Baylor University

Financial Statements

Years Ended May 31, 2017 and 2016,
and Report of Independent Certified Public Accountants

BAYLOR UNIVERSITY

FINANCIAL STATEMENTS

Years Ended May 31, 2017 and 2016

TABLE OF CONTENTS

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Grant Thornton LLP
1717 Main Street, Suite 1800
Dallas, TX 75201-4667

T 214.561.2300
F 214.561.2370
GrantThornton.com
linkd.in/GrantThorntonUS
twitter.com/GrantThorntonUS

The Board of Regents
Baylor University

Report on the financial statements
We have audited the accompanying financial statements of Baylor University (the "University"), which comprise the balance sheets as of May 31, 2017 and 2016, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University's preparation and fair presentation of the 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Baylor University as of May 31, 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.

Grant Thornton LLP

Dallas, Texas
September 28, 2017

BAYLOR UNIVERSITY
Balance Sheets

May 31, 2017 and 2016
(in thousands of dollars)

	2017	2016
ASSETS		
Cash & cash equivalents	$ 59,858	$ 61,513
Short-term investments	67,392	77,818
Student accounts receivable, net	20,307	19,653
Contributions receivable, net	71,725	90,038
Grants & other receivables, net	42,181	37,408
Prepaid expenses & other	5,989	6,498
Student loans receivable, net	10,221	10,553
Long-term investments, at fair value	1,278,254	1,198,048
Property, plant & equipment, net	1,173,563	1,178,885
Total assets	**$ 2,729,490**	**$ 2,680,414**
LIABILITIES & NET ASSETS		
Liabilities		
Accounts payable	$ 32,609	$ 47,320
Personnel related current liabilities	26,530	39,824
Deposits & deferred revenues	144,777	156,042
Accrued postretirement benefits	46,829	45,570
Notes & bonds payable, net	604,372	611,864
Other liabilities	22,899	24,590
Total liabilities	**878,016**	**925,210**
Net Assets		
Unrestricted	767,846	727,247
Temporarily restricted	303,446	280,599
Permanently restricted	780,182	747,358
Total net assets	**1,851,474**	**1,755,204**
Total liabilities & net assets	**$ 2,729,490**	**$ 2,680,414**

See accompanying notes to financial statements.

BAYLOR UNIVERSITY
Statements of Activities

For the Years Ended May 31, 2017 and 2016
(in thousands of dollars)

	Year Ended May 31, 2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES				
Tuition & fees	$ 688,693	$ --	$ --	**$ 688,693**
Less scholarships	(284,044)	--	--	**(284,044)**
Net tuition & fees	404,649	--	--	**404,649**
Endowment distributions & investment income	58,076	8,254	--	**66,330**
Gifts & private grants	28,979	5,854	--	**34,833**
Grants & contracts	25,106	796	--	**25,902**
Other sources - educational & general	28,246	12	--	**28,258**
Other sources - intercollegiate athletics	58,897	--	--	**58,897**
Sales & services of auxiliary enterprises	53,584	--	--	**53,584**
Net assets released from restrictions	15,741	(15,741)	--	**--**
Total operating revenues	673,278	(825)	--	**672,453**
OPERATING EXPENSES				
Program expenses				
Instruction	266,173			**266,173**
Academic support	55,452			**55,452**
Research & public service	38,257			**38,257**
Student services & activities	160,230			**160,230**
Auxiliary enterprises	40,194			**40,194**
Support expenses				
Institutional support	99,858			**99,858**
Total operating expenses	660,164			**660,164**
Change in net assets from operating activities	13,114	(825)	--	**12,289**
NON-OPERATING ACTIVITIES				
Return on long-term investments	32,347	78,732	4,784	**115,863**
Distributions from long-term investments	(14,832)	(52,507)	--	**(67,339)**
Endowment earnings & distributions re-invested	--	--	2,142	**2,142**
Change in value of split interest agreements	23	812	1,857	**2,692**
Gifts for endowment, annuity & living trusts	--	72	19,452	**19,524**
Gifts & grants for plant improvements, net of allowance adjustments	--	11,551	--	**11,551**
Net assets released from restrictions for plant improvements	11,600	(11,600)	--	**--**
Other components of postretirement benefits cost	(641)	--	--	**(641)**
Change in postretirement benefits obligation other than net periodic benefits cost	(1,796)	--	--	**(1,796)**
Other increases (decreases)	784	(3,388)	4,589	**1,985**
Total non-operating activities	27,485	23,672	32,824	**83,981**
Change in net assets	40,599	22,847	32,824	**96,270**
Net assets at beginning of year	727,247	280,599	747,358	**1,755,204**
Net assets at end of year	$ 767,846	$ 303,446	$ 780,182	**$ 1,851,474**

See accompanying notes to financial statements.

Year Ended May 31, 2016			
Unrestricted	Temporarily Restricted	Permanently Restricted	Total
$ 654,294	$ --	$ --	**$ 654,294**
(266,868)	--	--	**(266,868)**
387,426	--	--	**387,426**
55,970	8,137	--	**64,107**
42,565	5,995	--	**48,560**
26,406	447	--	**26,853**
26,073	4	--	**26,077**
52,275	--	--	**52,275**
51,464	--	--	**51,464**
14,789	(14,789)	--	**--**
656,968	(206)	--	**656,762**
251,720			**251,720**
53,485			**53,485**
37,267			**37,267**
148,154			**148,154**
37,706			**37,706**
106,317			**106,317**
634,649			**634,649**
22,319	(206)	--	**22,113**
(12,611)	2,195	(6,960)	**(17,376)**
(14,066)	(51,844)	--	**(65,910)**
--	--	2,609	**2,609**
87	(3,780)	1,033	**(2,660)**
--	251	27,521	**27,772**
--	4,766	--	**4,766**
64,536	(64,536)	--	**--**
(1,768)	--	--	**(1,768)**
11,182	--	--	**11,182**
(2,526)	514	590	**(1,422)**
44,834	(112,434)	24,793	**(42,807)**
67,153	(112,640)	24,793	**(20,694)**
660,094	393,239	722,565	**1,775,898**
$ 727,247	$ 280,599	$ 747,358	**$ 1,755,204**

BAYLOR UNIVERSITY
Statements of Cash Flows

For the Years Ended May 31, 2017 and 2016
(in thousands of dollars)

