Approved by the Regents
October 17, 2019

THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

ACTION REQUEST

SUBJECT: The University of Michigan Financial Statements for the Year Ended June 30, 2019

ACTION REQUESTED: Adoption of Financial Statements

The Board of Regents has received the University's consolidated audited financial statements for fiscal year 2019, as well as separate audited financial statements for the University of Michigan Health System, Intercollegiate Athletics, and the Veritas Insurance Corporation. The Finance, Audit and Investment Committee of the Board has also had a discussion with PricewaterhouseCoopers LLP, the University's independent auditors. We recommend adoption of the University's consolidated audited financial statements as submitted.

Respectfully submitted,

Kevin P. Hegarty
Executive Vice President and
Chief Financial Officer

October 2019

UNIVERSITY OF MICHIGAN

FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2019 and 2018
with
REPORT OF INDEPENDENT AUDITORS

THE UNIVERSITY OF MICHIGAN

June 30, 2019 and 2018

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Report of Independent Auditors

To the Regents of the University of Michigan

We have audited the accompanying consolidated financial statements of the University of Michigan and its subsidiaries (the "University"), which comprise the consolidated statement of net position as of June 30, 2019 and 2018, and the related consolidated statements of revenues, expenses and changes in net position and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University of Michigan and its subsidiaries as of June 30, 2019 and 2018, and the changes in their financial position and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The accompanying management's discussion and analysis on pages 3 through 27 and the supplementary information for pension and postemployment benefits on pages 77 through 80 are required by accounting principles generally accepted in the United States of America to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 17, 2019

UNIVERSITY OF MICHIGAN

Management's Discussion and Analysis (Unaudited)

Introduction

The following discussion and analysis provides an overview of the financial position of the University of Michigan (the "University") at June 30, 2019 and 2018 and its activities for the three fiscal years ended June 30, 2019. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The University is a comprehensive public institution of higher learning with over 63,700 students and approximately 8,500 faculty members on three campuses in southeast Michigan. The University offers a diverse range of degree programs from baccalaureate to post-doctoral levels through 19 schools and colleges, and contributes to the state and nation through related research and public service programs. The University also has a nationally renowned health system which includes the University of Michigan Health System ("UMHS"), the University's Medical School, Michigan Health Corporation (a wholly-owned corporation created for joint venture and managed care initiatives) and UM Health (a wholly-owned corporation created to hold and develop the University's statewide network of hospitals, hospital joint ventures and other hospital affiliations, currently consisting of Metropolitan Health Corporation). The University's health system currently includes four hospitals as well as numerous health centers and outpatient clinics.

The University consistently ranks among the nation's top universities by various measures of quality, both in general academic terms and in terms of strength of offerings, in specific academic disciplines and professional subjects. Research is central to the University's mission and a key aspect of its strong reputation among educational institutions. The University is widely recognized for the breadth and excellence of its research enterprise as well as for the exceptional level of cooperation across disciplines, which allows faculty and students to address the full complexity of real-world challenges. The University's health system also has a tradition of excellence in teaching, advancement of medical science and patient care, consistently ranking among the best health care systems in the nation.

Financial Highlights

The University's financial position remains strong, with total assets and deferred outflows of $22.9 billion and total liabilities and deferred inflows of $8.1 billion at June 30, 2019, compared to total assets and deferred outflows of $22.1 billion and total liabilities and deferred inflows of $7.8 billion at June 30, 2018. Net position, which represents the residual interest in the University's total assets and deferred outflows after total liabilities and deferred inflows are deducted, totaled $14.8 billion and $14.3 billion at June 30, 2019 and 2018, respectively. Changes in net position represent the University's results of operations and are summarized for the years ended June 30 as follows:

	2019	**2018** (in millions)	**2017**
Operating revenues and educational appropriations	$ 8,411	$ 7,879	$ 7,480
Private gifts for operating activities	178	197	159
Operating and net interest expenses	(9,099)	(8,625)	(7,976)
	(510)	(549)	(337)
Net investment income	810	1,261	1,401
Endowment, capital gifts and grants, and other	223	208	198
Increase in net position	$ 523	$ 920	$ 1,262

The results of operations reflect the University’s emphasis on maintaining its national standards in academics, research and health care, within a competitive recruitment environment for faculty and health care professionals and a period of continued pressure on federal funding for research. At the same time, the University is addressing constrained state appropriations and rising health care, regulatory and facility costs with aggressive cost cutting and productivity gains to help preserve access to affordable higher education for Michigan families. To achieve aggressive and sustainable long-term goals for cost cutting and productivity gains, the University is also strategically utilizing resources to support enterprise-wide information technology projects and other initiatives.

The University’s long-term investment strategy combined with its endowment spending policy serves to insulate operations from expected volatility in the capital markets and provides for a stable and predictable level of spending distributions from the endowment. Endowment spending rate distributions to University units totaled $361 million and $339 million in 2019 and 2018, respectively. The success of the University’s long-term investment strategy is evidenced by strong returns over sustained periods of time and the ability to limit losses in the face of challenging markets.

The University invests its financial assets in pools with distinct risk and liquidity characteristics based on its needs, with a majority of its financial assets invested in two such pools. The University’s working capital is primarily invested in relatively short duration, liquid assets, through its Daily and Monthly Portfolios, while the endowment is primarily invested, along with the noncurrent portion of the insurance and benefit reserves, in an equity oriented long-term strategy through its Long Term Portfolio.

Using the Financial Statements

The University’s financial report includes three financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (“GASB”) principles, which establish standards for external financial reporting for public colleges and universities.

Statement of Net Position

The statement of net position presents the financial position of the University at the end of the fiscal year and includes all assets, deferred outflows, liabilities and deferred inflows of the University. The difference between total assets and deferred outflows as compared to total liabilities and deferred inflows - net position - is one indicator of the current financial condition of the University, while the change in net position is an indication of whether the overall financial condition has improved or worsened during the year. The University's assets, deferred outflows, liabilities, deferred inflows and net position at June 30 are summarized as follows:

	2019	**2018** (in millions)	**2017**
Current assets	$ 2,931	$ 2,743	$ 2,696
Noncurrent assets:			
Endowment, life income and other investments	12,834	12,305	11,323
Capital assets, net	6,227	6,121	6,045
Other	500	510	439
Total assets	22,492	21,679	20,503
Deferred outflows	371	384	349
Total assets and deferred outflows	22,863	22,063	20,852
Current liabilities	1,754	1,775	1,802
Noncurrent liabilities	5,785	5,814	5,606
Total liabilities	7,539	7,589	7,408
Deferred inflows	520	193	83
Net position	$ 14,804	$ 14,281	$ 13,361

The University continues to maintain and protect its strong financial foundation. This financial health, as reflected in the University's net position, results from the prudent utilization of financial resources including careful cost controls, preservation of endowment funds, conservative utilization of debt and adherence to a long-range capital plan for the maintenance and replacement of the physical plant.

Current assets consist primarily of cash and cash equivalents, operating and capital investments and accounts receivable and totaled $2.9 billion and $2.7 billion at June 30, 2019 and 2018, respectively. Cash, cash equivalents and investments for operating activities totaled $1.3 billion at June 30, 2019, which represents approximately two months of total expenses excluding depreciation.

Deferred outflows represent the consumption of net assets attributable to a future period and are primarily associated with the University's obligations for postemployment benefits, debt and derivative activity, and the defined benefit pension plan for Metropolitan Health Corporation ("Metro Health"). Deferred outflows totaled $371 million and $384 million at June 30, 2019 and 2018, respectively.

Current liabilities consist primarily of accounts payable, accrued compensation, unearned revenue, commercial paper, the current portion of bonds payable and net long-term bonds payable subject to remarketing. Current liabilities totaled $1.8 billion at both June 30, 2019 and 2018.

Deferred inflows represent the acquisition of net assets attributable to a future period and are associated with the University's obligations for postemployment benefits, Metro Health's defined benefit pension plan and irrevocable split-interest agreements. Deferred inflows totaled $520 million and $193 million at June 30, 2019 and 2018, respectively.

Endowment, Life Income and Other Investments

The composition of the University's endowment, life income and other investments at June 30 is summarized as follows:

	2019	**2018** (in millions)	**2017**
Endowment investments	$ 12,449	$ 11,902	$ 10,936
Life income investments	147	144	132
Noncurrent portion of insurance and benefits obligations investments	216	208	205
Other	22	51	50
	$ 12,834	$ 12,305	$ 11,323

The University's endowment funds consist of both permanent endowments and funds functioning as endowment. Permanent endowments are those funds received from donors with the stipulation that the principal remain intact and be invested in perpetuity to produce income that is to be expended for the purposes specified by the donors. Funds functioning as endowment consist of restricted gifts or unrestricted funds that have been allocated by the University for long-term investment purposes, but are not limited by donor stipulations requiring the University to preserve principal in perpetuity. Programs supported by endowment funds include scholarships, fellowships, professorships, research efforts and other important programs and activities.

