



The University of Chicago

2016-2017 Financial Statements and Supplemental University Information



THE UNIVERSITY OF CHICAGO
Years ended June 30, 2017 and 2016

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THE UNIVERSITY OF CHICAGO

Management's Responsibility for Consolidated Financial Statements

June 30, 2017 and 2016

The management of The University of Chicago (University) is responsible for the preparation and fair presentation of the consolidated financial statements. The consolidated financial statements, presented on pages 4 to 49, have been prepared in conformity with U.S. generally accepted accounting principles and, as such, include amounts and disclosures based on judgments and estimates by management.

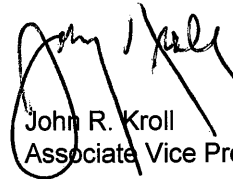
The consolidated financial statements have been audited by the independent accounting firm KPMG LLP (KPMG), which was given unrestricted access to all financial records and related data, including minutes of all meetings of Trustees. The University believes that all management representations made to KPMG during its audit were valid, complete, and appropriate. KPMG's audit opinion is presented on pages 2 and 3.

The University maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance that the consolidated financial statements are free from material misstatement, whether due to fraud or error. Such controls are maintained through the establishment and communication of accounting and financial policies and procedures, selection and training of qualified personnel, and an internal audit program designed to identify internal control weaknesses in order to permit management to take appropriate corrective action on a timely basis. There are, however, inherent limitations in the effectiveness of any system of internal control, including the possibility of human or system error and the intentional circumvention of controls. Accordingly, even an effective internal control system can provide only reasonable assurance.

The Trustees of the University, through its Audit Committee comprised of Trustees not employed by the University, are responsible for engaging the independent accountants and meeting with management, internal auditors, and the independent accountants to ensure that each is carrying out their responsibilities. Both internal auditors and the independent accountants have full and free access to the Audit Committee.



Ivan Samstein
Vice President and Chief Financial Officer



John R. Kroll
Associate Vice President for Finance



KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report

The Board of Trustees
The University of Chicago:

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The University of Chicago (the University), which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The University of Chicago as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Emphasis of Matters

As discussed in note 1(m) to the consolidated financial statements, in 2017, the University adopted Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, and ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Our opinion is not modified with respect to these matters.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating supplemental information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The consolidating supplemental information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

KPMG LLP

Chicago, Illinois
November 1, 2017

THE UNIVERSITY OF CHICAGO

Consolidated Balance Sheets

June 30, 2017 and 2016

(In thousands of dollars)

Assets	2017	2016
Cash and cash equivalents	\$ 50,384	72,119
Notes and accounts receivable, net	659,593	517,245
Prepaid expenses and other assets	254,309	149,459
Pledges receivable, net	655,584	612,672
Investments	8,704,732	7,999,523
Land, buildings, equipment, and books, net	<u>4,912,286</u>	<u>4,674,581</u>
Total assets	<u>\$ 15,236,888</u>	<u>14,025,599</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued liabilities	\$ 1,005,745	923,003
Deferred revenue	115,633	116,108
Assets held in custody for others	129,832	110,556
Self-insurance liability	287,581	256,947
Pension and other postretirement benefit obligations	491,828	570,276
Asset retirement obligation	55,827	57,292
Notes and bonds payable	4,691,832	4,513,220
Refundable U.S. government student loan funds	<u>39,375</u>	<u>39,414</u>
Total liabilities	<u>6,817,653</u>	<u>6,586,816</u>
Net assets:		
Without donor restrictions	2,815,466	2,282,205
With donor restrictions	<u>5,603,769</u>	<u>5,156,578</u>
Total net assets	<u>8,419,235</u>	<u>7,438,783</u>
Total liabilities and net assets	<u>\$ 15,236,888</u>	<u>14,025,599</u>

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO
Consolidated Statements of Activities
Years ended June 30, 2017 and 2016
(In thousands of dollars)

	<u>2017</u>	<u>2016</u>
Changes in net assets without donor restrictions:		
Operating:		
Revenue:		
Tuition and fees – gross	\$ 830,550	780,083
Less student aid	(405,833)	(384,309)
Tuition and fees – net	424,717	395,774
Government grants and contracts	367,577	364,940
Private gifts, grants, and contracts	229,526	219,857
Endowment payout	454,220	466,478
Patient service	2,128,591	1,746,208
Auxiliaries	216,622	217,420
Other income	393,729	373,089
Net assets released from restrictions	140,293	73,432
Total operating revenue	<u>4,355,275</u>	<u>3,857,198</u>
Expenses:		
Compensation:		
Academic salaries	590,246	549,422
Staff salaries	1,279,412	1,133,161
Benefits	475,024	430,000
Total compensation	<u>2,344,682</u>	<u>2,112,583</u>
Other operating expenses:		
Utilities, alterations, and repairs	85,109	77,732
Depreciation	321,327	280,768
Interest	166,571	145,667
Supplies, services, and other	1,409,963	1,173,741
Total other operating expenses	<u>1,982,970</u>	<u>1,677,908</u>
Total operating expenses	<u>4,327,652</u>	<u>3,790,491</u>
Excess of operating revenue over expenses	<u>\$ 27,623</u>	<u>66,707</u>

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Consolidated Statements of Activities
Years ended June 30, 2017 and 2016
(In thousands of dollars)

	2017	2016
Changes in net assets without donor restrictions :		
Nonoperating:		
Investment gains (losses)	\$ 105,275	(251,114)
Net periodic benefit cost other than service cost	(16,485)	(22,831)
Defined benefit pension plan curtailment (partial)	64,241	45,926
Other postretirement benefit changes	34,669	(142,939)
Changes in fair value of derivative instruments	67,401	(74,139)
Loss on debt refinancing	(27,028)	(16,946)
Contribution of Ingalls Health System net assets	309,740	—
Other, net	(32,175)	(82,502)
	505,638	(544,545)
Increase (decrease) in net assets without donor restrictions	533,261	(477,838)
Changes in net assets with donor restrictions:		
Private gifts	334,589	323,303
Endowment payout	923	1,990
Investment gains (losses)	212,306	(388,516)
Contribution of Ingalls Health System net assets	13,122	—
Other, net	26,544	11,225
Net assets released from restrictions	(140,293)	(73,432)
	447,191	(125,430)
Increase (decrease) in net assets with donor restrictions	980,452	(603,268)
Net assets at beginning of year	7,438,783	8,042,051
Net assets at end of year	\$ 8,419,235	7,438,783

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO
Consolidated Statements of Cash Flows
Years ended June 30, 2017 and 2016
(In thousands of dollars)

	2017	2016
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ <u>980,452</u>	<u>(603,268)</u>
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:		
Contribution of Ingalls Health System net assets	(322,862)	—
Depreciation	321,327	280,768
Change in value of derivative instruments	(71,358)	78,334
Loss on debt refinancing	27,028	16,946
Loss on disposal of land, buildings, equipment, and books	10,537	5,623
Gain on sale of property	(44,687)	(61,053)
Net (gain) loss on investments	(676,860)	245,222
Private gifts and grants restricted for long-term investment	(338,944)	(317,371)
Other nonoperating changes	207,400	167,948
Postretirement benefit changes	(84,375)	97,013
Changes in operating assets and liabilities:		
Notes and accounts receivable	(113,809)	(94,477)
Prepaid expenses and other assets	(106,206)	11,875
Accounts payable and other liabilities	140,725	66,087
Self-insurance liability	(2,510)	(9,246)
Total adjustments	<u>(1,054,594)</u>	<u>487,669</u>
Net cash used in operating activities	<u>(74,142)</u>	<u>(115,599)</u>
Cash flows from investing activities:		
Purchase of investments	(2,216,663)	(1,106,553)
Proceeds from sale of investments	2,491,198	1,224,468
Contribution of Ingalls Health System	28,003	—
Acquisition of land, buildings, equipment, and books	(444,570)	(573,647)
Acquisition of physician practice	—	(1,447)
Proceeds from sale of property	64,716	70,100
Loans disbursed	(2,976)	(7,055)
Principal collected on loans	7,914	7,435
Net cash used in investing activities	<u>(72,378)</u>	<u>(386,699)</u>
Cash flows from financing activities:		
Proceeds from issuance of debt instruments	1,787,661	1,980,981
Principal payments on debt instruments	(1,749,925)	(1,670,084)
Proceeds from private gifts and grants restricted for long-term investment	158,706	162,844
Other nonoperating changes	(71,657)	(97,679)
Net cash provided by financing activities	<u>124,785</u>	<u>376,062</u>
Decrease in cash and cash equivalents	(21,735)	(126,236)
Cash and cash equivalents at:		
Beginning of year	<u>72,119</u>	<u>198,355</u>
End of year	<u>\$ 50,384</u>	<u>72,119</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 178,968	147,347
Change in construction payable	(46,800)	1,452

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(1) Summary of Significant Accounting Policies

(a) Description of Business

The University of Chicago (the University) is a private, nondenominational, coeducational institution of higher learning and research. The University provides education and training services, primarily for students enrolled in undergraduate, graduate, and professional degree programs, and performs research, training, and other services under grants, contracts, and other agreements with sponsoring organizations, including both government agencies and private enterprises. Certain members of the University's faculty also provide professional medical services to patients at The University of Chicago Medical Center (the Medical Center) and other healthcare facilities located in the area.

Significant accounting policies followed by the University, the Medical Center, and the Marine Biological Laboratory (MBL) are set forth as follows. Accounting policies specific to the Medical Center and MBL are discussed in notes 2 and 3, respectively.

(b) Basis of Presentation

The consolidated financial statements of the University have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and include the accounts of the University, the Medical Center, and MBL. The organization of the Medical Center and MBL and associated agreements with the University are discussed in notes 2 and 3, respectively.

The University maintains its accounts in accordance with the principles of fund accounting. Under this method of accounting, resources for various purposes are classified into funds that are in accordance with activities or objectives specified by donors. Separate accounts are maintained for each fund.

For financial reporting purposes, however, the University follows the reporting requirements of GAAP, which requires that resources be classified for reporting purposes based on the existence or absence of donor-imposed restrictions. This is accomplished by classification of fund balances into two classes of net assets: without donor restrictions and with donor restrictions. Descriptions of the two net asset categories and the types of transactions affecting each category follow:

- Without Donor Restrictions – Net assets that are not subject to donor-imposed restrictions. Items that affect this net asset category principally consist of fees for service and related expenses associated with the core activities of the University: instruction, conduct of sponsored research, and provision of healthcare services. In addition to these exchange transactions, changes in this category of net assets include investment returns on “funds functioning as endowment” funds, actuarial adjustments to self-insurance liabilities, and certain types of philanthropic support.