	Year Ended May 31, 2017	Year Ended May 31, 2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	**$ 96,270**	**$ (20,694)**
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	56,779	50,532
Return on long-term investments	(115,863)	17,376
Distributions from long-term investments	67,339	65,910
Amortization of bond premium	(731)	(789)
Amortization of deferred debt issuance costs	394	179
Losses on disposal of property & equipment	526	1,357
Fixed assets gifts-in-kind	(1,411)	(449)
Contributions of securities	(12,201)	(15,228)
Proceeds from sale of contributed securities for operations	1,849	1,549
Contributions for endowment & plant improvements	(36,018)	(43,445)
Provision for uncollectible receivables	(1,613)	11,912
Changes in assets & liabilities:		
Short-term investments	10,426	16,145
Student accounts receivable	(1,128)	(1,885)
Contributions receivable	20,371	16,700
Grants & other receivables	(4,814)	1,723
Prepaid expenses & other	509	3,086
Accounts payable	(14,711)	(10,449)
Personnel related current liabilities	(13,294)	17,218
Deposits & deferred revenues	(11,265)	(2,668)
Accrued postretirement benefits	1,259	(10,286)
Other liabilities	(1,645)	1,581
Net cash provided by operating activities	**41,028**	**99,375**
CASH FLOWS FROM INVESTING ACTIVITIES		
Student loans made	(676)	(513)
Proceeds from collections of student loans	1,078	724
Proceeds from sales of long-term investments	28,328	34,712
Purchases of long-term investments	(60,010)	(99,285)
Purchases of property, plant & equipment	(50,572)	(98,618)
Net cash used for investing activities	**(81,852)**	**(162,980)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Contributions for endowment & plant improvements:		
Endowment & annuity/living trusts	18,597	19,541
Plant	17,421	23,904
Proceeds from sale of contributed securities for endowment & plant	10,352	13,679
Proceeds from long-term debt	59,750	--
Repayment of long-term debt	(66,591)	(6,530)
Debt issuance costs	(314)	--
Change in federal student loan funds refundable	(46)	(129)
Net cash provided by financing activities	**39,169**	**50,465**
Net change in cash & cash equivalents	**(1,655)**	**(13,140)**
Cash & cash equivalents at beginning of year	**61,513**	**74,653**
Cash & cash equivalents at end of year	**$ 59,858**	**$ 61,513**

See accompanying notes to financial statements.

OVERVIEW OF BAYLOR UNIVERSITY

The mission of Baylor University (the "University") is to educate men and women for worldwide leadership and service by integrating academic excellence and Christian commitment within a caring community.

Chartered in 1845 by the Republic of Texas and affiliated with the Baptist General Convention of Texas, the University is the oldest continuously operating institution of higher learning in the State of Texas. Established to be a servant of the church and of society, the University seeks to fulfill its calling through excellence in teaching and research, in scholarship and publication, and in service to the community, both local and global. The approximately 1,000-acre main campus is located on the banks of the Brazos River in Waco, Texas.

While remaining true to its Christian heritage, the University has grown to almost 17,000 students, and its nationally recognized academic units offer 129 undergraduate, 75 masters, and 41 doctoral degree programs. In addition, the education specialist degree is offered by the School of Education, and the Juris Doctor degree is offered by the School of Law.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting & Reporting

The financial statements of Baylor University include the accounts of the University, Brazos Valley Public Broadcasting Foundation, and Central Texas Technology & Research Park, legally separate entities, over which the University has control as a sole member or for which the board of directors are chosen by the University's Board of Regents. The University's financial statements do not include the accounts of the Baylor Line Foundation, formerly known as the Baylor Alumni Association, or Baylor Waco Stadium Authority. These entities are excluded due to the nature of their relationship to the University or due to their aggregate assets, revenues, expenses and net assets not being significant in relation to the University.

The financial statements of the University are prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The University's net assets, revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

Unrestricted – net assets that are not subject to donor-imposed or legal restrictions. Unrestricted net assets may be designated for specific purposes by the University's Board of Regents (the "Board").

Temporarily restricted – net assets subject to donor-imposed or legal restrictions that must be met either by actions of the University and/or the passage of time.

Permanently restricted – net assets subject to donor-imposed restrictions that the assets be maintained permanently. Generally, the donors of these assets permit the University to use all or part of the earnings on the related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless the use of the related assets is limited by donor-imposed restrictions that are not anticipated to be met in the year of receipt. Expenses are reported as decreases in unrestricted net assets. Income and net gains and losses on investments in donor restricted endowments are reported as increases or decreases in temporarily restricted net assets until appropriated for expenditure by the University. All other gains and losses on investments are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as net assets released from restrictions among applicable net asset classes. Changes or clarifications in donor stipulations may cause certain net assets to be reclassified between permanently restricted, temporarily restricted or unrestricted net assets. These reclassifications are reported as other increases (decreases) among applicable net assets classes.

Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources available to the University, the internal accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes are classified into funds that are in accordance with specified activities or objectives. These financial statements, however, are prepared to focus on the entity as a whole and to present transactions according to the existence or absence of donor-imposed restrictions.

Cash & Cash Equivalents

Cash on deposit and all highly liquid financial instruments with original maturities of three months or less are classified as cash and cash equivalents, except those amounts assigned to investment managers, which are classified as investments. The University maintains its cash and cash equivalents with high quality financial institutions and these cash balances, at times, may exceed federally insured limits. The University has not experienced any losses on such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Short-Term Investments

Short-term investments consist of operational funds invested in bank time deposits, short-term U.S. government securities, having original maturities longer than three months but less than one year, and highly liquid money market funds.

Student Accounts & Loans Receivable

Student accounts receivable are stated net of allowance for doubtful accounts of $1,296,000 and $888,000 as of May 31, 2017 and 2016, respectively.

Student loans receivable are stated net of allowance for doubtful accounts of $861,000 and $932,000 as of May 31, 2017 and 2016, respectively. The University considered the allowance recorded at May 31, 2017 and 2016 to be reasonable and adequate to absorb potential credit losses inherent in the student loan portfolio.

The assets and liabilities of student loans financed primarily by the federal government and administered by the University, primarily the Federal Perkins Loan Program, are included with those of the University. The total of the federal government portion of these loans is included in other liabilities in the accompanying balance sheets.

Split Interest Agreements

Split interest agreements consist primarily of gift annuities, charitable remainder trusts, life income funds, and perpetual trusts. Assets held under these agreements are included primarily in long-term investments (see Note 4). The agreements administered by HighGround Advisors, formerly known as the Baptist Foundation of Texas, and others as temporary trustees, in which the assets will be distributed to the University upon termination, are reflected at their net present value as contributions receivable (see Note 5). Annuities payable are recorded at the present value of future payments, based on the Internal Revenue Service discount rate at the time of the original gift, and are included in other liabilities in the accompanying balance sheets.

Property, Plant & Equipment

Property, plant and equipment valued at $5,000 or more are recorded at cost at the date of acquisition or, if acquired by gift, at estimated fair value at the date of gift. Additions to plant assets are capitalized, while maintenance and minor renovations are charged to operations. Plant assets are reflected net of accumulated depreciation calculated on a straight-line basis over the estimated useful lives ranging from three to fifty years. Land and art/collections are considered non-depreciable given the nature of the assets. Equipment is removed from the records at the time of disposal.

The University recognizes asset retirement obligations ("ARO"s) that are conditional on a future event, such as the legal obligation to safely dispose of asbestos when a building is remodeled or demolished. The University measures conditional AROs at estimated fair value using site specific surveys and a probability-weighted, discounted cash flow model with multiple scenarios, if applicable.

The University reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment charge is recognized when the fair value of the asset is less than the carrying value.

Deposits & Deferred Revenues

Deposits and deferred revenues consist of amounts contracted, billed, or received for education, research, intercollegiate athletics, auxiliary goods and services, vendor long-term contracts incentive payments, or rental space that have not yet been earned.