The University uses its endowment funds to support operations in a way that strikes a balance between generating a predictable stream of annual support for current needs and preserving the purchasing power of the endowment funds for future periods. A majority of the endowment is maintained in the University Endowment Fund, a unitized pool which represents a collection of approximately 11,700 separate (individual) funds, the majority of which are restricted for specific purposes. The University Endowment Fund is invested in the University's Long Term Portfolio, a single diversified investment pool.

The endowment spending rule provides for distributions from the University Endowment Fund to the entities that benefit from the endowment fund. The annual distribution rate is 4.5 percent of the one-quarter lagged seven year moving average fair value of University Endowment Fund shares. This spending rule is one element of an ongoing financial management strategy that has allowed the University to effectively weather challenging economic environments while avoiding measures such as faculty hiring freezes, furloughs, program cuts or halting construction.

To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. Capital gains or income generated above the endowment spending rate are reinvested so that in lean times funds will be available for distribution. In addition, departments may also use withdrawals from funds functioning as endowment to support capital expenditures and operations.

Endowment spending rate distributions totaled $368 million, $346 million and $325 million and withdrawals from funds functioning as endowment totaled $48 million, $33 million and $7 million in 2019, 2018 and 2017, respectively. Total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 4.6 percent, 4.4 percent and 4.2 percent of the current year average fair value of the University Endowment Fund for 2019, 2018 and 2017, respectively. Over the past ten years, total spending rate distributions combined with withdrawals from funds functioning as endowment averaged 4.9 percent.

The University participates in certain split-interest agreements and currently holds life income funds for beneficiaries of the pooled income fund, charitable remainder trusts and the gift annuity program. These funds generally pay lifetime income to beneficiaries, after which the principal is made available to the University in accordance with donor intentions.

Capital and Debt Activities

One of the critical factors in continuing the quality of the University's academic, research and clinical programs is the development and renewal of capital assets. The University continues to implement its long-range plan to maintain and modernize its existing infrastructure and strategically invest in new construction.

Capital asset additions totaled $679 million in 2019, as compared to $650 million in 2018. Capital asset additions primarily represent renovation and new construction of academic, research, clinical and athletic facilities, as well as significant investments in equipment, including information technology. Current year capital asset additions were primarily funded with net position and gifts designated for capital purposes of $504 million and debt proceeds of $175 million.

Projects completed in 2019 include significant new facilities for patient care and student life, as well as technology enhancements.

Construction of the Brighton Center for Specialty Care helps meet growing ambulatory care demands. The new facility, with 300,000 square feet, houses more than 40 specialty services for pediatric and adult health care, including a comprehensive musculoskeletal center, sleep lab, ambulatory diagnostic and treatment center, medical procedure unit, radiation oncology, infusion, pharmacy, radiology, operating rooms and lab services. This new center is located near the existing Brighton Health Center, which continues to be utilized.

The new William Monroe Trotter Multicultural Center celebrates and fosters the University's diversity in a way that is inclusive and more visible. The new facility, with 20,000 square feet, accommodates program, lounge, kitchen and conference room spaces from the former center and adds a multipurpose room with capacity for 300 people for conferences and events, and an active-learning, classroom-style configuration that accommodates 100 students. Its location on State Street near the heart of central campus is easily accessible to the academic community.

An extensive upgrade of the University's WiFi network improves connectivity and helps support greater collaboration and engaged learning throughout the University's north, central and south campuses. This multi-year project encompassed 16 million square feet and added more than 15,000 new wireless access points in 253 academic, research, administrative and residence hall buildings and the Diag. The project was designed to support an increasingly mobile and collaborative learning environment, while also providing a consistently positive WiFi experience for the University's prospective students, parents, alumni and guests.

Construction in progress, which totaled $413 million and $301 million at June 30, 2019 and 2018, respectively, includes important projects for academic instruction and research as well as student life and services.

Construction of a new research and teaching facility for the College of Engineering's Robotics program continues. This state-of-the-art facility will include 140,000 square feet to house research and testing laboratories, associated support functions, offices and classroom space. The building will also accommodate space for its corporate partner, Ford Motor Company, which will establish collaborative research activities within the facility. The open plan design of the building allows for greater collaboration, increased flexibility and better space utilization. The facility will include labs for robot walking, flight testing, rehabilitation robotics, and electronics and software development. This project is scheduled to be completed in winter 2020.

Renovation and expansion of the Engineering Lab Building on the University's Dearborn campus also continues. The renovated building, which was originally constructed in 1959, will include teaching labs designed to facilitate entrepreneurial problem solving, encourage multidisciplinary cooperation in the context of 21st-century engineering instruction, and provide students with new collaboration and project spaces. The new facility is also designed to allow for research partnerships with industry as well as expanded K-12 and community outreach efforts, with a focus on women and minorities. When finished, the new facility will include 123,000 square feet of space to be used for classrooms, research and teaching laboratories, faculty offices and student support spaces. Regional boiler and electrical distribution equipment replacement are also included in this project, which is scheduled to be completed in spring 2020.

The Edward Henry Kraus Building, which was originally completed in 1915, is undergoing an extensive renovation of 183,000 square feet as well as construction of an infill addition of 62,000 square feet within the exterior courtyard. This renovation and addition will enable the School of Kinesiology to consolidate its programs and operations into one location and allow for future growth. The Department of Ecology and Evolutionary Biology and the Department of Molecular, Cellular, and Developmental Biology that were previously located in the Kraus Building relocated to the Biological Sciences Building when it opened in 2018. This project is scheduled to be completed in fall 2020.

Laboratory renovations are underway at two of the North Campus Research Complex buildings, covering 158,000 square feet to accommodate growth of the Medical School's wet laboratory research over the next decade. Construction of a 6,900 square foot infill addition will also improve connectivity between the buildings and throughout the complex. The project will also address deferred maintenance, including heating, ventilation, air conditioning, electrical and life safety system upgrades, and provide accessibility improvements and new finishes in public spaces. This project is scheduled to be completed in winter 2020.

The Michigan Union, which originally opened in 1919 with building additions in the 1930s and 1950s, is undergoing an extensive renovation. This project will improve accessibility throughout the building, create state-of-the-art student organization and student involvement space, improve space for counseling and student support services, and enhance meeting, lounge and study spaces. Deferred maintenance will also be addressed, including life safety, electrical, mechanical, and plumbing system improvements, replacement of the roof, windows and elevators, and upgrades to interior finish and restrooms. This project is scheduled to be completed in winter 2020.

The University is aware of its financial stewardship responsibility and works diligently to manage its financial resources effectively, including the prudent use of debt to finance capital projects. A strong debt rating is an important indicator of the University's success in this area. In 2019, S&P Global affirmed its highest credit rating (AAA) for bonds backed by a broad revenue pledge based on the University's robust enrollment and demand, exceptional student quality, retention and graduation rates, strong reputation of the University's health system, excellent balance sheet, exceptional research presence and manageable debt burden. Moody's also affirmed its highest credit rating (Aaa) based on the University's ability to translate its international brand into solid revenue growth, excellent student demand, strong philanthropic support and abundant financial reserves.

Long-term debt activity for the years ended June 30 is summarized as follows:

	2019			
	Beginning Balance	Additions (in millions)	Reductions	Ending Balance
Commercial paper	$ 158		$ 13	$ 145
Bonds	2,236	$ 260	166	2,330
	$ 2,394	$ 260	$ 179	$ 2,475

	2018			
	Beginning Balance	Additions (in millions)	Reductions	Ending Balance
Commercial paper	$ 161	$ 6	$ 9	$ 158
Bonds	2,155	157	76	2,236
Other	2		2	-
	$ 2,318	$ 163	$ 87	$ 2,394

The University utilizes commercial paper, backed by a general revenue pledge, to provide interim financing for its capital improvement program. Outstanding commercial paper is converted to long-term debt financing as appropriate, within the normal course of business. Outstanding bonds are also supported by the University's general revenue pledge.

During 2019, the University issued $227 million of general revenue bonds with a net original issue premium of $33 million, which included $210 million of fixed rate, tax-exempt bonds, and $17 million of fixed rate, taxable bonds. Total bond proceeds of $260 million were utilized to refund existing bonds of $84 million and provide $176 million for capital projects and debt issuance costs.

During 2018, the University issued $138 million of fixed rate, tax-exempt, general revenue bonds with a net original issue premium of $19 million. Total bond proceeds of $157 million, were utilized for capital projects and debt issuance costs.

