

Washington University
Consolidated Financial Statements
June 30, 2017 and 2016

Washington University
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June 30, 2017 and 2016

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Report of Independent Auditors

To the Board of Trustees of Washington University:

We have audited the accompanying consolidated financial statements of Washington University and its subsidiaries (the “university”), which comprise the consolidated statements of financial position as of June 30, 2017 and 2016, and the related consolidated statements of activities and changes in net assets and of cash flows for the years then ended.

Management’s Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; 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 the 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 our 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, we consider internal control relevant to the university’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 university’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 Washington University and its subsidiaries 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 accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

September 26, 2017

Washington University
Consolidated Statements of Financial Position
Years Ended June 30, 2017 and 2016

(thousands of dollars)

	2017	2016
Assets		
Cash and cash equivalents	\$ 128,870	\$ 173,443
Investments	8,522,943	7,741,742
Collateral received for securities lending	178,231	43,845
Accounts and notes receivable, net	463,682	457,327
Pledges receivable, net	202,762	226,876
Other assets	191,768	159,338
Fixed assets, net	2,331,063	2,278,488
Total assets	<u>\$ 12,019,319</u>	<u>\$ 11,081,059</u>
Liabilities		
Accounts payable and accrued expenses	\$ 439,939	\$ 393,015
Liabilities under securities lending transactions	173,889	43,458
Deposits, advances and other	20,760	17,197
Professional liability	69,106	79,107
Deferred revenue	121,386	103,223
Liabilities under split-interest agreements	35,048	38,357
Government supported student loans	44,810	45,565
Notes and bonds payable	1,632,202	1,616,356
Total liabilities	<u>2,537,140</u>	<u>2,336,278</u>
Net assets		
Unrestricted	4,738,453	4,337,246
Temporarily restricted	2,942,867	2,699,302
Permanently restricted	1,800,859	1,708,233
Total net assets	<u>9,482,179</u>	<u>8,744,781</u>
Total liabilities and net assets	<u>\$ 12,019,319</u>	<u>\$ 11,081,059</u>

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

Washington University

Consolidated Statement of Activities

Year Ended June 30, 2017

<i>(thousands of dollars)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	June 30, 2017 Total
Revenues				
Tuition and fees, gross	\$ 626,033	\$ -	\$ -	\$ 626,033
Less: Scholarships	(232,546)			(232,546)
Tuition and fees, net	393,487	-	-	393,487
Endowment spending distribution	298,994	6,596		305,590
Investment income	12,174	369		12,543
Gifts	75,839	107,461		183,300
Grants and contracts revenues				
Direct costs recovered	408,630			408,630
Facilities and administrative costs recovered	144,988			144,988
Patient services, net	1,194,694			1,194,694
Auxiliary enterprises - sales and services	115,768			115,768
Educational activities - sales and services	156,775			156,775
Affiliated hospital revenues	116,731			116,731
Other revenue	35,849			35,849
Net assets released from restriction	127,438	(127,438)		-
Total revenues and other support	<u>3,081,367</u>	<u>(13,012)</u>	<u>-</u>	<u>3,068,355</u>
Expenses				
Instruction	1,812,306			1,812,306
Research	507,786			507,786
Academic support	185,692			185,692
Student services	88,918			88,918
Institutional support	146,386			146,386
Auxiliary enterprises expenditures	115,088			115,088
Other deductions	37,237			37,237
Total expenses	<u>2,893,413</u>	<u>-</u>	<u>-</u>	<u>2,893,413</u>
Net operating results	<u>187,954</u>	<u>(13,012)</u>	<u>-</u>	<u>174,942</u>
Non-operating revenues and (expenses)				
Investment returns net of endowment spending	232,055	256,987	3,691	492,733
Permanently restricted gifts			68,466	68,466
Gain (loss) on fixed asset disposals and other	(42,563)	(3,983)	10,219	(36,327)
Fair value of assets acquired in excess of consideration paid	23,761	3,573	10,250	37,584
Non-operating, net	<u>213,253</u>	<u>256,577</u>	<u>92,626</u>	<u>562,456</u>
Change in net assets	401,207	243,565	92,626	737,398
Net assets				
Beginning of the year	4,337,246	2,699,302	1,708,233	8,744,781
End of the year	<u>\$ 4,738,453</u>	<u>\$ 2,942,867</u>	<u>\$ 1,800,859</u>	<u>\$ 9,482,179</u>

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

Washington University

Consolidated Statement of Activities

Year Ended June 30, 2016

<i>(thousands of dollars)</i>	Unrestricted	Temporarily Restricted	Permanently Restricted	June 30, 2016 Total
Revenues				
Tuition and fees, gross	\$ 601,888	\$ -	\$ -	\$ 601,888
Less: Scholarships	(221,218)			(221,218)
Tuition and fees, net	380,670	-	-	380,670
Endowment spending distribution	280,914	5,644		286,558
Investment income	8,653	386		9,039
Gifts	52,971	108,080		161,051
Grants and contracts revenues				
Direct costs recovered	379,408			379,408
Facilities and administrative costs recovered	133,786			133,786
Patient services, net	1,106,349			1,106,349
Auxiliary enterprises - sales and services	106,270			106,270
Educational activities - sales and services	164,232			164,232
Affiliated hospital revenues	112,529			112,529
Other revenue	36,730			36,730
Net assets released from restriction	101,500	(101,500)		-
Total revenues and other support	<u>2,864,012</u>	<u>12,610</u>	<u>-</u>	<u>2,876,622</u>
Expenses				
Instruction	1,704,956			1,704,956
Research	474,337			474,337
Academic support	175,261			175,261
Student services	82,444			82,444
Institutional support	139,263			139,263
Auxiliary enterprises expenditures	112,900			112,900
Other deductions	30,416			30,416
Total expenses	<u>2,719,577</u>	<u>-</u>	<u>-</u>	<u>2,719,577</u>
Net operating results	<u>144,435</u>	<u>12,610</u>	<u>-</u>	<u>157,045</u>
Non-operating revenues and (expenses)				
Investment returns net of endowment spending	(214,574)	(335,613)	(1,598)	(551,785)
Permanently restricted gifts			99,976	99,976
Gain (loss) on fixed asset disposals and other	(12,708)	2,925	661	(9,122)
Non-operating, net	<u>(227,282)</u>	<u>(332,688)</u>	<u>99,039</u>	<u>(460,931)</u>
Change in net assets	<u>(82,847)</u>	<u>(320,078)</u>	<u>99,039</u>	<u>(303,886)</u>
Net assets				
Beginning of the year	4,420,093	3,019,380	1,609,194	9,048,667
End of the year	<u>\$ 4,337,246</u>	<u>\$ 2,699,302</u>	<u>\$ 1,708,233</u>	<u>\$ 8,744,781</u>

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

Washington University

Consolidated Statements of Cash Flows

Years Ended June 30, 2017 and 2016

(thousands of dollars)

