in fair value of derivative instruments, which includes realized gains and losses on positions closed, for the year ended June 30, 2017 is summarized as follows (in thousands):

Investment Derivative Instruments:	
Investment portfolios:	
Futures	$ 27,627
Foreign currency forwards	57,408
Other	(21,006)
	$ 64,029
Floating-to-fixed interest rate swap on debt	$ 462
Effective Cash Flow Hedges:	
Floating-to-fixed interest rate swaps on debt	$ 10,626

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 $60,470,000 at June 30, 2017, 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, 2017 and has a fair value of ($5,448,000).

The floating-to-fixed interest rate swap associated with the Series 2005B Hospital Revenue Bonds has a notional amount of $42,685,000 at June 30, 2017. 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 swap terminates 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, 2017 and has a fair value of ($3,564,000).

The floating-to-fixed interest rate swap associated with the Series 2002 General Revenue Bonds has a notional amount of $7,595,000 at June 30, 2017, 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 3.538 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 1, 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, 2017 and has a fair value of ($186,000).

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 June 30, 2017. 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, 2017 and has a fair value of ($8,663,000).

NOTE 7—DERIVATIVE INSTRUMENTS, CONTINUED

The floating-to-fixed interest rate swap associated with the Series 1998A-1 Medical Service Plan Revenue Refunding Bonds has a notional amount of $18,835,000 at June 30, 2017. 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 a portion of the underlying bonds in December 2021. 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, 2017 and has a fair value of ($1,637,000).

Using rates in effect at June 30, 2017, 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
2018	$ 14,020	$ 1,660	$ 4,633	$ 20,313
2019	13,770	1,543	4,256	19,569
2020	14,365	1,428	3,882	19,675
2021	15,000	1,303	3,476	19,779
2022	15,645	1,178	3,067	19,890
2023-2027	108,050	3,135	4,466	115,651
2028-2030	26,960	236		27,196
	$ 207,810	$ 10,483	$ 23,780	$ 242,073

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 a portion 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. At June 30, 2017, the University is not exposed to credit risk as 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 $21,099,000 at June 30, 2017 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 5 percent.

Changes in the total reported liability for insurance and benefits obligations for the year ended June 30, 2017 are summarized as follows (in thousands):

Balance, beginning of year	$ 203,203
Claims incurred and changes in estimates	628,681
Claim payments	(617,849)
Balance, end of year	214,035
Less current portion	97,799
	$ 116,236

NOTE 9—PENSION PLAN

Metro Health has a noncontributory, single employer defined benefit pension plan, which covered substantially all employees prior to being frozen as of December 31, 2007. The plan generally provides benefits based on each employee's years of service and final average earnings, as defined, and does not provide any automatic or ad-hoc cost of living adjustments. The Metro Health Board of Directors has the authority to establish and amend benefit provisions of the plan.

Metro Health's annual pension expense is actuarially determined in accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions an Amendment of GASB Statement No. 27* ("GASB 68"). The net pension liability is calculated using the entry age normal level percentage of pay method. As allowable under the terms of GASB 68, Metro Health has elected to measure the net pension liability one year prior to the fiscal year end reporting date. The net pension liability measured as of June 30, 2016 was determined based on an actuarial valuation as of October 1, 2015. There are no significant changes known which would impact the total pension liability between the measurement date and the reporting date, other than typical plan experience.

For purposes of the June 30, 2016 measurement date, the number of plan participants consisted of the following:

Active participants	685
Vested terminated participants	928
Retirees, beneficiaries and disabled participants	323
	1,936

NOTE 9—PENSION PLAN, CONTINUED

Changes in the net pension liability for the year ended June 30, 2017 are summarized as follows (in thousands):

	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
Balance, beginning of year	$ 96,414	$ 67,236	$ 29,178
Interest cost	4,482		4,482
Changes in assumptions	(24,906)		(24,906)
Differences between expected and actual plan experience	2,067		2,067
Benefit payments	(4,089)	(4,089)	-
Contributions from the employer		2,903	(2,903)
Net investment income:			
Expected investment earnings		3,166	(3,166)
Difference between expected and actual earnings		1,316	(1,316)
Balance, end of year	$ 73,968	$ 70,532	$ 3,436

The plan fiduciary net position as a percentage of the total pension liability was 95 percent and 70 percent at June 30, 2017 and July 1, 2016, respectively.

