Consolidated Financial Statements

Kansas University Endowment Association
Years Ended June 30, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

Kansas University Endowment Association

Consolidated Financial Statements

Years Ended June 30, 2016 and 2015

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Ernst & Young LLP
One Kansas City Place
Suite 2500
1200 Main Street
Kansas City, MO 64105-2143

Tel: +1 816 474 5200
Fax: +1 816 480 5369
ey.com

Report of Independent Auditors

The Members
Kansas University Endowment Association

We have audited the accompanying consolidated financial statements of Kansas University Endowment Association, which is comprised of the statements of financial position, as of June 30, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 consolidated financial position of the Kansas University Endowment Association as of June 30, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Report on Summarized Comparative Information

We have previously audited the Kansas University Endowment Association's 2015 consolidated financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated September 17, 2015. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2015, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Ernst & Young LLP

September 20, 2016

Kansas University Endowment Association

Consolidated Statements of Financial Position

	June 30 2016	June 30 2015
	(In Thousands)	
Assets		
Cash and cash equivalents	**$ 11,789**	$ 5,678
Receivables:		
Receivables from investing activities	**18,955**	877
Other receivables	**2,658**	1,593
Student loans receivable, less allowance of $1,542 and $1,574 in 2016 and 2015, respectively	**22,077**	22,271
Contributions pledged, less allowance of $1,727 and $1,785 in 2016 and 2015, respectively	**87,687**	111,485
Real estate loans receivable	**10,715**	8,864
Total receivables	**142,092**	145,090
Investments:		
Securities	**1,550,288**	1,609,660
Trusts held by others	**42,078**	42,469
Interest in other KU Endowment entities	**3,516**	3,783
Real estate	**13,489**	13,119
Total investments	**1,609,371**	1,669,031
Property and facilities:		
Land	**13,901**	14,513
Buildings	**26,183**	29,198
Equipment and furnishings	**2,852**	3,650
	42,936	47,361
Less accumulated depreciation	**12,296**	11,749
Net property and facilities	**30,640**	35,612
Deposits and other assets	**5,952**	5,841
Total assets	**$ 1,799,844**	$ 1,861,252

	June 30	
	2016	2015
	(In Thousands)	
Liabilities and net assets		
Liabilities:		
Accounts payable and accrued expenses	**$ 22,970**	$ 28,299
Payables from investment activities	**430**	853
Trust payable	**76**	–
Life income gifts payable	**23,179**	19,403
Agency funds	**65,768**	69,339
Total liabilities	**112,423**	117,894
Net assets:		
Unrestricted	**165,266**	176,743
Temporarily restricted	**1,082,707**	1,135,555
Permanently restricted	**439,448**	431,060
Total net assets	**1,687,421**	1,743,358
Total liabilities and net assets	**$ 1,799,844**	$ 1,861,252

See accompanying notes.

Kansas University Endowment Association

Consolidated Statements of Activities

	Year Ended June 30, 2016				Summarized Financial Information for the Year Ended June 30, 2015
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
			(In Thousands)		
Revenues, gains (losses), and other support:					
Fundraising:					
Contributions and grants received and pledged	**$ 2,632**	**$ 114,930**	**$ 7,428**	**$ 124,990**	$ 135,161
Bequests	**2,263**	**10,228**	**7,112**	**19,603**	59,743
Life income gifts	**–**	**391**	**31**	**422**	240
Change in value of life income gifts	**(30)**	**(1,630)**	**(1,587)**	**(3,247)**	2,453
Change in net interest in other KU Endowment entities	**–**	**(266)**	**–**	**(266)**	33
Total fundraising	**4,865**	**123,653**	**12,984**	**141,502**	197,630
Income (loss) from asset holdings:					
Investment income	**7,309**	**13,968**	**–**	**21,277**	20,839
Realized and unrealized gain (loss) on investments and trusts held by others	**5,846**	**(32,178)**	**(1,334)**	**(27,666)**	(11,237)
Loan interest income	**452**	**1,138**	**–**	**1,590**	1,268
Agricultural and mineral income	**771**	**713**	**–**	**1,484**	3,744
Rental, gain on sale of assets, and other income	**1,147**	**368**	**–**	**1,515**	6,068
Total income (loss) from asset holdings	**15,525**	**(15,991)**	**(1,334)**	**(1,800)**	20,682
Other receipts	**68**	**2,511**	**–**	**2,579**	16,559
Net assets released from restrictions:					
Satisfaction of program restrictions	**169,835**	**(169,835)**	**–**	**–**	–
Total revenues, gains and other support	**190,293**	**(59,662)**	**11,650**	**142,281**	234,871

Kansas University Endowment Association

Consolidated Statements of Activities (continued)