	2017	2016
Cash flows from operating activities		
Change in net assets	\$ 737,398	\$ (303,886)
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Realized and unrealized net (gains) and losses on investments	(804,486)	266,824
Depreciation expense	173,987	170,443
Permanently restricted gifts	(68,466)	(99,976)
Investments received as gifts - not permanently restricted	(8,797)	(19,554)
Proceeds from sales of investments received as gifts	8,797	19,554
Debt extinguishment costs	27,738	14,280
Fair value of noncash assets acquired in excess of consideration paid	(37,509)	-
Other noncash adjustments	7,955	(17,270)
Changes in assets and liabilities		
Accounts and notes receivable, net	(19,760)	(43,750)
Pledges receivable, net	26,738	(6,405)
Accounts payable and accrued expenses	55,272	25,741
Deposits and advances	(25,256)	(8,709)
Other assets and liabilities	(7,204)	5,181
Net cash provided by operating activities	<u>66,407</u>	<u>2,473</u>
Cash flows from investing activities		
Proceeds from sales and maturities of investments	6,471,569	3,763,089
Purchases of investments	(6,414,436)	(3,657,852)
Purchases of investments with securities lending collateral	(130,431)	(6,523)
Purchases of fixed assets	(223,272)	(316,322)
Student loans disbursed	(19,558)	(22,074)
Student loan payments received	22,655	23,936
Other	(28)	29
Net cash used in investing activities	<u>(293,501)</u>	<u>(215,717)</u>
Cash flows from financing activities		
Principal payments of debt	(272,093)	(282,394)
Proceeds from long-term debt issuance	288,663	417,842
Contributions restricted for long-term investment	16,601	40,561
Proceeds from sales of investments received as gifts	48,970	56,302
Securities lending collateral received	130,431	6,523
Debt extinguishment costs	(27,738)	(14,280)
Other	(2,313)	(2,101)
Net cash provided by financing activities	<u>182,521</u>	<u>222,453</u>
Net (decrease) increase in cash	(44,573)	9,209
Cash		
Beginning of year	173,443	164,234
End of year	<u>\$ 128,870</u>	<u>\$ 173,443</u>
Supplemental data		
Interest paid in cash	\$ 49,522	\$ 50,432
Noncash activities		
Fair value of assets acquired in excess of consideration paid	(37,509)	-
Contributions of securities and other noncash assets	58,242	91,352
Net change in accounts payable for fixed assets	(6,568)	5,330
Net change in accounts receivable for investments	(678)	(4,516)
Net change in accounts payable for investments	2,483	(1,894)

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

Washington University

Notes to the Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

1. Summary of Significant Accounting Policies

Organization

Washington University in St. Louis (the “university”), is an institution of higher education that, in furtherance of its role as a charitable and educational institution, engages in various activities, including instruction, research and provision of medical care.

Basis of Presentation and Use of Estimates

The consolidated financial statements have been prepared on the accrual basis of accounting. The consolidated financial statements are consolidated to include the accounts of the university and its affiliates.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to, the estimated useful lives of buildings and equipment, the fair value of certain investments (see footnote 2), the degree of precision in calculation of self-insurance reserves and adequacy of allowances for doubtful accounts. Actual results could differ from those estimates.

Net Assets

Resources are classified for accounting and reporting purposes according to externally (donor) imposed restrictions. Descriptions of the net asset categories follow:

- Unrestricted net assets are free of donor-imposed restrictions.
- Temporarily restricted net assets consist of gifts and related earnings that are subject to donor-imposed restrictions or legal stipulations that have not yet been met by actions of the university and/or passage of time.
- Permanently restricted net asset balances include gifts and trusts which, by donor restriction, are required to be held in perpetuity.

Revenues from sources other than contributions and investment returns are reported as increases in unrestricted net assets. Contributions are reported as increases in the appropriate category of net assets, except that contributions which impose restrictions that are met in the same fiscal year they are received are included in unrestricted revenues. Gains and investment income that are limited to specific uses by donor-imposed restrictions are reported as increases in unrestricted net assets if the restrictions are met in the same reporting period as the gains and income are recognized, except for gains and investment income earned by investment of donor-restricted endowments. Such amounts are not reported as unrestricted net assets until appropriated for expenditure. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Consolidated Statements of Activities as net assets released from restrictions. Permanently restricted gifts received are reported in the non-operating section of the Consolidated Statements of Activities. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the university reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service. Expenses are reported as decreases in unrestricted net assets.

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Notes to the Consolidated Financial Statements
Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

Temporarily and permanently restricted net assets are for the following purposes.

	2017		2016	
	Temporarily Restricted	Permanently Restricted	Temporarily Restricted	Permanently Restricted
General activities	\$ 1,996,993	\$ 1,226,591	\$ 1,887,498	\$ 1,156,348
Student assistance	472,681	399,311	406,657	378,457
Buildings and renovations	460,451	150,658	393,738	150,607
Life income	12,742	24,299	11,409	22,821
Total	\$ 2,942,867	\$ 1,800,859	\$ 2,699,302	\$ 1,708,233

Investments

Investment gains (losses) in excess of endowment spending distribution and the unrealized appreciation (depreciation) on investments are reported in the non-operating section of the Consolidated Statements of Activities. Investments acquired by gift or bequest are initially recorded at market or appraised value at the date so acquired.

At June 30, 2017, investments include \$7,582 purchased with unexpended proceeds from the Series 2016 A and Series 2014 A Missouri Health and Educational Facilities Authority (MOHEFA) revenue bonds issued in February 2016 and August 2014, respectively. At June 30, 2016, investments included \$26,775 purchased with unexpended proceeds from the Series 2016 A, Series 2014 A, and Series 2012 A Missouri Health and Educational Facilities Authority (MOHEFA) revenue bonds issued in August 2014 and July 2012, respectively. These funds may only be expended for specific construction project costs and costs of issuance related to the MOHEFA bonds.

Fair Value of Financial Instruments

The carrying amount of accrued investment income, accounts receivable, accounts payable and other various accruals approximate fair value because of the short maturity of these financial instruments. The carrying amount of notes and bonds payable with variable interest rates approximates their fair value because the variable rates reflect current market rates for bonds with similar maturities and credit quality.

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Notes to the Consolidated Financial Statements
Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

Fixed Assets

Fixed assets are stated at cost or at fair market values if received as a gift, less accumulated depreciation, computed on a straight-line basis over the estimated useful lives of the assets. Fixed assets include equipment and other assets acquired through sponsored programs during which title is retained by the resource provider. It is probable the university will be permitted to keep the assets when the program terminates. The cost and accumulated depreciation of fixed assets are removed from the records at the time of disposal. Gains and losses on fixed asset disposals are reported in the non-operating section of the Consolidated Statements of Activities. Fixed assets by classification at June 30, 2017 and 2016 consist of the following:

	<u>2017</u>	<u>2016</u>
Construction in progress	\$ 282,513	\$ 274,644
Land and improvements to land	146,326	137,906
Buildings	3,673,747	3,506,817
Equipment	<u>486,528</u>	<u>493,997</u>
Total cost	4,589,114	4,413,364
Accumulated depreciation	<u>(2,258,051)</u>	<u>(2,134,876)</u>
Total, net	<u>\$ 2,331,063</u>	<u>\$ 2,278,488</u>

Collections

In addition to the Mildred Lane Kemper Art Museum, the university archives rare book collections, works of art, literary works, historical treasures and artifacts. These collections are protected and preserved for public exhibition, education, research and the furtherance of public service. They are neither disposed of for financial gain nor encumbered in any manner. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Financing Receivables

Financing receivables are principally loans made to students or their parents utilizing gifts, endowment payout, and university resources designated for that purpose and from funds provided by the United States government under the Federal Perkins and Health Professional Student Loan programs. Loan funds are reported at estimated realizable value, as it is not practical to determine the fair value of loan fund receivables, which include a large component of federally sponsored student loans. Federally sponsored student loans have significant government restrictions as to marketability, interest rates, and repayment terms. Federal funds are ultimately refundable to the government and are recognized as a liability in the Consolidated Statements of Financial Position (see footnote 5).