Significant actuarial assumptions used at each respective measurement date are as follows:

	June 30, 2016	July 1, 2015
Discount rate	7.00%	4.75%
Inflation	2.75%	2.75%
Investment rate of return	7.00%	4.75%
Mortality table	RP-2014 Employee and Healthy Annuitant, Scale MP-2015	RP-2014 Employee and Healthy Annuitant, Scale MP-2014

Discount rates are based on the expected rate of return on pension plan investments. The projection of cash flows used to determine the single discount rate for each fiscal year end assumed that employer contributions will be made based on minimum contribution projection under provisions of ERISA and Pension Protection Act of 2006 (including MAP-21) for future years. Based on the stated assumptions, the pension plan's fiduciary net position and future contributions were sufficient to finance the future benefit payments of the current plan members for all projection years. As a result, the long-term expected rate of return on pension plan investments was applied to all periods of the projected benefit payments to determine the total pension liability.

The long-term expected rate of return on pension plan investments of 7.00 percent at June 30, 2016, was determined using the expected future rates of return for the target asset allocation of the portfolio. The target allocation and best estimate geometric rates of return by asset class are summarized as follows:

	Portfolio Allocation	Long-Term Expected Return
U.S. large cap	25.0%	7.3%
U.S. mid cap	10.5%	7.5%
U.S. small cap	6.5%	7.8%
International developed	14.0%	6.8%
Emerging market	9.0%	12.6%
STRIPs	7.0%	2.1%
Corporate 10+ year	28.0%	5.1%

A one-percentage point change in the discount rate would have the following impact on the net pension liability at June 30, 2017 (in thousands):

	1% Decrease	1% Increase
Net pension liability	$ 9,056	$ (7,470)

The components of pension expense (income) for the year ended June 30, 2017 are summarized as follows (in thousands):

Interest cost	$ 4,482
Expected investment earnings	(3,166)
Amortization of deferred outflows and inflows:	
Difference between expected and actual plan experience	720
Difference between expected and actual investment earnings	(263)
Changes in assumptions	(8,678)
	$ (6,905)

Deferred outflows and inflows related to the net pension liability at June 30, 2017 are summarized as follows (in thousands):

	Deferred Outflows	Deferred Inflows
Changes in assumptions		$ 16,228
Difference between expected and actual plan experience	$ 1,347	
Difference between expected and actual investment earnings		1,053
	1,347	17,281
Contributions made after measurement date	2,171	
	$ 3,518	$ 17,281

Deferred outflows and inflows related to differences between expected and actual experience, as well as changes in assumptions, will be recognized into expense in the following fiscal years ended June 30 based upon the average future work life expectancy of plan participants (in thousands):

2018	$ 8,221
2019	7,187
2020	263
2021	263
	$ 15,934

NOTE 9—PENSION PLAN, CONTINUED

At June 30, 2017, the reported fair value of the plan's investments based on the inputs used to value them is summarized as follows (in thousands):

	Level 1	Level 2	NAV	Total Fair Value
Equity securities	$ 49,494			$ 49,494
Fixed income securities		$ 19,555		19,555
Nonmarketable alternative investments			$ 1,483	1,483
	$ 49,494	$ 19,555	$ 1,483	$ 70,532

NOTE 10—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 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 75. 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's reported liability for postemployment benefits obligations is calculated using the entry age normal level percent of pay method. As allowable under the terms of GASB 75, the University has elected to measure the total postemployment liability one year prior to the fiscal year end reporting date. There are no significant changes known which would impact the total postemployment liability between the measurement date and the reporting date, other than typical plan experience.