Such philanthropic support includes gifts without restrictions, including those designated by the Board of Trustees (the Board) to function as endowment and restricted gifts whose donor-imposed restrictions were met during the fiscal year, as well as previously restricted gifts and grants for buildings and equipment that have been placed in service.

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- **With Donor Restrictions** – Net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time. Items that affect this net asset category are gifts for which donor-imposed restrictions have not been met in the year of receipt, including gifts and grants for buildings and equipment not yet placed in service; endowment, annuity, and life income gifts; pledges; and investment returns on “true” endowment funds, and endowments where the principal may be expended upon the passage of a stated period of time (term endowments). Expirations of restrictions on net assets with donor restrictions, including reclassification of restricted gifts and grants for buildings and equipment when the associated long-lived asset is placed in service, are reported as net assets released from restrictions.

Also included in this category are net assets subject to donor-imposed restrictions to be maintained permanently by the University, including gifts and pledges wherein donors stipulate that the corpus of the gift be held in perpetuity (primarily gifts for endowment and providing loans to students) and that only the income be made available for program operations. Other permanently restricted items in this net asset category include annuity and life income gifts for which the ultimate purpose of the proceeds is permanently restricted.

Net assets consisted of the following at June 30:

Detail of net assets	2017			2016		
	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
University:						
Operating	\$ (987,160)	25,256	(961,904)	(977,900)	33,680	(944,220)
Unamortized capital			—			
gifts for construction	140,991	21,897	162,888	150,913	16,119	167,032
Pledges receivable	—	648,341	648,341	—	603,814	603,814
Student loan funds	—	24,552	24,552	—	23,555	23,555
Endowment funds	1,909,298	4,627,648	6,536,946	1,795,157	4,249,846	6,045,003
Annuity and life income funds	—	67,298	67,298	—	62,457	62,457
Subtotal	1,063,129	5,414,992	6,478,121	968,170	4,989,471	5,957,641
Medical Center:						
Operating	849,046	11,635	860,681	421,179	10,374	431,553
Pledges receivable	—	3,619	3,619	—	4,150	4,150
Endowment funds	813,993	92,652	906,645	804,437	75,513	879,950
Subtotal	1,663,039	107,906	1,770,945	1,225,616	90,037	1,315,653
Marine Biological Laboratories						
Operating	79,704	5,486	85,190	79,234	4,077	83,311
Pledges receivable	—	3,624	3,624	—	4,708	4,708
Annuity and life income funds	—	1,225	1,225	—	1,207	1,207
Endowment funds	9,594	70,536	80,130	9,185	67,078	76,263
Subtotal	89,298	80,871	170,169	88,419	77,070	165,489
Total	\$ 2,815,466	5,603,769	8,419,235	2,282,205	5,156,578	7,438,783

The endowment component of net assets without donor restrictions is comprised of amounts designated by the Board to function as endowment which amounted to \$2,732,885 and \$2,608,779 as of June 30, 2017 and 2016, respectively. Included in the University's endowment without donor

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

restrictions is a fund designated by the Board to be used to support the University's strategic initiatives which amounted to \$288,123 and \$297,583 as of June 30, 2017 and 2016, respectively.

(c) Operations

Operating results in the consolidated statements of activities reflect all transactions increasing or decreasing net assets without donor restrictions except those items associated with long-term investment, actuarial adjustments to self-insurance liabilities, changes in postretirement benefit obligations other than service cost, changes in the fair value of derivative instruments, unamortized capital gifts associated with the acquisition or construction of long-lived assets placed in service, and other infrequent transactions. Operating results also include a reclassification associated with amortization of capital gifts placed in service, as described below.

(d) Capital Gifts to Acquire or Construct Long-Lived Assets

Capital gifts to acquire or construct a long-lived asset are recorded as a donor restricted gift until the related asset is placed in service, at which time the capital gift is released from net assets with donor restrictions to net assets without donor restrictions and subsequently amortized into operations over the estimated useful life of the acquired or constructed asset. This amortization, which amounted to \$10,302 in fiscal year 2017 and \$10,284 in fiscal year 2016, is recorded as a reclassification between the non-operating and operating sections of the change in net assets without donor restrictions in the consolidated statements of activities.

(e) Tuition and Fees

Student tuition and fees are recorded as revenue during the year in which the related academic services are rendered. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue.

(f) Gifts, Grants, and Contracts

Gifts, including unconditional pledges, are recognized in the appropriate category of net assets in the period received. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Pledges receivable are stated at the estimated net present value, net of an allowance for uncollectible amounts. Conditional promises to give are not recognized until the conditions on which they depend are substantially met.

Revenue from government and private grant and contract agreements is recognized as it is earned through expenditure in accordance with the agreements. Any funding received in advance of expenditure is recorded as deferred revenue on the consolidated balance sheets. Included in deferred revenue at June 30, 2017 and 2016 are \$50,693 and \$50,326, respectively, of private grant and contract receipts, that have not been expended.

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(In thousands of dollars)

Private gifts, grants, and contracts operating revenue for fiscal years 2017 and 2016 consist of the following:

	2017			2016 Consolidated
	University	Medical Center	MBL	
Private gifts:				
Unrestricted as to use	\$ 19,185	263	1,196	18,422
Restricted gifts whose restrictions were met during the fiscal year and reported as operating revenue	108,057	—	—	113,215
Private grants and contracts	96,271	—	4,554	88,220
Total	\$ 223,513	263	5,750	219,857

(g) Patient Service

Patient service revenue is reported net of a provision for doubtful accounts of \$7,302 and \$6,997 for the University and \$152,888 and \$84,243 for the Medical Center for the years ended June 30, 2017 and 2016, respectively. This provision reflects the estimated net realizable amounts due from third-party payors for services rendered. The Medical Center analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts receivable. A majority of patient service revenue is derived from contractual agreements with Medicare, Medicaid, Blue Cross/Blue Shield, managed care, and certain other programs. Payments under these agreements and programs are based on specific amounts per case or contracted prices. Certain revenue received from third-party payors is subject to audit and retroactive adjustment. Any changes in estimates under these contracts are recorded in operations currently. The Medical Center's gross write-offs increased from approximately \$146,200 in fiscal year 2016 to \$210,841 in fiscal year 2017. The Medical Center did not have significant write-offs from third-party payors.

(h) Capitalized Interest

The University capitalizes interest costs incurred on debt during the construction of major projects exceeding one year. During fiscal years 2017 and 2016, the amount of interest capitalized amounted to \$3,141 and \$12,288 for the University and \$2,766 and \$3,168 for the Medical Center, respectively.

(i) Fair Value

Fair value is defined as the price that the University would receive upon selling an asset or pay to settle a liability in an orderly transaction between market participants.

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June 30, 2017 and 2016

(In thousands of dollars)

The University uses a framework for measuring fair value that includes a hierarchy that categorizes and prioritizes the sources used to measure and disclose fair value. This hierarchy is broken down into three levels based on inputs that market participants would use in valuing the financial instruments based on market data obtained from sources independent of the University. Inputs refer broadly to the assumptions that market participants would use in pricing the asset, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset developed based on the best information available. The three-tier hierarchy of inputs is summarized in the three broad levels as follows:

Level 1 – quoted market prices in active markets for identical investments

Level 2 – inputs other than quoted prices for similar investments in active markets, quoted prices for identical or similar investments in markets that are not active, or inputs other than quoted prices that are observable including model-based valuation techniques

Level 3 – valuation techniques that use significant inputs that are unobservable because they trade infrequently or not at all

(i) *Cash Equivalents*

Cash equivalents include U.S. Treasury notes, commercial paper, and corporate notes with original maturities of three months or less, except that such instruments purchased with endowment assets or funds on deposit with bond trustees are classified as investments. Cash equivalents are classified in Level 1 of the fair value hierarchy.

(ii) *Investments*

Investments are recorded in the consolidated financial statements at estimated fair value. If an investment is held directly by the University and an active market with quoted prices exists, the market price of an identical security is used as reported fair value. Reported fair values for shares in mutual funds are based on share prices reported by the funds as of the last business day of the fiscal year and are classified in Level 1. The University's interests in alternative investment funds such as private debt, private equity, real estate, natural resources, and absolute return are generally reported at the net asset value (NAV) reported by the fund managers, which is used as a practical expedient to estimate the fair value, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of June 30, 2017 and 2016, the University had no plans to sell investments at amounts different from NAV. Funds measured at NAV as a practical expedient to estimate fair value are not classified in the fair value hierarchy.

The University does not engage directly in unhedged speculative investments; however, the Board has authorized the use of derivative investments to adjust market exposure within asset class ranges.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

A summary of the inputs used in valuing the University's investments as of June 30, 2017 and 2016 is included in note 5.

(iii) *Pledges Receivable*

Unconditional promises to give are recognized initially at fair value as private gift revenue in the period the promise is made by a donor. The fair value of the pledge is estimated based on anticipated future cash receipts (net of an allowance for uncollectible amounts), discounted using a risk-adjusted rate commensurate with the duration of the payment plan. These inputs to the fair value estimate are classified in Level 3 of the fair value hierarchy. In subsequent periods, the discount rate is unchanged and the allowance for uncollectible amounts is reassessed and adjusted if necessary.

(iv) *Land, Buildings, Equipment, and Books*

Land, buildings, equipment, and books are generally stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, ranging from 20 to 45 years for buildings and building improvements, 3 to 10 years for equipment, and 10 years for library books.

(v) *Split-Interest Agreements*

Split-interest agreements with donors consist primarily of charitable remainder trusts for which the University serves as trustee, gift annuity contracts, and pooled life income agreements. Assets associated with split-interest agreements are included in investments. A liability for split-interest obligations is recorded when the agreement is established at the estimated net present value of future cash flows using a risk-adjusted discount rate commensurate with the duration of the estimated payments. These inputs to the fair value estimate are classified in Level 3 of the fair value hierarchy. At June 30, 2017 and 2016, the University had liabilities of \$55,439 and \$55,669 associated with its charitable remainder trust and gift annuity contracts and deferred revenue of \$5,369 and \$5,474 associated with its pooled income agreements, respectively. In subsequent periods, the discount rate is unchanged.

(vi) *Interest Rate Swap Agreements*

In order to reduce exposure to adjustable interest rates on variable rate debt, the University has entered into debt-related interest rate swap agreements. These agreements have the effect of fixing the rate of interest for the variable rate debt. The fair value of these swap agreements is the estimated amount that the University would have to pay or receive to terminate the agreements as of the consolidated balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparty. These inputs to the fair value estimate are classified in Level 2 of the fair value hierarchy.