The university's loan portfolio includes nearly 10,000 individual loans and is geographically diverse. Loans that are made are due on the last business day of the month and are considered past due if the minimum payment is not received within forty-five days subsequent to the due date. At June 30, 2017 and 2016, respectively, 92% and 91% of the parent loans and 80% and 79% of the institutional student loans were considered current. Income earned on financing receivables is recorded on an accrual basis.

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Notes to the Consolidated Financial Statements
Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

Tuition and Financial Aid

Demonstrated financial need is the major criteria for undergraduate students to receive financial aid. Graduate students often receive tuition support in connection with research assistant, teaching assistant and fellowship appointments. Total financial aid granted to students by the university, including aid provided to employees and their dependents, was \$326,646 in 2017 and \$311,863 in 2016. The table below identifies student aid by type. Scholarships are reported net against tuition in the Consolidated Statements of Activities. Other amounts are reported as expenses.

	<u>2017</u>	<u>2016</u>
Scholarships from unrestricted sources	\$ 182,362	\$ 175,468
Scholarship support from gifts, endowment and other restricted sources	<u>50,184</u>	<u>45,750</u>
Total scholarships	232,546	221,218
Employee and dependent tuition benefits	32,628	31,478
Stipends	58,919	56,480
Work study	<u>2,553</u>	<u>2,687</u>
Total	<u>\$ 326,646</u>	<u>\$ 311,863</u>

Contributions

Contributions, including unconditional promises to give, are recognized as revenues in the period the contribution or promise is received. Contributions received for permanent endowments or perpetual trusts are reported as non-operating revenues. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift and, unless instructed otherwise by the donor, are liquidated upon receipt or as soon as practical thereafter.

Conditional gifts and promises to give are not recognized until the conditions on which they depend are substantially met. Contributions, in the form of unconditional promises to give, to be received after one year are discounted at credit-adjusted tax exempt borrowing rates in accordance with fair value accounting. Pledges outstanding are discounted with rates ranging from 0.67% to 1.45%. Amortization of the discount is recorded as contribution revenue. An allowance is made for uncollectible unconditional promises to give based upon management's judgment, past collections experience and other relevant factors.

Washington University
Notes to the Consolidated Financial Statements
Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

A summary of pledges receivable at June 30 is as follows:

	<u>2017</u>	<u>2016</u>
In one year or less	\$ 101,098	\$ 101,526
Between two and five years	99,520	117,127
Over five years	<u>10,543</u>	<u>16,910</u>
	211,161	235,563
Less:		
Discount	(2,792)	(3,350)
Allowance for uncollectible amounts	<u>(5,607)</u>	<u>(5,337)</u>
Total	<u>\$ 202,762</u>	<u>\$ 226,876</u>

Patient Services Revenue

The university recognizes revenues in the period in which services are rendered. The university has agreements with third-party payers that provide for payment to the university at amounts that are generally less than its established rates. Accordingly, patient revenue is reported net of contractual allowances, at estimated net realizable amounts from patients, third-party payers and others for services rendered. Also, reported in this caption are cost reimbursements from hospitals for services provided by university personnel in support of the hospital's clinical activities.

Tuition and Fee Revenue

Tuition and fee revenue, net of scholarships, is recorded in the fiscal year in which the educational programs are conducted.

Auxiliary Enterprises – Sales and Services

Auxiliary enterprises sales and services revenue is recorded in the fiscal year in which earned. This revenue is composed primarily of on and off campus housing charges, dining services, and parking and transportation fees.

Educational Activities – Sales and Services

Educational activities sales and services revenue is recorded in the fiscal year in which it is earned. This revenue is composed of a number of activities including clinical trial revenues, management services and salary reimbursements from affiliated hospitals, consulting, laboratory fees, conference center revenues and revenues from licensing and royalties.

Affiliated Hospital Revenues

Affiliated hospital revenue is recorded in the fiscal year in which earned. This revenue is composed of amounts received from affiliated hospitals for various services as more fully described in footnote 10.

Sponsored Programs

The university receives grant and contract revenue from governmental and private sources. Revenue associated with the direct costs of sponsored programs is generally recognized as the related costs are incurred. The university records revenue in unrestricted net assets upon its recovery of direct and indirect costs applicable to those sponsored programs that provide for the full or partial reimbursement of such costs. The recovery of indirect costs, also referred to as

Washington University

Notes to the Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

facilities and administrative costs is based on negotiated rates and represents recoveries of facilities and administrative costs incurred under grants and contracts agreements. Recovery of facilities and administrative costs of Federally sponsored programs is at rates negotiated with the university's cognizant agency, the Department of Health and Human Services. During fiscal 2017, the university and the Federal government operated under an agreement that established facilities and administrative cost reimbursement rates under Federal grants and contracts through June 30, 2017. The university submitted a rate proposal to its cognizant Federal agency for purposes of negotiating a rate to be applied in future years. The university will continue to recover indirect costs based on the previously negotiated rates until proposed rate negotiations are concluded.

Operating Results and Allocation of Certain Expenses

The university's measure of operations as presented in the Consolidated Statements of Activities includes income from tuition and fees, grants and contracts, medical services, contributions for operating programs, the endowment spending distribution and other revenues. Operating expenses are reported on the Consolidated Statements of Activities by functional categories, after allocating costs for operation and maintenance of plant, interest on indebtedness and depreciation expense. Operation and maintenance of plant and depreciation are allocated to functional categories largely based on square footage. Interest expense is allocated based on specific identification of the uses of debt proceeds. Instruction expenses include instruction, departmental research and patient care costs. Operating results exclude investment gains (losses) except for the portion of gains utilized for the endowment spending distribution, permanently restricted gifts, the fair value of net assets acquired in excess of consideration paid, and other non-operating amounts.

Split-Interest Agreements

The university's split-interest agreements with donors consist primarily of charitable gift annuities 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. Contribution revenues for charitable gift annuities and charitable remainder trusts are recognized after recording liabilities for the present value of the estimated future payments to be made to the respective donors and/or other beneficiaries. The discount rate used is a credit-adjusted rate in existence at the date of the gift. The rates used range from 1.02% to 3.03% for 2017 and 1.26% to 3.13% for 2016. Annually, the university records the change in value of split-interest agreements by recording at fair value the assets that are associated with each trust and recalculating the liability for the present value of the estimated future payments to be made to the donors and/or other beneficiaries.