	Year Ended June 30, 2016				Summarized Financial Information for the Year Ended June 30, 2015
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
			(In Thousands)		
Expenses:					
University support:					
Student support	**$ 33,622**	**$ –**	**$ –**	**$ 33,622**	$ 30,353
Faculty support and contractual services	**33,988**	**–**	**–**	**33,988**	36,053
Construction, furnishings, equipment and supplies	**61,521**	**–**	**–**	**61,521**	70,585
Program and other educational support	**40,488**	**–**	**–**	**40,488**	47,571
Total University support	**169,619**	**–**	**–**	**169,619**	184,562
Supporting services:					
Administrative and fundraising support	**21,117**	**–**	**–**	**21,117**	19,412
Asset management expense	**943**	**–**	**–**	**943**	8,342
Depreciation	**1,260**	**–**	**–**	**1,260**	1,372
Total supporting services	**23,320**	**–**	**–**	**23,320**	29,126
Total expenses	**192,939**	**–**	**–**	**192,939**	213,688
Excess (deficit) of revenues over expenses	**(2,646)**	**(59,662)**	**11,650**	**(50,658)**	21,183
Net interfund transfers	**(3,552)**	**6,814**	**(3,262)**	**–**	–
Change in net assets before amortization of pension adjustments	**(6,198)**	**(52,848)**	**8,388**	**(50,658)**	21,183
Amortization of unrecognized actuarial adjustments	**(5,279)**	**–**	**–**	**(5,279)**	(3,369)
Change in net assets	**(11,477)**	**(52,848)**	**8,388**	**(55,937)**	17,814
Net assets at beginning of year	**176,743**	**1,135,555**	**431,060**	**1,743,358**	1,725,544
Net assets at end of year	**$ 165,266**	**$ 1,082,707**	**$ 439,448**	**$ 1,687,421**	$ 1,743,358

See accompanying notes.

Kansas University Endowment Association

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2016	**2015**
	(In Thousands)	
Operating activities		
Change in net assets	**$ (55,937)**	$ 17,814
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	**1,260**	1,372
Net realized and unrealized gain on investments and trusts held by others	**27,666**	11,237
Contributions restricted for long-term investment	**(33,559)**	(46,001)
Noncash contributions	**(2,811)**	(680)
Changes in operating assets and liabilities:		
Decrease (increase) in student loan receivable, net	**194**	(174)
Decrease in contributions pledged, net	**23,798**	308
Increase in real estate loans receivable	**(1,851)**	(79)
(Decrease) increase in accounts payable & accrued expenses	**(5,329)**	13,938
(Decrease) increase in agency funds	**(3,571)**	449
Decrease (increase) in net interest of KU Endowment entities	**267**	(204)
Other	**4,079**	(6,559)
Net cash used in operating activities	**(45,794)**	(8,579)
Investing activities		
Net expenditures for property and facilities	**(274)**	(1,069)
Net proceeds (expenditures) from real estate held for investment	**171**	(1,267)
Net proceeds from sale of investments	**206,996**	126,566
Purchase of investments	**(188,547)**	(161,541)
Net cash provided by (used in) investing activities	**18,346**	(37,311)
Financing activities		
Proceeds from contributions restricted for:		
Permanent endowment	**13,844**	3,323
Temporary funds	**19,715**	42,678
Net cash provided by financing activities	**33,559**	46,001
Net increase in cash and cash equivalents	**6,111**	111
Cash and cash equivalents at beginning of year	**5,678**	5,567
Cash and cash equivalents at end of year	**$ 11,789**	$ 5,678

See accompanying notes.

1. Organization

The Kansas University Endowment Association (KU Endowment) is an independent, nonprofit organization serving as the official fundraising and fund-management foundation for the University of Kansas (the University). Founded in 1891, KU Endowment is the oldest foundation of its kind and one of the largest at a public university in the United States. KU Endowment partners with donors in providing philanthropic support to build a greater university.

KU Endowment is an organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and has received an Internal Revenue Service (IRS) determination letter stating that its exempt function income is exempt from tax, pursuant to Section 501(a) of the Code. Accordingly, income taxes are not provided for in the accompanying consolidated financial statements.

2. Summary of Significant Accounting Policies

Basis of Presentation

KU Endowment's consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The following is a summary of the significant accounting and reporting policies used in preparing the accompanying consolidated financial statements.

KU Endowment has four wholly owned LLC companies to hold real estate and rental properties that are purchased or contributed to benefit the University. The assets and financial activity of the LLCs are presented in the accompanying consolidated financial statements. All material intercompany balances eliminate upon consolidation.

Fund Accounting

To ensure observance of limitations and restrictions that donors have placed on the use of resources available to KU Endowment, the accounts of KU Endowment are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes, as specified by the resource donor, are classified for accounting and reporting purposes into separate fund accounts that are established according to their individual nature and purpose. However, these separate accounts that have similar characteristics have been combined into groups in the accompanying consolidated financial statements, and all financial transactions have been recorded and reported accordingly by fund groups.

2. Summary of Significant Accounting Policies (continued)

Funds have been grouped by classification into three categories: unrestricted, temporarily restricted and permanently restricted. Unrestricted funds represent assets and contributions that are available for the broad benefit of the University but are not otherwise restricted by donors. Temporarily restricted funds represent assets and contributions with a donor-imposed restriction that permits the organization to use or expend the donated assets as specified, and the restriction is satisfied either by the passage of time or by actions of the organization. Permanently restricted funds represent assets and contributions with a donor-imposed restriction that stipulates that the resources be maintained permanently, but permits the organization to use or expend part or all of the income derived from the donated assets.

Cash and Cash Equivalents

KU Endowment considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Student Loans Receivable

As of June 30, 2016 and 2015, there was $2,519,000 and $2,899,000, respectively, of loans 90 days or more past due. Interest is accrued on loans that are more than 90 days and less than 180 days past due at 5% and on loans 180 days or more past due at 14% but this interest is fully reserved within the consolidated financial statements. KU Endowment writes off uncollectible loans, both principal and interest, after the external collection agency partners have determined that they are uncollectible.