(vii) *Assets Held in Custody For Others*

Assets held in custody for others consist of resources, primarily investments, held by the University as a custodian for affiliated organizations. Investments held for others are included in the University's investment portfolio. The leveling of these investments is presented in note 5.

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Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(viii) Self-insurance Liability

The self-insurance liability is the estimated present value of self-insured claims that will be settled in the future and considers anticipated payout patterns as well as investment returns on available assets prior to payment. The discount rate used to value the self-insurance liability is a risk-adjusted rate commensurate with the duration of anticipated payments. These inputs to the fair value estimate of the liability are considered Level 2 in the fair value hierarchy.

(ix) Pension and Other Postretirement Benefit Obligations

The pension and other postretirement benefit obligations consider anticipated payout patterns as well as investment returns on available assets prior to payment. The discount rate used to value the pension and other postretirement benefit obligation is a risk-adjusted rate commensurate with the duration of anticipated payments. These inputs to the fair value estimate are classified in Level 2 of the fair value hierarchy.

(x) Asset Retirement Obligation

Asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The obligation to remove asbestos is estimated using site-specific surveys where available and a per square foot estimate where surveys were unavailable.

(xi) Notes and Bonds Payable

The carrying value of long-term debt does not differ materially from its estimated fair value based on quoted market prices for the same or similar issues.

(xii) All Other Assets and Liabilities

The carrying value of all other assets and liabilities do not differ materially from their estimated fair value.

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(j) Internally Managed Investment Derivatives

The following tables set forth the gross and net notional values and the University's gain (loss) related to internally managed investment derivative activities as of June 30, 2017 and 2016 and for the fiscal years then ended:

	2017		
	<u>Gross notional</u>	<u>Net notional</u>	<u>Gain (loss)</u>
Equity derivatives	\$ 159,191	159,191	7,191

	2016		
	<u>Gross notional</u>	<u>Net notional</u>	<u>Gain (loss)</u>
Equity derivatives	\$ 19,638	19,638	(11,145)

To minimize the risk of loss, externally managed absolute return investments are diversified by strategy, external manager, and number of positions. In addition, the activities of external hedge fund managers are externally audited and reviewed by the University Investment Office. The risk of any derivative exposure associated with an externally managed hedge fund is limited to the amount invested with each manager. Investment managers report derivative investments at fair value and valuation gains and losses are included in investment gains (losses) in the consolidated statements of activities.

(k) Income Taxes

The University, Medical Center, and MBL are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code and, except for unrelated business income, are exempt from federal income taxes. There was no provision for income taxes due on unrelated business income in fiscal years 2017 and 2016, and there are no uncertain tax positions considered to be material.

(l) Use of Estimates

The preparation of the consolidated financial statements in accordance with GAAP requires that management make a number of estimates and assumptions related to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the consolidated balance sheet dates, and the reporting of revenue, expenses, gains, and losses during the reporting periods. Actual results may differ from those estimates.

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(m) Recent Accounting Pronouncements

(i) *Pension and Postretirement Benefit Cost*

During 2017, the University adopted Accounting Standards Update (ASU) No. 2017-07 – *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This guidance requires the service cost component of net periodic benefit cost for pension and other postretirement benefits be presented as a component part of employee benefit expense. The other components of net periodic benefit cost, such as interest, expected return on plan assets, and amortization of other actuarially determined amounts, are required to be presented as a nonoperating change in net assets without restrictions. These changes have been applied retrospectively in the 2016 consolidated statement of activities by reclassifying \$22,831 of non-service related components of net periodic benefit cost from benefits expense to other nonoperating changes in net assets without donor restrictions.

(ii) *Not-for-Profit Financial Statement Presentation*

Also during 2017, the University adopted ASU No. 2016-14 – *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is placed in service; and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also enhances disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity, and expenses by both their natural and functional classification.

A recap of the net asset reclassifications driven by the adoption of ASU 2016-14 as of June 30, 2016 follows:

<u>Net Assets Classifications</u>	<u>ASU 2016-14 Classifications</u>		
	<u>Without donor restrictions</u>	<u>With donor restrictions</u>	<u>Total Net Assets</u>
As previously presented:			
Unrestricted	\$ 2,104,760	—	2,104,760
Temporarily Restricted	—	3,298,132	3,298,132
Permanently Restricted	—	2,035,891	2,035,891
Net assets as previously presented	2,104,760	5,334,023	7,438,783
Reclassifications to implement ASU 2016-14:			
Capital gifts for construction	150,913	(150,913)	—
Underwater endowments	26,532	(26,532)	—
Net assets, as reclassified	<u>\$ 2,282,205</u>	<u>5,156,578</u>	<u>7,438,783</u>

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(n) Subsequent Events

The University has performed an evaluation of subsequent events through November 1, 2017 which is the date the consolidated financial statements were issued.

(2) The University of Chicago Medical Center

(a) Organization

The Medical Center, an Illinois not-for-profit corporation, operates the Center for Care and Discovery, the Bernard Mitchell Hospital, the University of Chicago Comer Children's Hospital, the Duchossois Center for Advanced Medicine, the University of Chicago Medicine Care Network, various other outpatient clinics and treatment areas, and as of October 1, 2016, Ingalls Health System. The University, as the sole corporate member of the Medical Center, elects the Medical Center's Board of Trustees and approves its bylaws.

(b) Acquisition of Ingalls Health System

On October 1, 2016 the Medical Center acquired Ingalls Health System through an affiliation and member substitution agreement. As a result of this transaction, Ingalls Health System became a wholly owned subsidiary of the Medical Center through a newly created Community Health and Hospital Division of the Medical Center. Amounts included in the accompanying notes and consolidated financial statements and supplemental schedules reflect Ingalls activity beginning on October 1, 2016. Ingalls net assets of \$322,862 at October 1, 2016 have been recognized as a contribution in the consolidated statements of activities in fiscal 2017.

The following table sets forth the fair value of Ingalls assets and liabilities at October 1, 2016 which have been recognized in the consolidated financial statements.

Cash	\$	28,003
Investments		298,975
Land, buildings, and equipment		187,641
Notes and bonds payable		(111,990)
Other assets and liabilities, net		<u>(79,767)</u>
Net assets	\$	<u>322,862</u>

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(c) Agreements with the University

The relationship between the University and the Medical Center is defined in an Affiliation Agreement and an Operating Agreement along with an associated Lease Agreement. The Affiliation Agreement specifies University and Medical Center responsibilities for the provision of patient care, teaching, and research at the hospitals and clinics. The Operating Agreement provides for the management and operation by the Medical Center of the University's hospital and clinic facilities. The Lease Agreement provides the Medical Center a leasehold interest in certain University facilities and land.

(d) Community Benefits

The Medical Center's policy is to treat patients in immediate need of medical services without regard to their ability to pay for such services, including patients transferred from other hospitals and patients accepted through the Perinatal and Pediatrics Trauma Networks. Patients are offered discounts of up to 100% of charges on a sliding scale based both on income as a percentage of the Federal Poverty Level guidelines and the charges for services rendered. The Medical Center policy also contains provisions that are responsive to those patients subject to catastrophic healthcare expenses. Since the Medical Center does not pursue collection of these amounts, they are not reported as net patient care revenue. The unreimbursed cost of providing such care, along with the unreimbursed cost of government sponsored indigent healthcare programs, unreimbursed cost to support education, clinical research, and other community programs, amounted to \$374,957 and \$328,591 for the years ended June 30, 2017 and 2016, respectively.

(e) Basis of Presentation

The Medical Center maintains its accounts and prepares stand-alone financial statements in conformity with GAAP applicable to not-for-profit health care entities. For purposes of presentation of the Medical Center financial position and changes in net assets in the accompanying consolidated financial statements, several reclassifications have been made as follows: (1) investment gains used for operations of \$41,389 in fiscal year 2017 and \$45,045 in 2016 have been recorded as operating revenue and (2) transfers to the University of \$61,002 in fiscal year 2017 and \$68,843 in fiscal year 2016 have been recorded as a reduction of other income.

(3) Marine Biological Laboratory (MBL)

(a) Organization

MBL is a private, independent not-for-profit research and educational institution dedicated to establishing and maintaining a laboratory and station for scientific study and investigations, and a school for instruction in biology and natural history. MBL is located in Woods Hole, Massachusetts. The University is the sole corporate member of MBL, elects MBL's Board of Trustees, and approves its bylaws.

(b) Agreements with the University

The relationship between the University and MBL is defined in an Affiliation Agreements which specifies the University and MBL responsibilities for the provision of research and education in biology, biomedicine, ecology, and related fields.

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(4) Financial Assets and Liquidity Resources

As of June 30, 2017, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses, scheduled principal payments on debt, and capital construction costs not financed with debt, were as follows:

	2017			
	<u>University</u>	<u>Medical Center</u>	<u>MBL</u>	<u>Consolidated</u>
Financial assets:				
Cash and cash equivalents	\$ 11,060	37,446	1,878	50,384
Notes and accounts receivable, net	133,759	432,100	4,119	569,978
Pledge payments available for operations	115,972	1,256	625	117,853
Working capital investments	202,408	—	—	202,408
Board designations:				
Funds functioning as endowment available for operations	288,123	—	—	288,123
Fiscal 2018 endowment payout	382,841	50,933	4,414	438,188
Total financial assets available within one year	<u>1,134,163</u>	<u>521,735</u>	<u>11,036</u>	<u>1,666,934</u>
Liquidity resources:				
Taxable commercial paper	200,000	—	—	200,000
Bank lines of credit	<u>500,000</u>	<u>50,000</u>	<u>3,000</u>	<u>553,000</u>
Total financial assets and liquidity resources available within one year	<u>\$ 1,834,163</u>	<u>571,735</u>	<u>14,036</u>	<u>2,419,934</u>

The University's cash flows have seasonal variations during the year attributable to tuition billing, patient service reimbursement from the State of Illinois, and a concentration of contributions received at calendar and fiscal year-end. To manage liquidity, the University maintains lines of credit with several banks and a taxable commercial paper program that are drawn upon as needed during the year to manage cash flows. As of June 30, 2017, amounts outstanding under these lines of credit facilities amounted to \$476,765.

In addition, as of June 30, 2017 the University, Medical Center, and MBL had an additional \$1,621,175, \$813,993, and \$9,594 in funds functioning as endowment, respectively, which is available for general expenditure with Board approval.