Conditional Asset Retirement Obligation

The asset retirement obligation for the university relates primarily to the removal of asbestos from certain of its buildings. Known asbestos sites are appropriately encapsulated or controlled in accordance with current environmental regulations pending ultimate removal. As of June 30, 2017 and 2016, respectively, \$19,093 and \$17,139 of conditional asset retirement obligations are included within accounts payable and accrued expenses in the Consolidated Statements of Financial Position. Additional obligations recognized, obligations settled, and accretion expense were not material to results reported in the Consolidated Statements of Activities in any year.

Cash and Cash Equivalents

The university considers cash on hand and in banks and all highly liquid financial instruments with an original maturity of 90 days or less, except those amounts assigned to and invested by its

Washington University

Notes to the Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

investment managers, which amounts are classified as investments, to be cash and cash equivalents.

Income Taxes

The university is exempt from federal income taxes under Section 501 (c)(3) of the Internal Revenue Code except to the extent the university has unrelated business income or consolidated for-profit affiliates incur taxes. There was no significant provision for income taxes in the current year. The university has no uncertain tax positions that result in material unrecognized tax expense/benefits.

Fair Value of Net Assets Acquired in Excess of Consideration Paid

The Barnard Free Skin and Cancer Hospital; also known as Barnard Cancer Institute (BCI) was established in accordance with the will of George D. Barnard principally to provide care, treatment and hospitalization to persons suffering from cancer or skin diseases and diseases allied thereto. In connection with termination of a trust supporting BCI and a court-approved settlement agreement entered into in 2006, the exempt purposes of BCI were redefined to consist of (a) providing financial support for medical, surgical and/or nursing care to persons suffering from cancer or skin diseases or diseases allied thereto who are unable to pay for such care, (b) the study of cancer, and (c) outreach programs and the dissemination of information in regard to these diseases and their treatment. BCI leases its owned property to the university or Barnes Jewish Hospital. BCI has no employees and contracts with the university for administrative services. University personnel occupy a majority of seats on the board of directors of BCI. Effective July 1, 2016, BCI entered into a contract with the university to pool its endowment with the endowment of the university for investment purposes, with the result that the BCI endowment is managed according to the university's endowment policy. Based on the factors of majority board control and combined economic interest, the assets, liabilities and operating results of BCI have been consolidated with the university financial results as of and for the fiscal year ended June 30, 2017. The net assets of BCI as of July 1, 2016 are reported as Fair value of net assets acquired in excess of consideration paid on the Consolidated Statements of Activities. BCI assets, liabilities and net assets at June 30, 2017 are \$38,739, \$187, and \$38,552, respectively. BCI revenues and changes in net assets for 2017 and 2016 were not material to the university's financial statements.

Recent Accounting Pronouncements

During fiscal 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14, which will be effective for the university in fiscal 2020, will provide for presentation in the financial statements of two net asset categories; net assets with donor restrictions and net assets without donor restrictions, instead of the currently required three categories. Among other changes are greater disclosure of self-imposed limits on the use of resources without donor restrictions; qualitative and quantitative information on financial resources and liquidity; and expenses reported in both natural and functional classifications. The university is evaluating the impact of ASU 2016-14 to the consolidated financial statements.

During fiscal 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, which provides targeted updates to the financial instruments classification and measurement standard (Subtopic 825-10). Changes primarily affect accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. This amendment is effective for fiscal years beginning after December 15, 2018 or the university's fiscal year 2020. A provision of the update, which may be elected early, specifies that a not-for-profit (NFP) entity is not a business entity, and

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as such ASU 2016-01 eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost. The university chose to early adopt this provision in fiscal 2016. Both fiscal 2016 and fiscal 2017 debt fair value disclosures have been removed from the financial statements. The university is evaluating the impact of the remainder of ASU 2016-01 to the consolidated financial statements.

During fiscal 2016, the FASB issued ASU 2016-02, *Leases*. The ASU requires lessees to recognize in the Statements of Financial Position for leases with a term of greater than one year, a liability to make lease payments and a right-of-use asset representing its right to use the asset for the lease term. Generally, lease payments will be recognized as interest expense and as a reduction of the liability. The asset will be amortized over the life of the lease. Accounting by a lessor will be largely unchanged from that required by current generally accepted accounting principles. Adoption of ASU 2016-02 is required for the university's fiscal year 2020. The university is still evaluating the impact to the consolidated financial statements.

During 2014 the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09, effective in fiscal 2019, affects all contracts entered into with customers that result in a transfer of goods or services or a transfer of non-financial assets. The core principle of the standard is for organizations to recognize revenue in a way that depicts the transfer of goods or services to customers in amounts that reflect the consideration (payment) to which the organization expects to be entitled. Since 2014 the FASB has issued a number of clarifying updates. The university is currently evaluating the impact the adoption of ASU 2014-09 and subsequent updates will have on its consolidated financial statements.

2. Fair Value

The university follows FASB guidance for fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The FASB guidance establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the university and unobservable inputs reflect the university's assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the university for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- | | |
|---------|--|
| Level 1 | Quoted prices in active markets for identical assets or liabilities, such as exchange traded equity securities. |
| Level 2 | Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not |

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active; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities. Examples of Level 2 include U.S. Treasury securities and corporate bonds.

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

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

The following table presents the financial instruments carried at fair value as of June 30, 2017, on the Consolidated Statements of Financial Position by caption and by the valuation hierarchy defined above. Amounts measured at net asset value are reported using the practical expedient under ASC topic 820 and excluded from the fair value hierarchy. Included as Level 2 fixed income are U.S. Treasury securities of approximately \$672,807.

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measured at Net Asset Value	Balance June 30, 2017
Investments					
Public equity					
Domestic	\$ 159,856	\$ 7,163	\$ -	\$ 1,489,956	\$ 1,656,975
International	397,290	-	-	1,441,174	1,838,464
Fixed income - Nominal	-	751,331	-	-	751,331
Hedged strategies	-	-	-	1,738,040	1,738,040
Private equities	-	-	94,045	1,476,963	1,571,008
Short-term investments	181,168	1,534	-	-	182,702
Real assets	-	-	-	595,750	595,750
Other investments	45,427	(2,057)	66,645	33,636	143,651
Total investments at fair value	<u>783,741</u>	<u>757,971</u>	<u>160,690</u>	<u>6,775,519</u>	<u>8,477,921</u>
Fixed income assets received from security borrowers	-	178,231	-	-	178,231
Total assets reported at fair value	<u>\$ 783,741</u>	<u>\$ 936,202</u>	<u>\$ 160,690</u>	<u>\$ 6,775,519</u>	<u>\$ 8,656,152</u>

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The following table presents the financial instruments carried at fair value as of June 30, 2016, by caption on the Consolidated Statements of Financial Position and by the valuation hierarchy defined above. Included as Level 2 fixed income are U.S. Treasury securities of approximately \$314,649.