Pledges, Contributions, Bequests and Grants

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or the condition has been satisfied. Contributions are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is satisfied (as to either time or purpose), temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying consolidated statements of activities as net assets released from restrictions.

2. Summary of Significant Accounting Policies (continued)

All unconditional contributions, bequests and grants are included in the revenue of unrestricted net assets at the time they are received or pledged. Donated property is recorded at fair market value on the date it is received or pledged.

Real Estate Loans Receivable

Real estate loans represent long-term loans for University-related construction projects that will be repaid by the University or its affiliates.

Investment Programs

Short-Term Investment Program

KU Endowment invests the excess cash balances in individual fund accounts by pooling them into a short-term investment program to produce a net investment yield. The total investment yield, less distributions of earnings to certain accounts, is retained by KU Endowment and is allocated to the unrestricted net asset classification to defray administrative costs.

Long-Term Investment Program

The individual fund accounts also may invest in the Long-Term Investment Program (LTIP), which are pooled together for investment purposes. Investment earnings of the LTIP are allocated to participating fund accounts on a market-value unit basis. Amounts allocated to participating fund accounts, under KU Endowment's spending policy, are based on a constant growth spending policy, where spending is adjusted annually by inflation, measured by the Consumer Price Index for All Urban Consumers (CPI-U). The target spending rate of the constant growth spending policy is 5.5% of the market value, with 4.6% out of 5.5% being allocated to participating funds for current expenditure. An amount equal to 0.9% out of 5.5% is allocated to the unrestricted fund group to defray administrative costs. To avoid potential underdistributions or unsustainable overdistributions relative to the current market value in any given year, the constant growth spending policy is subject to a 4.5% floor and a 6.5% cap of the trailing four-quarter average market value.

2. Summary of Significant Accounting Policies (continued)

Investment earnings, including interest, dividends, realized gains (losses) and unrealized gains (losses) in excess of amounts allocated as described above (accumulated investment earnings), are maintained in the LTIP. Such accumulated investment earnings are classified for consolidated financial statement purposes as temporarily restricted or agency funds, based on the donor's intentions for the use of the income in conjunction with KU Endowment's spending policy.

Investment Earnings

Investment earnings that are distributed to individual fund accounts as expendable resources, in accordance with KU Endowment's LTIP spending policy, are classified as unrestricted or temporarily restricted primarily based on the donor's intentions for the use of the account (see Long-Term Investment Program). The spending policy determines investment earnings that can be spent and investment earnings that are treated as temporarily restricted funds functioning as an endowment.

Realized gains and losses on sales of investments are computed on an average-cost basis. Income from asset holdings is reported net of related investment expenses of $5,220,000 and $5,808,000 for the years ended June 30, 2016 and 2015, respectively.

KU Endowment has invested in bank common trust funds that retain all dividends for reinvestment. Such dividends have been recorded as investment earnings and as an increase in the cost of the fund.

Property and Facilities

Assets acquired are recorded at cost if purchased. Assets held for future earnings potential are classified as investments in the accompanying consolidated statements of financial position. Improvements and replacements are capitalized, and repairs and maintenance are expensed as incurred. Assets held for use by the University or KU Endowment are classified as property and facilities.

Assets contributed are recorded at fair value at the date of donation. If the donor stipulates how long the asset must be used, the contribution is recorded as restricted support. In the absence of such stipulations, the contribution is recorded as unrestricted support.

2. Summary of Significant Accounting Policies (continued)

Depreciation of assets held for use is computed over the estimated useful lives of the respective assets using the straight-line method. Estimated useful lives used by principal asset groups for calculating depreciation are as follows:

Assets	Estimated Useful Life
Buildings:	
New:	
Laboratories	30 years
Other	30 – 50 years
Used	10 – 30 years
Building improvements	8 – 30 years
Equipment and furnishings	3 – 15 years

Agency Funds

KU Endowment holds certain endowment and other funds on behalf of the University and other affiliated third parties. Such funds totaled $65,768,000 and $69,339,000 at June 30, 2016 and 2015, respectively.

University Support

Expenses include distributions to support purposes of the University as a whole, as well as specific departments or schools of the University. Certain distributions, such as faculty and staff salary support, are made to the University, while others, such as student awards, are paid directly to the recipients. Total University support was $169,619,000 and $184,562,000 during the years ended June 30, 2016 and 2015, respectively.

Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments that appears on the accompanying consolidated statements of financial position, for which it was practicable to estimate that value (for all categories listed, the carrying value approximates fair value):

Cash and Cash Equivalents – Cash and cash equivalents are defined as cash on hand and cash in demand accounts.

2. Summary of Significant Accounting Policies (continued)

Contributions Pledged – Fair value, after allowance for uncollectible pledges, was determined by discounting the expected future cash flows.

Loans Receivable – Loans receivable are reported in the accompanying consolidated statements of financial position as outstanding principal, adjusted for the allowance for doubtful accounts. Management estimates the allowance for doubtful accounts based on losses inherent in the loan portfolio and existing economic conditions.