For purposes of the June 30, 2016 measurement date, the number of plan participants consisted of the following:

	Retiree Health and Welfare	Long-term Disability
Active employees	39,510	34,496
Retirees receiving benefits	9,099	
Surviving spouses	872	
Participants receiving disability benefits		610
	49,481	35,106

Changes in the total reported liability for postemployment benefits obligations for the year ended June 30, 2017 are summarized as follows (in thousands):

	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 2,532,952	$ 237,974	$ 2,770,926
Service cost	97,193	24,880	122,073
Interest cost	99,036	9,525	108,561
Changes in assumptions	244,109	10,932	255,041
Differences between expected and actual plan experience	5,259	8,769	14,028
Benefit payments	(47,893)	(24,409)	(72,302)
Balance, end of year	2,930,656	267,671	3,198,327
Less current portion	48,910	28,464	77,374
	$ 2,881,746	$ 239,207	$ 3,120,953

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 $674,252,000 at June 30, 2017.

In accordance with GASB 75, the University's liability for postemployment benefits obligations at June 30, 2017 is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods. This subsidy would reduce the total postemployment benefits liability by approximately $427,000,000.

The University does not maintain a separate legal trust to house assets used to fund postemployment benefits, 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 reported postemployment benefits obligations at June 30, 2017 as a percentage of covered payroll of $3,568,918,000 was 90 percent.

NOTE 10—POSTEMPLOYMENT BENEFITS, CONTINUED

Significant actuarial assumptions used at each respective measurement date are as follows:

	June 30, 2016	July 1, 2015
Discount rate*	2.85%	3.80%
Inflation rate	2.75%	2.75%
Immediate/ultimate administrative trend rate	0.0%/3.0%	0.0%/3.0%
Immediate/ultimate medical trend rate	7.0%/4.5%	7.0%/4.5%
Immediate/ultimate Rx trend rate	10.0%/4.5%	10.5%/4.5%
Increase in compensation rate	4.00%	4.00%
Mortality table**	RP-2014 White Collar Head Count Table, Scale MP-2015	RP-2014 White Collar Head Count Table, Scale MP-2014
Average future work life expectancy (years):		
Retiree health and welfare	9.54	N/A
Long-term disability	11.90	N/A

* Bond Buyer 20-year General Obligation Municipal Bond Index as of the last publication of the measurement period

** Based on the University's study of mortality experience from 2010-2014

A one-percentage point change in the discount rate and assumed health care cost trend rates would have the following impact on the liability for postemployment benefits obligations at June 30, 2017 (in thousands):

	1% Decrease	1% Increase
Discount Rate:		
Retiree health and welfare	$ 672,064	$ (516,547)
Long-term disability	$ 9,360	$ (8,600)
Health Care Trend Rate:		
Retiree health and welfare	$ (570,224)	$ 776,594
Long-term disability	$ (9,402)	$ 9,661

The components of postemployment benefits expense for the year ended June 30, 2017 are summarized as follows (in thousands):

	Retiree Health and Welfare	Long-term Disability	Total
Service cost	$ 97,193	$ 24,880	$ 122,073
Interest cost	99,036	9,525	108,561
Amortization of deferred outflows	26,139	1,656	27,795
	$ 222,368	$ 36,061	$ 258,429

Deferred outflows related to postemployment benefits obligations at June 30, 2017 are summarized as follows (in thousands):

Changes in assumptions	$ 228,534
Difference between expected and actual plan experience	12,740
	241,274
Benefit payments made after measurement date	77,374
	$ 318,648

Deferred outflows related to changes in assumptions and the difference between expected and actual plan experience will be amortized into expense in the following years ended June 30 based upon the average future work life expectancy of plan participants (in thousands):

2018	$ 27,795
2019	27,795
2020	27,795
2021	27,795
2022	27,795
2023 and beyond	102,299
	$ 241,274

NOTE 11—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, while certain employees of the University's health system 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 year ended June 30, 2017 are summarized as follows (in thousands):

University contributions	$ 271,669
Employee contributions	$ 142,539
Payroll covered under plan	$ 3,568,918
Total payroll	$ 3,727,646

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12—NET POSITION

The composition of net position at June 30, 2017 is summarized as follows (in thousands):

Net investment in capital assets	$ 3,735,130
Restricted:	
Nonexpendable:	
Permanent endowment corpus	1,966,541
Expendable:	
Net appreciation of permanent endowments	1,828,744
Funds functioning as endowment	2,126,286
Restricted for operations and other	698,953
Unrestricted	3,071,403
	$ 13,427,057

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, 2017, substantially all of the unrestricted net position has been designated for various academic programs, research initiatives and capital projects.