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measured at Net Asset Value	Balance June 30, 2016
Investments					
Public equity					
Domestic	\$ 138,452	\$ 7,429	\$ -	\$ 1,192,353	\$ 1,338,234
International	534,311	-	-	988,217	1,522,528
Fixed income - Nominal	-	422,385	-	411,151	833,536
Hedge strategies	-	-	-	1,695,168	1,695,168
Private equities	-	-	141,249	1,226,752	1,368,001
Short-term investments	182,849	23,644	-	-	206,493
Real assets	-	-	-	572,496	572,496
Other investments	61,068	35,611	62,682	-	159,361
Total investments at fair value	<u>916,680</u>	<u>489,069</u>	<u>203,931</u>	<u>6,086,137</u>	<u>7,695,817</u>
Fixed income assets received from security borrowers	-	43,845	-	-	43,845
Total assets reported at fair value	<u>\$ 916,680</u>	<u>\$ 532,914</u>	<u>\$ 203,931</u>	<u>\$ 6,086,137</u>	<u>\$ 7,739,662</u>

As of June 30, 2016, it was probable that all of the private equity investments reported as Level 3 above would be sold at an amount different from the net asset value of the university's ownership interest in partners' capital. The fair value of these investments was estimated at the expected selling price of these investments based on sale negotiations in process at June 30, 2016. Other than the transfer of these positions into Level 3, there were no other material transfers between levels during the periods presented. In 2017, the university sold all of its Level 3 Private Equity investments held as of June 30, 2016 with a reported value of \$141,249, which led to a realized gain of \$10,261, and purchased \$86,959 of Level 3 Private Equity Investments, which experienced a \$7,086 unrealized gain at year end. The university recognizes transfers at the end of the periods presented.

Included as investments on the Consolidated Statements of Financial Position, at June 30, 2017 and 2016, respectively, but not reported in the tables above, are accrued investment income of \$4,484 and \$3,935 and investments in affiliates of \$40,538 and \$41,990, which are recorded on the equity basis of accounting. A portion of equity amounts measured at net asset value above as of June 30, 2017 and 2016 are in hedge-type strategies and a portion of real assets are invested in private equity-type structures. Beneficial interests in perpetual trusts held by third parties are valued at the present value of the future distributions expected to be received over the term of the agreement.

Following is a description of the university's valuation methodologies for assets and liabilities measured at fair value. The methods described below may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the university believes its valuation methods are appropriate and consistent with other market

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participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Fair value for Level 1 is based upon quoted prices in active markets that the university has the ability to access for identical assets and liabilities. Market price data is generally obtained from exchange or dealer markets. The university does not adjust the quoted price for such assets and liabilities.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers.

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all.

Investments measured at net asset value primarily consist of the university's ownership in alternative investments (principally limited partnership interests in hedged strategies, private equity investments, real assets, and other similar funds). The fair values (Net Asset Value ("NAV") or partner's capital per share) of the securities held by limited partnerships that do not have readily determinable fair values are determined by the respective general partners and are based on appraisals or other estimates that require varying degrees of judgment. If no public market exists for the investments, the fair value is determined by the general partners taking into consideration significant unobservable inputs including, among other things, the cost of the investments, prices of recent significant placements of investments of the same issuer, and subsequent developments concerning the companies to which the investments relate. Excluding the cost of the investment, significant increases or decreases in the remainder of those inputs could result in a significantly higher or lower fair value measurement. The university has performed due diligence with respect to these investments to ensure NAV or partner's capital per share is an appropriate measure of fair value as of June 30. NAVs are calculated by the investees in a manner consistent with generally accepted accounting principles for investment companies.

Valuation and other considerations concerning the major classes of investments are provided in the following paragraphs.

Equity

The equity class of investments is globally diversified across public markets including domestic and international developed and emerging market equities. The majority of equity assets are valued at quoted market price in accordance with Level 1 valuation techniques as described above, unless held in hedge-like strategies which are valued at NAV as described above.

Fixed Income and Short-Term Investments

Investments in this class include domestic and international nominal fixed income instruments. Fixed income investments are held principally as liquid vehicles for operating needs and as a source of diversification. A significant component of non-endowment fixed income investments is held in highly liquid funds. The valuation of these funds is determined using a market approach in accordance with the techniques for Level 2 as described above.

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Hedged Strategies

Investments in hedged strategies are made in sub-strategies including event driven, distressed/credit, relative value, long/short equity, and global macro funds. Generally, the redemption frequency for these funds varies from monthly to every two years. Similarly, the required redemption notice period varies from three to one hundred and ninety days. At June 30, 2017 and 2016, respectively, \$80,632 and \$78,125 were in “side pockets” and other similar restricted investments with indeterminate redemption periods. Another \$132,944 and \$67,232 were subject to initial investment lock-ups that expire over 12 to 21 months and 3 to 13 months as of June 30, 2017 and 2016, respectively. Some funds subject to lock-up permit early redemptions subject to a fee. Other elements of the portfolio include partnership interests that have no specified redemption frequency. At June 30, 2017 and 2016, such amounts were \$107,986 and \$105,670, respectively. At June 30, 2017, the university had commitments outstanding of approximately \$135,385 for hedged strategy funds and \$18,750 for equity investments with a hedge fund structure.

Private Equities

Investments in private equity strategies are made in targeted categories including buyout, venture capital, and corporate finance. Redemptions of such funds are not permitted and distributions are received as underlying investments are liquidated. Generally, the remaining lives of the agreements under which these investments are made vary from 1 to 16 years assuming all extension options under the agreements are exercised and approved. At June 30, 2017, the university had total private equities investment commitments outstanding of \$1,570,532, but only a portion of this amount is expected to be funded in 2018.

Real Assets

Investments in the real assets class are made in targeted categories including natural resources and real estate. The majority of these assets are not held directly but are held in private-equity-type structures that invest primarily in real estate and natural resources. These funds are valued at net asset value as described above. Generally, the remaining lives of the agreements under which these investments are made vary from 1 to 13 years assuming all extension options under the agreements are exercised and approved. At June 30, 2017, the university had total real asset commitments outstanding of \$332,243, but only a portion of this amount is expected to be funded in 2018.

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3. Investment Return

The following summarizes the return on investments. Investment income represents earnings on non-endowed funds. Return on investments is presented net of investment management fees. Certain investments, including some but not all of those in the hedged and private equity categories, report investment returns net of fees. Other fees paid directly to investment managers and internal investment management costs were \$64,499 and \$54,378 for 2017 and 2016, respectively.