Other Liabilities

Other liabilities consist of annuities payable, interest rate swap liability, liability for conditional asset retirement obligations, and federal student loan funds refundable.

Tuition & Fees

Tuition and fees revenues are recognized in the fiscal year during which the related semester concludes. Scholarships provided by the University for tuition and fees are reflected as a reduction of tuition and fees revenues. Scholarships are awarded to students by the University from unrestricted revenues, restricted endowment earnings, restricted gifts or government grants. Scholarships do not include payments to students for services rendered to the University.

Contributions

Contributions are recorded as revenues in the appropriate net asset class based on donor-imposed restrictions. Expiration of temporary restrictions on donor contributions are reported as net assets released from restrictions. Contributions received with donor-imposed restrictions that are anticipated to be met in the same year as received are reported as revenues of the unrestricted net asset class.

Donor contributions to fund construction projects are classified as temporarily restricted net assets until the facility is placed in service. At that time, the temporarily restricted net assets are released from restriction and replenish unrestricted net asset balances designated for plant projects. The University follows the policy of recording contributions of long-lived assets directly as invested in plant assets.

Contributions receivable are recorded, net of an allowance for uncollectible amounts, at the present value of estimated future cash flows using a discount rate appropriate to the effective date of the gift agreement. The allowance for uncollectible contributions receivable is estimated based upon management's judgment, considering such factors as prior collection history, type of contribution, relationship with donor, nature of fundraising activity, and other relevant factors.

Functional Allocation of Expenses

The expenses of providing various programs and support services have been categorized on a functional basis in the statements of activities. Accordingly, expenses such as depreciation, interest expense, and operation and maintenance of plant have been allocated directly or based on square footage among the functional categories.

Fundraising expenses of $15,990,000 and $18,170,000 incurred by the University in 2017 and 2016, respectively, are included primarily in the institutional support category in the statements of activities.

Use of Estimates & Assumptions

The preparation of financial statements requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues, and expenses during the reporting period, as well as the disclosure of contingent assets and liabilities. Significant items subject to such estimates and assumptions include valuations of certain investments which do not have readily determinable fair values, contributions receivable, allowances for uncollectible accounts and contingency reserves, calculations of asset retirement obligations, interest rate swap liability, and actuarially determined liabilities related to postretirement benefits. Actual results ultimately could differ from management's estimates and assumptions.

2. FAIR VALUE MEASUREMENTS

The estimated fair values of financial instruments that differ from the carrying amounts have been determined by the University using available market information. The estimates are not necessarily indicative of the amounts the University could realize in a current market exchange.

The carrying amounts of cash and cash equivalents, short-term investments, student accounts receivable, accounts payable, personnel related, and other liabilities approximate fair value because of their short maturity.

The carrying value of loans receivable from students under government loan programs is a reasonable estimate of fair value since the loans receivable cannot be sold and can only be assigned to the U.S. government or its designees. The fair value of loans receivable from students under University loan programs approximates carrying value.

The University records long-term investments and interest rate swaps at fair value. The estimated fair value of investments is based on quoted market prices except for certain investments for which quoted market prices are not available. U.S. GAAP provides guidance for estimating the fair value of investments in investment funds that calculate net asset value ("NAV"). Accordingly, investments for which observable market prices in active markets do not exist are reported at fair value, as determined by the University, using NAV as a practical expedient of fair value and other available information. The amount determined to be fair value may incorporate the University's own assumptions (including appropriate risk adjustments for nonperformance and lack of marketability).

The estimated fair value of alternative assets managed and held in limited partnership or other private fund structures is primarily based upon the practical expedient of external investment fund managers' provided NAV, adjusted for cash flows through May 31. The University implemented the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2015-07, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)." Under this standard, investments for which fair value is measured at NAV per share (or its equivalent using the practical expedient) are removed from the fair value hierarchy. The requirements of this update are reflected in the tables in Footnote 4 with 2016 amounts reclassified to conform to the current year presentation. In instances where external investment fund managers' provided NAV are not used, the University applied additional valuation procedures furnished by qualified third parties or incorporated additional related financial data provided by fund managers to arrive at a fair value different than external investment fund manager provided values. When the University determines a different value, the investment is carried at the more conservative of the two values. Therefore, the University believes the carrying amount of these financial instruments is a reasonable estimate of the fair value. Because alternative assets are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed.

The fair value of private investment funds offered for sale in secondary markets are estimated utilizing valuation and market study information provided by an outside consulting firm, resulting in discounts to external investment fund managers' provided NAV.

The fair value of direct real estate holdings is determined from the most recent information available to the University (i.e., appraisals and/or property tax statements).

The fair value of mineral interests is estimated based on the expected net revenues generated by those assets. With certain holdings, geological reserve analysis can provide additional information for estimating fair value. For the years ended May 31, 2017 and 2016, the University utilized an engineering report and geological study of its largest mineral interest holding to obtain a more informed estimate of fair value and incorporated the results of the study into its estimate of expected net revenues and fair value for this holding.

The fair value of income interests/perpetual trusts is estimated based on the underlying assets contributed to the trusts.

Fair value is reflected in a hierarchy which prioritizes and ranks the level of market price observability. Market price observability is impacted by a number of factors, including the type of investment, the characteristics specific to the investment, and the state of the marketplace (including the existence and transparency of transactions between market participants). Investments with readily-available actively quoted prices or for which fair value can be measured from actively-quoted prices in an orderly market will generally have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Investments measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

Level 1 – Quoted prices (unadjusted) are available in active markets for identical investments that the University has the ability to access as of the reporting date. The type of investments generally included in Level 1 are listed securities traded on public exchanges and open-end mutual funds and other publicly traded listed securities held indirectly through separately managed accounts, trusts, and private fund structures.

Level 2 – Pricing inputs are observable for the investments, either directly or indirectly, as of the reporting date, but are not the same as those used in Level 1. Fair value is determined through the use of models or other valuation methodologies. The types of investments generally included in this category are hedge funds primarily holding publicly-traded securities with significant fund level liquidity within ninety days.

Level 3 – Pricing inputs are unobservable for the investments and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant judgment or estimation. These types of investments generally include hedge funds with significant liquidity restrictions, private equities, and real assets held in partnership format.

Whereas Level 1 investments are able to be liquidated as of the reporting date at published market values, Level 2 and 3 investments may contain restrictions on the ability to liquidate assets as of the reporting date. Investments that can be liquidated within ninety days of the reporting date at NAV or its equivalent are classified as Level 2 investments. Investments classified as Level 3 have significant liquidity restrictions which would prevent redemption within ninety days of the reporting date, if at all.

U.S. GAAP permits entities to choose to measure financial instruments and other items at fair value that are not currently required to be measured at fair value. The University has elected not to value any other financial assets or liabilities at fair value as provided for in accounting guidelines.

The University implemented the provisions of FASB ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities." This standard removed the disclosure of the fair value of notes and bonds payable. The University has discontinued this disclosure in Footnote 8.

