

UNIVERSITY OF PITTSBURGH



FINANCIAL REPORT

FISCAL YEAR 2018



KPMG LLP
BNY Mellon Center
Suite 3400
500 Grant Street
Pittsburgh, PA 15219-2598

Independent Auditors' Report

The Board of Trustees of the
University of Pittsburgh – Of the Commonwealth
System of Higher Education:

We have audited the accompanying consolidated financial statements of the University of Pittsburgh – Of the Commonwealth System of Higher Education, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, 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 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 auditor considers 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 consolidated financial position of the University of Pittsburgh – Of the Commonwealth System of Higher Education as of June 30, 2018 and 2017, 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.

KPMG LLP

Pittsburgh, Pennsylvania
September 21, 2018

CONSOLIDATED FINANCIAL STATEMENTS

UNIVERSITY OF PITTSBURGH
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2018 AND 2017
(in thousands of dollars)

	2018	2017
ASSETS:		
Cash and cash equivalents (Notes 1 and 5)	\$ 45,809	\$ 22,494
Operating investments (Notes 4 and 5)	382,935	521,879
Inventories and deferred charges	23,556	20,924
Accounts and notes receivable, net (Note 2)	229,576	192,103
Contributions receivable, net (Note 3)	60,161	33,193
Student loans receivable, net	40,611	45,384
Foundation assets (Note 1)	29,697	27,893
Endowment investments (Notes 4 and 5)	4,226,330	3,970,047
Endowed funds held by third parties (Note 5)	23,591	22,944
Property, plant, and equipment, net (Note 6)	1,834,129	1,783,096
TOTAL ASSETS	\$ 6,896,395	\$ 6,639,957
LIABILITIES:		
Accounts payable and accrued expenses	\$ 99,001	\$ 96,032
Accrued payroll and related liabilities	80,804	80,779
Deferred student and other revenue	52,955	53,238
Advanced receipt of grant funds	68,321	64,061
Refundable U.S. government student loans	34,373	34,338
Other liabilities (Notes 5 and 8)	90,375	112,330
Pension and postretirement obligations (Note 9)	550,588	554,086
Conditional asset remediation obligation (Note 6)	29,764	30,644
Bonds and notes payable (Note 7)	833,420	939,379
TOTAL LIABILITIES	1,839,601	1,964,887
NET ASSETS:		
Unrestricted (Notes 1 and 10)	3,366,480	3,105,495
Temporarily restricted (Notes 1 and 10)	924,249	829,574
Permanently restricted (Notes 1 and 10)	766,065	740,001
TOTAL NET ASSETS	5,056,794	4,675,070
TOTAL LIABILITIES AND NET ASSETS	\$ 6,896,395	\$ 6,639,957

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED FINANCIAL STATEMENTS

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2018
COMPARED TO SUMMARY INFORMATION FOR THE YEAR ENDED JUNE 30, 2017
(in thousands of dollars)

	2018			Total	2017
	Unrestricted	Temporarily Restricted	Permanently Restricted		
OPERATING REVENUES:					
Tuition and fees	\$ 813,848	\$ -	\$ -	\$ 813,848	\$ 788,455
Tuition discounts	(192,748)	-	-	(192,748)	(187,897)
Net tuition and fees	621,100	-	-	621,100	600,558
Commonwealth appropriation	169,680	-	-	169,680	158,899
Commonwealth construction grants	21,582	-	-	21,582	24,645
Grants and contracts	808,082	-	-	808,082	764,478
Contributions for operations	31,627	46,011	-	77,638	44,823
Investment income – operating investments	7,391	-	-	7,391	6,808
Endowment distributions for operations	136,144	-	-	136,144	126,472
Sales and services, educational and other	187,792	-	-	187,792	193,600
Sales and services, auxiliary	151,688	-	-	151,688	152,767
Rental revenue	18,444	-	-	18,444	18,261
Other	76,466	-	-	76,466	78,351
Net assets released from restrictions	16,039	(16,039)	-	-	-
Total operating revenues	2,246,035	29,972	-	2,276,007	2,169,662
OPERATING EXPENSES:					
Salaries and wages	1,005,074	-	-	1,005,074	949,288
Fringe benefits	308,667	-	-	308,667	300,772
Total compensation	1,313,741	-	-	1,313,741	1,250,060
Supplies	112,940	-	-	112,940	111,818
Business and professional	354,887	-	-	354,887	328,759
Utilities	46,598	-	-	46,598	47,018
Maintenance and facilities	48,508	-	-	48,508	49,887
Depreciation	177,210	-	-	177,210	177,781
Interest	30,171	-	-	30,171	31,343
Other	91,606	-	-	91,606	87,333
Total operating expenses (Note 11)	2,175,661	-	-	2,175,661	2,083,999
Change in net assets from operating activities	70,374	29,972	-	100,346	85,663
OTHER ACTIVITIES:					
Investment gains, net of endowment distributions for operations	140,366	64,703	1,767	206,836	330,579
Contributions for endowment	-	-	24,297	24,297	29,006
Change in fair value of interest rate swaps	20,526	-	-	20,526	33,826
Nonperiodic changes in benefit plans (Note 9)	29,719	-	-	29,719	54,787
Bond refunding (Note 7)	-	-	-	-	(46,464)
Total other activities	190,611	64,703	26,064	281,378	401,734
CHANGE IN NET ASSETS	260,985	94,675	26,064	381,724	487,397
NET ASSETS, BEGINNING OF YEAR	3,105,495	829,574	740,001	4,675,070	4,187,673
NET ASSETS, END OF YEAR	\$ 3,366,480	\$ 924,249	\$ 766,065	\$ 5,056,794	\$ 4,675,070

The accompanying notes are an integral part of these consolidated financial statements.

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2017
(in thousands of dollars)

	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES:				
Tuition and fees	\$ 788,455	\$ -	\$ -	\$ 788,455
Tuition discounts	(187,897)	-	-	(187,897)
Net tuition and fees	600,558	-	-	600,558
Commonwealth appropriation	158,899	-	-	158,899
Commonwealth construction grants	24,645	-	-	24,645
Grants and contracts	764,478	-	-	764,478
Contributions for operations	32,462	12,361	-	44,823
Investment income – operating investments	6,808	-	-	6,808
Endowment distributions for operations	126,472	-	-	126,472
Sales and services, educational and other	193,600	-	-	193,600
Sales and services, auxiliary	152,767	-	-	152,767
Rental revenue	18,261	-	-	18,261
Other	78,351	-	-	78,351
Net assets released from restrictions	13,667	(13,667)	-	-
Total operating revenues	2,170,968	(1,306)	-	2,169,662
OPERATING EXPENSES:				
Salaries and wages	949,288	-	-	949,288
Fringe benefits	300,772	-	-	300,772
Total compensation	1,250,060	-	-	1,250,060
Supplies	111,818	-	-	111,818
Business and professional	328,759	-	-	328,759
Utilities	47,018	-	-	47,018
Maintenance and facilities	49,887	-	-	49,887
Depreciation	177,781	-	-	177,781
Interest	31,343	-	-	31,343
Other	87,333	-	-	87,333
Total operating expenses (Note 11)	2,083,999	-	-	2,083,999
Change in net assets from operating activities	86,969	(1,306)	-	85,663
OTHER ACTIVITIES:				
Investment gains, net of endowment distributions for operations	212,108	116,142	2,329	330,579
Contributions for endowment	-	-	29,006	29,006
Change in fair value of interest rate swaps	33,826	-	-	33,826
Nonperiodic changes in benefit plans (Note 9)	54,787	-	-	54,787
Bond refunding	(46,464)	-	-	(46,464)
Total other activities	254,257	116,142	31,335	401,734
CHANGE IN NET ASSETS	341,226	114,836	31,335	487,397
NET ASSETS, BEGINNING OF YEAR	2,764,269	714,738	708,666	4,187,673
NET ASSETS, END OF YEAR	\$ 3,105,495	\$ 829,574	\$ 740,001	\$ 4,675,070

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED FINANCIAL STATEMENTS

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017
(in thousands of dollars)