Investments – Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value, with gains and losses included in the accompanying consolidated statements of activities. The fair value is recorded based on prices quoted by securities dealers or brokers, investment bankers, or valuation specialists on the valuation date. Management's estimate of the fair value of investments is included in Note 5.

KU Endowment invests in limited partnerships and commingled vehicles, some of which employ traditional strategies in readily marketable securities and others of which employ less traditional strategies. The fair value of these investments is generally determined by an investment manager or their third-party administrator based on the net asset value (NAV) of the underlying investments. These investments are accounted for using the NAV practical expedient. A portion of the underlying investments is not readily marketable. Therefore, its estimated fair value is subject to uncertainty and may differ from the value that would have been used had a ready market for such investments existed.

Trusts Held by Others – Trusts that provide an irrevocable beneficial interest to KU Endowment and that are administered by third parties for the benefit of KU Endowment are included in the consolidated financial statements at the fair value of the assets contributed to the trust. Changes in the fair value of the trusts that exist in perpetuity are recorded in the accompanying consolidated statements of activities as permanently restricted.

Life Income Gifts – Life income gifts consist primarily of gift annuities and charitable remainder trusts and are recognized at fair value in the period the trust is established and adjusted accordingly in subsequent years. Generally, the terms of the life income gifts require KU Endowment to pay a specified amount or percentage of a fund's market value to a designated beneficiary for a specified term or the beneficiary's lifetime. Assets of such gifts are reported as a component of investment securities. Liabilities related to the gifts are recognized at the present value of the expected future

2. Summary of Significant Accounting Policies (continued)

cash payments to the beneficiaries and are discounted as of June 30, 2016, at the 2012 Individual Annuity Reserving table rates, and as of June 30, 2015, at rates specified by the Code Section 7520(a). The change in the rates used to discount the liabilities presents a more current mortality estimation that reflects a greater liability. Obligations to beneficiaries at June 30, 2016, were \$9,016,000 for gift annuities and \$14,163,000 for charitable remainder trusts. Obligations to beneficiaries at June 30, 2015, were \$6,779,000 for gift annuities and \$12,624,000 for charitable remainder trusts.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue, gains, and other support and expenses during the reporting periods. Actual results could differ from those estimates.

Concentrations of Credit Risk

Financial instruments that potentially subject KU Endowment to concentrations of credit risk include cash and cash equivalents, investments, loans receivable and contributions receivable. Investments and cash and cash equivalents are managed within guidelines established by KU Endowment, which, as a matter of policy, requires prudent diversification in order to minimize risk exposures. Concentrations of credit risk with respect to loans receivable and contributions receivable are limited since amounts are generally due from a large number of individual donors or corporations.

KU Endowment's investment programs are exposed to various kinds and levels of risk. Fixed-income securities expose KU Endowment to interest rate risk, credit risk, and liquidity risk. The current value of many fixed-income securities is affected as interest rates change, particularly those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligation. Liquidity risk is affected by the willingness of market participants to buy and sell given securities.

Equity securities expose KU Endowment to market risk, performance risk and liquidity risk. Market risk is the risk associated with major movements of equity markets, both domestic and international. Performance risk is the risk associated with a particular company's operating performance. Liquidity risk, as previously defined, tends to be higher for international equities and small capitalization equity companies.

2. Summary of Significant Accounting Policies (continued)

2015 Financial Information

The accompanying consolidated financial statements include certain prior-year summarized, comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. GAAP. Accordingly, such information should be read in conjunction with the organization's consolidated financial statements for the year ended June 30, 2015, from which the summarized information was derived.

New Accounting Pronouncements

In February of 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Under ASU 2016-02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor, and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2019, and requires a modified retrospective adoption, with early adoption permitted. The Endowment is in the process of evaluating the future impact of ASU 2016-02 on its consolidated statements of financial position, activities, and cash flows.

In August of 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 changes certain financial statement requirements for not-for-profit (NFP) entities. NFPs will no longer be required to distinguish between resources with temporary and permanent restrictions on the face of their financial statements, meaning they will present two classes of net assets instead of three. The guidance also will change how NFPs report certain expenses and provide information about their available resources and liquidity. ASU 2016-14 is effective for annual reporting periods beginning after December 15, 2018, and requires a retrospective adoption, with early application permitted. The Endowment is in the process of evaluating the future impact of ASU 2016-14 on its consolidated statements of financial position, activities, and cash flows.

3. Contributions Receivable

Contributions are generally recognized as revenue, gains, and other support at fair value when unconditional contributions are made. Contributions receivable at June 30, 2016 and 2015, are classified in the accompanying consolidated financial statements as follows (in thousands):

	2016	2015
Unrestricted	**$ 28,014**	$ –
Temporarily restricted	**60,281**	112,895
Permanently restricted	**1,119**	376
	$ 89,414	$ 113,271

Contributions receivable at June 30, 2016 and 2015, are due to be received in the following periods (in thousands):

	2016	2015
Receivable in less than one year	**$ 28,112**	$ 35,500
Receivable in one to five years	**55,424**	71,057
Receivable after five years	**9,246**	11,685
Total undiscounted contributions receivable	**92,782**	118,242
Less present value discount (weighted average discount rate of 1.60% in 2016 and 1.81% in 2015)	**(3,368)**	(4,972)
	89,414	113,270
Less allowance for doubtful contributions	**(1,727)**	(1,785)
Contributions receivable, net	**$ 87,687**	$ 111,485

An allowance for doubtful contributions is estimated from past-due pledge balances. Special consideration is given to significant pledges for which KU Endowment is concerned about future collectability.