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(5) Investments

Investments at June 30, 2017 and 2016 are comprised of the following:

	<u>2017</u>	<u>2016</u>
	<u>Consolidated</u>	<u>Consolidated</u>
Cash equivalents	\$ 538,277	233,304
Global public equities (primarily international)	2,085,220	1,774,567
Private debt	380,089	358,522
Private equity:		
U.S. venture capital	482,875	375,962
U.S. corporate finance	306,809	311,726
International	449,109	401,184
Real estate	497,359	485,153
Natural resources	582,574	459,791
Absolute return:		
Equity-oriented	769,693	768,992
Global macro/relative value	515,996	511,965
Multistrategy	605,844	580,936
Credit-oriented	436,552	365,223
Protection-oriented	141,202	140,332
Fixed income:		
U.S. treasuries, including TIPS	481,345	309,290
Other fixed income (primarily credit funds)	318,756	665,928
Funds in trust	113,032	256,648
Total	<u>\$ 8,704,732</u>	<u>7,999,523</u>

(a) Overall Investment Objective

The overall investment objective of the University is to invest its assets in a prudent manner that will achieve a long-term rate of return sufficient to fund a portion of its annual operating activities and increase investment value after inflation. The University diversifies its investments among various asset classes incorporating multiple strategies and external investment managers. Major investment decisions are authorized by the Board's Investment Committee, which oversees the University's investment program in accordance with established guidelines.

(b) Investment Strategies

Cash equivalent investments include cash equivalents and fixed-income investments with maturities of less than one year, which are valued based on quoted market prices in active markets. The majority of

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these investments are held in U.S. money market accounts. Global public equity investments consist of separate accounts, commingled funds with liquidity ranging from daily to monthly, and limited partnerships. Securities held in separate accounts and daily traded commingled funds are generally valued based on quoted market prices in active markets. Commingled funds with monthly liquidity are valued based on independently determined NAV. Limited partnership interests in equity-oriented funds are valued based upon NAV provided by external fund managers.

Fixed-income investments consist of directly held actively traded treasuries, separately managed accounts, commingled funds, and bond mutual funds that hold securities, the majority of which have maturities greater than one year and are valued based on quoted market prices in active markets, except for a commingled fund that is valued on independently determined NAV.

Funds in trust investments consist primarily of project construction funds and externally managed endowments.

Investments in private debt, private equity, real estate, and natural resources are in the form of limited partnership interests, which typically invest in private securities for which there is no readily determinable market value. In these cases, market value is determined by external managers based on a combination of discounted cash flow analysis, industry comparables, and outside appraisals. Where private equity, private debt, real estate, and natural resources managers hold publicly traded securities, these securities are generally valued based on market prices. The value of the limited partnership interests are held at the manager's reported NAV, unless information becomes available indicating the reported NAV may require adjustment. The methods used by managers to assess the NAV of these external investments vary by asset class. The University monitors the valuation methodologies and practices of managers.

The absolute return portfolio is comprised of investments of limited partnership interests in hedge funds and drawdown private equity style partnerships whose managers have the authority to invest in various asset classes at their discretion, including the ability to invest long and short. The majority of the underlying holdings are marketable securities. The remainder of the underlying holdings is held in marketable securities that trade infrequently or in private investments, which are valued by the manager on the basis of an appraised value, discounted cash flow, industry comparables, or some other method. Most hedge funds that hold illiquid investments designate them in special side pockets, which are subject to special restrictions on redemption.

The University believes that the reported amount of its investments is a reasonable estimate of fair value as of June 30, 2017 and 2016. Because of the inherent uncertainties of valuation, these estimated fair values may differ significantly from values that would have been used had a ready market existed.

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(c) Fair Value Hierarchy of Investments

Following is the fair value hierarchy of investments as of June 30, 2017:

	Level 1	Level 2	2017 Consolidated total
Cash equivalents	\$ 538,278	—	538,278
Global public equities (primarily international)	608,390	44,956	653,346
Real estate	102,113	—	102,113
Natural resources	48,884	—	48,884
Absolute return:			
Global macro/relative value	83,583	27,754	111,337
Fixed income:			
U.S. treasuries, including TIPS	481,345	—	481,345
Other fixed income (primarily credit funds)	282,558	50	282,608
Funds in trust	74,928	20,370	95,298
	\$ 2,220,079	93,130	2,313,209
Investments measured at net asset value			6,391,523
Total investments at fair value as of June 30, 2017			\$ 8,704,732

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Following is the fair value hierarchy of investments as of June 30, 2016:

	<u>Level 1</u>	<u>Level 2</u>	2016 Consolidated total
Cash equivalents	\$ 233,304	—	233,304
Global public equities (primarily international)	452,674	44,181	496,855
Real estate funds	50,282	—	50,282
Absolute return:			
Equity-oriented	—	50,617	50,617
Global macro/relative value	85,888	26,015	111,903
Fixed income:			
U.S. treasuries, including TIPS	309,291	—	309,291
Other fixed income (primarily credit funds)	546,023	—	546,023
Funds in trust	250,104	—	250,104
	<u>\$ 1,927,566</u>	<u>120,813</u>	2,048,379
Investments measured at net asset value			<u>5,951,144</u>
Total investments at fair value as of June 30, 2016			\$ <u>7,999,523</u>

During fiscal years 2017 and 2016, there were no transfers between investment Levels 1 and 2.

A summary of the University's investment return by entity, net of expenses, is presented below for the years ended June 30, 2017 and 2016:

	<u>2017</u>			<u>2016</u>	<u>Consolidated</u>
	<u>University</u>	<u>Medical Center</u>	<u>MBL</u>	<u>Consolidated</u>	<u>Consolidated</u>
Investment return:					
Interest and dividends	\$ 69,921	14,391	815	85,127	73,449
Net realized and unrealized gains (losses)	593,442	86,906	7,249	687,597	(244,611)
Investment return	\$ <u>663,363</u>	<u>101,297</u>	<u>8,064</u>	<u>772,724</u>	<u>(171,162)</u>

Investment return is reported in the accompanying consolidated statements of activities as endowment payout and investment gains (losses).

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The University is obligated under certain limited partnership investment fund agreements to advance additional funding periodically up to specified levels. At June 30, 2017, the University had unfunded commitments of \$1,240,860, which are likely to be called through 2026. Details of these commitments are as follows:

	Unfunded commitments
Private equity	\$ 471,679
Real estate	281,855
Natural resources	182,711
Absolute return	25,810
Private debt	<u>278,805</u>
Total	<u>\$ 1,240,860</u>

The University has made investments in various long-lived partnerships and, in other cases, has entered into contractual agreements that may limit its ability to initiate redemptions due to notice periods, lock-ups, and gates. Details on typical redemption terms by asset class and type of investment are provided as follows:

	Remaining life	Redemption terms	Redemption restrictions and terms	Redemption restrictions or side pockets at June 30, 2017
Cash	N/A	Daily	None	None
Global public equities:				
Commingled funds	N/A	Daily to annual with notice periods of 2 to 180 days	Lock-up provisions for up to 2 years, some investments have a portion of capital held in side pockets with no redemptions permitted	\$0.1 million
Partnerships	N/A	Monthly to biennial with notice periods of 7 to 90 days	Lock-up provisions for up to 4 years, some investments have a portion of capital held in side pockets with no redemptions permitted	\$36.1 million

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	Remaining life	Redemption terms	Redemption restrictions and terms	Redemption restrictions or side pockets at June 30, 2017
Separate accounts	N/A	Daily with notice periods of 1 to 7 days	Lock-up provisions ranging for up to 1 year	None
Private debt:				
Drawdown partnerships	1 to 11 years	Redemptions not permitted	N/A	N/A
Partnerships	N/A	Redemptions not permitted	Capital held in side pockets with no redemptions permitted	\$0.5 million
Private equity:				
Drawdown partnerships	1 to 20 years	Redemptions not permitted	N/A	N/A
Separate account	N/A	Daily with notice period of 1 day	None	None
Partnerships	N/A	Semi-annual with notice period of 90 days	A portion of capital is held in side pockets with no redemption permitted	\$7.2 million
Real estate:				
Drawdown partnerships	1 to 15 years	Redemptions not permitted	N/A	N/A
Separate account	N/A	Daily with notice period of 5 days	None	None
Natural resources:				
	1 to 18 years	Redemptions not permitted	N/A	N/A

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	Remaining life	Redemption terms	Redemption restrictions and terms	Redemption restrictions or side pockets at June 30, 2017
Drawdown partnerships				
Commingled Funds	N/A	Daily with notice period of 1 day	None	None
Absolute return:				
Commingled funds	N/A	Daily to triennial with notice periods of 1 to 122 days	Lock-up provisions for up to 3 years, some investments have a portion of capital held in side pockets with no redemptions permitted	\$8.9 million
Drawdown partnerships	1 to 3 years	Redemptions not permitted	N/A	N/A
Partnerships	N/A	Quarterly to triennial with notice periods of 45 to 180 days	Lock-up provisions for up to 5 years, some investments have a portion of capital held in side pockets with no redemptions permitted	\$151.0 million
Fixed income:				
Commingled funds	N/A	Weekly to monthly with notice periods of 5 to 10 days	None	None
Separate accounts	N/A	Daily to monthly with notice periods of 1 to 30 days	None	None
Funds in Trust	N/A	Daily	None	None

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(6) Endowments

The University's endowment consists of approximately 4,000 individual funds established for a variety of purposes. The endowment includes both donor-restricted "true" endowment funds and funds designated by the Board to function as endowments commonly referred to as "funds functioning as endowment" (FFE). Net assets associated with endowment funds, including funds functioning as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University, Medical Center, and MBL endowment each invest in an investment pool, the Total Return on Investment Pool (TRIP). As of June 30, 2017, 99%, 85%, and 100% of the University, Medical Center, and MBL endowments respectively, are invested in TRIP.