3. ENDOWMENT

The University's endowment totals $1,231,712,000 and $1,153,535,000 as of May 31, 2017 and 2016, respectively, and is a component of the University's long-term investment pool. The endowment consists of $983,954,000 and $919,230,000 of donor-restricted endowment net assets and $247,758,000 and $234,305,000 of Board designated endowment net assets as of May 31, 2017 and 2016, respectively. The management of the endowment is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 ("UPMIFA"). The Board of the University has an established policy consistent with UPMIFA as adopted by the State of Texas. The University seeks to preserve the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. Accordingly, 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 agreement 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 net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

(1) The duration and preservation of the fund
(2) The purposes of the University and the donor restricted endowment fund
(3) General economic conditions
(4) The possible effect of inflation and deflation
(5) The expected total return from income and the appreciation of investments
(6) Other resources of the University
(7) The investment policies of the University

Board designated endowment net assets include gifts and other revenues that have been designated by the Board to function as endowment. These funds may be expended at the discretion of the Board. Also included are certain temporarily restricted net assets that have not been expended for their restricted purpose but are being invested and the earnings expended for the restricted purpose.

Changes in endowment net assets for the year ended May 31, 2017 are as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2016	$ 195,146	$ 234,657	$ 723,732	$ 1,153,535
Investment earnings, net of expenses	2,300	9,133	--	11,433
Net realized & unrealized gains (losses) on investments	27,337	69,763	4,739	101,839
Contributions	--	--	19,133	19,133
Terminated annuities & other	--	--	5,091	5,091
Transfers to Board designated	7,511	(3,222)	--	4,289
Distributions reinvested	46	1	2,076	2,123
Distributions	(13,224)	(52,507)	--	(65,731)
Endowment net assets, May 31, 2017	$ 219,116	$ 257,825	$ 754,771	$ 1,231,712

Changes in endowment net assets for the year ended May 31, 2016 (reclassified), are as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, May 31, 2015	$ 187,103	$ 282,153	$ 696,294	$ 1,165,550
Investment earnings, net of expenses	2,460	10,222	--	12,682
Net realized & unrealized gains (losses) on investments	(14,908)	(6,553)	(6,882)	(28,343)
Contributions	--	--	27,079	27,079
Terminated annuities & other	7	--	4,698	4,705
Transfers to Board designated	32,913	679	--	33,592
Distribution reinvested	47	--	2,543	2,590
Distributions	(12,476)	(51,844)	--	(64,320)
Endowment net assets, May 31, 2016	$ 195,146	$ 234,657	$ 723,732	$ 1,153,535

From time to time, the market value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the University to retain as a fund of perpetual duration. In such instances, the difference is reported in unrestricted net assets in the accompanying balance sheets and totaled $8,748,000 and $17,046,000 as of May 31, 2017 and 2016, respectively.

Return Objectives & Risk Parameters

The University has adopted investment and spending policies for endowment assets that attempt to meet three objectives: (1) provide a predictable, stable stream of earnings to participating accounts; (2) ensure that the purchasing power of this revenue stream does not decline over time; and (3) ensure that the purchasing power of the endowment assets do not decline over time. To meet its long-term rate-of-return objectives, the University relies on a total return strategy utilizing both income and growth to maximize the risk adjusted return through diversification of the assets. Under this policy, actual earnings, as well as a prudent portion of realized and unrealized gains may be distributed for operational needs or in accordance with donor restrictions. Accordingly, the endowment assets are invested in a diversified manner that is intended to produce results that exceed its long-term performance benchmarks. The University expects its endowment funds, over time, to provide an average rate of return at least equal to the spending policy requirements plus the rate of inflation. Actual returns in any given year may vary from this amount.

Spending Policy & How the Investment Objectives Relate to Spending Policy

The Baylor University Fund ("BUF") is a unitized fund consisting of publicly traded equity and fixed income securities, alternative assets, and mineral rights; and serves as the primary investment vehicle for the University's endowment and other long-term investments. As permitted under Texas law, the Board has adopted a spending policy for the BUF that authorizes a dividend to be paid for endowments participating in the BUF to be used for the purposes intended by donors. For the years ended May 31, 2017 and 2016, this dollar dividend per BUF unit was based on 5% of the previous 48-months' rolling average net asset market value per unit of the BUF. The permitted change in this dividend amount from the previous year shall be no less than 0% and no more than 6%, and in no case shall the annual fiscal year distribution (dollar dividend amount per BUF unit) exceed 7% of the previous 48-months' rolling average net asset market value per BUF unit. The dividend amount remained the same for the years ended May 31, 2017 and 2016. Endowment earnings distributed include endowment distributions in accordance with the University's BUF spending policy, as well as, distributions of income from other endowment assets.

In establishing this spending policy, the University considered the long-term expected return on its endowment assets. Accordingly, the University expects the current spending policy to preserve the real purchasing power of the endowment assets, while helping to maintain intergenerational value of the assets, as well as to provide additional real growth through new gifts and investment return.

4. LONG-TERM INVESTMENTS

The University diversifies its investments among various financial instruments and asset categories and uses multiple investment strategies. As with most large endowments, these financial assets are managed primarily through external investment management firms selected and monitored by the University's Office of Investments and the Baylor Executive Investment Committee in accordance with the University's Endowment Investment Policy. The investment management firms are predominately organized in limited partnership, private fund, registered investment company (1940 Act mutual fund), separately managed account, and trust format. Excluding income interests and perpetual trusts, the University's long-term investments were invested with 89 and 90 different managers at May 31 2017 and 2016, respectively. Of those, alternative assets were invested with 65 and 67 managers, respectively.

Fixed income securities are assets predominately invested (directly or indirectly) in domestic and international government or corporate bonds for which active trading markets exist, including open and closed-end mutual funds holding such securities.

Public equities are assets invested (directly or indirectly) in publicly traded equity shares which are listed on national and international exchanges as well as publicly traded mutual fund trusts and private fund structures holding such securities.

Alternative assets consist of private equities, real assets, and hedge funds investments and are primarily held in limited partnership format. Capital is allocated to domestic and international markets in the various alternative investment funds. Most of the underlying assets in the private equity and real asset partnerships and trusts are not immediately liquid. Private equity fund strategies include buyouts, venture capital, distressed/special situations, emerging markets, and secondary markets. Real asset funds are predominately private limited partnerships investing in numerous types of properties and strategies such as commercial real estate, energy, power, and infrastructure, as well as timber and other natural resources and commodities including industrial and precious metals. Private equity and real asset funds are held as long-term investments and are structured as closed-end, commitment-based investment funds where the investor commits a specified amount of capital upon inception of the fund which is then drawn down over a specified period of the fund's life. These funds generally cannot be redeemed prior to the specified termination date and will only receive distributions upon a disposition of the underlying assets of the portfolio. As a limited partner, the University will not generally have any influence over the amount and timing of capital contributions and distributions. At May 31, 2017, the remaining life of private equity and real asset funds ranged from one to twelve years. Hedge fund investments are generally open-end funds structured in limited partnership format. These funds employ various investment strategies such as long/short equity, fundamental value, multi-strategy (including a small allocation to fund-of-funds), distressed asset and debt, and short credit. The amount of liquidity available to investors is directly related to the liquidity and risk associated with the underlying portfolio. Hedge funds typically offer subscription and redemption options to investors over time periods shorter than private equity/real asset funds; however, the frequency of subscriptions or redemptions is dictated by each fund's governing documents. Liquidity of individual hedge funds also varies due to illiquid "side-pocket" investments, as well as contractual restrictions on redemption such as gating and holdback provisions. Redemption terms of hedge funds range from monthly upon thirty day notice to rolling three years upon forty-five day notice. At May 31, 2017, BUF included twenty-five hedge funds totaling $259,656,000, of which six funds totaling $3,783,000 have been suspended, gated, or are monetizing illiquid side pocket investments. These six funds are in liquidation mode.