	2018	2017
CASH AND CASH EQUIVALENTS:		
End of year	\$ 45,809	\$ 22,494
Beginning of year	22,494	6,400
CHANGE IN CASH AND CASH EQUIVALENTS	\$ 23,315	\$ 16,094
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 381,724	\$ 487,397
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	177,210	177,781
Nonperiodic changes in benefit plans	(29,719)	(54,787)
Bond refunding	-	46,464
Write-off of issuance costs and net premiums on refunded bonds	-	(5,467)
Amortization of debt issuance costs and bond premiums, net	66	(2,360)
Loss on disposal of plant assets	1,719	2,882
Investment gains	(321,918)	(437,093)
Change in fair value of interest rate swaps	(20,526)	(33,826)
Contributions restricted for long-term investment	(47,453)	(57,024)
Changes in operating assets and liabilities:		
Accounts, notes, contributions, and loans receivable, net	(67,891)	13,195
Other assets	(2,632)	60
Accounts payable and accrued expenses	(355)	(3,648)
Pension and postretirement obligations	26,221	19,488
Conditional asset remediation obligation	(880)	(6,702)
Other liabilities	(1,404)	3,328
Government student loans and deferred revenue	4,012	4,250
Net cash provided by operating activities	98,174	153,938
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expended for property, plant, and equipment - University	(208,380)	(165,049)
Expended for property, plant, and equipment - commonwealth	(21,582)	(24,645)
Change in accounts payable for property, plant, and equipment	3,324	4,468
Proceeds from sales of operating investments, net	133,065	29,875
Purchases of endowment investments	(2,411,292)	(2,163,200)
Proceeds from sales/maturities of endowment investments	2,482,201	2,182,433
Change in endowed funds held by third parties, excluding gains	(43)	453
Change in foundation assets	(1,804)	(1,542)
Net cash used for investing activities	(24,511)	(137,207)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal repayment of debt including bond refundings	(106,025)	(846,161)
Proceeds from issuance of debt including bond refundings	-	847,881
Defeasance of debt	-	(49,927)
Change in deposits of bond proceeds	-	6,598
Contributions restricted for long-term investment	55,677	40,972
Net cash used for financing activities	(50,348)	(637)
CHANGE IN CASH AND CASH EQUIVALENTS	\$ 23,315	\$ 16,094
Supplemental disclosure of cash flow information:		
Cash paid for interest (excluding fees)	\$ 30,401	\$ 43,071
Noncash investing activity for property, plant, and equipment - accounts payable	\$ 28,598	\$ 25,274

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING PRACTICES

Organization

Founded in 1787, the University of Pittsburgh (the University) is one of the oldest institutions of higher education in the United States. The University's mission is to provide high-quality undergraduate and graduate programs in the arts and sciences and professional fields; engage in research, artistic, and scholarly activities that advance learning through the extension of the frontiers of knowledge and creative endeavor; cooperate with industrial and governmental institutions to transfer knowledge in science, technology, and health care; offer continuing educational programs adapted to the personal enrichment, professional upgrading, and career advancement interests and needs of adult Pennsylvanians; and make available to local communities and public agencies the expertise of the University in ways that are consistent with the primary teaching and research functions and contribute to social, intellectual, and economic development in the commonwealth, the nation, and the world.

The University's main campus in the City of Pittsburgh comprises 16 schools and several academic centers educating nearly 29,000 students in various undergraduate, graduate, and doctorate-professional programs. Four regional campuses with a total enrollment approximating 6,000 students are located throughout western Pennsylvania.

Relationship with the Commonwealth of Pennsylvania

The University derives its corporate existence under the laws of the Commonwealth of Pennsylvania (the commonwealth) by reason of the act of the General Assembly of the commonwealth establishing an "Academy or Public School in the town of Pittsburgh" on February 28, 1787 and from the act of February 18, 1819 incorporating the "Western University of Pennsylvania." In 1908, the University's name was changed to the "University of Pittsburgh" by order of the Court of Common Pleas of Allegheny County. In 1966, the Pennsylvania State Legislature enacted the "University of Pittsburgh-Commonwealth Act," which changed the name of the University to the "University of Pittsburgh – of the Commonwealth System of Higher Education" and established the University as an instrumentality of the commonwealth to serve as a state-related institution in the Commonwealth System of Higher Education. The University is a Pennsylvania nonprofit corporation subject to the Nonprofit Corporation Law of 1988.

The entire management, control, and conduct of the instructional, administrative, and financial affairs of the University are vested in the Board of Trustees. The Board of Trustees is comprised of fifty-two members

(thirty-six voting members), including twelve commonwealth trustees and sixteen special trustees elected by the board. Special trustees may attend all meetings of the board and are entitled to and exercise all rights, responsibilities, and privileges of trusteeship, except the right to vote at board meetings.

As a state-related institution, the University receives an annual operating and capital appropriation from the commonwealth. There is no assurance that such appropriation will continue to be made, or will be made, at current levels or at levels requested by the University. The appropriation from the commonwealth was \$169.7 million in 2018 and \$158.9 million in 2017. In addition to the annual appropriation, the commonwealth also funds certain capital projects in support of the University's mission. Amounts funded by the commonwealth for capital projects were \$21.6 million in 2018 and \$24.6 million in 2017.

The University also receives sponsored program support from the commonwealth. Such support in 2018 and 2017 was \$12.8 million and \$13.2 million, respectively.

Basis of Presentation

The consolidated financial statements include the accounts of the University, which do not include the net assets or activities of the University of Pittsburgh Medical Center (UPMC) or the University of Pittsburgh Physicians (UPP) clinical practice plans, as they are separate legal entities not controlled by the University. The University does have the right to designate one-third of the members of the UPMC Board of Directors and any Executive Committee thereof.

The other activities section of the Consolidated Statements of Activities includes investment gains, net of endowment distributions for operations; contributions for endowment; change in fair value of interest rate swaps; nonperiodic changes in pension and postretirement benefit plans; and certain bond refunding activities. Endowment distributions for operations represent those distributions not reinvested in the endowment (see Note 10).

Basis of Accounting

The consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Financial Accounting Standards Board (FASB).

In accordance with GAAP, the University's net assets have been classified as unrestricted, temporarily restricted, or permanently restricted based upon the

existence or absence of donor-imposed restrictions. Unrestricted net assets are not subject to donor-imposed restrictions and are used for general operating purposes of the University. This class of net assets also includes certain contributions and endowment distributions whose donor-imposed restrictions have been met within the fiscal year. Temporarily restricted net assets are subject to certain time or purpose restrictions by the donor. Upon satisfaction of these restrictions, the net assets are transferred to unrestricted. Amounts released from restrictions relate primarily to cash collections on pledges, where purpose restrictions had already been met. Temporarily restricted net assets at June 30, 2018 and 2017 consist of endowment balances (\$865.5 million and \$801.6 million, respectively); the net present value of temporarily restricted contributions and unconditional pledges (\$52.5 million and \$22.6 million, respectively); and split-interest agreements (\$6.2 million and \$5.4 million, respectively). Permanently restricted net assets are those subject to permanent donor-imposed restrictions and at June 30, 2018 and 2017 consist of endowment balances (\$742.3 million and \$713.5 million, respectively); the net present value of permanently restricted contributions and unconditional pledges (\$10.1 million and \$13.1 million, respectively); and private student loan funds (\$13.7 million and \$13.4 million, respectively). Net assets restricted for purpose are for programmatic purposes including scholarships, instruction, and research.

Donor-restricted endowed contributions require that the original corpus of the contributions be maintained in perpetuity. The distributions generated by these contributions may be either expended or reinvested in the endowment, in accordance with donor restrictions and endowment contribution and spending policies (see Note 10).

Estimates

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Revenue Recognition

Revenue for programs or activities to be conducted in future periods, such as student tuition and room and board, is classified as deferred revenue. Revenue for these activities is recognized as services are provided.

Advanced receipts of grants and contracts are also classified as deferred revenue, with revenue being recognized as funds are expended and sponsored programs are executed.

Tuition discounts are recorded to the extent that either institutional financial aid or aid funded by contributions, endowment distributions, and grant activities are awarded. Tuition discounts attributable to institutional funds in 2018 and 2017 were \$163.9 million and \$162.6 million, respectively. Tuition discounts attributable to contributions, endowment distributions, and grant activities were \$28.8 million and \$25.3 million in 2018 and 2017, respectively.

Cash and Cash Equivalents and Operating Investments

Cash equivalents consist of operating investments with original maturities of 90 days or less. Operating investments include U.S. Treasury instruments and other high-quality, liquid securities that at the time of purchase are rated A3/P-1 or better by Moody's Investors Service or A-/A-1 or better by Standard & Poor's Ratings Services. Operating investments, together with cash, are utilized to fund the University's short-term operating needs and are invested with the expectation that such securities can be liquidated at their current value in a short time frame. Cash and cash equivalents that are part of endowment investments are shown therewith, as such funds are utilized for endowment purposes rather than University operating needs.

Allowance for Doubtful Accounts

The University maintains allowances for doubtful accounts to reflect management's best estimate of probable losses inherent in receivable balances. Management determines the allowances for doubtful accounts based on known troubled accounts, historical experience, and other currently available evidence. Receivables are written off when management determines they will not be collected.