	<u>2017</u>	<u>2016</u>
Investment income	\$ 12,543	\$ 9,039
Pooled endowment dividends and interest income, net of investment management fees	(6,164)	1,597
Pooled endowment distribution in excess of income	<u>311,754</u>	<u>284,961</u>
Pooled endowment spending distribution	<u>305,590</u>	<u>286,558</u>
Investment gains (losses), net	804,487	(266,824)
Gains distributed as endowment distribution	<u>(311,754)</u>	<u>(284,961)</u>
Investment gains (losses) net of endowment spending distribution	<u>492,733</u>	<u>(551,785)</u>
Net investment return	<u>\$ 810,866</u>	<u>\$ (256,188)</u>

At June 30, 2017 and 2016, investments with a fair value of \$173,570 and \$42,125, respectively, were loaned to various brokers on an open-ended basis for average periods varying from several days to several months, depending on the type of loan. The university receives lending fees and continues to earn interest and dividends on the loaned securities. These securities are returnable on demand and are collateralized by cash deposits or U.S. Treasury securities amounting to 102.7% and 104.0% of the market value of the securities loaned at June 30, 2017 and 2016, respectively. The university is indemnified against borrower default by the financial institution that is acting as its lending agent. The borrowers provided \$178,207 and \$43,820 of collateral in the form of cash or U.S. Treasury securities for the loaned securities at June 30, 2017 and 2016, respectively. Cash collateral is reinvested in other vehicles by the lending agent. Cash and non-cash collateral had a fair value of \$178,231 and \$43,845 at June 30, 2017 and 2016, respectively, and is reported in Collateral received for securities lending on the Consolidated Statements of Financial Position. The cost basis of collateral of \$173,889 and \$43,458 at June 30, 2017 and 2016, respectively, is reported as Liabilities under securities lending transactions on the Consolidated Statements of Financial Position.

4. Endowment

The state of Missouri has adopted legislation that incorporates the provisions outlined in the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The statutory guidelines contained in this legislation relate to the prudent management, investment, and expenditure of donor-restricted endowment funds held by charitable organizations. Additionally, the legislation specifies factors for fiduciaries to consider prior to making a decision to appropriate from or accumulate into an institution's endowment funds.

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At June 30, 2017, the university's endowment consists of 3,402 individual donor-restricted endowment funds and Board of Trustees or management-designated endowment funds for a variety of purposes plus split-interest agreements and other net assets where the assets have been designated for endowment. The net assets associated with endowment funds, including funds designated by the Board of Trustees or management to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The university has interpreted Missouri UPMIFA as requiring the preservation of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the university classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted until the donor-imposed stipulations attached to those amounts have been met by actions of the university and/or passage of time and appropriated for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA.

Endowment net asset composition, which includes the effect of changes in endowment investments as well as other endowment-related assets and liabilities, by type of fund as of June 30, 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (200)	\$ 2,579,388	\$ 1,729,427	\$ 4,308,615
Board-designated endowment funds	<u>2,561,567</u>	<u>215,848</u>	<u>-</u>	<u>2,777,415</u>
Total endowment funds	<u>\$ 2,561,367</u>	<u>\$ 2,795,236</u>	<u>\$ 1,729,427</u>	<u>\$ 7,086,030</u>

Changes in endowment net assets for the year ended June 30, 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	<u>\$ 2,316,271</u>	<u>\$ 2,529,810</u>	<u>\$ 1,639,696</u>	<u>\$ 6,485,777</u>
Investment return				
Net investment income	(2,655)	(2,062)	-	(4,717)
Net appreciation (realized and unrealized)	<u>344,158</u>	<u>453,375</u>	<u>3,861</u>	<u>801,394</u>
Total investment return	341,503	451,313	3,861	796,677
Gifts	179	1,826	67,764	69,769
Appropriation of endowment assets for expenditure	(131,648)	(173,942)	-	(305,590)
Net transfers of funds	84,459	10,333	14,743	109,535
Allocation of endowment return to treasurers investment pool	(55,668)	(18,008)	-	(73,676)
Reclassification of deficits in donor-designated funds	3,789	(3,789)	-	-
Other activity	<u>2,482</u>	<u>(2,307)</u>	<u>3,363</u>	<u>3,538</u>
Endowment net assets, end of year	<u>\$ 2,561,367</u>	<u>\$ 2,795,236</u>	<u>\$ 1,729,427</u>	<u>\$ 7,086,030</u>

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Of the amount classified as temporarily restricted endowment net assets, \$2,265,185 represents the portion of endowment funds subject to time restrictions under Missouri's enacted version of UPMIFA.

Endowment net asset composition by type of fund as of June 30, 2016:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (3,990)	\$ 2,341,643	\$ 1,639,696	\$ 3,977,349
Board-designated endowment funds	<u>2,320,261</u>	<u>188,167</u>	<u>-</u>	<u>2,508,428</u>
Total endowment funds	<u>\$ 2,316,271</u>	<u>\$ 2,529,810</u>	<u>\$ 1,639,696</u>	<u>\$ 6,485,777</u>

Changes in endowment net assets for the year ended June 30, 2016:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	<u>\$ 2,446,786</u>	<u>\$ 2,854,317</u>	<u>\$ 1,543,769</u>	<u>\$ 6,844,872</u>
Investment return				
Net investment income	675	2,440	-	3,115
Net appreciation (realized and unrealized)	<u>(110,103)</u>	<u>(154,518)</u>	<u>(1,890)</u>	<u>(266,511)</u>
Total investment return	(109,428)	(152,078)	(1,890)	(263,396)
Gifts	723	1,797	97,965	100,485
Appropriation of endowment assets for expenditure	(121,186)	(165,373)	-	(286,559)
Net transfers of funds	61,909	4,525	1,116	67,550
Allocation of endowment return to treasurers investment pool	38,170	(16,854)	-	21,316
Reclassification of deficits in donor-designated funds	(3,833)	3,833	-	-
Other activity	<u>3,130</u>	<u>(357)</u>	<u>(1,264)</u>	<u>1,509</u>
Endowment net assets, end of year	<u>\$ 2,316,271</u>	<u>\$ 2,529,810</u>	<u>\$ 1,639,696</u>	<u>\$ 6,485,777</u>

Of the amount classified as temporarily restricted endowment net assets, \$2,036,733 represents the portion of endowment funds subject to time restrictions under Missouri's enacted version of UPMIFA.

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Permanently Restricted Net Assets

The portion of perpetual endowment funds net assets that is required to be retained permanently by explicit donor stipulation:

	<u>2017</u>	<u>2016</u>
Restricted for general activities	\$ 1,166,424	\$ 1,099,457
Restricted for student assistance	388,046	366,811
Restricted for buildings and renovations	150,658	150,607
Life income	<u>24,299</u>	<u>22,821</u>
Total endowment net assets classified as permanently restricted net assets	<u>\$ 1,729,427</u>	<u>\$ 1,639,696</u>

Temporarily Restricted Net Assets

Temporarily restricted endowment funds net assets:

	<u>2017</u>	<u>2016</u>
Restricted for general activities	\$ 1,874,381	\$ 1,743,601
Restricted for student assistance	462,794	414,282
Restricted for buildings and renovations	445,233	360,460
Life income	<u>12,828</u>	<u>11,467</u>
Total endowment net assets classified as temporarily restricted net assets	<u>\$ 2,795,236</u>	<u>\$ 2,529,810</u>

Endowment Funds With Deficits

As determined under UPMIFA, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (i.e., deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits of this nature reported in unrestricted net assets were immaterial as of June 30, 2017 and 2016, respectively. The deficits resulted largely from unfavorable market fluctuations that occurred shortly after the investment of newly established endowments.

Return Objectives and Risk Parameters

The university has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to meet or exceed the return of its policy benchmark, based on the endowment's target allocation applied to the appropriate individual benchmarks. The university expects its endowment funds, over time, to provide an average rate of return that will exceed the sum of inflation and the spending rate. Actual returns in any given year may vary from this amount.