Real estate & other investments represent direct real estate and asset holdings of the University and are not held in the fund, limited partnership, and trust structures described above.

Mineral rights are held and managed for the benefit of the University under various contractual and revocable trust arrangements and are not held in the fund and limited partnership structures described above. The University retains ultimate ownership and control of these assets.

Income interests/perpetual trusts are held and managed by outside trustees under various annuity and trust arrangements for the benefit of Baylor. The University receives income distributions over time in accordance with the governing annuity, trust and gift instruments. The underlying investments of the income interests/perpetual trusts are primarily comprised of publicly traded equity and fixed income investments held in common trust funds and other funds managed or selected by the outside trustees.

The following table presents information about the University's long-term investments that are measured at fair value as of May 31, 2017 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value *(in thousands of dollars)*:

	Level 1	Level 2	Level 3	NAV	Total
Fixed income securities	$ 192,646	$ --	$ --	$ --	$ 192,646
Public equities	314,793	--	973	--	315,766
Alternative assets	--	--	40,155	524,054	564,209
Real estate & other	--	--	5,025	--	5,025
Mineral rights	--	--	12,226	--	12,226
Income interests/perpetual trusts	--	--	188,382	--	188,382
Total	$ 507,439	$ --	$ 246,761	$ 524,054	$ 1,278,254

The following table presents additional information about assets that have been measured at fair value as of May 31, 2017 on a recurring basis using significant unobservable inputs (Level 3) *(in thousands of dollars)*:

	May 31, 2016 Balance	Transfers In (Out) of Level 3	Additions	Distributions	Realized & Unrealized Gains (Losses)	May 31, 2017 Balance
Public equities	$ 933	$ --	$ --	$ --	$ 40	$ 973
Alternative assets	52,762	--	351	(17,440)	4,482	40,155
Real estate & other	9,631	--	403	(4,844)	(165)	5,025
Mineral rights	16,141	--	2,238	(2,392)	(3,761)	12,226
Income interests/ perpetual trusts	176,398	--	2,652	(1,150)	10,482	188,382
Total	$ 255,865	$ --	$ 5,644	$ (25,826)	$ 11,078	$ 246,761

The following table presents information about the University's long-term investments that are measured at fair value as of May 31, 2016 (reclassified), and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value *(in thousands of dollars)*:

	Level 1	Level 2	Level 3	NAV	Total
Fixed income securities	$ 124,337	$ --	$ --	$ --	$ 124,337
Public equities	338,648	--	933	--	339,581
Alternative assets	--	--	52,762	479,198	531,960
Real estate & other	--	--	9,631	--	9,631
Mineral rights	--	--	16,141	--	16,141
Income interests/perpetual trusts	--	--	176,398	--	176,398
Total	$ 462,985	$ --	$ 255,865	$ 479,198	$ 1,198,048

The following table presents additional information about assets that have been measured at fair value as of May 31, 2016 (reclassified) on a recurring basis using significant unobservable inputs (Level 3) *(in thousands of dollars)*:

	May 31, 2015 Balance	Transfers In (Out) of Level 3	Additions	Distributions	Realized & Unrealized Gains (Losses)	May 31, 2016 Balance
Public equities	$ 830	$ --	$ --	$ --	$ 103	$ 933
Alternative assets	66,281	--	2,600	(24,402)	8,283	52,762
Real estate & other	12,535	--	1,032	(3,928)	(8)	9,631
Mineral rights	24,270	--	3,246	(3,322)	(8,053)	16,141
Income interests/	191,267	--	3,019	(1,310)	(16,578)	176,398
Total	$ 295,183	$ --	$ 9,897	$ (32,962)	$ (16,253)	$ 255,865

Whereas the preceding tables reflect income interests and perpetual trusts separately based on fair value hierarchy, the following table reflects total investments, regardless of fair value hierarchy, using traditional classification descriptions as used by the University to manage its investment portfolio. Accordingly, the underlying assets of income interests/perpetual trusts are reflected within the traditional investment classifications. Additionally, alternative assets are reflected by major asset category. Estimated fair value of long-term investments as of May 31, 2017 and 2016, are as follows *(in thousands of dollars)*:

	2017	2016
Fixed income securities:		
Short-term funds	$ 66,179	$ 31,679
Bonds	164,475	136,875
Other	--	4,945
Public equities:		
Domestic	228,390	213,408
International	193,972	219,199
Alternative assets:		
Private equities	185,813	166,425
Hedge funds	271,228	300,413
Real assets	148,446	100,479
Mineral rights	19,751	24,625
Total	$ 1,278,254	$ 1,198,048

Long-term investments include operating, endowment, and annuity and life income assets. The annuity and life income assets under split-interest agreements total $25,916,000 and $23,750,000 as of May 31, 2017 and 2016, respectively.

The cost of long-term investments was $1,060,311,000 and $1,031,397,000 as of May 31, 2017 and 2016, respectively.

Return on long-term investments for the years ended May 31, 2017 and 2016, consist of the following *(in thousands of dollars)*:

	2017	2016
Investment earnings	$ 18,465	$ 19,587
Investment expenses	(6,959)	(6,832)
Net realized & unrealized gains (losses)	104,357	(30,131)
Total return on long-term investments	$ 115,863	$ (17,376)

Investment earnings consist of interest income, dividends, mineral, and other earnings. Investment expenses include consulting, custodian, and direct investment management expenses.

Distributions from long-term investments include distributions of endowment assets invested in long-term investments as well as distributions from funds other than endowment that are included in the long-term investments pool. Endowment distributions and other distributions are included in endowment distributions & investment income in the statements of activities.

Both the return on long-term investments and distributions from long-term investments are shown under non-operating activities in the statements of activities.

As part of the University's alternative assets program, the University is obligated under certain limited partnership agreements to advance funding up to specified levels upon the request of the general partner. The University had unfunded commitments consisting of the following at May 31, 2017 and 2016, respectively, which are expected to be called over the next three years *(in thousands of dollars)*.

	2017	2016
Alternative assets:		
Private equities	$ 200,811	$ 168,519
Real assets	123,115	130,721
Total unfunded commitments	$ 323,926	$ 299,240

5. CONTRIBUTIONS RECEIVABLE

As gift pledges are made to the University, the intent of the donor, the circumstances surrounding the pledge and any action taken by the University in response to the pledge are considered in determining whether the pledge is an "intent to give" or an "unconditional promise to give." An unconditional promise to give is recorded as a contribution receivable at the present value of the estimated future cash flows. Unconditional promises to give related to split interest agreements are discounted based on life expectancies of the annuity recipients.