Contributions

The University initially records at fair value unconditional pledges (which are agreements with donors involving non-reciprocal transfers of cash or other assets) as either temporarily restricted or permanently restricted contributions depending on the nature of the donor-imposed restrictions. Contributions whose restrictions are met in the same fiscal year in which they are received are combined and reported with unrestricted contributions. Contributions receivable are discounted at a risk-adjusted rate commensurate with the donor's payment plan.

Conditional pledges of cash or other assets are recognized as contribution revenues and receivables when the conditions surrounding the pledge are substantially met.

Bequests are considered to be intentions to give and do not fall within the definition of an unconditional pledge, and hence, are not recognized in the consolidated financial statements.

Foundation Assets

The University's foundation assets represent the Bradford Educational Foundation (BEF). The BEF is a 509(a)(3) Type III supporting organization whose sole purpose is to receive, administer, and distribute property for the benefit of the University of Pittsburgh Bradford campus. The BEF is governed by an independent board of directors, with the majority of members being non-University members. Although the University does not exercise control of the BEF, all assets held by the BEF are held for the financial benefit of the University. As such, the consolidated financial statements include the net assets and annual change in net assets of the BEF.

Endowment Investments

The University's endowment investments are reported at fair value. The fair value of direct University holdings in publicly traded securities and exchange traded funds are based upon quoted or published market prices. The fair value of all other investments, which consist of indirect holdings in both privately and publicly traded assets, is determined using net asset value (NAV) per share or unit of interest. Used as a practical expedient for the estimated fair value, NAV per share or its equivalent is provided by the fund manager and reviewed by the University. Indirect holdings of private assets primarily consist of University interests in funds investing in nonmarketable alternatives, real assets, and/or distressed securities, whereas indirect holdings of publicly traded assets primarily consist of University interests in marketable alternatives or other commingled funds. Nonmarketable alternatives are private equity or equity-like holdings, such as mezzanine and subordinated debt interests, in venture, buyout, or recapitalized companies or properties. Real assets are physical assets, or financial assets associated with such physical assets, whose income streams and/or fair values tend to rise with inflation; they include real estate, natural resources, commodities, and other hard assets. Marketable alternatives consist of distressed debt and hedging strategies, including event-driven hedging strategies, such as merger or credit arbitrage, and value-driven hedging strategies, such as long/short, market neutral, and other hedging strategies.

In the case of indirect holdings, changes in market conditions, economic environment, regulatory environment, currency exchange rates, interest rates, and commodity prices may significantly impact the NAV of the funds holding the investments and, consequently, the fair value of the University's interest in such funds and could materially affect the amounts reported in the consolidated financial statements. Although a secondary market exists for these investments, it is not active, and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported NAV. It is therefore possible that if the University were to sell these investments in the secondary market, a buyer may require a discount to the reported NAV, and the discount could be significant. The University attempts to manage these risks through diversification, ongoing due diligence of fund managers, maintaining adequate liquidity, and continuously monitoring economic and market conditions.

Dividend income is recognized net of applicable withholding taxes on the ex-dividend date. Noncash dividends are recorded at the fair value of the securities received. Interest income and expenses are recorded net of management fees and applicable withholding taxes on the accrual basis of accounting.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Unobservable inputs for the asset or liability that are used to measure fair value when observable inputs are not available. These inputs are developed based upon the best information available in such circumstances.

In the event that changes in the inputs used in the fair value measurement of an asset or liability result in a transfer of the fair value measurement into a different level, such transfers are recognized at the end of the reporting period.

Derivative Financial Instruments

The University records derivatives at fair value on the Consolidated Balance Sheets with changes in fair value reflected in the Consolidated Statements of Activities (see Note 8).

Split-Interest Agreements

These agreements with donors consist primarily of charitable gift annuities, pooled income funds, and irrevocable charitable remainder trusts for which the University serves as trustee. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with the respective agreements. Endowment investments include \$24.1 million and \$22.4 million at June 30, 2018 and 2017, respectively, for the split-interest agreements. Other liabilities include \$12.9 million and \$12.3 million at June 30, 2018 and 2017, respectively, for the split-interest agreements.

The University maintains separate and distinct reserve funds adequate to meet future payments of all outstanding charitable gift annuities administered by the University. The University complies with applicable state annuity reserve requirements.

Property, Plant, and Equipment, Net

Property, plant, and equipment is recorded at cost, or if acquired by contribution, at fair value as of the date of the contribution. Depreciation is calculated using the straight-line method. Useful lives generally range from 15 to 40 years for buildings and improvements and 5 to 10 years for furnishings and equipment. As assets are retired, sold, or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts, and gains or losses are recognized in the Consolidated Statements of Activities. Costs associated with the construction of new facilities and renovation and expansion of existing facilities are capitalized within construction in progress until such projects are placed in service. The University capitalizes software and certain implementation costs and generally depreciates such assets over 5 to 10 years. Works of art, historical treasures, and similar assets include a variety of paintings, sculptures, photographs, antiques, and furnishings, as well as scholarly papers and archives. These assets are used for public exhibition, the preservation of artifacts and antiques for future generations, and scholarly research. Due to their nature, these assets are not depreciated. Library books, which include hard copy publications, periodicals, and electronic publications with rights to archival content, are depreciated over a period of 7 years. Maintenance and repairs are expensed as incurred generally.

Insurance Liabilities

The University is self-insured through an agreement with UPMC to provide medical coverage for its employees. A liability for estimated incurred but unreported claims of \$7.5 million and \$8.6 million has been recorded at June 30, 2018 and 2017, respectively, based upon management's analysis of claims history. This liability is reflected in accrued payroll and related liabilities on the Consolidated Balance Sheets.

The University is also self-insured for other activities, including workers' compensation, unemployment compensation, and certain litigation claims. Liabilities have been established for these programs generally based on third-party administrators' estimates using the University's historical loss experience. The self-insurance accrual is subject to periodic adjustment by the University based on actual loss experience factors. Liabilities for these other self-insured obligations aggregated \$9.3 million and \$9.0 million at June 30, 2018 and 2017, respectively, and are included in accrued payroll and related liabilities on the Consolidated Balance Sheets.

Grants and Contracts

The University conducts sponsored program activity with various sponsors, including agencies and departments of the federal government, the commonwealth, local government entities, companies, and foundations. Sponsored activity in 2018 and 2017 was \$808.1 million and \$764.5 million, respectively, with approximately 66% of the funding awarded through the National Institutes of Health. Most University sponsored activity is conducted on a cost reimbursable basis with the University receiving funding after the related expenses have been incurred. Certain sponsors, however, provide funding in advance of related expenses, and such funding is recorded as advanced receipt of grant funds on the Consolidated Balance Sheets. Revenue from sponsored awards is recognized as the related expenses are incurred. There is no assurance that sponsored awards will continue to be made at current levels.

The University incurs both direct and indirect costs in the conduct of its sponsored activity. Recovery of indirect costs through federal awards is based upon predetermined rates negotiated with the Department of Health and Human Services. Indirect cost recovery rates from nonfederal sources may vary. Funds received through federal sources are subject to audit each year in accordance with the Office of Management and Budget's Uniform Guidance.

Government Loan Funds

U.S. government student loans are recorded as liabilities because these funds are refundable to the federal government under certain conditions. Student loan funds donated by private groups, organizations, or individuals are recorded as permanently restricted net assets since such funds operate on a revolving fund basis with principal and interest payments remaining in the fund for future lending.

Tax-Exempt Status

The University is exempt from federal income tax under Section 501(c)(3) of the United States Internal Revenue Code. Accordingly, it is not subject to income taxes except to the extent it has taxable income from activities that are not related to its exempt purpose. The University annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the consolidated financial statements. No provision for income taxes was required for 2018 or 2017.

Reclassifications

Certain 2017 operating expense line items include reclassifications related to the presentation of internal cost recovery to conform with the 2018 presentation.

Recent Accounting Pronouncements

In March 2017, FASB issued the Accounting Standards Update (ASU) No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This ASU requires presentation of the service cost component of the net periodic benefit cost within the same line item or items as other compensation costs arising from services rendered by relevant employees during the period, and presentation of the other cost components of net periodic benefit cost separately and outside of the change in net assets from operating activities. The ASU is effective for the University for fiscal year 2020, and early adoption is permitted. The University is currently evaluating the impact this ASU will have on the consolidated financial statements and related disclosures.

In August 2016, FASB issued ASU No. 2016-14, *Not-for-Profit Entities (NFPs) (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities*. The ASU is effective for the University for fiscal year 2019. The ASU reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions; requires all NFPs to present expenses by their functional and natural classifications in one location in the financial statements; and requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date. The University is currently evaluating the impact this ASU will have on the consolidated financial statements and related disclosures.