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Strategies Employed for Achieving Investment Objectives

To achieve its long-term rate of return objectives, the university relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The university targets a diversified global asset allocation that places greater emphasis on equity-based and alternative investments to achieve its long-term objectives within prudent risk constraints.

Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives

The university has an endowment spending distribution policy designed to stabilize annual spending levels and preserve the real value of the endowment over time. Under this policy, earnings of the pooled endowment are distributed at a rate set annually to the schools and other units of the university. Consideration is given to the provisions of UPMIFA in determining the amount to appropriate. This spending rate must fall within the range of 3.0% to 5.5% of the five-year average market value of a unit of the pooled endowment. For 2017, the spending rate from the pooled endowment was 4.7% of the beginning market value of the pooled endowment. The spending rate is funded from current earnings and, in years when current earnings are insufficient, from previously accumulated earnings of the endowment.

The university's endowment assets at June 30 are as follows:

	Fair Market Value at June 30, 2017	Fair Market Value at June 30, 2016
Pooled endowment and other funds	\$ 7,872,501	\$ 7,059,916
Life income trusts and pools	75,686	75,397
Externally administered trusts	37,040	34,449
Separately invested endowment	6,512	6,735
Total	<u>7,991,739</u>	<u>7,176,497</u>
Less: Operating funds invested in pool	<u>(776,781)</u>	<u>(649,771)</u>
Net endowment assets	<u>\$ 7,214,958</u>	<u>\$ 6,526,726</u>

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5. Accounts and Notes Receivable

Accounts and notes receivable at June 30 were as follows:

	<u>2017</u>	<u>2016</u>
Patient services	\$ 327,044	\$ 340,786
Student and parent loans		
Parent loan fund	45,091	45,813
Government student loans	40,200	44,148
Institutional student loans	23,229	22,941
Due from affiliates	117,483	108,579
Sponsored project receivables	62,667	53,550
Other	45,948	46,961
	<u>661,662</u>	<u>662,778</u>
Less: Allowance for contractual adjustments and doubtful accounts	<u>(197,980)</u>	<u>(205,451)</u>
Total	<u>\$ 463,682</u>	<u>\$ 457,327</u>

The university is exposed to credit risk on amounts receivable from student and parent loans. Parent loan funds are offered by the university as a way for parents to finance their children's education at a fixed rate. Institutional student loans are offered by the university based on financial need. Both parent and institutional loans typically have ten year terms and, in the case of parent loans, existing economic conditions are evaluated annually in determining the interest rates for these loans. Government sponsored student loans carry minimal risk for the university.

The principal credit quality indicator used by the university for the portfolio of non-government student and parent loans is collection experience. In order to reduce its credit risk, the university has adopted credit policies which include a review of credit limits and maintaining an active collections process with the assistance of third party collection agencies as necessary. At June 30, 2017, the allowance for parent and institutional student loans was \$4,400 compared to \$4,571 at June 30, 2016. Accounts are considered past due if a scheduled payment is forty-five days late. The balance in such accounts was \$7,569 and \$8,407 at June 30, 2017 and June 30, 2016, respectively. Allowances are established based on management's best estimate of exposure at June 30 and are influenced by historical losses, existing economic conditions, and the current payment activity on loans. Activity in these allowances was not significant.

Parent loans and institutional student loans are sent to a third party collection agency if the loan is past due for a period of time and the university has been unable to collect payment. As these loans are non-dischargeable in bankruptcy, accounts are not typically considered uncollectible until all collection efforts have been exhausted with no receipt of payment. At this time, a loan will be written off.

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6. Notes and Bonds Payable

Outstanding principal on bonds and notes payable at June 30, 2017 and 2016 consists of the following:

	Rates at June 30, 2017	Maturity	2017	2016
Missouri Health and Educational Facilities Authority				
\$142,400 of 1996A, B, C and D Series Variable Rate Bonds, due in full	.27% - .93%	September 1, 2030	\$ 142,400	\$ 142,400
\$88,000 of 2000B and C Series Variable Rate Bonds, due in full	.27% - .93%	March 1, 2040	88,000	88,000
\$25,135 of 2003B Series Variable Rate Bonds, due in full	.29% - .87%	February 15, 2033	25,135	25,135
\$149,625 of 2008A Series Educational Facilities Revenue Bonds, due March 15, 2039 (\$149,625)	5.25% - 5.38%	March 15, 2039	-	149,625
\$93,770 of 2009A Series Educational Facilities Revenue Bonds, due November 15, 2030 (\$20,000) and November 15, 2039 (\$73,770)	4.50% - 5.00%	November 15, 2030 and 2039	-	93,770
\$22,985 of 2011A Series Revenue Bonds due in full	5.00%	November 15, 2041	22,985	22,985
\$96,350 of 2011B Series Revenue Bonds due in full November 15, 2030 (\$39,050) and November 15, 2037 (\$57,300)	5.00%	November 15, 2030 and 2037	96,350	96,350
\$77,495 of 2011C Series Revenue Bonds due serially from November 15, 2012 to November 15, 2037	.75% - 5.06%	November 15, 2037	61,215	64,585
\$200,785 of 2012A Series Revenue Bonds due serially from February 15, 2023 to February 15, 2047	2.39% - 3.69%	February 15, 2047	200,785	200,785
\$150,000 of 2014A Series Revenue Bonds due in full	4.07%	October 15, 2044	150,000	150,000
\$402,920 of 2016A Series Revenue Bonds due in full January 15, 2036 (\$109,300) and January 15, 2046 (\$293,620)	3.47% - 3.65%	January 15, 2036 and 2046	402,920	402,920
\$272,750 of 2016 B Series Revenue Bonds due in full	3.09%	September 15, 2051	272,750	-
Other Bonds:				
\$131,435 of 2015A Series Taxable Bonds due in full	3.79%	October 15, 2055	131,435	131,435
Other notes payable			39,816	49,231
Total outstanding notes and bonds payable			1,633,791	1,617,221
Unamortized original issue premiums/discounts and cost of issuance, net			(1,589)	(865)
Total			\$ 1,632,202	\$ 1,616,356

Bonds payable are redeemable at the option of the university at various times from 2017 through 2055. The university is required to maintain certain ratios and comply with other restrictive covenants principally that the university maintain a ratio of expendable financial resources to debt of at least 1.25 times. The university is in compliance with this covenant. During 2017 and 2016, interest, accretion of debt discount and related fees incurred on notes and bonds payable totaled \$54,036 and \$55,174, respectively.

Maturities on notes and bonds payable for the next five fiscal years are as follows:

2018	\$ 34,405
2019	3,380
2020	11,356
2021	2,295
2022	2,380
Thereafter	1,579,975

Washington University

Notes to the Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

During fiscal 2017, the university issued \$272,750 of taxable Series 2016B bonds. \$243,395 of net proceeds from the issuance and other funds were placed in an irrevocable trust to be used to satisfy all interest and principal payments, including principal to be paid at the first scheduled call date, for \$149,625 of the 2008 Series A Missouri Health and Educational Facilities Authority (MOHEFA) Bonds and \$93,770 of the 2009 Series A MOHEFA Bonds. In accordance with the terms of the MOHEFA Bond indentures and loan agreements, establishment of the trust results in the legal defeasance of the university's obligation under the bonds. The transaction was accounted for as an extinguishment with a recognized loss of \$23,980 reported on the Gain (Loss) on fixed asset disposals and other line of the Consolidated Statements of Activities.