As of May 31, 2017 and 2016, contributions receivable consists of the following *(in thousands of dollars)*:

	2017	2016
Due in 1 year	$ 23,352	$ 29,038
Due in 2 to 5 years	39,434	50,442
Due in 6 to 10 years	4,667	10,157
Due in greater than 10 years	400	400
Split interest agreements	19,611	19,295
Less: Present value adjustment	(8,954)	(10,290)
Less: Allowance for uncollectible contributions receivable	(6,785)	(9,004)
Total contributions receivable, net	$ 71,725	$ 90,038

Contributions receivable expected to be fulfilled more than one year from the date of the financial statements are discounted at 0.40% to 2.89%, with the discount amortized over the life of the unconditional promise. At May 31, 2017, contributions receivable primarily consisted of unconditional promises related to endowment or the construction of the new football stadium, Business School facility, and other building projects, of which twelve donors represented 75% of the total.

An intent to give is not recorded as gifts revenue until collected or converted to an unconditional promise to give. Intents to give totaled $38,067,000 and $33,021,000 as of May 31, 2017 and 2016, respectively. Payments on these intents to give are due in varying periods. Additionally, the University is the beneficiary under various wills and trust agreements of which the realizable amounts are not presently determinable. The University's share of such bequests is recorded when the University has an irrevocable right to the bequest and the proceeds are measurable.

6. PROPERTY, PLANT & EQUIPMENT

At May 31, 2017 and 2016, property, plant and equipment assets consist of the following *(in thousands of dollars)*:

	2017	2016
Land	$ 76,328	$ 75,550
Land/leasehold improvements	120,871	112,174
Buildings	1,261,469	1,212,065
Equipment	157,934	144,333
Arts/collections	12,648	12,177
Other	42,253	41,066
	1,671,503	1,597,365
Less accumulated depreciation	(516,326)	(463,754)
	1,155,177	1,133,611
Construction-in-progress	18,386	45,274
Property, plant & equipment, net	$ 1,173,563	$ 1,178,885

Depreciation expense was $56,779,000 and $50,532,000 as of May 31, 2017 and 2016, respectively. The "Equipment" category includes computers, software and other types of equipment above the $5,000 threshold. The "Other" category includes vehicles, library materials and miscellaneous other assets. Real and personal property were insured for $2 billion and $1.6 billion at May 31, 2017 and 2016, respectively. The liability for conditional asset retirement obligations was $4,516,000 and $4,293,000 as of May 31, 2017 and 2016, respectively, and is included in other liabilities in the accompanying balance sheets.

7. DEPOSITS & DEFERRED REVENUES

At May 31, 2017 and 2016, deposits and deferred revenues consist of the following *(in thousands of dollars)*:

	2017	2016
Tuition & fees	$ 41,536	$ 39,398
Student enrollment deposits	2,605	2,779
Intercollegiate athletics income	42,903	49,784
Vendor long-term contracts incentive payments	48,329	54,995
Sponsored research income	1,457	818
Rental & other income	7,947	8,268
Total deposits & deferred revenues	$ 144,777	$ 156,042

The deferred tuition and fees, student enrollment deposits, sponsored research, and other income will primarily be earned in the subsequent fiscal year. Intercollegiate athletics, vendor long-term contracts incentive payments, and rental deferred income includes advance ticket sales, football suite revenues, television income, advertising income, vendor long-term contracts incentive payments, and rental contracts advance payments that will be earned over the next one to thirteen years.

8. NOTES & BONDS PAYABLE

Notes and bonds payable consist of both non-interest bearing unsecured notes and interest bearing unsecured and secured notes, commercial paper with varying maturities, and bonds with varying terms and maturity dates to March 1, 2043. Interest payments on a cash basis totaled $26,069,000 and $26,111,000, and interest expense was $26,298,000 and $26,344,000 for the years ended May 31, 2017 and 2016, respectively. These amounts are exclusive of premium amortization. The amount of bond premium amortization that offset interest expense was $731,000 and $789,000 for the years ended May 31, 2017 and 2016, respectively. Bond premiums are being amortized using the effective interest method over the life of the bonds. Interest expense (net of earnings) of $0 and $475,000 was capitalized to projects for the years ended May 31, 2017 and 2016, respectively. Amortization expense and adjustments of bond issuance costs was $394,000 and $179,000 for the years ended May 31, 2017 and 2016, respectively.

Notes and bonds payable at May 31, 2017 and 2016, consist of the following *(in thousands of dollars)*:

	2017	2016
Interest bearing secured note payable to a corporation due in quarterly installments beginning May 1, 2015 to April 30, 2025	$ 4,081	$ 4,502
Non-interest bearing unsecured note payable to a corporation, due in annual installments through July 31, 2022	1,419	1,729
Taxable Commercial Paper Notes, Series A, with varying maturities and discount rates rolled at each maturity	15,000	15,000
Series 2008A Waco Education Finance Corporation Tax-Exempt Variable Rate Demand Bonds, swapped to a fixed rate of 2.476% (see Note 10), interest payable monthly, principal payable annually to February 1, 2032	--	62,400
Series 2008C Waco Education Finance Corporation Tax-Exempt Fixed Rate Bonds, interest ranging from 5.0% to 5.25% payable semiannually, principal payable annually beginning March 1, 2019 to March 1, 2036	112,100	112,100
Series 2011 Clifton Higher Education Finance Corporation Tax-Exempt Fixed Rate Bonds, interest ranging from 3.0% to 5.25% payable semiannually, principal payable annually beginning March 1, 2012 to March 1, 2032	84,335	87,795
Series 2012 Waco Education Finance Corporation Tax-Exempt Fixed Rate Bonds, interest ranging from 4.125% to 5.00% payable semiannually, principal payable March 1, 2043	120,000	120,000
Series 2012A Baylor University Taxable Fixed Rate Bonds, bearing interest at 4.313% payable semiannually, principal payable March 1, 2042	200,000	200,000
Series 2017 Waco Education Finance Corporation Tax-Exempt Variable Rate Bonds, swapped to a fixed rate of 2.476% (see Note 10), interest payable monthly, principal payable annually to February 1, 2032	59,750	--
Total notes & bonds payable prior to unamortized premium & debt issuance costs	596,685	603,526
Unamortized bond premium	11,401	12,132
Unamortized bond issuance cost	(3,714)	(3,794)
Total notes & bonds payable, net	$ 604,372	$ 611,864

The University implemented the provisions of FASB ASU 2015-03 “Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs.” Under this standard, unamortized debt issuance costs are presented as a deduction from the corresponding debt liability. The University has presented debt issuance costs as a reduction to notes & bonds payable within its May 31, 2017 financial statements and has reclassified $3,794,000 of unamortized debt issuance cost as of May 31, 2016 to conform with the current year presentation.

During the fiscal year ended May 31, 2017, the University issued $59,750,000 of tax-exempt variable rate bonds in order to refinance the Series 2008A bonds.