(a) University Endowment

Changes in the fair value of the University endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2017:

	2017		
	Without Donor Restrictions	With Donor Restrictions	Total
Changes in the fair value of endowment investments:			
Investment return:			
Endowment yield (interest and dividends)	\$ 19,813	49,523	69,336
Net appreciation (realized and unrealized) on investments	190,812	403,210	594,022
Total investment return	210,625	452,733	663,358
Endowment payout	(153,444)	(251,346)	(404,790)
Investment return, net at payout	57,181	201,387	258,568
Other changes in endowment investments:			
Gifts and pledge payments received in cash	—	140,920	140,920
Transfers to create funds functioning as endowment	56,409	—	56,409
Other changes	551	35,495	36,046
Total other changes in endowment investments	56,960	176,415	233,375
Net change in endowment investments	114,141	377,802	491,943
Endowment investments at:			
Beginning of year	1,795,157	4,249,846	6,045,003
End of year	\$ 1,909,298	4,627,648	6,536,946
Investments by type of fund:			
Donor-restricted "true" endowment:			
Historical gift value	\$ —	1,900,208	1,900,208
Appreciation	—	2,727,440	2,727,440
Board-designated "funds functioning as endowment"	1,909,298	—	1,909,298
Total – as above	\$ 1,909,298	4,627,648	6,536,946

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Changes in the fair value of the University endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2016:

	2016		
	Without donor restrictions	With donor restrictions	Total
Changes in the fair value of endowment investments:			
Investment return:			
Endowment yield (interest and dividends)	\$ 18,676	42,862	61,538
Net depreciation (realized and unrealized) on investments	<u>(50,240)</u>	<u>(163,562)</u>	<u>(213,802)</u>
Total investment return	(31,564)	(120,700)	(152,264)
Endowment payout	<u>(180,291)</u>	<u>(235,080)</u>	<u>(415,371)</u>
Investment return, net of payout	<u>(211,855)</u>	<u>(355,780)</u>	<u>(567,635)</u>
Other changes in endowment investments:			
Gifts and pledge payments received in cash	—	114,495	114,495
Transfers to create funds functioning as endowment	24,445	—	24,445
Other changes	<u>350</u>	<u>11,539</u>	<u>11,889</u>
Total other changes in endowment investments	<u>24,795</u>	<u>126,034</u>	<u>150,829</u>
Net change in endowment investments	(187,060)	(229,746)	(416,806)
Endowment investments at:			
Beginning of year	<u>1,982,217</u>	<u>4,479,592</u>	<u>6,461,809</u>
End of year	<u>\$ 1,795,157</u>	<u>4,249,846</u>	<u>6,045,003</u>
Investments by type of fund:			
Donor-restricted "true" endowment:			
Historical gift value	\$ —	1,745,000	1,745,000
Appreciation	—	2,504,846	2,504,846
Board-designated "funds functioning as endowment"	<u>1,795,157</u>	<u>—</u>	<u>1,795,157</u>
Total – as above	<u>\$ 1,795,157</u>	<u>4,249,846</u>	<u>6,045,003</u>

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(b) Medical Center Endowment

Changes in the fair value of the Medical Center endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2017:

	2017		
	Without donor restrictions	With donor restrictions	Total
Changes in the fair value of endowment investments:			
Investment return:			
Endowment yield (interest and dividends)	\$ 29,989	1,001	30,990
Net appreciation (realized and unrealized) on investments	42,567	6,843	49,410
Investment return, net of payout	72,556	7,844	80,400
Endowment payout	(40,953)	(4,997)	(45,950)
Net investment return	31,603	2,847	34,450
Other changes in endowment investments:			
Gifts and pledge payments received in cash	—	799	799
Contribution - Ingalls Health System	—	13,122	13,122
Withdrawal to finance capital expenditures	(25,000)	—	(25,000)
Other changes	2,953	371	3,324
Total other changes in endowment investments	(22,047)	14,292	(7,755)
Net change in endowment investments	9,556	17,139	26,695
Endowment investments at:			
Beginning of year	804,437	75,513	879,950
End of year	\$ 813,993	92,652	906,645
Investments by type of fund:			
Donor-restricted "true" endowment:			
Historical gift value	\$ —	17,445	17,445
Appreciation	—	75,207	75,207
Board-designated "funds functioning as endowment"	813,993	—	813,993
Total – as above	\$ 813,993	92,652	906,645

Included in board-designated "funds functioning as endowment" are \$395,515 of net assets that are separately invested by the Medical Center.

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Changes in the fair value of the Medical Center endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2016:

	<u>Without donor restrictions</u>	<u>With donor restrictions</u>	<u>Total</u>
Changes in the fair value of endowment investments:			
Investment return:			
Endowment yield (interest and dividends)	\$ 16,383	737	17,120
Net depreciation (realized and unrealized) on investments	<u>(34,742)</u>	<u>(3,162)</u>	<u>(37,904)</u>
Total investment return	(18,359)	(2,425)	(20,784)
Endowment payout	<u>(44,622)</u>	<u>(4,229)</u>	<u>(48,851)</u>
Investment return, net of payout	<u>(62,981)</u>	<u>(6,654)</u>	<u>(69,635)</u>
Other changes in endowment investments:			
Gifts and pledge payments received in cash	—	10	10
Withdrawal to finance capital expenditures	(50,000)	—	(50,000)
Other changes	<u>2,939</u>	<u>487</u>	<u>3,426</u>
Total other changes in endowment investments	<u>(47,061)</u>	<u>497</u>	<u>(46,564)</u>
Net change in endowment investments	(110,042)	(6,157)	(116,199)
Endowment investments at:			
Beginning of year	<u>914,479</u>	<u>81,670</u>	<u>996,149</u>
End of year	<u>\$ 804,437</u>	<u>75,513</u>	<u>879,950</u>
Investments by type of fund:			
Donor-restricted "true" endowment:			
Historical gift value	\$ —	8,112	8,112
Appreciation	—	67,401	67,401
Board-designated "funds functioning as endowment"	<u>804,437</u>	<u>—</u>	<u>804,437</u>
Total – as above	<u>\$ 804,437</u>	<u>75,513</u>	<u>879,950</u>

Included in board-designated "funds functioning as endowment" are \$213,898 of net assets that are separately invested by the Medical Center.

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(c) MBL

Changes in the fair value of the MBL endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2017:

	2017		
	Without donor restrictions	With donor restrictions	Total
Changes in the fair value of endowment investments:			
Investment return:			
Endowment yield (interest and dividends)	\$ 99	714	813
Net appreciation (realized and unrealized) on investments	794	6,455	7,249
Total investment return	893	7,169	8,062
Endowment payout	(564)	(3,839)	(4,403)
Investment return, net of payout	329	3,330	3,659
Other changes in endowment investments:			
Gifts and pledge payments received in cash	—	205	205
Other changes	80	(77)	3
Total other changes in endowment investments	80	128	208
Net change in endowment investments	409	3,458	3,867
Endowment investments at:			
Beginning of year	9,185	67,078	76,263
End of year	\$ 9,594	70,536	80,130
Investments by type of fund:			
Donor-restricted "true" endowment:			
Historical gift value	\$ —	52,513	52,513
Appreciation	—	18,023	18,023
Board-designated "funds functioning as endowment"	9,594	—	9,594
Total – as above	\$ 9,594	70,536	80,130

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Changes in the fair value of the MBL endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2016:

	2016		
	Without donor restrictions	With donor restrictions	Total
Changes in the fair value of endowment investments:			
Investment return:			
Endowment yield (interest and dividends)	\$ 91	651	742
Net depreciation (realized and unrealized) on investments	(327)	(2,324)	(2,651)
Total investment return	(236)	(1,673)	(1,909)
Endowment payout	(617)	(3,629)	(4,246)
Investment return, net of payout	(853)	(5,302)	(6,155)
Other changes in endowment investments:			
Gifts and pledge payments received in cash	—	413	413
Other changes	(250)	242	(8)
Total other changes in endowment investments	(250)	655	405
Net change in endowment investments	(1,103)	(4,647)	(5,750)
Endowment investments at:			
Beginning of year	10,288	71,725	82,013
End of year	\$ 9,185	67,078	76,263
Investments by type of fund:			
Donor-restricted "true" endowment:			
Historical gift value	\$ —	52,304	52,304
Appreciation	—	14,774	14,774
Board-designated "funds functioning as endowment"	9,185	—	9,185
Total – as above	\$ 9,185	67,078	76,263

(d) Interpretation of Relevant Law

The "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), which was enacted in the state of Illinois in 2009, does not preclude the University from spending below the original gift value of donor-restricted "true" endowment funds.

For accounting and reporting purposes, the University, Medical Center, and MBL classify as net assets with donor restrictions the historical value of donor-restricted "true" endowment funds, which includes (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) changes to the permanent endowment made in accordance with the direction of the applicable donor gift instrument. Also included in net assets with donor restrictions is accumulated appreciation on donor restricted "true" endowment funds which are available for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA, and deficiencies associated with funds where the value of the fund has fallen below the original value of the gift.

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(e) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor restricted “true” endowment funds may fall below the level that the donor or UPMIFA requires to be retained as a fund of perpetual duration. Deficiencies of this nature are reported in net assets with donor restrictions. As of June 30, 2017 and 2016, funds with an original gift value of \$216,528 and \$589,053 were “underwater” by \$5,905 and \$26,532, respectively.

(f) Endowment Payout

Approximately 97% of the University, Medical Center, and MBL endowment is merged into one investment pool referred to as the Total Return Investment Pool (TRIP). The University utilizes the total return concept in allocating endowment income from TRIP. In accordance with the University’s return objective, between 4.5% and 5.5% of a 12 quarter moving average of the fair value of endowment investments lagged by one year, is available each year for expenditure in the form of endowment payout. The payout percentage, which is set each year by the Board with the objective of a 5% average payout over time, was 5.5% for the fiscal years ended June 30, 2017 and 2016. Periodically, the University’s Board will adjust the endowment payout to fund specifically approved strategic initiatives.

If endowment income received is not sufficient to support the total return objective, the balance is provided from capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

The endowment payout is comprised of the TRIP formula payout, payout from separately held investments, as well as special payouts for the funding of Alumni Relations and Development and University wide strategic initiatives as follows:

	2017				2016
	University	Medical Center	MBL	Consolidated	Consolidated
TRIP formula payout	\$ 353,116	38,151	4,403	395,670	379,974
Payout from separately invested endowment	4,177	7,799	—	11,976	12,246
Special payouts:					
Alumni Relations and Development	21,897	—	—	21,897	21,055
Strategic initiatives	16,600	—	—	16,600	21,513
Operational support	9,000	—	—	9,000	33,680
Total	<u>\$ 404,790</u>	<u>45,950</u>	<u>4,403</u>	<u>455,143</u>	<u>468,468</u>

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(7) Notes and Accounts Receivable

Components of notes and accounts receivable at June 30, 2017 and 2016 are shown as follows:

	2017			2016 Net receivable
	Receivable	Allowance for doubtful accounts	Net receivable	
University:				
Patients	\$ 32,121	(1,398)	30,723	21,971
Students:				
Loans	42,272	(3,000)	39,272	44,053
Tuition and fees	2,895	(1,454)	1,441	647
U.S. government	50,301	—	50,301	54,206
All other	106,010	(5,595)	100,415	102,549
Total University	233,599	(11,447)	222,152	223,426
Medical Center - patients	572,978	(140,878)	432,100	288,401
MBL	5,376	(35)	5,341	5,418
Total	\$ 811,953	(152,360)	659,593	517,245

Accounts receivable are carried at estimated net realizable value. Management regularly assesses the adequacy of the allowance for doubtful accounts, and balances are written off when deemed uncollectible.