In February 2016, FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The ASU is effective for fiscal year 2020. The ASU will require lessees to report most leases as assets and liabilities on the balance sheet, while lessor accounting will remain substantially unchanged. The ASU requires a modified retrospective transition approach for existing leases, whereby the new rules will be applied to the earliest year presented. The University is currently evaluating the impact this ASU will have on the consolidated financial statements and related disclosures.

In May 2014, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will replace the current revenue recognition requirements in GAAP. The core principle of this ASU is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration it expects to be entitled in exchange. In addition, the ASU requires disclosures about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The ASU is effective for fiscal year 2019. The University is currently evaluating the impact this ASU will have on the consolidated financial statements and related disclosures.

NOTE 2: ACCOUNTS AND NOTES RECEIVABLE, NET

Accounts and notes receivable, net, at June 30 consists of the following:

	2018	2017
	<i>(in thousands of dollars)</i>	
Sponsored grant receivables, net	\$ 120,480	\$ 109,813
Commonwealth appropriation receivable	51,285	1,037
Hospitals and affiliated organizations receivables, net	18,202	31,944
Plant construction receivables due from commonwealth	17,491	22,708
Other receivables, net	14,124	14,856
Student receivables, net	7,994	11,745
Total accounts and notes receivable, net	\$ 229,576	\$ 192,103

NOTE 3: CONTRIBUTIONS RECEIVABLE, NET

Contributions receivable, net, at June 30 consists of the following:

	2018	2017
	<i>(in thousands of dollars)</i>	
Amounts due in:		
Less than one year	\$ 18,268	\$ 14,856
One to five years	34,905	18,322
Greater than five years	14,061	2,350
Gross contributions receivable	67,234	35,528
Less:		
Allowance for uncollectible pledges	(765)	(846)
Unamortized discounts	(6,308)	(1,489)
Total contributions receivable, net	\$ 60,161	\$ 33,193

At June 30, 2018 and 2017, the five largest outstanding pledge balances represented 61% and 29%, respectively, of the University's net contributions receivable.

The University has been named a beneficiary in the wills of numerous donors or has received conditional pledges totaling \$271.8 million and \$239.5 million at June 30, 2018 and 2017, respectively. These bequests and conditional pledges have not been recognized in the consolidated financial statements.

NOTE 4: ENDOWMENT AND OPERATING INVESTMENTS

Investments at June 30 consist of the following:

	2018	2017
	<i>(in thousands of dollars)</i>	
Endowment investments:		
Pooled	\$ 4,188,409	\$ 3,934,117
Nonpooled	37,921	35,930
Subtotal endowment investments	4,226,330	3,970,047
Operating investments (<i>Note 1</i>)	382,935	521,879
Total endowment and operating investments	\$ 4,609,265	\$ 4,491,926
Composition of endowment investments:		
Cash and cash equivalents	\$ 101,225	\$ 99,132
Domestic equities	674,604	628,229
International equities	844,240	841,031
U.S. government and government agencies' securities, bank acceptances and certificates, and commercial paper	249,614	222,563
Corporate bonds and other obligations	108,862	121,745
Alternative investment funds, partnerships, and exchange traded funds:		
Marketable alternatives	830,639	739,118
Nonmarketable alternatives	745,331	681,045
Real assets	671,815	637,184
Total endowment investments	\$ 4,226,330	\$ 3,970,047
Composition of operating investments:		
U.S. government and government agencies' securities, repurchase agreements, and commercial paper	\$ 210,301	\$ 300,341
Corporate bonds and other obligations	148,909	201,126
Other	23,725	20,412
Total operating investments	\$ 382,935	\$ 521,879

Unless precluded by size or donor restrictions, individual endowment fund assets are pooled and collectively managed on a unitized basis. Each endowment fund subscribes to or disposes of units in the pool using fair value per unit at the beginning of the month such subscription or disposition occurs to account for the transaction.

The philosophies and policies employed in the management of the endowment are long-term by definition, as they are based on the expectation that the endowment will continue to provide financial support to

the University in perpetuity. Accordingly, the University's investment policy is intended to optimize long-term total return — income plus capital appreciation — relative to the level of risk taken.

The University's investment policy contemplates the effects of its spending policy. The endowment spending policy balances the need for reliable and predictable earnings distributions to support current University activities with the desire to maintain the purchasing power of endowment assets so that they can continue providing financial support for future generations (see Note 10).

The following table summarizes the University's investments at June 30, 2018 and 2017, for which NAV was used as a practical expedient to estimate fair value:

Asset Class	Fair Value		Unfunded	Redemption	Redemption
	Determined Using NAV		Commitments	Frequency	Notice
	2018	2017	at June 30, 2018		Period
(in thousands of dollars)					
International equities	\$ 139,647	\$ 127,969	\$ -	Quarterly	60-120 days
Marketable alternatives:					
Redeemable within one year	711,582	585,896	-	90-365 days	30-180 days
Redeemable beyond one year	18,882	45,829	-	1-3 years	30-60 days
Nonredeemable	29,725	35,957	28,579	NA	NA
Total marketable alternatives	760,189	667,682	28,579		
Nonmarketable alternatives	745,331	681,045	432,065	NA	NA
Real assets:					
Redeemable	61,914	52,718	-	Monthly	10 days
Nonredeemable	585,947	570,938	301,367	NA	NA
Total real assets	647,861	623,656	301,367		
Total	\$ 2,293,028	\$ 2,100,352	\$ 762,011		

Descriptions follow for each asset class set forth in the table above:

International Equities

A portion of the University's investments in emerging market equities includes an interest in one fund that holds publicly traded emerging market equities.

Marketable Alternatives

The University's investments in marketable alternatives are interests in commingled funds that hold various combinations of long and short positions predominantly in publicly traded equities, fixed income, and financial derivatives. Funds that are nonredeemable typically have investment periods of three or more years during which committed capital may be called and invested. The University's interests in the nonredeemable funds are considered to be illiquid in that they are not easily transferable and typically achieve liquidity over multi-year periods when and if the fund managers distribute proceeds realized from the underlying fund assets.

Nonmarketable Alternatives

The University's investments in nonmarketable alternatives are interests in commingled, private equity funds, including venture capital. These funds are invested

in equity and equity-like securities of mostly nonpublicly traded companies over investment periods of typically three to five years during which committed capital may be called and invested. The University's interests in private equity funds are considered to be illiquid in that they are not easily transferable and typically achieve liquidity over multi-year periods when and if the fund managers distribute proceeds realized from underlying fund assets.

Real Assets

The University's investments in real assets are interests in commingled funds that hold various combinations of publicly and nonpublicly traded physical assets (such as real estate, natural resources, commodities, and utilities), the financial assets and derivatives associated with such physical assets, and the equity and equity-like securities of companies engaged in physical asset ownership, operations and/or services. Funds that are nonredeemable typically have investment periods of three or more years during which committed capital may be called and invested. The University's interests in the nonredeemable funds are considered to be illiquid in that they are not easily transferable and typically achieve liquidity over multi-year periods when and if the fund managers distribute proceeds realized from the underlying fund assets.

NOTE 5: FAIR VALUE MEASUREMENTS

The following tables summarize the inputs used in valuing the University's assets and liabilities carried at fair value, excluding investments stated at NAV as a practical expedient, at June 30, 2018 and 2017:

2018				
	Level 1	Level 2	Level 3	Total
	<i>(in thousands of dollars)</i>			
Assets				
Cash and cash equivalents	\$ 31,428	\$ 14,381	\$ -	\$ 45,809
Endowment investments:				
Cash and cash equivalents	80,475	20,750	-	101,225
Domestic equities	664,575	10,029	-	674,604
International equities	701,706	-	2,887	704,593
U.S. government, corporate bonds, and other obligations	288,141	59,585	10,750	358,476
Marketable alternatives	70,450	-	-	70,450
Real assets	23,954	-	-	23,954
Subtotal endowment investments ⁽¹⁾	1,829,301	90,364	13,637	1,933,302
Operating investments:				
U.S. government, corporate bonds, and other obligations	300,452	58,758	-	359,210
Other	1,741	-	21,984	23,725
Endowed funds held by third parties	-	-	23,591	23,591
Total assets	\$ 2,162,922	\$ 163,503	\$ 59,212	\$ 2,385,637
Liabilities				
Interest rate swaps	\$ -	\$ 56,789	\$ -	\$ 56,789
2017				
	Level 1	Level 2	Level 3	Total
	<i>(in thousands of dollars)</i>			
Assets				
Cash and cash equivalents	\$ 21,173	\$ 1,321	\$ -	\$ 22,494
Endowment investments:				
Cash and cash equivalents	57,510	41,622	-	99,132
Domestic equities	615,254	12,975	-	628,229
International equities	708,761	-	4,301	713,062
U.S. government, corporate bonds, and other obligations	278,319	56,641	9,348	344,308
Marketable alternatives	71,436	-	-	71,436
Real assets	13,528	-	-	13,528
Subtotal endowment investments ⁽¹⁾	1,744,808	111,238	13,649	1,869,695
Operating investments:				
U.S. government, corporate bonds, and other obligations	412,748	88,719	-	501,467
Other	1,699	-	18,713	20,412
Endowed funds held by third parties	-	-	22,944	22,944
Total assets	\$ 2,180,428	\$ 201,278	\$ 55,306	\$ 2,437,012
Liabilities				
Interest rate swaps	\$ -	\$ 77,315	\$ -	\$ 77,315

⁽¹⁾ The subtotals of endowment investments within the fair value tables above exclude investments of \$2,293,028 and \$2,100,352 as of June 30, 2018 and 2017, respectively, which are measured at NAV as a practical expedient and are not classified in the fair value hierarchy (see Note 4).