The composition of the University's debt at June 30 is summarized as follows:

	2019	**2018** (in millions)	**2017**
Variable rate:			
Commercial paper	$ 145	$ 158	$ 161
Bonds	566	580	602
Fixed rate bonds	1,764	1,656	1,553
Other			2
	$ 2,475	$ 2,394	$ 2,318

A significant portion of the University's variable rate bonds are subject to remarketing and, in accordance with GASB requirements, such debt is classified as current unless supported by liquidity arrangements such as lines of credit or standby bond purchase agreements, which could refinance the debt on a long-term basis. In the event that variable rate bonds are put back to the University by the debt holder, management believes that the University's strong credit rating will ensure that the bonds will be remarketed within a reasonable period of time. In addition, the University utilizes remarketing agents to achieve a wide distribution of its variable rate bonds.

While fixed rate bonds typically have a higher effective rate of interest at the date of issuance as compared to variable rate bonds, they reduce the volatility of required debt service payments and do not require liquidity support, such as lines of credit, standby bond purchase agreements or internal liquidity.

Effective interest rates averaged 3.0 percent and 2.9 percent in 2019 and 2018, respectively, including the federal subsidies for interest on taxable Build America Bonds. Interest expense net of federal subsidies received for interest on taxable Build America Bonds and interest capitalized during construction totaled $74 million and $66 million in 2019 and 2018, respectively.

Obligations for Postemployment Benefits

Using current actuarial assumptions, and presuming a continuation of the current level of benefits, the University's obligations for postemployment benefits totaled $3.1 billion at June 30, 2019, as compared to $3.3 billion and $3.2 billion at June 30, 2018 and 2017, respectively. The decrease in the reported liability at June 30, 2019 was driven primarily by an increase in the discount rate and a reduction in the expected health care claims cost due to favorable experience. The increase in the reported liability at June 30, 2018, was driven primarily by the recognition of additional service cost and interest expense, offset somewhat by an increase in the discount rate used in developing the valuation. Since a portion of retiree medical services will be provided by the University's health system, this liability is net of the related margin and fixed costs associated with providing those services which totaled $580 million, $611 million and $674 million at June 30, 2019, 2018 and 2017, respectively.

By implementing a series of health benefit initiatives over the past several years, the University has favorably impacted its total liability for postemployment benefits by $1.4 billion at June 30, 2019. These initiatives have included cost sharing changes, elimination of Medicare Part B reimbursements for certain retirees and the adjustment of retirement eligibility criteria.

Net Position

Net position represents the residual interest in the University's assets and deferred outflows after liabilities and deferred inflows are deducted. The composition of the University's net position at June 30 is summarized as follows:

	2019	2018 (in millions)	2017
Net investment in capital assets	$ 3,743	$ 3,722	$ 3,735
Restricted:			
Nonexpendable:			
Permanent endowment corpus	2,329	2,146	1,967
Expendable:			
Net appreciation of permanent endowments	2,144	2,068	1,829
Funds functioning as endowment	2,382	2,308	2,126
Restricted for operations and other	686	632	633
Unrestricted	3,520	3,405	3,071
	$ 14,804	$ 14,281	$ 13,361

Net investment in capital assets represents the University's capital assets net of accumulated depreciation, outstanding principal balances of debt and capital lease liabilities, unexpended bond proceeds and deferred outflows associated with the acquisition, construction or improvement of those assets.

Restricted nonexpendable net position represents the historical value (corpus) of gifts to the University's permanent endowment funds. Restricted expendable net position is subject to externally imposed stipulations governing their use and includes net appreciation of permanent endowments, funds functioning as endowment and net position restricted for operations, facilities and student loan programs. Restricted expendable net position increased 4 percent, or $204 million, to $5.2 billion at June 30, 2019, as compared to an increase of 9 percent, or $420 million, to $5.0 billion at June 30, 2018. The increase experienced during both 2019 and 2018 was driven primarily by investment income and new gift activity.

Although unrestricted net position is not subject to externally imposed stipulations, substantially all of the University's unrestricted net position has been designated for various academic programs, research initiatives and capital projects. Unrestricted net position at June 30, 2019 totaled $3.5 billion and included funds functioning as endowment of $5.4 billion offset by unfunded obligations for postemployment benefits of $3.2 billion. Unrestricted net position at June 30, 2018 totaled $3.4 billion and included funds functioning as endowment of $5.2 billion offset by unfunded obligations for postemployment benefits of $3.1 billion. Unrestricted net position also includes other net resources which totaled $1.3 billion at both June 30, 2019 and 2018.

Statement of Revenues, Expenses and Changes in Net Position

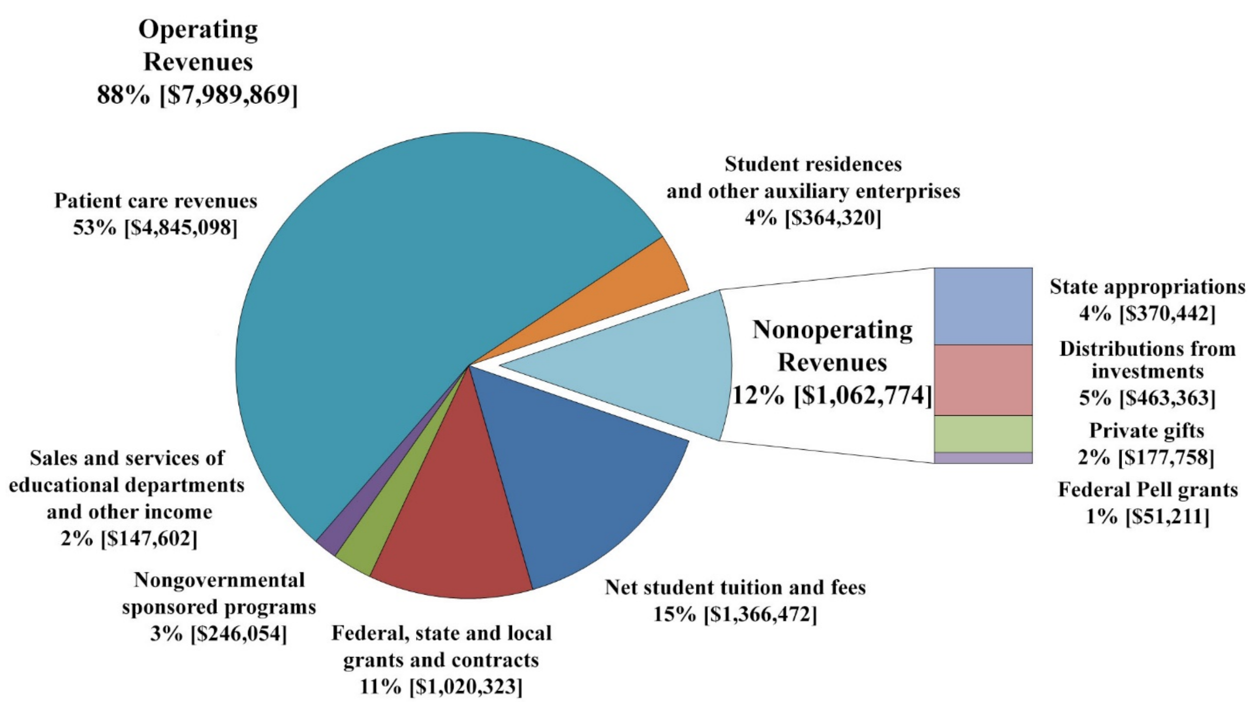
The statement of revenues, expenses and changes in net position presents the University's results of operations. In accordance with GASB reporting principles, revenues and expenses are classified as either operating or nonoperating. The University's revenues, expenses and changes in net position for the years ended June 30 are summarized as follows:

	2019	2018 (in millions)	2017
Operating revenues:			
Net student tuition and fees	$ 1,366.5	$ 1,310.9	$ 1,240.6
Sponsored programs	1,266.4	1,229.4	1,180.2
Patient care revenues, net	4,845.1	4,438.7	4,200.1
Other	511.9	487.9	458.8
	7,989.9	7,466.9	7,079.7
Operating expenses	9,025.0	8,559.4	7,910.0
Operating loss	(1,035.1)	(1,092.5)	(830.3)
Nonoperating and other revenues (expenses):			
State educational appropriations	370.4	363.1	356.0
Federal Pell grants	51.2	49.2	43.8
Private gifts for operating activities	177.8	196.6	159.1
Net investment income	810.0	1,261.4	1,400.6
Interest expense, net	(81.4)	(72.9)	(73.1)
Federal subsidies for interest on Build America Bonds	7.0	7.4	7.5
State capital appropriations		5.0	18.0
Endowment and capital gifts and grants	206.1	209.2	187.0
Other	16.9	(6.1)	(6.9)
Nonoperating and other revenues, net	1,558.0	2,012.9	2,092.0
Increase in net position	522.9	920.4	1,261.7
Net position, beginning of year	14,281.0	13,360.6	13,001.2
Affiliation with Metro Health and adoption of GASB 75 and GASB 81			(902.3)
Net position, beginning of year, as restated	14,281.0	13,360.6	12,098.9
Net position, end of year	$ 14,803.9	$ 14,281.0	$ 13,360.6

One of the University's greatest strengths is the diverse streams of revenue that supplement its student tuition and fees, including private support from individuals, foundations and corporations, along with government and other sponsored programs, state appropriations and investment income. The University continues to aggressively seek funding from all possible sources consistent with its mission in order to supplement student tuition and prudently manage the financial resources realized from these efforts to fund its operating activities, which include instruction, patient care and research.