Excluding the maturity of commercial paper, scheduled principal payments on long-term notes and bonds for the periods subsequent to May 31, 2017, are as follows *(in thousands of dollars)*:

2018	$ 7,157
2019	10,290
2020	10,739
2021	11,209
2022	11,558
2023 and thereafter	530,732
Total	$ 581,685

The University has a taxable commercial paper program that provides for borrowings in the form of individual notes up to an aggregate of $50,000,000. The notes bear a fixed discount rate, established on the borrowing date, with no more than $15,000,000 maturing on any one day and maturities not to exceed 270 days. At May 31, 2017, the University had an outstanding balance of $15,000,000 in commercial paper notes with a discount rate of 1.00%. The University anticipates that the commercial paper will continue to be rolled at maturity until such time that it is refunded by long-term debt or repaid by the University.

9. NET ASSETS

The University's unrestricted, temporarily restricted, and permanently restricted net assets for the year ended May 31, 2017 are categorized by purpose as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Unrestricted-designated for operations	$ 84,178	$ --	$ --	$ 84,178
Unrestricted-designated for plant	82,050	--	--	82,050
Restricted	--	20,082	4,912	24,994
Endowment	(8,748)	237,931	754,771	983,954
Endowment-Board designated	227,864	19,894	--	247,758
Annuity & living trusts	--	12,382	20,499	32,881
Invested in or restricted for plant	382,502	13,157	--	395,659
Total net assets	$ 767,846	$ 303,446	$ 780,182	$ 1,851,474

The University's unrestricted, temporarily restricted, and permanently restricted net assets for the year ended May 31, 2016 are categorized by purpose as follows *(in thousands of dollars)*:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Unrestricted-designated for operations	$ 70,523	$ --	$ --	$ 70,523
Unrestricted-designated for plant	74,213	--	--	74,213
Restricted	--	20,902	4,915	25,817
Endowment	(17,046)	212,544	723,732	919,230
Endowment-Board designated	212,192	22,113	--	234,305
Annuity & living trusts	--	11,663	18,711	30,374
Invested in or restricted for plant	387,365	13,377	--	400,742
Total net assets	$ 727,247	$ 280,599	$ 747,358	$ 1,755,204

10. DERIVATIVE FINANCIAL INSTRUMENTS

On June 11, 2010, the University entered into a swap arrangement with a financial institution counterparty in order to swap the University's Series 2008A variable rate demand bonds with an original balance of $75,860,000 as of May 31, 2010 for a fixed rate of 2.476% through February 1, 2032, in exchange for monthly payments equal to 68% of three-month London Interbank Offered Rate. On May 30, 2017, the Series 2008A bonds, with a value of $59,750,000 were refinanced through the issuance of the Series 2017 variable rate bonds, having the same maturity schedule. The notional amount of the swap declines in accordance with the repayment of the Series 2017 bonds. The fair value of the University's interest rate swap liability was $4,784,000 and $6,866,000 at May 31, 2017 and 2016, respectively, and is included in other liabilities in the balance sheets. The change in the fair value of the interest rate swap resulted in a gain of $2,082,000 and a loss of $1,348,000 for the years ended May 31, 2017 and 2016, respectively. The fair value was measured using Level 2 valuation techniques.

11. EXPENSES BY NATURAL CLASSIFICATION

While the statements of activities present expenses by function, the University's expenses by natural classification are as follows *(in thousands of dollars)*:

	2017	2016
Salaries & wages	$ 269,700	$ 260,713
Personnel benefits	80,211	75,828
Student wages & fellowships	30,565	29,989
Operating expenses	197,342	192,507
Depreciation	56,779	50,532
Interest on indebtedness	25,567	25,080
Total expenses	$ 660,164	$ 634,649

12. RETIREMENT PLAN

The University provides a defined contribution retirement income plan and a voluntary tax deferred annuity program for faculty and staff that are administered by outside sources. The defined contribution plan is not a matching plan. Retirement benefits equal the amount accumulated to each individual employee's credit at the date of retirement. The University's contributions to the plan for the years ended May 31, 2017 and 2016 were $24,529,000 and $23,094,000, respectively.

13. POSTRETIREMENT BENEFITS

The University provides medical and life insurance benefits for eligible retired faculty and staff. Employees are eligible for such benefits if they retire after attaining specified age and service requirements while employed by the University. Group medical benefits have no lifetime maximum, and the maximum benefit for life insurance is $20,000.

Through May 31, 2002, full-time faculty and staff became eligible for these benefits upon reaching age fifty-five and having twenty years of full-time service at retirement. Effective June 1, 2002, employees with twenty years of continuous, full-time service at the University as of May 31, 2007, continue under the postretirement medical and life insurance programs in effect before June 1, 2002. Employees not meeting the above eligibility requirements may still participate in the postretirement medical program upon reaching age fifty-five and having ten years of full-time service at retirement. These employees will not receive postretirement life insurance benefits and will not be reimbursed for Medicare Part B premiums. Effective June 1, 2002, upon death of a retiree, the surviving spouse (current spouse upon retirement) has the same option of continuation in the postretirement medical program. These surviving spouses will not receive postretirement life insurance benefits and will not be reimbursed for Medicare Part B premiums.

Effective January 1, 2014, retirees age 65 and over transitioned from the existing medical benefits plan to a Health Reimbursement Arrangement to provide fixed annual contributions for medical expenses. Retirees age 65 and over, with twenty years of continuous, full-time service at the University as of May 31, 2007, continue to receive a Medicare Part B premium reimbursement.

Effective December 31, 2015, the University approved the establishment of a Health Reimbursement Arrangement ("HRA") to provide fixed annual contributions for pre-65 retiree medical expenses. Current pre-65 retirees, and those retiring prior to January 1, 2017, may elect to remain in the group medical plan; or, beginning January 1, 2017, opt into the HRA. This change resulted in a prior service cost decrease of $6,296,000 for the year ended May 31, 2016, which is included in the change in postretirement benefits obligation in the statements of activities.

The University implemented the provisions of FASB ASU 2017-07 "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." Under this standard, the service cost component of net periodic benefits cost is reported in the same line item as other compensation costs. The other components of net benefits cost (interest cost and amortization of both prior service cost and actuarial net gain or loss) are required to be presented in the statement of activities separately from the service cost component and outside a subtotal of change in net assets from operating activities. Accordingly, the University has reported $641,000 and $1,768,000 of interest cost and amortization of prior service cost and actuarial loss for the years ended May 31, 2017 and 2016, respectively, as other components of postretirement benefits cost in the non-operating activities portion of the statement of activities. Other components of net postretirement benefits cost totaling $1,768,000 for the year ended May 31, 2016 have been reclassified out of operating expenses to conform with the current year presentation.