4. Securities

Securities, carried at fair value or amounts that approximate fair value, consist of the following (in thousands):

	June 30	
	2016	**2015**
Money market and short-term investments	**$ 95,689**	$ 64,679
Domestic equity	**34,596**	38,302
U.S. treasury obligations	**730**	711
Exchange-traded funds	**19,308**	26,667
Open-ended mutual funds	**217,382**	288,100
Closed-ended mutual funds	**31,664**	39,708
Collateralized mortgage obligations	**65,206**	59,759
Common trust funds – equities	**299,933**	261,815
Common trust funds – fixed income	**99,884**	96,349
Real estate	**1,695**	1,695
Royalties and mineral interests	**162**	162
Hedge funds	**428,196**	485,713
Private investments	**194,171**	153,353
Other LLCs and LLPs	**61,672**	92,647
	$ 1,550,288	$ 1,609,660

5. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures,* issued by the Financial Accounting Standards Board (FASB), establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). In determining fair value, KU Endowment uses various methods, including the market, income and cost approaches. Based on these approaches, KU Endowment utilizes certain assumptions that market participants would use in pricing the assets, including assumptions about risk and the risks inherent in the inputs to the valuation techniques. The

5. Fair Value Measurements (continued)

inputs can be readily observable, market corroborated, or generally unobservable inputs. KU Endowment uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The observability of the inputs used in the valuation techniques is the basis for determining the appropriate fair value hierarchy level.

Certain of KU Endowment's financial assets and financial liabilities are measured at fair value on a recurring basis, including money market, fixed-income and equity instruments. The three levels of the fair value hierarchy and a description of the valuation methodologies used for instruments measured at fair value are as follows:

> *Level 1* – Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date. Level 1 primarily consists of financial instruments, such as money market securities and exchange-traded equities.
>
> *Level 2* – Pricing inputs other than quoted prices included in Level 1 that are either directly observable or that can be derived or supported by observable data as of the reporting date. Instruments in this category include certain U.S. government agency and sponsored entity debt securities and commingled common trust funds.
>
> *Level 3* – Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

5. Fair Value Measurements (continued)

The fair value of financial assets measured at fair value on a recurring basis was determined using the following inputs at June 30, 2016 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	June 30, 2016	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Long-term investments:				
Money markets and short-term investments	$ 95,689	$ 95,689	$ –	$ –
Marketable domestic equity securities	34,596	34,596	–	–
U.S. treasury obligations	730	–	730	–
Open-ended mutual funds	217,382	217,382	–	–
Closed-ended mutual funds	31,664	31,664	–	–
Exchange-traded funds	19,308	19,308	–	–
Collateralized mortgage obligations (CMOs)	65,206	–	65,206	–
Real estate	1,695	–	–	1,695
Royalties and mineral rights	162	–	–	162
	466,432	398,639	65,936	1,857
Trusts held by others	37,483	28,519	3,300	5,664
Interest in other KU Endowment entities	2,905	2,866	39	–
	$ 506,820	$ 430,024	$ 69,275	$ 7,521

Changes in Level 3 fair value measurements were as follows for the year ended June 30, 2016 (in thousands):

Fair value beginning balance	$ 8,339
Transfers into trusts held by others	–
Realized and unrealized loss on trusts held by others	(818)
Realized and unrealized loss on royalties and mineral interests	–
Fair value ending balance	$ 7,521

5. Fair Value Measurements (continued)

The fair value of financial assets measured at fair value on a recurring basis was determined using the following inputs at June 30, 2015 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	June 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Long-term investments:				
Money markets and short-term investments	$ 64,679	$ 64,679	$ –	$ –
Marketable domestic equity securities	38,303	38,303	–	–
U.S. treasury obligations	711	–	711	–
Open-ended mutual funds	288,100	288,100	–	–
Closed-ended mutual funds	39,708	39,708	–	–
Exchange-traded funds	26,667	26,667	–	–
Collateralized mortgage obligations (CMOs)	59,759	–	59,759	–
Real estate	1,695	–	–	1,695
Royalties and mineral rights	162	–	–	162
	519,784	457,457	60,470	1,857
Trusts held by others	37,220	27,719	3,019	6,482
Interest in other KU Endowment entities	3,162	3,112	50	–
	$ 560,166	$ 488,288	$ 63,539	$ 8,339

Changes in Level 3 fair value measurements were as follows for the year ended June 30, 2015 (in thousands):

Fair value beginning balance	$ 8,527
Transfers into trusts held by others	–
Realized and unrealized gains on trusts held by others	(59)
Realized and unrealized gains on royalties and mineral interests	(129)
Fair value ending balance	$ 8,339

5. Fair Value Measurements (continued)

The fair values of the securities included in Level 1 were determined through quoted market prices. The fair values of Level 2 securities were determined through evaluated bid prices based on recent trading activity and other relevant information, including market interest rate curves, referenced credit spreads, and estimated prepayment rates, where applicable, which are used for valuation purposes and are provided by third-party pricing services where quoted market values are not available. Level 2 investments include corporate fixed income, government bonds, American depository receipts, collateralized mortgage obligations, and commingled common trust funds. Due to the volatility of the capital markets, there is a reasonable possibility of significant changes in fair value and additional gains (losses) in the near term subsequent to June 30, 2016.