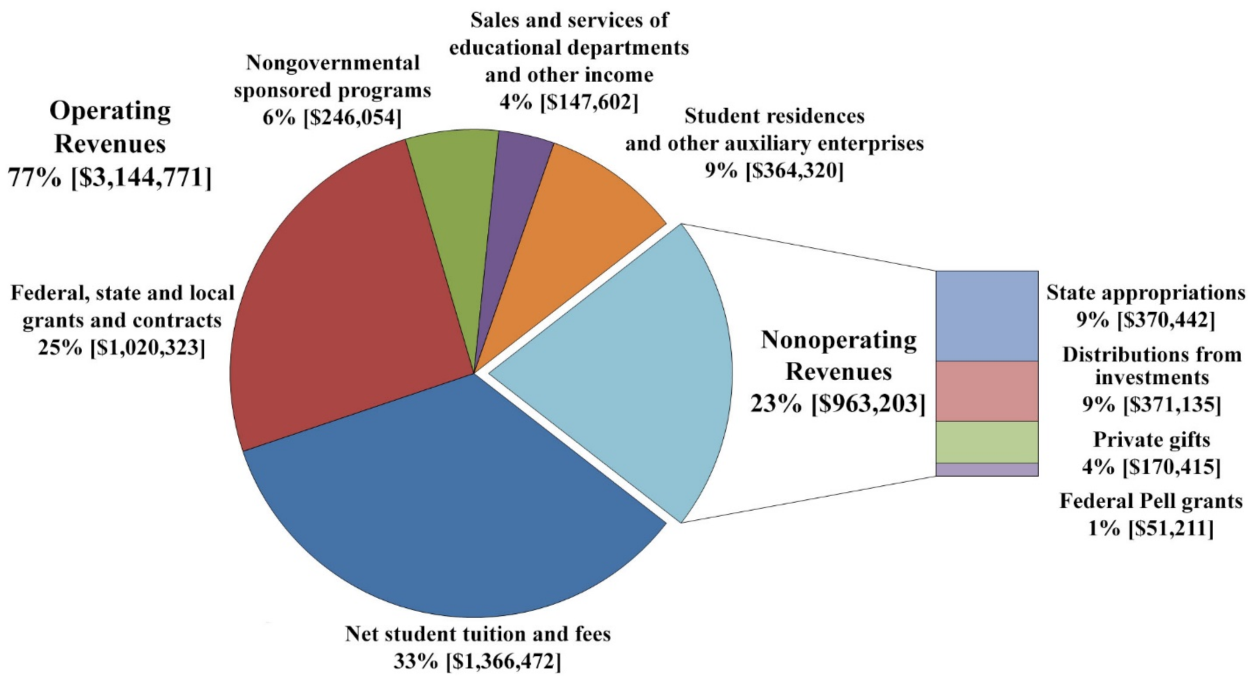
The following is a graphic illustration of revenues by source, both operating and nonoperating, which are used to fund the University's operating activities for the year ended June 30, 2019 (amounts are presented in thousands of dollars). Certain recurring sources of the University's revenues are considered nonoperating, as defined by GASB, such as state appropriations, distributions from investments, private gifts and federal Pell grants.

2019 Revenues for Operating Activities



The University measures its performance both for the University as a whole and for the University without its health system and other clinical activities. The exclusion of these activities allows a clearer view of the operations of the schools and colleges, as well as central administration. The following is a graphic illustration of University revenues by source, both operating and nonoperating, which are used to fund operating activities other than the health system and other clinical activities, for the year ended June 30, 2019 (amounts are presented in thousands of dollars).

2019 Revenues for Operating Activities
Excluding Revenues from the Health System and Other Clinical Activities



Tuition and state appropriations are the primary sources of funding for the University's academic programs. There is a relationship between the growth or reduction in state support and the University's ability to restrain tuition fee increases. Together, net student tuition and fees and state educational appropriations increased 4 percent, or $63 million, to $1.74 billion in 2019, as compared to 5 percent, or $77 million, to $1.67 billion in 2018.

In 2019, the University's state educational appropriations increased 2 percent, or $7 million, to $370 million. In 2018, the University's state educational appropriations increased 2 percent, or $7 million, to $363 million.

For the years ended June 30, net student tuition and fees revenue consisted of the following components:

	2019	2018 (in millions)	2017
Student tuition and fees	$ 1,812.5	$ 1,726.0	$ 1,616.6
Less scholarship allowances	446.0	415.1	376.0
	$ 1,366.5	$ 1,310.9	$ 1,240.6

In 2019, net student tuition and fees revenue increased 4 percent, or $56 million, to $1.4 billion, which reflects an increase of 5 percent, or $87 million, in gross student tuition and fees revenue offset by an increase of 7 percent, or $31 million, in scholarship allowances. Tuition rate increases in 2019 were 2.9 percent for resident undergraduate students, 3.9 percent for nonresident undergraduate students and 3.3 percent for most graduate students on the Ann Arbor campus, with a 3.7 and 4.3 percent tuition rate increase for most resident undergraduate students on the Dearborn and Flint campuses, respectively. During 2019, the University experienced moderate growth in the number of students, as well as a shift in mix from resident to nonresident students.

In 2018, net student tuition and fees revenue increased 6 percent, or $70 million, to $1.3 billion, which reflects an increase of 7 percent, or $109 million, in gross student tuition and fees revenue offset by an increase of 10 percent, or $39 million, in scholarship allowances. Tuition rate increases in 2018 were 2.9 percent for resident undergraduate students, 4.5 percent for nonresident undergraduate students and 4.1 percent for most graduate students on the Ann Arbor campus, with a 3.7 and 4.1 percent tuition rate increase for most resident undergraduate students on the Dearborn and Flint campuses, respectively. During 2018, the University experienced moderate growth in the number of students, as well as a shift in mix from resident to nonresident students.

The University's tuition rate increases have consistently been among the lowest in the state, even in years of significant reductions in state appropriations, which reflects a commitment to affordable higher education for Michigan families. In addition, the University has increased scholarship and fellowship expenses and related allowances to benefit students in financial need. The University's long-term plan includes an ongoing commitment to cost containment and reallocating resources to the highest priorities to provide support for innovative new initiatives to maintain academic excellence and help students keep pace with the evolving needs of society.

While tuition and state appropriations fund a large percentage of University costs, private support is also essential to the University's academic distinction. Private gifts for other than capital and endowment purposes totaled $178 million in 2019, as compared to $197 million in 2018 and $159 million in 2017.

The University receives revenues for sponsored programs from various government agencies and private sources, which normally provide for both direct and indirect costs to perform these sponsored activities, with a significant portion related to federal research. Revenues for sponsored programs increased 3 percent, or $37 million, to $1.3 billion in 2019, and 4 percent, or $49 million, to $1.2 billion in 2018, driven primarily by increases in federally sponsored activity during these periods.

Patient care revenues are principally generated within the University's hospitals and ambulatory care facilities. Patient care revenues increased 9 percent, or $406 million, to $4.8 billion in 2019, due primarily to an increase in patient volume. Patient care revenues increased 6 percent, or $239 million, to $4.4 billion in 2018, resulting from growth in patient volume as well as an increase in revenue per patient case.

For the years ended June 30, patient care revenues by source are summarized as follows:

	2019	**2018**	**2017**
		(in millions)	
University of Michigan Health System	$ 4,212.4	$ 3,890.0	$ 3,694.7
UM Health	472.5	433.9	376.4
Michigan Health Corporation	39.1	17.9	18.4
Other	121.1	96.9	110.6
	$ 4,845.1	$ 4,438.7	$ 4,200.1

The largest component of patient care revenues is generated by UMHS, a national leader in advanced patient care and comprehensive education of physicians and medical scientists. UMHS serves as the principal teaching facility for the University's Medical School and operates three hospitals with 1,043 licensed beds for acute care and psychiatric needs, as well as numerous ambulatory care centers, outpatient clinics and various other health care programs across the state. Substantially all physician services to UMHS patients are provided by the University's Medical School faculty. UMHS also provides educational and clinical opportunities to students of the University's Schools of Nursing, Dentistry, Social Work and Public Health, as well as the College of Pharmacy.