The following table summarizes the change in the Level 3 activity for the years ended June 30, 2018 and 2017:

	International Equities	U.S. Government Corporate and Other	Other Operating and Endowed Funds Held by Third Parties	Total
	<i>(in thousands of dollars)</i>			
Fair Value - June 30, 2016	\$ 7,796	\$ 3,780	\$ 40,176	\$ 51,752
Capital calls/purchases	-	5,380	1,537	6,917
Distributions/sales	(3,018)	-	(638)	(3,656)
Transfers out	(1,275)	-	-	(1,275)
Realized gains	675	-	-	675
Unrealized gains	123	188	582	893
Fair Value - June 30, 2017	4,301	9,348	41,657	55,306
Capital calls/purchases	-	1,175	3,366	4,541
Distributions/sales	(1,340)	-	(1,155)	(2,495)
Realized gains	144	-	-	144
Unrealized (losses) gains	(218)	227	1,707	1,716
Fair Value - June 30, 2018	\$ 2,887	\$ 10,750	\$ 45,575	\$ 59,212

Realized and unrealized gains (losses) for Level 3 activity are reported in other activities in the Consolidated Statements of Activities. Unrealized gains related to

investments held at June 30, 2018 and 2017 were \$1.0 million and \$0.03 million, respectively.

NOTE 6: PROPERTY, PLANT, AND EQUIPMENT, NET

Property, plant, and equipment, net, at June 30 is summarized below:

	2018	2017
	<i>(in thousands of dollars)</i>	
Land	\$ 63,849	\$ 63,533
Buildings and improvements	3,247,659	3,150,047
Equipment	783,323	746,030
Library books	297,372	287,073
Works of art, historical treasures, and similar assets	21,555	20,949
Construction in progress	185,442	120,102
Subtotal	4,599,200	4,387,734
Less: Accumulated depreciation	(2,765,071)	(2,604,638)
Total property, plant, and equipment, net	\$ 1,834,129	\$ 1,783,096

The amount capitalized in property, plant, and equipment related to expenditures funded by the commonwealth on behalf of the University totaled \$757.5 million and \$729.5 million at June 30, 2018 and 2017, respectively. The net book value of these items was \$333.9 million and \$331.5 million at June 30, 2018 and 2017, respectively.

The University has recognized a liability for conditional asset retirement obligations. The University performed an analysis of such obligations and determined that asbestos remediation costs represented the primary source of the liability. The University reviewed facilities on all campuses and estimated the timing, method, and cost of remediation. The resulting liability for conditional asset remediation obligations recognized at June 30, 2018 and 2017 was \$29.8 million and \$30.6 million, respectively.

NOTE 7: BONDS AND NOTES PAYABLE

Bonds and notes payable at June 30 are reported based upon outstanding principal and consist of the following:

	Range of Years Remaining to Maturity	2018 Effective Interest Rates	Outstanding Principal	
			<i>(in thousands of dollars)</i>	
			2018	2017
Variable-rate bonds:				
Series 2017-C1, taxable	13-21	1.04%-2.11%	\$ 55,000	\$ 55,000
Series 2017-C2, taxable	21-23	1.04%-2.10%	55,000	55,000
Series 2017-C3, taxable	14-19	1.04%-2.17%	50,000	50,000
Series 2014-B1/B2, tax-exempt	7-17	0.80%-1.65%	46,000	46,000
Total variable-rate bonds			206,000	206,000
Fixed-rate bonds and notes:				
Series 2017-A, taxable	3 mos.-18	1.00%-3.65%	477,500	512,480
Series 2017-B, taxable	3 mos.-12	0.91%-3.60%	103,335	104,380
Series 2014-A, tax-exempt	18-26	3.51%-3.65%	49,000	49,000
Series 2016 PANTHERS™ Notes, due August 15, 2017		0.60%	-	70,000
Noninterest-bearing promissory note			171	171
Total fixed-rate bonds and notes			630,006	736,031
Unamortized net premium			1,335	1,517
Debt issuance costs			(3,921)	(4,169)
Total bonds and notes payable			\$ 833,420	\$ 939,379

The principal payments of bonds and notes payable for the next five years ending June 30 in millions of dollars are:

2019	\$ 43.6
2020	\$ 42.6
2021	\$ 41.8
2022	\$ 41.2
2023	\$ 39.4

The foregoing principal payments do not include \$206.0 million of variable-rate demand bonds (VRDBs) in commercial paper (CP) mode, all of which have final maturity dates between 2030 and 2041. These bonds bear short-term rates that are fixed over staggered periods of approximately 45 days each and are remarketed at the expiry of their respective rate periods.

Liquidity support for the \$206.0 million of outstanding VRDBs in CP mode is provided by the University. In the event that the University receives notice of an optional tender on its VRDBs in CP mode, the tendered bonds will be purchased with remarketing proceeds. If the remarketing proceeds are insufficient to purchase all tendered bonds, the University would have a current obligation to meet the shortfall. As an additional source of liquidity for this situation, the University entered into a \$40.0 million unsecured standby liquidity agreement with a financial institution that matures in June 2019. Since the University commenced providing self-liquidity in October 2009, there have been no failed remarketings.

On January 17, 2017, the University issued \$512.5 million fixed-rate Taxable University Refunding Bonds (Series 2017-A). The proceeds were used to fund an escrow account that was irrevocably placed with a trustee to meet the principal and interest payments of the Series 2000-A/B/C (\$124.4 million), Series 2002-A (\$20.0 million), Series 2002-B (\$14.5 million) and Series 2009-A/B (\$290.3 million) fixed-rate bonds until their respective first call date and to redeem \$15.0 million tax-exempt Series 2002-B VRDBs in CP mode. The Series 2017-A bonds were issued at par.

On March 21, 2017, the University issued \$104.4 million fixed-rate Taxable University Refunding Bonds (Series 2017-B). The proceeds were used to fund an escrow account that was irrevocably placed with a trustee to meet the principal and interest payments of the Series 2005-A (\$35.0 million) and Series 2007-B (\$60.0 million) fixed-rate bonds until their respective first call date. The Series 2017-B bonds were issued at par.

The Series 2017-A and Series 2017-B refundings (A/B refundings) referenced above meet the legal requirements for defeasance of bond liabilities. Therefore, neither the

escrow accounts nor the refunded bonds are included in the Consolidated Balance Sheet at June 30, 2017. The A/B refundings resulted in a \$46.5 million reduction to net assets, which is reflected in the other activities section of the Consolidated Statement of Activities for the year ended June 30, 2017. This reduction in net assets represents the amount of principal required from the A/B refundings in excess of the face value of the refunded bonds, net of interest expense up to the date of the refundings and new debt issuance costs. A \$5.5 million write-off of debt issuance costs and net premiums associated with the refunded bonds is reflected as a net decrease in interest expense in the Consolidated Statement of Activities for the year ended June 30, 2017.

On May 4, 2017, the University issued \$160.0 million in Taxable University Refunding Bonds (Series 2017-C); such bonds were issued as VRDBs in CP mode. The proceeds were used to redeem \$159.6 million tax-exempt Series 2005-A/B/C and Series 2007-B VRDBs at their CP maturity date.

In August 2018, the University issued its Pitt Asset Notes – Tax-Exempt Higher Education Registered Series of 2018 (Series 2018 PANTHERS™ Notes) in the amount of \$110.0 million to reimburse the University for prior capital and equipment expenditures. These three-year floating rate notes will mature on September 15, 2021.