The fair value of trusts held by others is estimated based on KU Endowment's beneficial interests in the trusts held by others. Certain of the underlying investments within the trusts held by others utilize significant unobservable inputs. Thus, KU Endowment's ownership of these underlying investments is categorized as Level 3 in the fair value hierarchy. The fair values of real estate, royalties, and mineral rights are based on inputs that are not observable in the market. Thus, KU Endowment's ownership of these investments is categorized as Level 3 in the fair value hierarchy.

In May 2015, the FASB issued Accounting Standards Update (ASU) 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)*. The amendments apply to reporting entities that elect to measure the fair value of an investment using the NAV per-share (or its equivalent) practical expedient. The amendments remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the NAV per-share practical expedient. The amendments in this ASU are effective for reporting periods beginning after December 15, 2016, with early adoption permitted. KU Endowment reviewed this ASU and elected to early adopt these amendments in the year ended June 30, 2015, and has removed certain investments that are measured using the NAV practical expedient from the fair value hierarchy in all periods presented in the consolidated financial statements. These investments, by type, are outlined in the table below.

5. Fair Value Measurements (continued)

	Fair Value June 30, 2016	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Common trust funds – equities	**$ 303,547**	**$ –**	Daily, monthly, quarterly	1–45 days
Common trust funds – fixed income	**100,787**	**–**	Daily, monthly	1–10 days
Hedge funds	**428,449**	**5,200**	Monthly, quarterly, semi-annually, annually	15–90 days
Private investments	**194,289**	**144,329**	N/A	N/A
Other LLCs and LLPs	**61,990**	**–**	Monthly	1–30 days
Total	**$ 1,089,062**	**$ 149,529**		

	Fair Value June 30, 2015	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Common trust funds – equities	$ 267,225	$ –	Daily, monthly, quarterly	1–45 days
Common trust funds – fixed income	96,370	–	Daily, monthly	1–10 days
Hedge funds	486,001	–	Monthly, quarterly, annually	15–90 days
Private investments	153,447	150,692	N/A	N/A
Other LLCs and LLPs	92,704	–	Monthly	1–30 days
Total	$ 1,095,747	$ 150,692		

Investments in common trust funds are invested primarily in marketable common stocks and bonds. The fair values of these investments have been estimated using the NAV per share of the investments.

Hedge funds, private investments (private equity, venture capital and private real assets), and investments in other LLCs and LLPs are also accounted for at fair value using the NAV as the practical expedient. The primary objectives for these investment types are to improve diversification and reduce volatility. These investments have various liquidity schedules, which are monitored on a continuous basis. Redemption frequency of hedge funds can be subject to rolling lockups. Of the hedge funds above, for the period ended June 30, 2016, approximately 82% is available for redemption within 12 months and another 17% is available for redemption within three years. The remaining 1% is deemed to be illiquid due to special investments of the manager. For the period ended June 30, 2015, approximately 83% is available for redemption within 12 months and another 16% is available for redemption within three years. The remaining 1% is deemed to be illiquid due to special investments of the manager. Private investments cannot be redeemed with the investees, but instead KU Endowment will receive distributions through the liquidation of the underlying assets of the investees.

6. Benefit Plans

Pension Plan

KU Endowment has a defined benefit pension plan that provides the participants of the plan with a life annuity benefit. Employees of KU Endowment meeting years of service requirements are eligible to participate in the plan with contributions funded solely by KU Endowment. KU Endowment's policy is to make periodic employer contributions in conformance with at least the minimum funding requirements as set forth in the Employee Retirement Income Security Act of 1974, as amended (ERISA).

The benefit obligation is the present value of benefits for all retired and vested terminated participants, plus a present value of benefits for active participants, based on service rendered prior to June 30, 2016, and projected future pay levels at expected retirement ages. The plan's funded status and the amounts recognized in KU Endowment's consolidated statements of financial position are as follows (in thousands):

	2016	**2015**
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 31,963**	$ 27,617
Service cost	**1,393**	1,253
Interest cost	**1,398**	1,180
Actuarial loss	**4,456**	2,408
Benefits and expenses paid	**(592)**	(495)
Benefit obligation at end of year	**$ 38,618**	$ 31,963
Change in plan assets		
Fair value of plan assets at beginning of year	**$ 22,760**	$ 21,425
Actual return on plan assets	**218**	279
Employer contribution	**1,656**	1,551
Benefits and expenses paid	**(592)**	(495)
Fair value of plan assets at end of year	**$ 24,042**	$ 22,760
Unfunded status included in accounts payable and accrued expenses	**$ (14,576)**	$ (9,203)

6. Benefit Plans (continued)

Federal legislation requires KU Endowment to fund the value of accrued benefits for the pension plan over time, based on the average discount rate derived from high-quality corporate bonds. The intent of the legislation is to measure the plan's liability based on benefits earned to date by plan participants. For the plan years ended June 30, 2016 and 2015, the percentage of the value of accrued benefits then funded in the plan was 126.5% and 126.6%, respectively, as certified by KU Endowment's independent actuarial consultant. The plan's accumulated benefit obligation was $33,684,000 on June 30, 2016, and $27,367,000 on June 30, 2015.