UM Health is a growing component of patient care activity and its revenues currently represent Metro Health, a community health care provider in west Michigan, which operates a hospital with 208 licensed beds for acute care, as well as neighborhood outpatient clinics and a growing network of specialty services. The University's affiliation with Metro Health positions UM Health to expand research capabilities, primary care, specialty services and the use of complex medical technologies.

Michigan Health Corporation generates revenue through its various joint venture and managed care initiatives, which provide services to patients including dialysis and other health services.

Other patient care revenues include amounts received from governmental and commercial payers associated with initiatives designed to improve accessibility and quality of care for patients, services provided by physicians working at facilities outside of the University and ambulatory care services provided by University Health Service, the School of Dentistry and the School of Nursing.

Contractual arrangements with governmental payers (Medicare and Medicaid) and private insurers impact patient care revenues. In 2019, the University realized payment rate increases from the majority of private insurers and governmental payers as compared to 2018. The distribution of net patient care service revenue by primary payer source for the years ended June 30 is summarized as follows:

	2019	**2018**	**2017**
Medicare	26%	26%	26%
Medicaid	12%	12%	11%
Blue Cross	38%	38%	34%
Other	24%	24%	29%

Net investment income totaled $810 million in 2019 as compared to $1.3 billion in 2018 and $1.4 billion in 2017. The investment environment in 2019 was similar to that of 2018, but with increased volatility in the U.S. public equity markets as well as a more challenging landscape in the world equity markets. For 2019, the alternative asset class performance was relatively strong returning 11 percent. Leaders in this asset class included venture capital and private equity, which returned 24 percent and 10 percent, respectively. This compares to 2018 when the U.S. public equity markets were strong, as were alternative asset classes such as private equity and venture capital, which both returned 20 percent. In 2017, returns were strong in all asset classes including equity securities, as well as the alternative asset class where private equity and natural resources had the highest returns at 17 percent.

State capital appropriations help the University improve its academic buildings. Recent capital outlays have supported renovations of the George Granger Brown Memorial Laboratories on the Ann Arbor campus, the Science Building and Computer Information Science Building on the Dearborn campus and the William R. Murchie Science Building on the Flint campus.

Gifts and grants for endowment and capital purposes continue to be a significant part of sustaining the University's excellence. Private gifts for permanent endowment purposes totaled $176 million in 2019, as compared to $169 million and $143 million in 2018 and 2017, respectively. Capital gifts and grants totaled $30 million in 2019, as compared to $40 million and $44 million in 2018 and 2017, respectively. In recent years, major gifts have been received in support of the University's wide-ranging capital initiatives which include the health system, Ross School of Business, College of Engineering and Intercollegiate Athletics.

In addition to revenue diversification, the University continues to make cost containment an ongoing priority. This is necessary as the University faces significant financial pressures, particularly in the areas of compensation and benefits, which represent 63 percent of total expenses, as well as in the areas of energy, technology and ongoing maintenance of facilities and infrastructure.

The University's expenses for the years ended June 30 are summarized as follows (amounts in millions):

	2019		**2018**		**2017**	
Operating:						
Compensation and benefits	$ 5,769.0	63%	$ 5,431.4	63%	$ 5,064.4	63%
Supplies and services	2,523.8	28	2,402.6	27	2,164.0	27
Depreciation	567.8	6	568.7	7	537.7	7
Scholarships and fellowships	164.4	2	156.7	2	143.9	2
	9,025.0	99	8,559.4	99	7,910.0	99
Nonoperating:						
Interest, net	74.4	1	65.5	1	65.6	1
	$ 9,099.4	100%	$ 8,624.9	100%	$ 7,975.6	100%

The University is committed to recruiting and retaining outstanding faculty and staff and the compensation package is one way to successfully compete with peer institutions and nonacademic employers. Compensation and benefits increased 6 percent, or $338 million, to $5.8 billion in 2019 as compared to 7 percent, or $367 million, to $5.4 billion in 2018. Of the 2019 increase, compensation increased 6 percent, or $257 million, to $4.4 billion, driven primarily by increases in staffing levels resulting from patient activity and capacity expansion within the University's health system, and employee benefits increased 6 percent, or $81 million, to $1.4 billion, resulting from an increase in prescription drug costs as well as activity associated with the University's postemployment benefits obligations. For 2018, compensation increased 6 percent, to $4.1 billion, and benefits increased 10 percent, to $1.3 billion.

The University faces external and industry realities that put significant pressure on its ability to reduce compensation costs while remaining competitive. To help address this risk, the University continues to review components of its existing benefits program to find opportunities for potential savings without compromising the ability to offer competitive benefits to all faculty and staff.

Health care benefits are one of the most significant employee benefits. Over the past several years, the University has implemented initiatives to better control its rate of cost increase, encourage employees to choose the lowest cost health care plan that meets their needs and share a larger portion of health care cost increases with employees. These initiatives reflect the reality of the national landscape, while remaining true to the commitment we make to our employees for a robust benefits package. Careful stewardship of our health benefit plans, including the use of wellness initiatives, helps maintain our competitive position while preserving funding for the University's core mission.

During 2013, the University began to implement changes to eligibility requirements and the University contribution to retiree health benefits that were announced in 2011. These changes were recommended by a committee that evaluated ways to maintain competitive retiree health benefits while helping address the acceleration of future costs, and are being phased in over eight years in order to assist current employees with the transition.

Compared to most employers, the University is in a unique position to utilize internal experts to advise and guide its health care and drug plans. For example, the Pharmacy Benefits Advisory Committee, which consists of internal experts including health system physicians, College of Pharmacy faculty and on-staff pharmacists, monitors the safety and effectiveness of covered medications and guides appropriate prescribing, dispensing and cost effective use of prescription drugs. In addition, the University utilizes its nationally recognized health policy experts to guide future health plan strategies.

Supplies and services expenses increased 5 percent, or $121 million, to $2.5 billion in 2019 as compared to an increase of 11 percent, or $239 million, to $2.4 billion in 2018. These increases reflect the growth in patient care related expenses including higher costs of prescription drugs and infusion treatments, as well as costs associated with significant capital projects.

Depreciation expense decreased less than 1 percent, or $850,000, to $568 million in 2019, as compared to an increase of 6 percent, or $31 million, to $569 million in 2018. The decrease in depreciation expense is primarily related to a $25 million impairment charge recorded in 2018 associated with certain components of Metro Health's hospital facilities. Capital assets placed in service during 2019 include the Brighton Center for Specialty Care, North Campus Recreation Building renovation and the William Monroe Trotter Multicultural Center. Capital assets placed in service during 2018 include the Biological Science Building, Weiser Hall renovation, West Ann Arbor Health Center, Clinical Pathology renovation and relocation, and Athletics South Competition and Performance Project.

In addition to their natural (object) classification, it is also informative to review operating expenses by function. The University's expenses by functional classification for the years ended June 30 are summarized as follows (amounts in millions):

	2019		2018		2017	
Operating:						
Instruction	$ 1,195.2	13%	$ 1,153.2	13%	$ 1,099.8	14%
Research	857.6	10	823.6	10	803.5	10
Public service	208.7	2	211.5	2	187.8	2
Institutional and academic support	767.0	8	681.0	8	646.7	8
Auxiliary enterprises:						
Patient care	4,661.5	51	4,349.2	50	3,976.1	50
Other	251.2	3	264.6	3	198.1	2
Operations and maintenance of plant	351.6	4	350.9	4	316.4	4
Depreciation	567.8	6	568.7	7	537.7	7
Scholarships and fellowships	164.4	2	156.7	2	143.9	2
	9,025.0	99	8,559.4	99	7,910.0	99
Nonoperating:						
Interest, net	74.4	1	65.5	1	65.6	1
	$ 9,099.4	100%	$ 8,624.9	100%	$ 7,975.6	100%

Instruction expenses increased 4 percent, or $42 million, in 2019, and 5 percent, or $53 million, in 2018. This increase reflects the level of growth in the related revenue sources offset by cost containment efforts.