(8) Land, Buildings, Equipment, and Books

Components of land, buildings, equipment, and books at June 30, 2017 and 2016 are shown as follows:

	2017				2016
	University	Medical Center	MBL	Consolidated	Consolidated
Land	\$ 119,271	54,505	52,931	226,707	209,117
Buildings	4,064,007	1,765,121	104,283	5,933,411	5,296,804
Equipment	543,314	667,388	26,646	1,237,348	1,068,582
Books	377,434	—	—	377,434	361,681
Construction in progress	141,825	38,456	172	180,453	483,420
Subtotal	5,245,851	2,525,470	184,032	7,955,353	7,419,604
Less accumulated depreciation	(2,065,638)	(900,265)	(77,249)	(3,043,152)	(2,764,669)
Subtotal	3,180,213	1,625,205	106,783	4,912,201	4,654,935
Residential properties held for sale	85	—	—	85	19,646
Total	\$ 3,180,298	1,625,205	106,783	4,912,286	4,674,581

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(9) Notes and Bonds Payable

Notes and bonds payable at June 30, 2017 and 2016 are shown as follows:

	<u>Fiscal year maturity</u>	<u>Interest rate</u>	<u>2017</u>	<u>2016</u>
University:				
Fixed rate:				
Illinois Finance Authority (IFA)	2039–2053	3.2%–5.0%	\$ 1,704,856	1,734,854
Taxable bonds	2031–2046	3.3–5.2	1,002,885	1,012,285
Unamortized premium net of issuance costs			146,621	149,510
Total fixed rate			<u>2,854,362</u>	<u>2,896,649</u>
Variable rate:				
Illinois Educational Facilities Authority (IEFA)	2026–2037	0.5–1.7	226,142	299,853
IFA	2035	0.7	76,107	78,941
Taxable commercial paper (\$200,000 available)	2018	0.7	172,265	100,000
Bank lines of credit (\$500,000 available)	2018	1.0–1.1	301,500	253,500
Total variable rate			<u>776,014</u>	<u>732,294</u>
Total University			<u>3,630,376</u>	<u>3,628,943</u>
Medical Center:				
Fixed rate:				
IFA	2027–2045	3.5–5.5	765,555	703,275
Taxable bonds	2047	4.4	30,000	—
New market tax credit bonds (NMTC)	2024–2032	1.2–1.5	21,296	—
Unamortized premium and issuance costs			25,425	3,591
Total fixed rate			<u>842,276</u>	<u>706,866</u>
Variable rate:				
IFA	2034	1.2–1.3	116,402	73,757
IEFA	2038	0.7	72,567	75,671
Bank lines of credit (\$50,000 available)	2018	2.3	3,000	—
Total variable rate			<u>191,969</u>	<u>149,428</u>
Total Medical Center			<u>1,034,245</u>	<u>856,294</u>
MBL:				
Fixed rate:				
Massachusetts Development Finance Authority	2018–2038	3.4	27,365	28,145
Unamortized issuance cost			(154)	(162)
Variable rate:				
Bank line of credit (\$3,000 available)	2018	—	—	—
Total MBL			<u>27,211</u>	<u>27,983</u>
Total notes and bonds payable			<u>\$ 4,691,832</u>	<u>4,513,220</u>

As of June 30, 2017, the University, Medical Center, and MBL fixed rate notes and bonds payable include variable rate debt with interest rates that have been fixed through interest rate swap agreements which amounted to \$177,751, \$325,000, and \$27,365, respectively. As of June 30, 2016, the University, Medical Center, and MBL fixed rate notes and bonds payable include variable rate debt with interest rates that have been fixed through interest rate swap agreements which amounted to \$180,909, \$325,000, and \$28,145, respectively.

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(a) Fiscal 2017 Transactions

During fiscal year 2017, the University redeemed \$72,265 of the IFA variable rate bonds. The redemption was funded with taxable commercial paper.

During fiscal year 2017, the Medical Center issued \$187,320 in fixed rate bonds through the IFA and \$30,000 in taxable fixed rate bonds. Proceeds were used to 1) advance refund \$174,630 of the IFA fixed rate bonds and 2) finance the construction of a new adult emergency department and adult trauma center. During fiscal year 2017, the Medical Center also entered into NMTC financing agreements amounting to \$21,296 for the purpose of financing a variety of projects that benefit the surrounding community.

(b) Interest Rate Swaps

At June 30, 2017 and 2016, the fair value of the interest rate swap agreements was an accrued liability of \$179,954 and \$238,459, respectively as follows:

	2017	2016
University	\$ 46,236	66,767
Medical center	129,450	165,417
MBL	4,268	6,275
Total	\$ 179,954	238,459

Changes in the fair value of the interest rate swap agreements are included as a nonoperating change in the without donor restrictions section of accompanying consolidated statements of activities for the years ended June 30, 2017 and 2016 as follows:

	2017	2016
University	\$ 20,531	(21,545)
Medical center	44,863	(50,775)
MBL	2,007	(1,819)
Total	\$ 67,401	(74,139)

These financial instruments involve counterparty credit exposure. The counterparties for these swap transactions are major financial institutions that meet the University's criteria for financial stability and creditworthiness.

The Medical Center maintains two cash flow hedges against interest on variable rate debt which were entered into in August 2011 and have a combined notional amount of \$325,000. The interest rate swaps terminate on February 1, 2044.

The Medical Center is required to provide collateral on one of the interest rate swap agreements when the liability of that swap exceeds \$50,000. If the Medical Center's credit rating were to be downgraded

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one level, collateral would need to be provided under the swap with JP Morgan when the liability of that swap exceeds \$60,000 and under the Wells Fargo swap when the liability of that swap exceeds \$40,000. Upon further downgrade, the collateral requirements increase. At June 30, 2017 and 2016, \$14,200 and \$36,700 was held as collateral, respectively.

(c) Debt Payments

Principal payments required in each of the five years ending June 30, 2018 through 2022 for the University notes and bonds are \$59,251, \$27,629, \$43,225, \$89,698 and \$46,729, respectively.

Principal payments required in each of the five years ending June 30, 2018 through 2022 for the Medical Center notes and bonds are \$19,418, \$17,183, \$18,003, \$18,875, and \$19,788, respectively.

Principal payments required in each of the five years ending June 30, 2018 through 2022 for MBL's notes and bonds are \$810, \$840, \$875, \$910, and, \$945, respectively.

(d) Collateral

Each of the Medical Center bond series is collateralized by accounts receivable and subject to certain contractual restrictions. In addition, the Medical Center variable rate bonds are guaranteed by bank letters of credit.

(e) Remarketing

Included in the University, Medical Center, and MBL's notes and bonds payable are \$953,765, \$513,969, and \$27,365, respectively, of variable rate notes and bonds maturing through fiscal year 2045. In the event the University, Medical Center, or MBL's remarketing agents are unable to remarket the notes and bonds, they become demand obligations and require immediate payment. To supplement internal liquidity, the University, Medical Center, and MBL have credit facility agreements totaling \$400,000, \$397,567 and \$27,620, respectively, which support variable rate debt in the event of a failed remarketing.

(f) Subsequent Event

In September 2017 the Medical Center increased its available operating lines of credit from \$50,000 to \$110,000.

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(10) Pledges

Pledges receivable at June 30, 2017 and 2016 are shown as follows:

	2017			2016 Consolidated
	University	Medical Center	MBL	
Unconditional promises expected to be collected in:				
Less than one year	\$ 161,001	1,256	1,811	171,486
One year to five years	386,639	2,440	2,789	313,070
More than five years	232,009	—	—	251,053
	<u>779,649</u>	<u>3,696</u>	<u>4,600</u>	<u>735,609</u>
Less:				
Unamortized discount	(78,715)	(77)	(322)	(75,256)
Allowance for uncollectible pledges	(52,593)	—	(654)	(47,681)
Total	<u>\$ 648,341</u>	<u>3,619</u>	<u>3,624</u>	<u>612,672</u>

The University's five largest pledges comprise 86% of pledges expected to be collected in more than five years. Included in this amount is the estimated fair value of a nonmarketable equity investment (based on discounted cash flow and market multiples) specifically aligned with a promise to give, the proceeds of which, when sold, will be used to satisfy the pledge.

In addition, at June 30, 2017, the University has received \$356,815 of promises to give, that are conditional upon the raising of matching gifts from other sources, implementation of new academic programs, or future income from pledged investments. These amounts will be recognized as revenue in the periods in which the conditions are fulfilled.

(11) Self-Insurance Liability

The University maintains a self-insurance program for medical malpractice liability. This program is supplemented with commercial excess insurance above the University's self-insurance retention, which, for the years ended June 30, 2017 and 2016, was \$5,000 per claim and unlimited in the aggregate. Claims in excess of \$5,000 are subject to an additional self-insurance retention limited to \$12,500 per claim and \$22,500 in annual aggregate. The Medical Center is included under this insurance program and is charged for its portion of self-insurance costs. The University and Medical Center also maintain a self-insurance program for workers' compensation and certain other liability claims.

Under the medical malpractice self-insurance program, the University and Medical Center make annual contributions to a related trust fund at an actuarially determined rate that is intended to provide adequate funding of the self-insurance liability over a period of years. Actual settlements of medical malpractice claims may be more or less than the liability estimated by the University.

The medical malpractice self-insurance liability is the estimated present value of self-insured claims that will be settled in the future, and considers anticipated payout patterns as well as interest to be earned on

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available assets prior to payment. If the present value method was not used, the liability for medical malpractice self-insurance claims would be approximately \$33,953 higher than the amount recorded in the consolidated financial statements at June 30, 2017. The interest rate assumed in determining the present value was 3.8%. The University recorded nonoperating actuarial adjustments of (\$2,195) and (\$39,005) during the years ended June 30, 2017 and 2016, respectively, which are included in the without donor restrictions section of the accompanying consolidated statements of activities.

In addition, the Medical Center's Community Health and Hospital Division maintains a separate self-insurance program for medical malpractice and workers' compensation. Coverage from commercial insurance carriers is maintained for claims in excess of self-insured retentions at various levels by policy year. Under this program, annual contributions are made to a related trust at an actuarially determined rate.