NOTE 13—FEDERAL DIRECT LENDING PROGRAM

The University distributed $291,964,000 during the year ended June 30, 2017, 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 $2,429,000 at June 30, 2017, for DoED funding received subsequent to distribution.

NOTE 14—COMMITMENTS AND CONTINGENCIES

Authorized expenditures for construction and other projects unexpended as of June 30, 2017 were $901,039,000. Of these expenditures, the University expects that $796,450,000 will be funded by internal sources, gifts, grants and future borrowings, $6,134,000 by the State Building Authority and the remaining $98,455,000 will be funded using unexpended bond 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, 2017, the University had committed, but not paid, a total of $4,766,977,000 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):

2018	$ 1,645,335
2019	1,124,702
2020	774,249
2021	444,811
2022	298,685
2023 and beyond	479,195
	$ 4,766,977

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
2018	$ 10,718	$ 45,271
2019	11,175	40,092
2020	10,589	37,319
2021	10,053	31,898
2022	10,211	28,343
2023-2027	46,267	84,848
2028-2032	47,139	8,300
2033-2037	32,022	88
2038-2039	6,624	
	184,798	$ 276,159
Less amount representing interest	87,538	
Present value of minimum lease payments	$ 97,260	

Operating lease expenses totaled $50,409,000 in 2017.

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 15—OPERATING EXPENSES BY FUNCTION

Operating expenses by functional classification for the year ended June 30, 2017 are summarized as follows (in thousands):

	Compensation and Benefits	Supplies and Services	Depreciation	Scholarships and Fellowships	Total
Instruction	$ 939,548	$ 160,206			$ 1,099,754
Research	538,613	264,980			803,593
Public service	120,755	67,010			187,765
Academic support	237,819	60,278			298,097
Student services	87,885	24,075			111,960
Institutional support	181,106	55,556			236,662
Operations and maintenance of plant	40,575	275,789			316,364
Auxiliary enterprises	2,918,121	1,256,124			4,174,245
Depreciation			$ 537,670		537,670
Scholarships and fellowships				$ 143,932	143,932
	$ 5,064,422	$ 2,164,018	$ 537,670	$ 143,932	$ 7,910,042

NOTE 16—UM HEALTH

Condensed financial information for UM Health, a blended component unit, before the elimination of certain intra-University transactions, as of and for the year ended June 30, 2017 is as follows (in thousands):

Condensed Statement of Net Position	
Assets:	
Current assets	$ 142,403
Noncurrent assets	258,190
Total assets	400,593
Deferred outflows	7,851
Total assets and deferred outflows	$ 408,444
Liabilities:	
Current liabilities	$ 56,449
Noncurrent liabilities	229,256
Total liabilities	285,705
Deferred inflows	20,258
Net position:	
Net investment in capital assets	18,691
Restricted:	
Nonexpendable	177
Expendable	11,569
Unrestricted	72,044
Total net position	102,481
Total liabilities, deferred inflows and net position	$ 408,444

Condensed Statement of Revenues, Expenses and Changes in Net Position	
Operating revenues	$ 377,202
Operating expenses other than depreciation expense	367,561
Depreciation expense	20,952
Operating loss	(11,311)
Nonoperating expenses, net	(9,512)
Other expenses, net	(1,974)
Net expenses before transfers	(22,797)
Transfers from other University units	45,000
Increase in net assets	22,203
Net position, beginning of year	80,278
Net position, end of year	$ 102,481

NOTE 16—UM HEALTH, CONTINUED

Condensed Statement of Cash Flows	
Net cash provided by operating activities	$ 16,916
Net cash provided by noncapital financing activities	38,113
Net cash used in capital and related financing activities	(63,550)
Net cash used in investing activities	(529)
Net decrease in cash and cash equivalents	(9,050)
Cash and cash equivalents, beginning of year	53,773
Cash and cash equivalents, end of year	$ 44,723