The \$70.0 million Series 2016 PANTHERS™ Notes, issued in July 2016, were repaid on August 15, 2017.

The University had four general unsecured credit facilities aggregating \$100.0 million at June 30, 2018. No draws were made under the facilities during 2018 or 2017. Although each of the four credit facilities carry an expiry date of October 23, 2018, it is management's intention to extend each facility for another 364-day term.

Interest costs incurred in 2018 and 2017 were \$30.2 million and \$31.3 million, respectively. Included in these amounts are net swap payments and capitalized interest associated with various construction projects. Capitalized interest for 2018 and 2017 was \$0.5 million and \$0.7 million, respectively.

NOTE 8: DERIVATIVE AND OTHER FINANCIAL INSTRUMENTS

The University does not issue or trade derivative financial instruments except as described herein. University financial assets are invested on its behalf with various investment managers, some of whom are authorized to employ derivative instruments, including swaps, futures, forwards, and options. These derivatives are generally used for managing interest rate or foreign currency risk or to attain or hedge a specific financial market position. Additionally, the University has entered into various interest rate swap agreements to hedge its interest rate risk associated with certain debt obligations.

The University may be exposed to financial loss should a derivative counterparty fail to perform pursuant to the instrument. In the case of exchange-traded derivatives, the counterparty is the exchange itself. In the case of over-the-counter derivatives, the counterparty is typically a financial institution. Counterparty risks are mitigated by using creditworthy counterparties, settling positions periodically, and requiring collateral to be posted at predetermined levels of exposure.

Not including University derivative instruments held by various alternative investment funds, the University invested in futures contracts with gross notional values of \$59.8 million and \$50.9 million at June 30, 2018 and 2017, respectively. When the University uses futures to replicate an investment position, it has opted to do so on a fully collateralized basis. Futures contracts are marked-to-market daily based on settlement prices established by the board of trade or exchange on which they are traded. Gains and losses are realized when the contracts expire or are closed. There were unrealized losses on these future contracts of \$0.7 million and \$0.2 million at June 30, 2018 and June 30, 2017, respectively.

The University liabilities arising from variable-to-fixed interest rate swap agreements associated with certain University debt obligations had an aggregated fair value of \$56.8 million and \$77.3 million at June 30, 2018 and 2017, respectively, and are included in other liabilities on the Consolidated Balance Sheets (see also Note 5). The fair value represents the estimated amount the University would be required to pay to terminate these agreements as of the respective fiscal year-end. The University recorded in the Consolidated Statements of Activities unrealized gains of \$20.5 million and \$33.8 million in 2018 and 2017, respectively, due to changes in fair value of the swaps.

The aggregate notional amount of the swap agreements associated with University debt was \$335.3 million and \$350.3 million at June 30, 2018 and 2017, respectively. These swaps were entered into for the sole purpose of hedging interest payable on certain University VRDBs. The variable interest rates received by the University under the swap agreements are either 67% or 70% of one- or three-month London Interbank Offered Rates (LIBOR), while the fixed rates paid by the University range from 3.25% to 5.14%. Net swap payments made or received by the University are reported in interest expense in the Consolidated Statements of Activities. No collateral was called or posted during 2018 or 2017 with respect to these swap agreements. Furthermore, the University does not anticipate posting collateral pursuant to these swap agreements since there are no collateral thresholds applicable to the University given the University's current credit ratings.

NOTE 9: PENSION AND POSTRETIREMENT OBLIGATIONS

Pension

The University provides retirement benefits under contributory or noncontributory plans to substantially all employees. The University's contributory plan provides for participant directed investment in certain investments managed by the Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF) and in certain investment funds of the Vanguard Group. The plan requires three years of service for vesting of the University contribution. Employees hired before January 1, 1995 were immediately vested. University contributions to this plan in 2018 and 2017 were \$82.5 million and \$79.0 million, respectively.

The noncontributory plan is a defined-benefit pension plan that covers employees who do not participate in the contributory plan. The plan was amended to freeze new entrants effective November 3, 2015. The plan provides for vesting after five years with pension benefits accruing at 2.1% of base salary or the Social Security wage base, whichever is lower. Pension benefits are payable upon normal retirement at age 65 or early retirement at age 55, in accordance with the conditions and pension eligibility criteria described in the plan. University contributions to this plan in 2018 and 2017 were \$6.7 million and \$15.0 million, respectively.

Postretirement

The University also provides postretirement medical and life insurance benefits to eligible employees and their spouses upon retirement through a contributory benefit plan.

Though funding is not required, the University has elected to fund its postretirement liability via a quasi-endowment fund, which is managed within the University's pooled endowment investments (see Notes 4 and 10). The fair value of these investments at June 30, 2018 and 2017 was \$455.0 million and \$410.6 million, respectively, and is included in endowment investments on the Consolidated Balance Sheets. Although the University has established this quasi-endowment for the postretirement plan, payments to beneficiaries of this plan are currently made through nonendowed operating funds.

Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, the federal government provides a subsidy to employers equal to 28% of the employer's qualifying prescription drug costs for retirees if the plan offered by the employer is at least actuarially equivalent to Medicare Part D. The University is qualified for and receives the subsidy via a reduction in premiums charged by its provider.

The University uses a measurement date of June 30 for plan assets and the benefit obligations. Information related to the benefit obligation, assets, and funded status of the defined-benefit pension plan and the postretirement benefit plan as of and for the years ended June 30, 2018 and 2017 is summarized in the table below:

	Defined-Benefit Plan		Postretirement Plan	
	2018	2017	2018	2017
	<i>(in thousands of dollars)</i>			
Net periodic benefit cost:				
Service cost	\$ 8,089	\$ 8,136	\$ 19,224	\$ 19,525
Interest cost	6,069	5,851	20,237	20,237
Expected return on plan assets	(9,393)	(7,427)	-	-
Actuarial loss	1,887	3,443	3,637	5,789
Amortization of prior service credit	-	-	-	(4,025)
Net periodic benefit cost	\$ 6,652	\$ 10,003	\$ 43,098	\$ 41,526
Funded status:				
Benefit obligation at beginning of year	\$ 156,877	\$ 151,266	\$ 528,040	\$ 541,785
Service cost	8,089	8,136	19,224	19,525
Interest cost	6,069	5,851	20,237	20,237
Actuarial gains	(4,783)	(7,000)	(19,003)	(36,470)
Benefits paid	(1,273)	(1,376)	(16,878)	(17,037)
Benefit obligation at end of year	\$ 164,979	\$ 156,877	\$ 531,620	\$ 528,040
Fair value of plan assets at beginning of year	\$ 130,831	\$ 103,666		
Actual return on plan assets	9,801	13,537		
Actual plan contributions	6,652	15,004		
Benefits paid	(1,273)	(1,376)		
Fair value of plan assets at end of year	\$ 146,011	\$ 130,831		
Funded status – liability recognized on Consolidated Balance Sheets:				
Pension and postretirement obligations	\$ (18,968)	\$ (26,046)	\$ (531,620)	\$ (528,040)
Accumulated benefit obligation	\$ 157,471	\$ 149,723		

Estimated 2019 employer contribution to the defined-benefit plan:
(in thousands of dollars)

\$ 4,907

	Defined-Benefit Plan		Postretirement Plan	
	2018	2017	2018	2017
Weighted-average assumptions used to determine the benefit obligation (liability) at June 30:				
Discount rate	4.25%	3.9%	4.25%	3.9%
Rate of compensation increase	3.0%	3.0%	-	-
Assumed health care trend cost:				
Initial trend – pre-age 65 retirees	-	-	7.0%	7.0%
Initial trend – post-age 65 retirees	-	-	6.0%	7.0%
Ultimate trend	-	-	4.5%	4.5%
Year to reach ultimate	-	-	2026	2025

Weighted-average assumptions used to determine the net periodic cost (expense) for the years ended June 30:

Discount rate	3.9%	3.9%	3.9%	3.8%
Rate of compensation increase	3.0%	3.0%	-	-
Expected long-term return on plan assets	7.25%	7.25%	-	-
Assumed health care trend cost:				
Initial trend – pre-age 65 retirees	-	-	7.0%	7.0%
Initial trend – post-age 65 retirees	-	-	7.0%	7.0%
Ultimate trend	-	-	4.5%	4.5%
Year to reach ultimate	-	-	2025	2024

	Defined-Benefit Plan	Postretirement Plan
Estimated future benefit payments:		
	<i>(in thousands of dollars)</i>	
2019	\$ 2,913	\$ 18,034
2020	\$ 3,310	\$ 21,148
2021	\$ 3,749	\$ 22,404
2022	\$ 4,206	\$ 24,215
2023	\$ 4,767	\$ 25,765
2024 - 2028	\$ 31,627	\$ 151,197