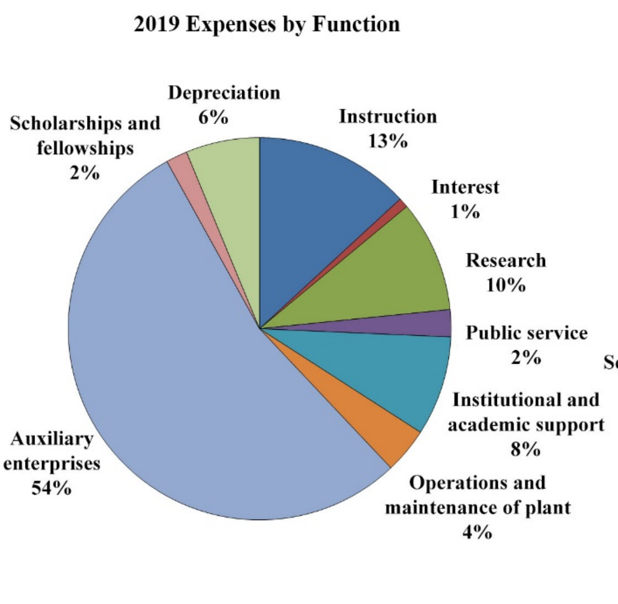
Research expenses increased 4 percent, or $34 million, in 2019, and 3 percent, or $20 million, in 2018. The increase in 2019 reflects the strength of the University's research enterprise, in spite of continued pressure on federal funding and intense competition for research dollars. To measure its total volume of research expenditures, the University considers research expenses included in the above table, as well as research related facilities and administrative expenses, research initiative and start-up expenses and research equipment purchases. These amounts totaled $1.62 billion, $1.55 billion and $1.48 billion in 2019, 2018 and 2017, respectively.

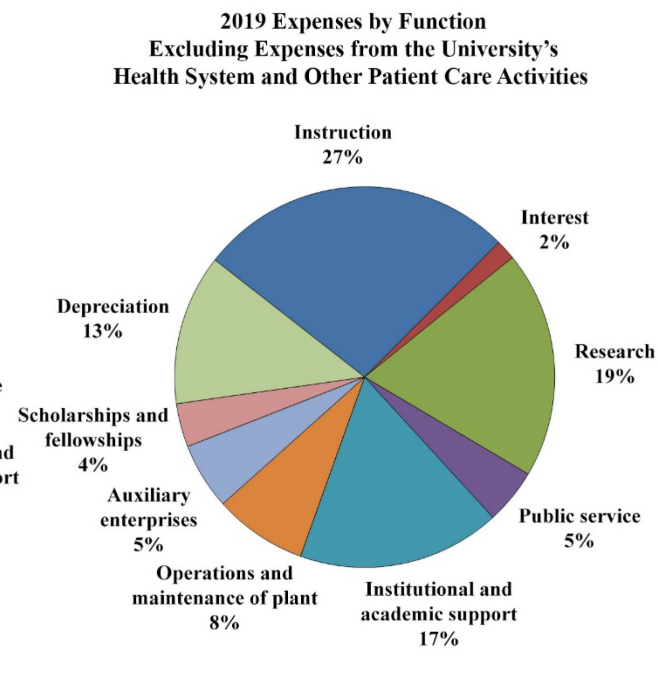
Patient care expenses increased 7 percent, or $312 million, in 2019, and 9 percent, or $373 million, in 2018, and reflect the impact of additional patient activity and capacity expansion. Increased compensation expense related to patient care includes both growth in staff levels and wage increases. Increased medical supplies expense results from higher patient activity levels, new information technology initiatives and the rising cost of pharmaceuticals.

Scholarships and fellowships provided to students totaled $635 million in 2019, as compared to $596 million in 2018 and $543 million in 2017, an increase of 17 percent over the past two years. Tuition, housing and fees revenues are reported net of aid applied to students' accounts, while amounts paid directly to students are reported as scholarship and fellowship expenses. Scholarships and fellowships for the years ended June 30 are summarized as follows:

	2019	**2018** (in millions)	**2017**
Paid directly to students	$ 164.4	$ 156.7	$ 143.9
Applied to tuition and fees	446.0	415.1	376.0
Applied to University Housing	24.2	23.8	22.7
	$ 634.6	$ 595.6	$ 542.6

The following graphic illustrations present total expenses by function, with and without the University's health system and other patient care activities:





Statement of Cash Flows

The statement of cash flows provides additional information about the University's financial results by reporting the major sources and uses of cash. The University's cash flows for the years ended June 30 are summarized as follows:

	2019	2018 (in millions)	2017
Cash received from operations	$ 7,965.9	$ 7,505.7	$ 7,103.6
Cash expended for operations	(8,283.8)	(7,916.8)	(7,277.3)
Net cash used in operating activities	(317.9)	(411.1)	(173.7)
Net cash provided by noncapital financing activities	767.7	732.7	715.5
Net cash used in capital and related financing activities	(597.2)	(592.6)	(497.9)
Net cash provided by (used in) investing activities	411.3	299.3	(278.4)
Net increase (decrease) in cash and cash equivalents	263.9	28.3	(234.5)
Cash and cash equivalents, beginning of year	133.4	105.1	285.8
Affiliation with Metro Health			53.8
Cash and cash equivalents, beginning of year, as restated	133.4	105.1	339.6
Cash and cash equivalents, end of year	$ 397.3	$ 133.4	$ 105.1

Cash received from operations primarily consists of student tuition, sponsored program grants and contracts, and patient care revenues. Significant sources of cash provided by noncapital financing activities, as defined by GASB, include state appropriations, federal Pell grants and private gifts used to fund operating activities.

Economic Factors That May Affect the Future

The University maintains the highest credit ratings of S&P Global (AAA) and Moody's (Aaa). Achieving and maintaining the highest credit ratings provides the University with significant flexibility in securing capital funds on the most competitive terms. This flexibility, along with ongoing efforts toward revenue diversification and cost containment, will enable the University to provide the necessary resources to support a consistent level of excellence in service to students, patients, the research community, the state and the nation.

A crucial element to the University's future continues to be a strong relationship with the state of Michigan. Historically, there has been a connection between the growth, or reduction, of state support and the University's ability to control tuition increases. Over the past several years, the University has successfully addressed the realities of the state's challenging economy and, pursuant to a long-range plan, continues to work relentlessly to cut and mitigate operational costs in order to remain affordable and preserve access, while protecting the academic enterprise.

The University's budget for 2020 anticipates a 1.5 percent increase in state educational appropriations, a 1.9 percent tuition rate increase for Ann Arbor campus resident undergraduates and a 11.2 percent increase in centrally awarded financial aid. Nonresident undergraduate tuition rates will increase 3.7 percent, while most graduate and professional rates will increase 3.2 percent. Resident undergraduate tuition rates on the Dearborn and Flint campuses will increase 3.2 percent and 5.0 percent, respectively.

The University continues to execute its long-range plan to maintain, modernize and expand its complement of older facilities while adding key new facilities for instruction, research, patient care, athletics and residential life. This strategy addresses the University's growth and the continuing effects of technology on teaching, research and clinical activities. Authorized costs to complete construction and other projects totaled $906 million at June 30, 2019. Funding for these projects is anticipated to include $726 million from internal sources, gifts, grants and future borrowings, $89 million from the State Building Authority and $91 million from the utilization of unexpended bond proceeds. In September 2019, the Board of Regents approved plans for the construction of a 690,000 square foot clinical inpatient tower with an estimated cost of $920 million and an expected completion date of fall 2024.

The University's health system continues its strategy to expand access to patients, locally and on a statewide basis. In addition to strategic capital and technological investments, the University's health system is also focusing on clinical affiliation arrangements and population management programs designed to expand community access and improve patient, family and provider experiences across the continuum of care. The affiliation arrangements are also expected to enhance clinical research, physician recruitment and support services.

While the University's health system is well positioned to maintain a strong financial condition in the near term, ongoing constraints on revenue are expected due to fiscal pressures from employers and federal and state governments. Lawmakers continue to discuss Medicare and Medicaid changes which may target graduate medical education-related payments and could result in a significant impact on teaching hospitals. In addition, private insurance and managed care contracts historically provide for annual increases in reimbursement rates that met or exceeded the rate of inflation; however, there can be no assurance that such trends will continue. Management believes that much of the payment pressure can be offset by growth in patient volume and continued efforts to contain certain costs.

The University will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to preserve endowment capital and insulate the University's operations from temporary market volatility.

As a labor-intensive organization, the University faces competitive pressures related to attracting and retaining faculty and staff. Moreover, consistent with the national landscape, the University also faces rising costs of health benefits for its employees and retirees. The University has successfully taken and will continue to take proactive steps to respond to these challenges while protecting the quality of the overall benefits package.

A portion of the University's labor force is unionized, with negotiated labor agreements defining terms and conditions of employment. Changes in relations with unions and represented employees, including the negotiation of new agreements, could have a material effect on the University.

While it is not possible to predict the ultimate results, management believes that the University's financial position will remain strong.