Included in unrestricted net assets at June 30 are the following amounts, which have not yet been recognized in net periodic pension cost (in thousands):

	2016	2015
Unrecognized actuarial losses	**$ 14,318**	$ 9,039

Changes in plan assets and benefit obligations in unrestricted net assets during the years ended June 30, include (in thousands):

	2016	2015
Unrecognized actuarial loss	**$ 5,863**	$ 3,660
Amortization of actuarial loss	**(584)**	(291)
	$ 5,279	$ 3,369

The amount of unrecognized actuarial losses expected to be recognized through the net periodic pension cost during the year ending June 30, 2017, is $1,046,000.

The components of the net periodic pension cost were as follows for the years ended June 30 (in thousands):

	2016	2015
Service cost	**$ 1,393**	$ 1,253
Interest cost	**1,398**	1,179
Expected return on plan assets	**(1,625)**	(1,530)
Recognized net actuarial loss	**584**	291
Net periodic pension cost	**$ 1,750**	$ 1,193

6. Benefit Plans (continued)

KU Endowment's funding policy is to make at least the minimum annual contributions required by ERISA. The expected total contributions during the year ending June 30, 2017, will be approximately $1,900,000.

KU Endowment's asset-allocation target is 70% equity and 30% fixed income for pension fund assets. The actual pension plan weighted average asset allocations by asset category are as follows:

	June 30	
	2016	**2015**
Equity securities	**71%**	74%
Debt securities	**29**	26
	100%	100%

The fair value of pension plan assets was determined using the following inputs at June 30, 2016 (in thousands):

		Fair Value Measurements Using		
	Fair Value	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Money markets and short-term investments	**$ 115**	**$ 115**	**$ –**	**$ –**
Domestic equity funds	**10,698**	**10,698**	**–**	**–**
International equity funds	**6,342**	**6,342**	**–**	**–**
Domestic fixed-income funds	**5,675**	**5,675**	**–**	**–**
Foreign fixed-income funds	**1,212**	**1,212**	**–**	**–**
	$ 24,042	**$ 24,042**	**$ –**	**$ –**

6. Benefit Plans (continued)

The fair value of pension plan assets was determined using the following inputs at June 30, 2015 (in thousands):

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money markets and short-term investments	$ 79	$ 79	$ –	$ –
International enhanced cash funds	2,425	2,425	–	–
Domestic equity funds	7,012	7,012	–	–
International equity funds	6,313	6,313	–	–
International balanced funds	1,133	1,133	–	–
Domestic fixed-income funds	5,798	5,798	–	–
	$ 22,760	$ 22,760	$ –	$ –

The actuarial valuation of the plan used a 7.0% long-term return assumption for the years ended June 30, 2016, and June 30, 2015. These amounts are consistent with the return expectations for a diversified, equity-oriented portfolio of publicly traded stocks and bonds over long periods of time. KU Endowment's review of long-term risk and return assumptions supports this target allocation.

6. Benefit Plans (continued)

The assumptions used in determining pension information for the plan for the years ended June 30, using a June 30 measurement date, were as follows:

	2016	2015
Benefit obligations:		
Weighted average discount rate	**3.74%**	4.42%
Rate of compensation increase	**2.50%–6.50%**	2.50%–6.50%
Benefit costs:		
Weighted average discount rate	**4.42%**	4.32%
Expected return on plan assets	**7.00%**	7.00%
Rate of compensation increase	**2.50%–6.50%**	2.50%–6.50%

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

Fiscal Year	**Future Expected Benefit Payments**
2017	$ 699
2018	720
2019	767
2020	950
2021	1,180
2022–2026	7,923

Defined Contribution Plan

KU Endowment also has a 401(k) Plan (the Plan), which is a defined contribution plan that covers substantially all employees meeting the eligibility requirements set forth under the Plan. KU Endowment contributes an amount based on a percentage of the amount contributed to the Plan by eligible employees. KU Endowment recorded expenses of $529,000 and $473,000 related to the Plan during fiscal years 2016 and 2015, respectively, which are included in administrative and fundraising support in the accompanying consolidated statement of activities.

7. Temporary Restrictions Satisfied

For the years ended June 30, 2016 and 2015, temporarily restricted net assets were released from restrictions by incurring expenses satisfying the restricted purposes or by the occurrence of other events specified by donors, as follows (in thousands):

	2016	2015
Program restrictions:		
University support:		
Student support	**$ 32,925**	$ 29,685
Faculty support and contractual services	**32,976**	35,168
Construction, furnishings, equipment, and supplies	**63,071**	53,461
Program and other educational support	**39,472**	46,295
	$ 168,444	$ 164,609

8. Temporarily Restricted Net Assets

Temporarily restricted net assets available at June 30 are restricted for the following purposes (in thousands):

	2016	2015
Scholarships, fellowships and awards	**$ 349,394**	$ 358,879
Construction	**88,922**	120,751
Equipment	**6,754**	5,669
Research	**57,749**	61,849
Salaries and services	**186,473**	190,870
Other University support	**393,415**	397,537
	$ 1,082,707	$ 1,135,555

9. Permanently Restricted Net Assets

Permanently restricted net assets by purpose at June 30 are as follows (in thousands):

	2016	2015
Scholarships, fellowships, and awards	**$ 165,067**	$ 162,097
Equipment	**2,497**	2,415
Research	**25,897**	25,063
Salaries and services	**103,603**	97,258
Other University support	**142,384**	144,227
	$ 439,448	$ 431,060

The income generated from these permanently restricted assets is to be used for activities relating to the purpose.