A one-percentage point change in assumed health care cost trend rates would have the following effects on the postretirement plan:

	Increase		Decrease	
	(in millions of dollars)			
	Revised Amount	Percent Change	Revised Amount	Percent Change
Service and interest cost (medical component only)	\$ 37.5	2.3%	\$ 35.8	2.4%
Total periodic benefit cost	\$ 44.7	3.8%	\$ 41.3	4.1%
Benefit obligation for health care benefits	\$ 502.0	3.0%	\$ 470.8	3.4%
Total benefit obligation	\$ 546.5	2.8%	\$ 515.1	3.1%

Pension Assets

Assets related to the University's defined-benefit pension plan are segregated in a trust managed by a third-party investment manager. The fair value of these assets at June 30, 2018 and 2017 was \$146.0 million and \$130.8 million, respectively. The fund is invested through common collective trust funds in domestic and international equities and fixed-income securities using the S&P 500 Index as a benchmark for domestic equities, the MSCI EAFE Index for international equities, and the Barclays Intermediate Government/Credit Bond Index for the fixed-income securities. Common collective trust funds are similar to mutual funds; however, they are generally not registered with the U.S. Securities and Exchange Commission and participation is not open to the public but limited to institutional investors. The specific investment objective is to meet or exceed the investment policy benchmark over the long term. Plan investments are determined using NAV per share available at the measurement date, as published by the fund manager. The plan has no unfunded commitments. Pension plan assets are Level 1 in the fair value hierarchy.

The long-term investment strategy for pension plan assets is to meet present and future benefit obligations to all

participants and beneficiaries; cover reasonable expenses incurred to provide such benefits, including expenses incurred in the administration of the trust and the plan; provide sufficient liquidity to meet benefit and expense payment requirements on a timely basis; and provide a total return that, over the long term, maximizes the ratio of trust assets to liabilities by maximizing investment return, at an appropriate level of risk. The expected return on plan assets is based on a weighted average of the individual expected return for each asset category in the plan's portfolio. Expected return comprises inflation plus the real rate of return for each asset class.

Over the long term, asset allocation is believed to be the single greatest determinant of risk and return. Asset allocation will deviate from the target percentages due to market movement, cash flows, and investment manager performance. Material deviations from the asset allocation target can alter the expected return and risk of the trust. However, frequent rebalancing to the asset allocation targets may result in significant transaction costs, which can impair the trust's ability to meet its investment objective.

The target allocation for both fiscal years and the fair value of the University's pension plan assets at June 30, by asset category, were as follows:

Asset class:	Target	2018	2017
	Allocation	<i>(in thousands of dollars)</i>	
Equity securities:			
Stock index and small cap	35%	\$ 50,326	\$ 45,684
International	35%	51,049	45,748
Debt securities	30%	44,136	39,098
Cash and cash equivalents	-	500	301
Total pension plan assets		\$ 146,011	\$ 130,831

NOTE 10: ENDOWMENT NET ASSETS

The commonwealth has not adopted The Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and, instead, enacted in December 1998 Pennsylvania Act 141 (codified as Title 15 of the Pennsylvania Consolidated Statutes §5548(c) and referred to herein as Title 15) to govern the investment of restricted funds held in trust by Pennsylvania nonprofit corporations. Title 15 permits Pennsylvania nonprofit corporations to elect a total return approach for determining income distributions from restricted funds held in trust, whereby income is defined as a stipulated percentage of the value of the assets held; the stipulated percentage must be determined at least annually and may be no less than 2% nor more than 7%, and the value of the assets held must be averaged over a period of three or more preceding years. A resolution to elect a total return approach for determining endowment income distributions for the University's consolidated investment pool was passed by the University's Board of Trustees on October 21, 1999. The University's endowment income distribution is determined annually using a stipulated

percentage of 4.25% of the endowment's three-year average fair value, provided that such distribution is not less than the amount distributed in the previous year. The endowment income distribution amounts for 2018 and 2017 were approximately 4.26% and 4.25%, respectively, of the endowment's three-year average fair value.

Employing the total return approach, the University records the original value of an endowed contribution as a permanently restricted asset, along with any endowment income distributions that are reinvested in the endowment. Nonendowed funds that lack third-party donor restrictions but function as endowments (quasi-endowments) are classified as unrestricted net assets. Gains and losses attributable to donor-restricted endowed funds are recorded as temporarily restricted net assets, whereas gains and losses attributable to quasi-endowment funds are recorded as unrestricted net assets.

The University's endowment net assets at June 30 were as follows:

2018				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(in thousands of dollars)</i>			
Donor-restricted endowment funds	\$ -	\$ 865,510	\$ 742,250	\$ 1,607,760
Quasi-endowment funds	2,617,544	-	-	2,617,544
Total endowment net assets	\$ 2,617,544	\$ 865,510	\$ 742,250	\$ 4,225,304
2017				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(in thousands of dollars)</i>			
Donor-restricted endowment funds	\$ -	\$ 801,566	\$ 713,522	\$ 1,515,088
Quasi-endowment funds	2,439,453	-	-	2,439,453
Total endowment net assets	\$ 2,439,453	\$ 801,566	\$ 713,522	\$ 3,954,541

The change in endowment net assets for the years ended June 30, 2018 and 2017 was as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(in thousands of dollars)</i>			
Endowment net assets – June 30, 2016	\$ 2,163,439	\$ 686,118	\$ 684,922	\$ 3,534,479
Endowment return:				
Endowment earnings	17,146	-	2,057	19,203
Gains	326,039	115,448	117	441,604
Total endowment return	343,185	115,448	2,174	460,807
Contributions	497	-	26,426	26,923
Distributions for operations	(126,472)	-	-	(126,472)
Net transfers	58,804	-	-	58,804
Endowment net assets – June 30, 2017	2,439,453	801,566	713,522	3,954,541
Endowment return:				
Endowment earnings	15,285	-	1,495	16,780
Gains	262,111	63,944	110	326,165
Total endowment return	277,396	63,944	1,605	342,945
Contributions	270	-	27,123	27,393
Distributions for operations	(136,144)	-	-	(136,144)
Net transfers	36,569	-	-	36,569
Endowment net assets – June 30, 2018	\$ 2,617,544	\$ 865,510	\$ 742,250	\$ 4,225,304

Approximately 99% of the University's endowment funds are collectively managed in a broadly diversified pool of assets called the consolidated investment pool. The Investment Committee of the Board of Trustees

provides general oversight, policy guidance, and performance review of the consolidated investment pool and approves asset allocation and spending policies.

NOTE 11: FUNCTIONAL EXPENSES

The University accounts for expenses according to major classes of program services or functions. Functional expenses for the years ended June 30 consist of the following:

	2018	2017
	<i>(in thousands of dollars)</i>	
Instruction	\$ 600,751	\$ 581,624
Research	752,423	707,495
Public service	83,908	85,899
Academic support	219,644	205,833
Libraries	46,652	47,342
Student services	176,399	166,434
Institutional support	152,173	145,404
Auxiliary enterprises	143,711	143,968
Total functional expenses	\$ 2,175,661	\$ 2,083,999

Costs related to the operation and maintenance of property, including depreciation of property and equipment and interest on related debt, are primarily allocated to program and support activities based upon salary effort.

NOTE 12: RELATED PARTIES

The University has relationships and affiliation agreements with separately incorporated entities including UPMC and affiliated hospitals and UPP. These relationships include a common paymaster arrangement for certain University School of Medicine (SOM) faculty with academic and clinical responsibilities; contractual

obligations for UPMC and UPP to support certain educational and research functions at the University; and property rental agreements. There is no guarantee these agreements will be renewed in future periods. Transactions with all related entities are conducted in the ordinary course of business and are discussed below.