The estimated liability for incurred malpractice, workers' compensation, and other claims (filed and unfiled) as of June 30, 2017 and 2016 is presented as follows:

	2017			2016
	University	Medical Center	Consolidated	
Medical malpractice	\$ 236,770	29,509	266,279	238,213
Workers' compensation	8,299	7,877	16,176	14,737
Others	4,795	331	5,126	3,997
Total	\$ 249,864	37,717	287,581	256,947

(12) Pension Plans and Other Postretirement Benefits

(a) Pension Plans

Substantially all personnel of the University participate in either the defined contribution pension plan for academic staff or the defined benefit and contribution pension plans for nonacademic personnel. The majority of Medical Center employees participate in the University's pension plans for nonacademic employees. The University and Medical Center make annual contributions to the defined benefit pension plans at a rate necessary to maintain plan funding on an actuarially recommended basis. The University and Medical Center share contributions to the defined benefit pension plans based primarily on participation.

Effective July 1, 2016, the 401(a) defined benefit pension plan was frozen for the majority of University employees participating in the plan and was replaced with an enhanced defined contribution plan. This curtailment resulted in a current year reduction in the defined benefit pension obligation of \$45,926 and a curtailment credit of \$7,119 in pension cost.

Effective January 1, 2017, the 401(a) plan was frozen for all Medical Center employees participating in the plan and replaced with an enhanced defined contribution plan. This curtailment, along with a further reduction of University employees participating in the 401(a) plan, resulted in a current year reduction in the defined benefit obligation of \$64,241 and a curtailment credit of \$5,002 in pension cost.

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(b) Postretirement Benefits

In addition to providing pension benefits, the University and MBL provide certain healthcare benefits for retired employees and a retirement incentive bonus for eligible faculty electing to participate in a retirement incentive program. In addition to a retirement bonus, all Medicare eligible-tenured faculty who elect to participate in the retirement incentive program receive supplemental health insurance at no cost for themselves and their spouses. All other academic and nonacademic employees are entitled to supplemental health insurance coverage subject to deductibles, copayment provisions, and other limitations.

(c) Funded Status

The funded status and amounts recognized in the consolidated financial statements for the defined benefit pension plans and other postretirement benefit plans are shown as follows:

	Defined benefit pension plans		Other postretirement benefit plans	
	2017	2016	2017	2016
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 1,017,137	954,886	318,714	241,379
Service cost	14,061	41,662	12,496	10,205
Interest cost	34,597	40,869	11,568	10,812
Benefits paid	(46,835)	(47,455)	(7,822)	(10,267)
Plan amendment	—	(18,728)	(26,503)	(8,945)
Curtailment (effect of partial plan freeze)	(64,241)	(45,926)	—	—
Actuarial loss, net	13,098	91,829	33,585	75,530
Benefit obligation at end of year	967,817	1,017,137	342,038	318,714
Change in fair value of plan assets:				
Fair value of plan assets at beginning of year	741,696	695,869	37,019	30,536
Actual return on plan assets	77,171	28,282	3,470	1,830
Employer contributions	—	65,000	13,328	14,920
Benefits paid	(46,835)	(47,455)	(7,822)	(10,267)
Fair value of plan assets at end of year	772,032	741,696	45,995	37,019
Funded status – liability	\$ 195,785	275,441	296,043	281,695

The accumulated benefit obligation for the defined benefit pension plans was \$963,930 and \$935,609 at June 30, 2017 and 2016, respectively.

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(d) Components of Net Periodic Benefit Cost

	Defined benefit pension plans		Other postretirement benefit plans	
	2017	2016	2017	2016
Operating - Service cost	\$ 14,061	41,662	12,496	10,205
Nonoperating:				
Interest cost	34,597	40,869	11,568	10,812
Expected return on plan assets	(47,094)	(45,724)	(2,744)	(2,295)
Amortization of prior service cost (benefit)	(986)	611	(8,828)	(7,082)
Amortization of actuarial loss	24,715	26,367	10,259	6,392
Partial curtailment	(5,002)	(7,119)	—	—
Total nonoperating	6,230	15,004	10,255	7,827
 Net periodic benefit cost	 \$ 20,291	 56,666	 22,751	 18,032
Amounts included in the consolidated statements of activities:				
University	\$ 7,640	24,166	22,751	18,032
Medical Center	12,651	32,500	—	—
Total	\$ 20,291	56,666	22,751	18,032

(e) Actuarial Assumptions

The weighted average assumptions used in the accounting for the pension and other postretirement benefit plans are shown as follows:

	Defined benefit pension plans		Other postretirement benefit plans	
	2017	2016	2017	2016
Discount rate	3.7 %	3.6 %	4.0 %	3.7 %
Expected return on plan assets	6.5	6.5	6.5	6.5
Rate of compensation increase	3.5	3.5	4.3	4.4
Healthcare cost trend rates:				
Next two fiscal years			7.5%–7.8%	6.5%–6.7%
Next seven fiscal years			5.3%–7.2%	5.1%–6.3%
Thereafter			4.5%–5.0%	4.5%–4.9%

The expected return on plan assets assumptions for both the defined benefit pension plan and the other postretirement benefit plans is determined based on models that incorporate a number of different methodologies, including historical returns and capital market forecasts.

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Assumed healthcare cost trend rates have a significant effect on the amounts reported for healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects for the fiscal years ended June 30:

	<u>2017</u>	<u>2016</u>
Effect on total service cost and interest cost:		
One-percentage-point increase	\$ 5,091	4,254
One-percentage-point decrease	(3,764)	(3,219)
Effect on year-end postretirement benefit obligation:		
One-percentage-point increase	\$ 59,667	54,970
One-percentage-point decrease	(46,855)	(43,120)

(f) Plan Assets

Weighted average asset allocations as of fiscal year end by asset category are as follows:

	<u>Defined benefit pension plans</u>		<u>Other postretirement benefit plans</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Domestic public equities	26 %	26 %	50 %	49 %
International public equities	21	20	—	—
Fixed income	53	54	50	51
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

As of June 30, 2017, 75% of plan assets for the defined benefit pension plans are invested in cash, mutual funds, exchange traded funds, or separately managed accounts comprised of individual securities and are valued based on quoted market prices in active markets for identical investments (Level 1). The remaining 25% of plan assets are primarily invested in commingled funds and limited partnerships generally reported at NAV by external fund managers.

The defined benefit plans combined target asset allocation of 49% public equities and 51% fixed income securities is meant to result in a favorable long-term rate of return from a diversified portfolio of equity and fixed income investments. Plan assets for the other postretirement benefit plans are managed by the University and were held in mutual funds (Level 1) at June 30, 2017.

(g) Contributions

The University expects to make a \$12,700 contribution to its postretirement healthcare plan in fiscal year 2018. The University and Medical Center do not expect to make any contributions to the defined benefit pension plans in fiscal year 2018.

THE UNIVERSITY OF CHICAGO
Notes to Consolidated Financial Statements
June 30, 2017 and 2016
(In thousands of dollars)

(h) Estimated Future Benefits Payments

The following benefit payments, which reflect expected future service, are expected to be paid for each of the fiscal years ending June 30:

<u>Fiscal year</u>	<u>Defined benefit pension plans</u>	<u>Other postretirement benefit plans</u>
2018	\$ 102,597	8,583
2019	60,777	10,678
2020	58,878	12,340
2021	59,278	12,305
2022	58,876	13,145
2023–2027	267,576	84,408

(i) Prescription Drug Act

The Medicare Prescription Drug, Improvement, and Modernization Act provides for special tax-free subsidies to employers that offer retiree medical benefit plans with qualifying drug coverage. Effective January 1, 2014, the University ceased its participation in the Part D Retiree Drug Subsidy (RDS) program and began providing prescription drug benefits to Medicare eligible retirees through an Employer Group Waiver Plan (EGWP) design. As a result, the University is eligible for reimbursement from the federal government prescription drug program and, in addition, is eligible for government mandated rebates from pharmaceutical companies that participate in the Medicare Part D program. The University has recognized the effect of these subsidies in the calculation of its postretirement benefit obligation, the impact of which was to reduce the benefit obligation by \$30,807 at June 30, 2017.

(j) Curtailed Pension Plan

The Medical Center maintains a separate noncontributory defined benefit pension plan on behalf of a former affiliated organization. Prior to assumption, the benefit plan was curtailed by freezing participation and benefit accruals. At June 30, 2017 and 2016, the benefit obligation for the plan exceeded the plan's assets thus creating an unfunded liability of \$10,583 and \$13,140 at June 30, 2017 and 2016, respectively.

(k) Defined Contribution Pension Plan

Defined contribution pension plan expenses included in the consolidated statements of activities amounted to \$71,986 in fiscal year 2017 and \$52,096 in fiscal year 2016 for the University and \$24,600 in fiscal year 2017 and \$13,100 in fiscal year 2016 for the Medical Center.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(13) Functional Classification of Expenses

The University's primary program service is academic instruction and research. Expenses reported as auxiliary enterprises, library, and student services are incurred in support of this primary program activity. Natural expenses attributable to more than one functional expense category are allocated using a variety of cost allocation techniques such as square footage and time and effort.

Expenses by functional classification for the year ended June 30, 2017 consist of the following:

	2017			
	Academic and research	Healthcare service	Administrative support	Total
Compensation	\$ 1,343,737	789,013	211,932	2,344,682
Utilities, alterations, and repairs	41,490	27,582	16,037	85,109
Depreciation	170,811	107,640	42,876	321,327
Interest	104,056	36,178	26,337	166,571
Supplies, services, and other	472,598	804,673	132,692	1,409,963
Subtotal	<u>\$ 2,132,692</u>	<u>1,765,086</u>	<u>429,874</u>	<u>4,327,652</u>

Expenses by functional classification for the year ended June 30, 2016 consist of the following:

	2016			
	Academic and research	Healthcare service	Administrative support	Total
Compensation	\$ 1,267,351	638,740	206,492	2,112,583
Utilities, alterations, and repairs	46,035	22,507	9,190	77,732
Depreciation	160,484	80,993	39,291	280,768
Interest	91,229	31,069	23,369	145,667
Supplies, services, and other	463,908	619,782	90,051	1,173,741
Subtotal	<u>\$ 2,029,007</u>	<u>1,393,091</u>	<u>368,393</u>	<u>3,790,491</u>

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(In thousands of dollars)

(14) Affiliated Organizations

The University has an ongoing relationship with the National Opinion Research Center (NORC), a not-for-profit organization that conducts research in the public interest primarily for various federal agencies. The majority of NORC's Board of Trustees are faculty members or officers of the University. Program-related revenue for the years ended December 31, 2016 and 2015 was \$188,131 and \$179,385, respectively. Net assets at December 31, 2016 and 2015 were \$38,340 and \$36,921, respectively. Consolidation of this not-for-profit organization is not required because the University does not have both control and an economic interest.