The following tables set forth the required disclosures for postretirement benefits, as well as the components of net periodic benefits costs and weighted-average assumptions as of the measurement date, May 31 *(in thousands of dollars)*:

Change in benefits obligation:	2017	2016
Measurement date	5/31/2017	5/31/2016
Accumulated postretirement benefits obligation (APBO) at beginning of year	$ 45,570	$ 55,856
Service cost	945	1,187
Interest cost	1,783	2,273
Plan participants' contributions	279	276
Plan changes	--	(6,296)
Actuarial (gain) loss	654	(5,391)
Retiree drug subsidy paid	--	--
Benefit payments	(2,402)	(2,335)
Accumulated postretirement benefits obligation (APBO) at end of year	$ 46,829	$ 45,570
Change in plan assets:		
Fair value of plan assets at beginning of year	$ --	$ --
Employer contributions	2,123	2,059
Plan participants' contributions	279	276
Benefit payments	(2,402)	(2,335)
Fair value of plan assets at end of year	$ --	$ --
Funded (unfunded) status of plan	$ (46,829)	$ (45,570)

Amounts recognized as changes in unrestricted net assets arising from postretirement benefits plan but not yet included in periodic benefits cost:	2017	2016
Transition obligation	$ --	$ --
Prior service cost (credit)	(13,926)	(15,899)
Net loss	17,798	17,976
Total	$ 3,872	$ 2,077

The University expects to amortize, from accumulated unrestricted net assets, $1,973,000 of prior service cost credits and $801,000 of net losses as components of net periodic benefits cost during the year ending May 31, 2018.

Weighted-average assumptions at measurement date:	5/31/2017	5/31/2016
Discount rate	4.10%	4.00%
Health care cost trend rate	8.50%	8.00%
Ultimate health care cost trend rate	4.50%	4.50%
Year ultimate trend rate reached	2026	2023

The inflation rates for retiree contributions are assumed to be the same as the medical cost inflation rates.

Plan contributions:

The University expects to contribute $2,174,000 to its postretirement benefits plan during the year ending May 31, 2018. The tables below provide additional information related to projected cash flows and fiscal year costs *(in thousands of dollars)*:

Projected cash flows:	Gross Benefits Payments Net of Employee Contributions
2018 fiscal year	$ 2,174
2019 fiscal year	2,229
2020 fiscal year	2,264
2021 fiscal year	2,303
2022 fiscal year	2,382
2023-2027 fiscal years	12,583

Components of net periodic postretirement benefits cost:	6/1/2016-5/31/2017	6/1/2015-5/31/2016
Measurement date	5/31/2016	5/31/2015
Service cost	$ 945	$ 1,187
Other components of postretirement benefits cost:		
Interest cost	$ 1,783	$ 2,273
Amortization of:		
Transition obligation	--	--
Prior service cost	(1,973)	(1,620)
Actuarial loss	831	1,115
Total other components of postretirement benefits cost	$ 641	$ 1,768
Total net periodic postretirement benefits cost	$ 1,586	$ 2,955
Other changes in plan assets & benefits obligation recognized:		
Net actuarial loss	$ 654	$ (5,391)
Prior service cost	--	(6,296)
Amortization of:		
Transition obligation	--	--
Prior service cost	1,973	1,620
Actuarial gain	(831)	(1,115)
Change in postretirement benefits obligation other than net periodic benefits cost	$ 1,796	$ (11,182)
Total recognized in net assets & net periodic benefits cost	$ 3,382	$ (8,227)

Weighted-average assumptions for net periodic postretirement benefits cost:		
Measurement date	5/31/2016	5/31/2015
Discount rate	4.00/4.41%	4.41%
Health care cost trend rate	8.00%	7.50%
Ultimate health care cost trend rate	4.50%	5.00%
Year ultimate trend rate reached	2023	2020
Average future working lifetime (years)	16.2	16.2

Other information: (in thousands of dollars:)	6/1/2016-5/31/2017	6/1/2015-5/31/2016
1% increase in trend rates		
Effect on service + interest cost	$ 1	$ 71
Effect on APBO	29	611
1% decrease in trend rates		
Effect on service + interest cost	$ (1)	$ (59)
Effect on APBO	(27)	(526)

14. TAX STATUS & ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES

The University is exempt from income tax under section 501(a) of the Internal Revenue Code ("IRC") of 1986, as amended, as an organization described in section 501(c)(3) of the IRC as evidenced by its most recent determination letter dated May 23, 2002. The University has been classified as an organization that is not a private foundation because it qualifies under section 509(a)(1) as an educational institution, and donations to it qualify for deduction as charitable contributions. However, income generated from activities unrelated to the University's exempt purpose is subject to tax under IRC section 511. The University files unrelated business income tax and other returns as required by government authorities.

Tax positions taken relating to the University's tax-exempt status, unrelated business income activities taxable income and deductibility of expenses, and other miscellaneous tax positions taken by the University would more likely than not be sustained by examination. Accordingly, the University has not recorded an income tax liability for uncertain tax benefits. As of May 31, 2017, the University's tax years ended May 31, 2014 through 2017, generally, remain subject to examination.

15. RELATED PARTY TRANSACTIONS

Members of the University's Board of Regents and senior administration may, from time to time, be associated, either directly or indirectly, with entities doing business with the University. Accordingly, the University has Board of Regents, faculty, and staff written conflict of interest policies that require any such association, including those of immediate family members, to be disclosed on an annual basis and updated as appropriate during the year. If such associations exist, measures are taken to mitigate any actual or perceived conflict. For the years ended May 31, 2017 and 2016, there were no related party transactions that were considered to be significant or that were not effectively mitigated.

16. COMMITMENTS & CONTINGENCIES

Capital Expenditures & Other Commitments

At May 31, 2017, the University has commitments to expend approximately $13,771,000 to fulfill contracts related to building renovations and other capital projects.

The University also is contractually obligated under various agreements ensuring access to, or advantageous pricing of, goods and services used in the operations of the University.

Leases

The University incurred $2,031,000 and $2,120,000 in operating lease expenses for facilities and equipment in the years ended May 31, 2017 and 2016, respectively. As of May 31, 2017, the University has lease commitments for future periods as follows *(in thousands of dollars)*:

	2018	2019	2020	2021	2022	2023 and Thereafter	Total
Equipment	$ 68	$ 20	$ 18	$ 11	$ 3	$ --	$ 120
Other	1,288	300	34	34	34	82	1,772
Total	$ 1,356	$ 320	$ 52	$ 45	$ 37	$ 82	$ 1,892

Contingencies

The University is a party to various investigations, legal proceedings and claims associated with the University's implementation of Title IX of the Education Amendments of 1972 and the Violence Against Women Reauthorization Act of 2013, some of which are covered by insurance. Although it is impossible to predict with certainty the outcome, the administration is not aware of any current claims or contingencies, that either are not already reflected in the financial statements or will not be covered by insurance, which would materially impact the financial position of the University. Additional claims relating to such matters may be asserted in the future; however, sufficient information is not currently available to predict the potential outcome or financial impact.

The University is a party to various other legal proceedings and complaints arising in the ordinary course of business, some of which are covered by insurance. The resolution of such matters is not currently expected to have a material impact on the financial position of the University.

The University participates in several federal and state grant programs and must comply with requirements of the grantor agencies. The administration is of the opinion that the University is in compliance with these grantor requirements.

17. SUBSEQUENT EVENTS

The University has evaluated subsequent events through September 28, 2017, the date when financial statements were issued, and concluded that there were no material subsequent events requiring adjustment or disclosure.