The following summarizes the significant related party transactions between the University and UPMC for the years ended June 30, 2018 and 2017:

Service Agreement	Location on the Consolidated Financial Statements	2018 <i>(in thousands of dollars)</i>	2017 <i>(in thousands of dollars)</i>
Common paymaster arrangement ^(a)	Net on balance sheet	\$ 113,878	\$ 122,174
Facilities-related services, mail, telephone, printing, and other services ^(a)	Net on balance sheet	15,249	14,628
Net balance sheet transactions with UPMC		\$ 129,127	\$ 136,802
UPMC dean's tax, Children's Hospital of Pittsburgh, and other academic support ^(b)	Sales and services, educational and other	\$ 84,642	\$ 88,498
UPMC academic affiliation agreement ^(c)	Other revenue	30,500	30,000
Commonwealth and federal funds for medical assistance services that pass through UPMC ^(d)	Commonwealth appropriation	13,174	12,126
Rental revenue ^(e)	Rental revenue	10,226	10,164
UPMC Hillman Cancer Center research support payments ^(f)	Other revenue	10,039	14,444
Cost sharing for Medical and Health Sciences Foundation ^(g)	Other revenue	3,644	3,577
Institute for Personalized Medicine	Other revenue	1,946	2,346
Police services	Other revenue	685	2,436
Revenues from UPMC		\$ 154,856	\$ 163,591
Health insurance coverage for University employees ^(h)	Fringe benefits	\$ 124,970	\$ 118,365
WPIC and UPMC Hillman Cancer Center research services ⁽ⁱ⁾	Primarily compensation	26,258	23,096
Rental expense paid to UPMC ^(e)	Other expense	23,332	21,894
Expenses paid to UPMC		\$ 174,560	\$ 163,355

- (a) Certain University SOM faculty and staff provide clinical services through their University appointments to UPMC, UPP, and affiliated hospitals. The University invoices these entities monthly for reimbursement of the clinical portion of the associated compensation costs. SOM faculty members, having both a University academic appointment and a separate, external appointment for clinical responsibilities, participate in the common paymaster arrangement for purposes of determining appropriate FICA taxation. In addition to the reimbursable compensation costs, the University also engages in other transactions with these entities, which include providing certain facilities-related services, telephone, mailing, printing, and various other services, which are reimbursed at cost.

- (b) UPMC provides support to the SOM for the School's general academic mission, research, new programs, and faculty recruitment, and to augment operating budgets for certain departments that do not generate sufficient revenues to meet their academic and research costs. Additionally, UPMC provides financial support to the SOM through the Children's Hospital of Pittsburgh of UPMC (CHP), which supports pediatric research programs.
- (c) The University signed an agreement with UPMC that included financial commitments designed to further the two entities' commitment to their interrelated teaching, research, clinical care, and community service missions. As part of the agreement, UPMC provides annual funding for the SOM.
- (d) UPMC receives commonwealth and federal matching funds, and remits these funds to the University, for costs incurred by academic medical centers for medical assistance services. The funds are remitted to the University to support the activities of the SOM, the Western Psychiatric Institute and Clinic (WPIC), the Center for Public Health Practice, and the clinic within the School of Dental Medicine.
- (e) The University is involved in certain rental arrangements in which the University acts as both lessor or lessee with UPMC and its affiliates.
- (f) UPMC provides support payments to the UPMC Hillman Cancer Center (UHCC) for various subsidies, research initiatives, and general support.
- (g) In 2003, the University and UPMC created the Medical and Health Sciences Foundation (MHSF), a separate 501(c)(3) organization. The MHSF serves as a unified fundraising organization for the University's schools of the health sciences and UPMC. The arrangement calls for the cost of MHSF to be split between the University and UPMC.
- (h) UPMC serves as the provider of health insurance coverage to all eligible University employees who enroll in the plan. The University is self-insured for these costs and reimburses UPMC for actual claims cost.
- (i) The University has an arrangement with UPMC whereby certain research-related costs incurred by UPMC (primarily staff compensation) in relation to WPIC and UHCC research awards are charged to such awards via an electronic billing and reimbursed to UPMC each month.

A lease arrangement exists between the University and the commonwealth for WPIC. Since 1949, the University has managed WPIC under an agreement between the University and the commonwealth whereby the University rents for a consideration of \$1 per year the land, building, equipment, and other items that are used by WPIC. The agreement provides for continuing terms of 10 years each; however, this agreement is cancelable by either party on one year's written notice. In 1992, the University subleased to UPMC the land, building,

equipment, and other items subject to the current lease arrangement between the commonwealth and the University. This sublease arrangement continued to be in effect during 2018 and 2017. Included in property, plant, and equipment is \$193.2 million and \$191.9 million at June 30, 2018 and 2017, respectively, related to the land, buildings, and equipment used by WPIC. Accumulated depreciation related to these assets totaled \$167.6 million and \$163.8 million at June 30, 2018 and 2017, respectively.

NOTE 13: COMMITMENTS AND CONTINGENCIES

At June 30, 2018 and 2017, the University had outstanding contractual commitments of \$66.1 million and \$75.6 million, respectively, for property, plant, and equipment expenditures.

The University engages in various leasing activities as both a lessor and lessee. Rental revenue from operating leases was \$18.4 million and \$18.3 million in 2018 and 2017, respectively. Rental expense for operating leases was \$49.8 million in 2018 and \$47.8 million in 2017. Minimum future rental revenue and expense under operating leases that have initial or remaining noncancelable lease terms for the years ended June 30 are as follows:

	Rental Revenue	Rental Expense
	<i>(in thousands of dollars)</i>	
2019	\$ 17,020	\$ 50,253
2020	\$ 8,605	\$ 40,693
2021	\$ 8,113	\$ 26,348
2022	\$ 5,401	\$ 20,487
2023	\$ 3,753	\$ 18,459
Thereafter	\$ 9,382	\$ 97,490

The University is a defendant in a number of legal actions seeking damages and other relief from the University. While the final outcome of each action cannot be determined at this time, legal counsel and University management are of the opinion that the liability, if any, in these legal actions will not have a material adverse effect on the University's consolidated financial statements.

The University receives significant financial assistance from the federal government including the sponsorship of federal research projects. Grants and contracts normally

provide for the recovery of direct and indirect costs. Recovery of indirect costs is recorded at predetermined rates negotiated with the federal government. Entitlement to these resources for the recovery of the applicable direct and related indirect costs is generally conditioned upon compliance with the terms and conditions of the grant or contract agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants and contracts, and the University's indirect cost rate, are subject to financial and compliance reviews and audits by the grantors. In management's opinion, the likelihood of a material adverse outcome on the University's financial position from those reviews and audits is remote.

As part of ongoing operations, the University enters into utility contracts to secure electric and natural gas rates. These contracts are with various utility suppliers and some of the contracts cover multiple years. The University monitors the energy markets on an ongoing basis and will make commitments on new rates if deemed in the best interest of the University.

The University conducts a review of contracts and agreements that may contain guarantees, including loan guarantees such as standby letters of credit and indemnifications. In certain contracts, the University agrees to indemnify a third-party service provider under certain circumstances. Pursuant to its bylaws, the University provides indemnification to directors, officers, and, in some cases, employees and agents against certain liabilities incurred as a result of service provided on behalf of or at the request of the University. The terms of indemnity vary from agreement to agreement, and the amount of indemnification, if any, cannot be reasonably determined.

NOTE 14: SUBSEQUENT EVENTS

The University has evaluated subsequent events through September 21, 2018, the date on which the consolidated financial statements were issued, and determined that

there were no subsequent events requiring additional disclosure or adjustment to the consolidated financial statements.

MEMBERSHIP OF THE BOARD OF TRUSTEES FISCAL YEAR 2018

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<p>MEMBER EX OFFICIO (VOTING)</p> <p>Patrick Gallagher, Chancellor and Chief Executive Officer</p>	<p>SPECIAL TRUSTEES</p> <p><i>2015 – 19</i> G. Nicholas Beckwith III Louis R. Cestello Thomas M. Kurtz Jeannine T. Schoenecker</p> <p><i>2016 – 20</i> David C. Chavern Robert M. Hernandez Marlee S. Myers Shawndya L. Simpson</p> <p><i>2017 – 21</i> Douglas M. Browning Deborah J. Gillotti Tamara M. Haddad Vacant</p> <p><i>2018 – 22</i> David J. Morehouse Michael G. Wells Marna Cupp Whittington Vacant</p>	<p>COMMONWEALTH TRUSTEES</p> <p><i>G: Governor appointment H: House appointment S: Senate appointment</i></p> <p><i>2015 – 19</i> Jake Wheatley Jr. (G) Herbert S. Shear (H) Peter C. Varischetti (S)</p> <p><i>2016 – 20</i> Bradley J. Franc (G) Thomas O. Johnson II (H) Jay Costa Jr. (S)</p> <p><i>2017 – 21</i> Sy Holzer (G) Thomas VanKirk (H) William K. Lieberman (S)</p> <p><i>2018 – 22</i> Vacant (G) John A. Maher III (H) John J. Verbanac (S)</p>	
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The consolidated financial statements have been reviewed and approved by the University's Audit Committee. The Audit Committee is comprised of outside directors having requisite financial expertise and meets regularly with University management and both internal and external auditors to review internal accounting controls, audit issues, and financial reporting matters. The committee meets with the external auditors in private sessions and is also responsible for approving the independent auditing firm retained each year. Nonvoting representatives on the committee include members of the University's administration as well as student, faculty, and staff representatives.