The University, through its affiliate UChicago Argonne, LLC, operates Argonne National Laboratory (ANL) under a contract with the U.S. Department of Energy (DOE). This contract provides for the payment of a fixed management allowance and an additional fee based on performance judged against established measures. The University is the sole member of UChicago Argonne, LLC; however, the performance fee is shared with a subcontractor that assists UChicago Argonne, LLC with the management and operation of ANL.

The University, as a member of Fermi Research Alliance, LLC (FRA), also operates Fermi National Accelerator Laboratory (Fermilab) on behalf of DOE. The Fermilab contract between DOE and FRA provides for the payment of a fixed management allowance and an additional performance fee. The University shares the performance fee with Universities Research Association, the other member of FRA, and with a subcontractor that assists FRA with the management and operation of Fermilab.

The expenditures under the respective contracts and the related reimbursements of \$794,889 for ANL and \$402,169 for Fermilab in fiscal year 2017, and \$760,697 for ANL and \$422,394 for Fermilab in fiscal year 2016 are not included in the consolidated statements of activities. Net assets relating to ANL and to Fermilab are owned by the U.S. government and, therefore, are not included in the consolidated balance sheets.

(15) Contingencies

Various lawsuits, claims, and other contingent liabilities arise in the ordinary course of the University's education, research, and healthcare activities. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material adverse effect on the consolidated financial position of the University.

THE UNIVERSITY OF CHICAGO

Consolidating Balance Sheet

June 30, 2017

(In thousands of dollars)

Assets	University	Medical Center	MBL	2017 Consolidated
Cash and cash equivalents	\$ 11,060	37,446	1,878	50,384
Notes and accounts receivable, net	222,152	432,100	5,341	659,593
Prepaid expenses and other assets	139,119	111,924	3,266	254,309
Pledges receivable, net	648,341	3,619	3,624	655,584
Investments	7,390,796	1,223,580	90,356	8,704,732
Land, buildings, equipment, and books, net	3,180,298	1,625,205	106,783	4,912,286
Total assets	<u>\$ 11,591,766</u>	<u>3,433,874</u>	<u>211,248</u>	<u>15,236,888</u>
Liabilities and Net Assets				
Liabilities:				
Accounts payable and accrued liabilities	\$ 413,362	583,628	8,755	1,005,745
Deferred revenue	111,250	—	4,383	115,633
Assets held in custody for others	129,102	—	730	129,832
Self-insurance liability	249,864	37,717	—	287,581
Pension and other postretirement benefit obligations	491,828	—	—	491,828
Asset retirement obligation	48,488	7,339	—	55,827
Notes and bonds payable	3,630,376	1,034,245	27,211	4,691,832
Refundable U.S. government student loan funds	39,375	—	—	39,375
Total liabilities	<u>5,113,645</u>	<u>1,662,929</u>	<u>41,079</u>	<u>6,817,653</u>
Net assets:				
Without donor restrictions	1,063,129	1,663,039	89,298	2,815,466
With donor restrictions	5,414,992	107,906	80,871	5,603,769
Total net assets	<u>6,478,121</u>	<u>1,770,945</u>	<u>170,169</u>	<u>8,419,235</u>
Total liabilities and net assets	<u>\$ 11,591,766</u>	<u>3,433,874</u>	<u>211,248</u>	<u>15,236,888</u>

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Consolidating Statement of Activities

Year ended June 30, 2017

(In thousands of dollars)

	<u>University</u>	<u>Medical Center</u>	<u>MBL</u>	<u>2017 Consolidated</u>
Changes in net assets without donor restrictions:				
Operating:				
Revenue:				
Tuition and fees – gross	\$ 828,714	—	1,836	830,550
Less student aid	(404,486)	—	(1,347)	(405,833)
Tuition and fees – net	424,228	—	489	424,717
Government grants and contracts	355,032	—	12,545	367,577
Private gifts, grants, and contracts	223,513	263	5,750	229,526
Endowment payout	403,867	45,950	4,403	454,220
Patient service	271,920	1,856,671	—	2,128,591
Auxiliaries	212,101	—	4,521	216,622
Other income	309,555	82,964	1,210	393,729
Net assets released from restrictions	138,133	—	2,160	140,293
Total operating revenue	<u>2,338,349</u>	<u>1,985,848</u>	<u>31,078</u>	<u>4,355,275</u>
Expenses:				
Compensation:				
Academic salaries	574,977	—	15,269	590,246
Staff salaries	588,203	690,219	990	1,279,412
Benefits	300,137	169,422	5,465	475,024
Total compensation	<u>1,463,317</u>	<u>859,641</u>	<u>21,724</u>	<u>2,344,682</u>
Other operating expenses:				
Utilities, alterations, and repairs	52,670	30,051	2,388	85,109
Depreciation	199,581	117,275	4,471	321,327
Interest	126,096	39,416	1,059	166,571
Supplies, services, and other	520,073	876,703	13,187	1,409,963
Total other operating expenses	<u>898,420</u>	<u>1,063,445</u>	<u>21,105</u>	<u>1,982,970</u>
Total operating expenses	<u>2,361,737</u>	<u>1,923,086</u>	<u>42,829</u>	<u>4,327,652</u>
Excess (deficiency) of operating revenue over expenses	\$ (23,388)	62,762	(11,751)	27,623

THE UNIVERSITY OF CHICAGO

Consolidating Statement of Activities

Year ended June 30, 2017

(In thousands of dollars)

	<u>University</u>	<u>Medical Center</u>	<u>MBL</u>	<u>2017 Consolidated</u>
Changes in net assets without donor restrictions:				
Nonoperating:				
Investment gains	\$ 57,181	47,765	329	105,275
Net periodic benefit cost other than service cost	(16,195)	(290)	—	(16,485)
Defined benefit pension plan curtailment (partial)	64,241	—	—	64,241
Other postretirement benefit changes	31,778	2,266	625	34,669
Change in value of derivative instruments	20,531	44,863	2,007	67,401
Loss on debt refinancing	—	(27,028)	—	(27,028)
Contribution of Ingalls Health System net assets	—	309,740	—	309,740
Other, net	(39,189)	(2,655)	9,669	(32,175)
Nonoperating changes in net assets without donor restrictions	<u>118,347</u>	<u>374,661</u>	<u>12,630</u>	<u>505,638</u>
Increase in net assets without donor restrictions	<u>94,959</u>	<u>437,423</u>	<u>879</u>	<u>533,261</u>
Changes in net assets with donor restrictions:				
Private gifts	327,674	3,683	3,232	334,589
Endowment payout	923	—	—	923
Investment gains	201,392	7,582	3,332	212,306
Contribution of Ingalls Health System net assets	—	13,122	—	13,122
Other, net	33,665	(6,518)	(603)	26,544
Net assets released from restrictions	(138,133)	—	(2,160)	(140,293)
Increase in net assets with donor restrictions	<u>425,521</u>	<u>17,869</u>	<u>3,801</u>	<u>447,191</u>
Increase in net assets	520,480	455,292	4,680	980,452
Net assets at beginning of year	<u>5,957,641</u>	<u>1,315,653</u>	<u>165,489</u>	<u>7,438,783</u>
Net assets at end of year	<u>\$ 6,478,121</u>	<u>1,770,945</u>	<u>170,169</u>	<u>8,419,235</u>

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Consolidating Statement of Cash Flows

Year ended June 30, 2017

(In thousands of dollars)

	University	Medical Center	MBL	2017 Consolidated
Cash flows from operating activities:				
Increase in net assets	\$ 520,480	455,292	4,680	980,452
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:				
Contribution of Ingalls Health System net assets	—	(322,862)	—	(322,862)
Depreciation	199,581	117,275	4,471	321,327
Change in value of derivative instruments	(20,531)	(48,820)	(2,007)	(71,358)
Loss on debt refinancing	—	27,028	—	27,028
Loss on disposal of land, buildings, equipment, and books	10,469	91	(23)	10,537
Gain on sale of property	(44,687)	—	—	(44,687)
Net gain on investments	(594,027)	(74,763)	(8,070)	(676,860)
Private gifts and grants restricted for long-term investment	(327,674)	(11,265)	(5)	(338,944)
Other nonoperating changes	138,040	78,268	(8,908)	207,400
Postretirement benefit changes	(79,824)	(2,266)	(2,285)	(84,375)
Changes in operating assets and liabilities:				
Notes and accounts receivable	(3,663)	(111,222)	1,076	(113,809)
Prepaid expenses and other assets	(68,979)	(38,123)	896	(106,206)
Accounts payable and other liabilities	64,124	75,736	865	140,725
Self-insurance liability	(778)	(1,732)	—	(2,510)
Total adjustments	(727,949)	(312,655)	(13,990)	(1,054,594)
Net cash provided by (used in) operating activities	(207,469)	142,637	(9,310)	(74,142)
Cash flows from investing activities:				
Purchase of investments	(1,810,457)	(402,496)	(3,710)	(2,216,663)
Proceeds from sale of investments	1,997,034	488,139	6,025	2,491,198
Contribution of Ingalls Health System	—	28,003	—	28,003
Acquisition of land, buildings, equipment, and books	(232,353)	(209,244)	(2,973)	(444,570)
Proceeds from sale of property	64,248	—	468	64,716
Loans disbursed	(2,976)	—	—	(2,976)
Principal collected on loans	7,914	—	—	7,914
Net cash provided by (used in) investing activities	23,410	(95,598)	(190)	(72,378)
Cash flows from financing activities:				
Proceeds from issuance of debt instruments	1,528,265	259,396	—	1,787,661
Principal payments on debt instruments	(1,526,832)	(222,321)	(772)	(1,749,925)
Proceeds from private gifts and grants restricted for long-term investment	154,533	4,747	(574)	158,706
Other nonoperating changes	(9,426)	(71,750)	9,519	(71,657)
Net cash provided by (used in) financing activities	146,540	(29,928)	8,173	124,785
Increase (decrease) in cash and cash equivalents	(37,519)	17,111	(1,327)	(21,735)
Cash and cash equivalents at:				
Beginning of year	48,579	20,335	3,205	72,119
End of year	\$ 11,060	37,446	1,878	50,384
Supplemental disclosure of cash flow information:				
Cash paid for interest	\$ 135,994	41,907	1,067	178,968
Change in construction payable	(8,166)	(39,109)	475	(46,800)

See accompanying independent auditors' report.