10. Endowment

KU Endowment's endowment consists of approximately 3,283 individual fund accounts established for a variety of purposes to benefit the University. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

KU Endowment has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of 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. As a result of this interpretation, KU Endowment 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 net assets until

10. Endowment (continued)

the donor's restriction is met. In accordance with UPMIFA, KU Endowment considers the following factors in making a determination whether to appropriate or to accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of KU Endowment
- The investment policies of KU Endowment.

At June 30, 2016, KU Endowment's net assets composition, by type of fund, consisted of the following (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	**$ 4,814**	**$ 610,371**	**$ 391,971**	**$ 1,007,156**
Board-designated endowment funds	**2,882**	**–**	**–**	**2,882**
Total funds	**$ 7,696**	**$ 610,371**	**$ 391,971**	**$ 1,010,038**

10. Endowment (continued)

For the year ended June 30, 2016, the changes in the endowment net assets are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	**$ 7,241**	**$ 638,210**	**$ 378,874**	**$ 1,024,325**
Investment return:				
Investment income	**76**	**10,519**	**–**	**10,595**
Net depreciation	**(83)**	**(25,365)**	**–**	**(25,448)**
Total investment return	**(7)**	**(14,846)**	**–**	**(14,853)**
Contributions	**16**	**20,171**	**13,564**	**33,751**
Appropriation of endowment assets for expenditure	**(259)**	**(30,232)**	**–**	**(30,491)**
Other changes:				
Other receipts	**626**	**461**	**–**	**1,087**
Interfund transfer within KU Endowment fund accounts, including wholly expendable accounts	**79**	**(3,393)**	**(467)**	**(3,781)**
Endowment net assets, end of year	**$ 7,696**	**$ 610,371**	**$ 391,971**	**$ 1,010,038**

At June 30, 2015, KU Endowment's net assets composition, by type of fund, consisted of the following (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ 4,109	$ 638,210	$ 378,874	$ 1,021,193
Board-designated endowment funds	3,132	–	–	3,132
Total funds	$ 7,241	$ 638,210	$ 378,874	$ 1,024,325

10. Endowment (continued)

For the year ended June 30, 2015, the changes in the endowment net assets are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 6,550	$ 602,146	$ 375,200	$ 983,896
Investment return:				
Investment income	146	10,413	–	10,559
Net appreciation	(42)	(12,036)	–	(12,078)
Total investment return	104	(1,623)	–	(1,519)
Contributions	–	70,755	3,190	73,945
Appropriation of endowment assets for expenditure	(149)	(30,529)	–	(30,678)
Other changes:				
Other receipts	1,566	968	–	2,534
Interfund transfer within KU Endowment fund accounts, including wholly expendable accounts	(830)	(3,507)	484	(3,853)
Endowment net assets, end of year	$ 7,241	$ 638,210	$ 378,874	$ 1,024,325

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor contributed, which is defined by KU Endowment as the amount required under UPMIFA to be retained as a fund of perpetual duration. In the absence of donor stipulations or law to the contrary, decreases in the value of assets of a donor-restricted endowment fund to an amount below the historical gift value shall reduce temporarily restricted net assets. Accordingly, the aggregate of these deficiencies shall reduce temporarily restricted net assets to the extent there is net appreciation on related funds with donor-imposed temporary

10. Endowment (continued)

restrictions. Deficiencies of this nature that are reported in temporarily restricted net assets were $2,233,034 and $606,000 as of June 30, 2016 and 2015, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs, which was deemed prudent by the Board of Trustees.

Any remaining depreciation in excess of amounts classified as temporarily restricted net assets shall reduce unrestricted net assets. There were no deficiencies sufficient enough to reduce unrestricted net assets as of June 30, 2016 or 2015.

Return Objectives and Risk Parameters

KU Endowment has investment policies that attempt to provide a predictable stream of funding to programs supported by operations, as well as endowment donations. Assets are invested in a manner that is intended to produce results that exceed the respective benchmark, while assuming a moderate level of investment risk. KU Endowment expects its endowment funds, over time, to provide an average rate of return of approximately 8% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, KU Endowment relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends, net of fees). KU Endowment targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

Except as specified by the donor, KU Endowment has adopted a constant growth policy in which earnings are allocated monthly for spending using a target spending rate of 5.5% of the market value of the endowment fund investment pool as of September 30. Spending is adjusted annually by inflation, measured by the CPI-U. The policy is subject to a 4.5% floor and a 6.5% cap of the trailing four-quarter average market value. In establishing this policy, KU Endowment considered the long-term expected return on its endowment. Accordingly, over the long term, KU Endowment expects the current spending policy to allow its endowment to grow at an average of the long-term

10. Endowment (continued)

rate of inflation. This is consistent with KU Endowment's objective to maintain the purchasing power of the endowed assets held in perpetuity while providing a stable source of funding for the University, as well as growing over the years though the addition of new gifts.

11. Subsequent Events

KU Endowment evaluated events and transactions occurring subsequent to June 30, 2016, through September 20, 2016, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

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