UNIVERSITY OF MICHIGAN

Consolidated Statement of Net Position

	June 30, 2019	June 30, 2018
	(in thousands)	
Assets and Deferred Outflows		
Current Assets:		
Cash and cash equivalents	**$ 397,279**	$ 133,365
Investments for operating activities	**882,303**	1,117,063
Investments for capital activities	**594,681**	533,855
Investments for student loan activities	**74,365**	57,135
Accounts receivable, net	**714,621**	666,811
Current portion of notes and pledges receivable, net	**80,035**	79,765
Current portion of prepaid expenses and other assets	**158,320**	125,159
Cash collateral held by agent	**29,485**	29,727
Total Current Assets	**2,931,089**	2,742,880
Noncurrent Assets:		
Unexpended bond proceeds	**90,813**	82,797
Endowment, life income and other investments	**12,834,065**	12,305,228
Notes and pledges receivable, net	**301,427**	336,870
Prepaid expenses and other assets	**107,303**	90,618
Capital assets, net	**6,226,969**	6,120,997
Total Noncurrent Assets	**19,560,577**	18,936,510
Total Assets	**22,491,666**	21,679,390
Deferred Outflows	**371,574**	383,589
Total Assets and Deferred Outflows	**$ 22,863,240**	$ 22,062,979
Liabilities, Deferred Inflows and Net Position		
Current Liabilities:		
Accounts payable	**$ 293,728**	$ 290,563
Accrued compensation and other	**508,597**	451,458
Unearned revenue	**312,092**	306,803
Current portion of insurance and benefits reserves	**104,235**	98,159
Current portion of obligations for postemployment benefits	**87,712**	87,638
Commercial paper and current portion of bonds payable	**232,095**	237,371
Long-term bonds payable subject to remarketing, net	**133,616**	195,552
Collateral held for securities lending	**29,485**	29,727
Deposits of affiliates and others	**52,296**	77,422
Total Current Liabilities	**1,753,856**	1,774,693
Noncurrent Liabilities:		
Accrued compensation	**34,126**	40,682
Insurance and benefits reserves	**127,677**	137,003
Obligations for defined benefit pension plan, net	**(2,918)**	(3,823)
Obligations for postemployment benefits	**3,026,343**	3,216,102
Obligations under life income agreements	**74,516**	74,180
Government loan advances	**83,542**	81,510
Bonds payable	**2,109,317**	1,961,085
Deposits of affiliates and other	**332,850**	307,210
Total Noncurrent Liabilities	**5,785,453**	5,813,949
Total Liabilities	**7,539,309**	7,588,642
Deferred Inflows	**520,023**	193,292
Net Position:		
Net investment in capital assets	**3,742,630**	3,722,086
Restricted:		
Nonexpendable	**2,328,667**	2,146,358
Expendable	**5,212,557**	5,007,324
Unrestricted	**3,520,054**	3,405,277
Total Net Position	**14,803,908**	14,281,045
Total Liabilities, Deferred Inflows and Net Position	**$ 22,863,240**	$ 22,062,979

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

UNIVERSITY OF MICHIGAN

Consolidated Statement of Revenues, Expenses and Changes in Net Position

	Year Ended June 30, 2019	2018
	(in thousands)	
Operating Revenues		
Student tuition and fees	**$ 1,812,466**	$ 1,726,033
Less scholarship allowances	**445,994**	415,092
Net student tuition and fees	**1,366,472**	1,310,941
Federal grants and contracts	**1,006,368**	982,143
State and local grants and contracts	**13,955**	13,304
Nongovernmental sponsored programs	**246,054**	233,919
Sales and services of educational departments	**145,070**	140,139
Auxiliary enterprises:		
Patient care revenues (net of provision for bad debts of $137,660 in 2019 and $128,747 in 2018)	**4,845,098**	4,438,744
Student residence fees (net of scholarship allowances of $24,226 in 2019 and $23,814 in 2018)	**120,122**	117,866
Other revenues	**244,198**	227,288
Student loan interest income and fees	**2,532**	2,537
Total Operating Revenues	**7,989,869**	7,466,881
Operating Expenses		
Compensation and benefits	**5,768,951**	5,431,392
Supplies and services	**2,523,804**	2,402,592
Depreciation	**567,857**	568,707
Scholarships and fellowships	**164,428**	156,738
Total Operating Expenses	**9,025,040**	8,559,429
Operating Loss	**(1,035,171)**	(1,092,548)
Nonoperating Revenues (Expenses)		
State educational appropriations	**370,442**	363,074
Federal Pell grants	**51,211**	49,190
Private gifts for other than capital and endowment purposes	**177,758**	196,639
Net investment income	**809,997**	1,261,443
Interest expense, net	**(81,372)**	(72,905)
Federal subsidies for interest on Build America Bonds	**6,961**	7,451
Total Nonoperating Revenues, Net	**1,334,997**	1,804,892
Income Before Other Revenues (Expenses)	**299,826**	712,344
Other Revenues (Expenses)		
State capital appropriations		4,978
Capital gifts and grants	**29,884**	39,835
Private gifts for permanent endowment purposes	**176,210**	169,337
Other	**16,943**	(6,104)
Total Other Revenues, Net	**223,037**	208,046
Increase in Net Position	**522,863**	920,390
Net Position, Beginning of Year	**14,281,045**	13,360,655
Net Position, End of Year	**$ 14,803,908**	$ 14,281,045

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

UNIVERSITY OF MICHIGAN

Consolidated Statement of Cash Flows

	Year Ended June 30, 2019	2018
	(in thousands)	
Cash Flows from Operating Activities		
Student tuition and fees	**$ 1,365,386**	$ 1,314,268
Federal, state and local grants and contracts	**1,016,393**	973,815
Nongovernmental sponsored programs	**242,527**	250,617
Sales and services of educational departments and other	**388,016**	394,892
Patient care revenues	**4,812,476**	4,431,064
Student residence fees	**118,862**	118,192
Payments to employees	**(4,352,547)**	(4,108,246)
Payments for benefits	**(1,239,145)**	(1,157,316)
Payments to suppliers	**(2,520,758)**	(2,478,042)
Payments for scholarships and fellowships	**(164,428)**	(156,738)
Student loans issued	**(6,940)**	(16,453)
Student loans collected	**19,716**	20,328
Student loan interest and fees collected	**2,532**	2,537
Net Cash Used in Operating Activities	**(317,910)**	(411,082)
Cash Flows from Noncapital Financing Activities		
State educational appropriations	**369,103**	361,787
Federal Pell grants	**51,211**	49,190
Private gifts and other receipts	**350,112**	317,215
Student direct lending receipts	**280,307**	298,011
Student direct lending disbursements	**(279,638)**	(301,194)
Amounts received for annuity and life income funds	**6,442**	16,878
Amounts paid to annuitants and life beneficiaries and related expenses	**(9,828)**	(9,186)
Net Cash Provided by Noncapital Financing Activities	**767,709**	732,701
Cash Flows from Capital and Related Financing Activities		
State capital appropriations	**1,217**	4,968
Private gifts and other receipts	**46,264**	47,655
Proceeds from issuance of capital debt	**260,034**	163,328
Principal payments on capital debt	**(164,553)**	(75,918)
Interest payments on capital debt	**(94,202)**	(82,096)
Federal subsidies for Build America Bonds interest	**3,696**	7,413
Payments for bond refunding and related costs	**(791)**	(526)
Purchases of capital assets	**(677,883)**	(658,839)
Proceeds from sales of capital assets	**28,996**	1,329
Net Cash Used in Capital and Related Financing Activities	**(597,222)**	(592,686)
Cash Flows from Investing Activities		
Interest and dividends on investments, net	**52,846**	51,985
Proceeds from sales and maturities of investments	**6,172,854**	5,477,448
Purchases of investments	**(5,841,764)**	(5,119,195)
Net (increase) decrease in unexpended capital debt proceeds	**(8,016)**	15,658
Net decrease (increase) in cash equivalents from noncurrent investments	**60,971**	(126,745)
Net (decrease) increase in deposits of affiliates and other	**(25,554)**	154
Net Cash Provided by Investing Activities	**411,337**	299,305
Net Increase in Cash and Cash Equivalents	**263,914**	28,238
Cash and Cash Equivalents, Beginning of Year	**133,365**	105,127
Cash and Cash Equivalents, End of Year	**$ 397,279**	$ 133,365

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

UNIVERSITY OF MICHIGAN

Consolidated Statement of Cash Flows--Continued

	Year Ended June 30, 2019	2018
	(in thousands)	
Reconciliation of Operating Loss to Net Cash Used in Operating Activities:		
Operating loss	**$ (1,035,171)**	$ (1,092,548)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	**567,857**	568,707
Changes in assets and liabilities:		
Accounts receivable, net	**(35,743)**	(21,468)
Prepaid expenses and other assets	**(26,249)**	(65,680)
Accounts payable	**4,052**	(32,228)
Accrued compensation and other	**24,027**	6,106
Unearned revenue	**5,539**	23,502
Deposits of affiliates and others	**2,078**	
Insurance and benefits reserves	**(3,250)**	21,127
Obligations for defined benefit pension plan, net	**905**	(7,259)
Obligations for postemployment benefits	**(189,685)**	105,413
Deposits of affiliates and other	**32,240**	20,345
Changes in deferred outflows	**12,762**	(43,176)
Changes in deferred inflows	**322,728**	106,077
Net Cash Used in Operating Activities	**$ (317,910)**	$ (411,082)

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

Note 1--Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation: The University of Michigan (the "University") is a state-supported institution with an enrollment of over 63,700 students on its three campuses. The financial statements include the individual schools, colleges and departments, the University of Michigan Health System ("UMHS"), Michigan Health Corporation (a wholly-owned corporation created for joint venture and managed care initiatives), UM Health (a wholly-owned corporation created to hold and develop the University's statewide network of hospitals, hospital joint ventures and other hospital affiliations, currently consisting of Metropolitan Health Corporation) and Veritas Insurance Corporation (a wholly-owned captive insurance company). While the University is a political subdivision of the state of Michigan, it is not a component unit of the State in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*. The University is classified as a state instrumentality under Internal Revenue Code Section 115 and a charitable organization under Internal Revenue Code Section 501(c)(3), and is therefore exempt from federal income taxes. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514.