During fiscal 2016, the university issued \$402,920 of taxable Series 2016 bonds. \$274,995 of net proceeds from the issuance and other funds were placed in an irrevocable trust to be used to satisfy all interest and principal payments, including principal to be paid at the first scheduled call date, for \$230,995 of the 2007 Series A and B Missouri Health and Educational Facilities Authority (MOHEFA) Bonds and \$44,000 of the 2008 Series A MOHEFA Bonds. In accordance with the terms of the MOHEFA Bond indentures and loan agreements, establishment of the trust results in the legal defeasance of the university's obligation under the bonds. The transaction was accounted for as an extinguishment with a recognized loss of \$6,176 reported on the Gain (Loss) on fixed asset disposals and other line of the Consolidated Statements of Activities.

The university has other lines of credit, which generally expire annually, aggregating \$302,515, of which \$262,786 is available at June 30, 2017. The university expects that these lines of credit will be renewed but can make no assurances.

7. Derivative and Other Financial Instruments

In accordance with the university's investment policies, derivative instruments may be purchased and sold to manage the risk and return of investment market positions. Investment managers purchase and sell derivatives on various fixed income instruments to control the risk of fluctuations in interest rates, relative to portfolio benchmarks, on the university's fixed income investments. Certain equity investment managers purchase derivatives to obtain cost efficient exposure to equity markets or to hedge currency. These contracts are valued at periodic intervals (daily, monthly, quarterly, etc.) as well as at June 30, with the resulting changes in the values of the contracts either added to or deducted from the university's custodial account. In addition, derivative transactions (primarily futures, options and swaps) can be entered into using a derivatives administrator for multiple purposes including hedging, rebalancing or tactical trading. Hedging derivatives are utilized in the event that the university determines that the endowment should hedge market exposures. Rebalancing derivatives are utilized to synthetically adjust the university's investment allocation towards its policy allocation. Tactical trading derivatives are utilized to implement a view that the university may have on a particular market. Derivative activity, when initiated by the university, is executed, settled and managed by the derivatives administrator on a non-discretionary basis. Such instruments are not designated as hedges for accounting purposes. Gains or losses from these derivative instruments are reported as realized and unrealized gains or losses in the Consolidated Statements of Activities. The contracts and gains or losses they generate are not material to the university's consolidated financial statements.

The university has investments in certain funds, generally in the form of limited partnerships that participate directly, or have the option to participate, in derivative instruments. The university regularly reviews the performance of these funds in the context of its overall investment objectives.

Washington University

Notes to the Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

8. Commitments and Contingencies

At June 30, 2017, the university had outstanding commitments under certain construction contracts in the amount of \$88,336, the majority of which will be payable during the year ending June 30, 2018.

The university maintains a self-insurance program for professional liability. This program is supplemented with commercial excess insurance above the university's self-insurance retention. Funding for the program reserves is based on claims made. The assets supporting the funded reserve are reported as investments in the Consolidated Statements of Financial Position. The university also accrues for an estimate of claims incurred but not reported. Reserves, funded and unfunded, are based upon actuarial studies and represent undiscounted estimated claims and related costs. The total self-insurance reserves at June 30, 2017 and 2016, respectively, were \$69,106 and \$79,107. Self-insurance reserves are necessarily estimates based on historical loss experience and other factors, and while management believes that the reserves are adequate, the ultimate liabilities may be in excess of or less than the amounts provided.

The university is a party, along with other universities, to an agreement with a reciprocal risk retention group for purposes of obtaining general liability and auto liability insurance coverage in excess of a pre-determined retention level. Under the terms of these agreements, the university can be called upon to make additional capital contributions. In management's view, any such capital calls would not be material.

The university is involved in various legal proceedings arising in the normal course of operations. Although the outcome of any legal proceeding cannot be predicted with certainty, it is the opinion of the university's management that the outcome of these proceedings individually or in the aggregate, will not have a material adverse effect on the business, Consolidated Statements of Activities, financial position or liquidity of the university.

9. Retirement Plan

The university provides its faculty and staff with a defined contribution (403(b)) retirement savings plan in which employee contributions, university contributions and investment earnings accumulate to assist employees at retirement. Participating employees own individual retirement accounts through the Teachers Insurance and Annuity Association (TIAA) and College Retirement Equity Fund (CREF). Under this arrangement, the university and plan participants make monthly contributions to TIAA-CREF. During 2016, the university consolidated custody of retirement plan assets and administration of annuity contracts under TIAA-CREF. For employees who were benefits eligible as of August 31, 2006, the amount of contribution made by the university, commencing after two years of eligible service, is based upon the employee's age and salary. For benefits-eligible employees hired or rehired after August 31, 2006, the university contribution commences after two years of eligible service and is based upon the employee's years of eligible service and salary. Vesting provisions are full and immediate. The university's share of the cost of these benefits in 2017 and 2016 was \$75,739 and \$72,383, respectively.

Washington University

Notes to the Consolidated Financial Statements

Years Ended June 30, 2017 and 2016

(All amounts in thousands of dollars)

10. Agreements With Affiliated Hospitals

The university has affiliation agreements with Barnes Jewish Hospital (BJH) and St. Louis Children's Hospital (SLCH), collectively the Hospitals. This includes operating activities of Barnes Jewish Hospital at Barnes Jewish West County Hospital (BJWCH), Barnes Jewish Orthopedic Center (OC) in Chesterfield, the Siteman Cancer Center – South County, and the Children's Specialty Care Center in Town and Country.

The terms of the affiliation agreements provide for the university to be responsible for providing professional medical staff and direction, supervision of residents and interns, appropriate resources for research and medical education, and participation in joint clinical planning. BJH and SLCH are responsible for the hospitals and health care delivery facilities. BJH and SLCH compensate the university for services provided by the university through a fixed annual base payment (adjusted annually for inflation) and an additional contingent payment equal to a share of the combined BJH and SLCH adjusted net operating income. The combined compensation payments are reported as Affiliated hospital revenue on the Consolidated Statements of Activities. In addition, the university derives revenue from patient services provided at Barnes-Jewish at St. Peters Hospital under an agreement with that hospital and BJH. During 2013, BJH agreed to fund on a cost-reimbursement basis over a period of years, certain expenditures by the university. Payments of \$34,483 and \$11,723 were received or accrued as gifts on the Consolidated Statements of Activities under the agreement during 2017 and 2016, respectively.

11. Subsequent Events

The university has performed an evaluation of subsequent events through September 26, 2017, which is the date the consolidated financial statements were issued. In July 2017, the university issued \$375,000 of taxable revenue bonds through Missouri Health and Educational Facilities Authority (MOHEFA). The bonds bear a fixed rate of 3.652% and will mature on August 15, 2057. The proceeds of these bonds will be used to finance various construction projects.