The University reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB, on the accrual basis. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The financial statements of all controlled organizations are included in the University's financial statements; affiliated organizations that are not controlled by, and not dependent on the University, such as booster and alumni organizations, are not included.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Net position is categorized as:

- Net investment in capital assets: Capital assets, net of accumulated depreciation, outstanding principal balances of debt and capital lease liabilities, unexpended bond proceeds and deferred outflows associated with the acquisition, construction or improvement of those assets.
- Restricted:

  Nonexpendable - Net position subject to externally imposed stipulations that it be maintained permanently. Such net position includes the corpus portion (historical value) of gifts to the University's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

  Expendable - Net position subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time. Such net position includes net appreciation of the University's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- Unrestricted: Net position not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. Substantially all unrestricted net position is designated for various academic programs, research initiatives and capital projects.

Summary of Significant Accounting Policies: For purposes of the statement of cash flows, the University considers all highly liquid investments purchased with a maturity of three months or less, to be cash equivalents. Cash equivalents representing assets of the University's endowment, life income and other investments are included in noncurrent investments as these funds are not used for operating purposes.

Investments are reported in four categories in the statement of net position. Investments reported as endowment, life income and other investments are those funds invested in portfolios that are considered by management to be of a long duration. Investments for student loan and capital activities are those funds that are intended to be used for these specific activities. All other investments are reported as investments for operating activities.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

GASB defines fair value and establishes a framework for measuring fair value that includes a three tiered hierarchy of valuation inputs, placing a priority on those which are observable in the market. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the University's own assumptions about how market participants would value an asset or liability based on the best information available. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The three levels of inputs, of which the first two are considered observable and the last unobservable, are as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date
- Level 2 - Other significant observable inputs, either direct or indirect, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; or market corroborated inputs
- Level 3 - Unobservable inputs

GASB allows for the use of net asset value ("NAV") as a practical expedient to determine the fair value of nonmarketable investments if the NAV is calculated in a manner consistent with the Financial Accounting Standards Board's measurement principles for investment companies. Investments that use NAV in determining fair value are disclosed separately from the valuation hierarchy as presented in Note 2.

Investments in marketable securities are carried at fair value, as established by the major securities markets. Purchases and sales of investments are accounted for on the trade date basis. Investment income is recorded on the accrual basis. Realized and unrealized gains and losses are reported in investment income.

Investments in nonmarketable limited partnerships are carried at fair value, which is generally established using the NAV provided by the management of the investment partnerships at June 30, 2019 and 2018. The University may also adjust the fair value of these investments based on market conditions, specific redemption terms and restrictions, risk considerations and other factors. As these investments are not readily marketable, the estimated value is subject to uncertainty, and therefore, may differ from the value that would have been used had a ready market for the investments existed.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Investments denominated in foreign currencies are translated into U.S. dollar equivalents using year end spot foreign currency exchange rates. Purchases and sales of investments denominated in foreign currencies and related income are translated at spot exchange rates on the transaction dates.

Derivative instruments such as financial futures, forward foreign exchange contracts and interest rate swaps held in investment portfolios, are recorded on the contract date and are carried at fair value using listed price quotations or amounts that approximate fair value. To facilitate trading in financial futures, the University is required to post cash or securities to satisfy margin requirements of the exchange where such futures contracts are listed. The University monitors the required amount of cash and securities on deposit for financial futures transactions and withdraws or deposits cash or securities as necessary.

Accounts receivable are recorded net of an allowance for uncollectible accounts receivable. The allowance is based on management's judgment of potential uncollectible amounts, which includes such factors as historical experience and type of receivable.

The University receives pledges and bequests of financial support from corporations, foundations and individuals. Revenue is recognized when a pledge representing an unconditional promise to give is received and all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Permanent endowment pledges do not meet eligibility requirements, as defined by GASB, and are not recorded as assets until the related gift is received.

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are made, commensurate with expected future payments. An allowance for uncollectible pledges receivable is provided based on management's judgment of potential uncollectible amounts and includes such factors as prior collection history, type of gift and nature of fundraising.

Capital assets are recorded at cost or, if donated, at acquisition value at the date of donation. Depreciation of capital assets is provided on a straight-line method over the estimated useful lives of the respective assets, which generally range from three to fifty years. The University does not capitalize works of art or historical treasures that are held for exhibition, education, research or public service. These collections are neither disposed of for financial gain nor encumbered in any way. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Deferred outflows represent the consumption of net assets attributable to a future period and are primarily associated with the University's obligations for postemployment benefits, debt and derivative activity, and the defined benefit pension plan for Metropolitan Health Corporation ("Metro Health").

Unearned revenue consists primarily of cash received from grant and contract sponsors which has not yet been earned under the terms of the agreement. Unearned revenue also includes amounts received in advance of an event, such as student tuition and advance ticket sales related to future fiscal years.

Deposits of affiliates and others represents cash and invested funds held by the University as a result of agency relationships with various groups. Noncurrent deposits of affiliates represents the portion of endowment and similar funds held by the University on behalf of others.

The University holds life income funds for beneficiaries of the pooled income fund, charitable remainder trusts and the gift annuity program. These funds generally pay lifetime income to beneficiaries, after which the principal is made available to the University in accordance with donor intentions. All life income fund assets, including those held in trust, are recorded at fair value. The present value of estimated future payments due to life income beneficiaries is recorded as a liability.

Deferred inflows represent the acquisition of net assets attributable to a future period and are associated with the University's obligations for postemployment benefits, Metro Health's defined benefit pension plan and irrevocable split-interest agreements.

For donor restricted endowments, the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate amounts for endowment spending rule distributions as is considered prudent. The University's policy is to retain net realized and unrealized appreciation with the endowment after spending rule distributions. Net appreciation of permanent endowment funds, which totaled $2,144,532,000 and $2,067,392,000 at June 30, 2019 and 2018, respectively, is recorded in restricted expendable net position. The University's endowment spending rule is further discussed in Note 2.

Student tuition and residence fees are presented net of scholarships and fellowships applied to student accounts, while stipends and other payments made directly to students are presented as scholarship and fellowship expenses.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Patient care revenues are reported net of contractual allowances and bad debt expenses. Contractual allowances are estimated based on agreements with third-party payers that provide payments for patient care services at amounts different from established rates. These allowances are subject to the laws and regulations governing the federal and state programs and post-payment audits, and adjusted in future periods as final settlements are determined. Patient care services are primarily provided through the University's health system, which includes University Health Service, which offers health care services to students, faculty and staff, and Dental Faculty Associates, which offers dental care services performed by faculty dentists.

Patient care services are provided to patients who meet certain criteria under the University's charity care policies without charge or at amounts less than its established rates. Accordingly, charity care is not reported as revenue in the accompanying statement of revenues, expenses and changes in net position. Charges forgone for charity care services totaled $78,370,000 and $77,259,000 in 2019 and 2018, respectively.

Other auxiliary enterprise revenues primarily represent revenues generated by intercollegiate athletics, parking, student unions and student publications.

The University's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net position are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Nearly all of the University's expenses result from exchange transactions.

Certain significant revenue streams relied upon for operations result from nonexchange transactions and are recorded as nonoperating revenues including state appropriations, federal Pell grants, gifts and investment income.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The most significant areas that require management estimates relate to self-insurance and benefits obligations.

Note 2--Cash and Investments

Summary: The University maintains centralized management for substantially all of its cash and investments.

Working capital of individual University units is primarily invested in the University Investment Pool ("UIP"). Together with the University's short-term insurance and other benefits reserves, the UIP is invested in the Daily and Monthly Portfolios, which are principally invested in investment-grade money market securities, U.S. government and other fixed income securities, and absolute return strategies.

The University collectively invests substantially all of the assets of its endowment funds along with a portion of its insurance and benefits reserves, charitable remainder trusts and gift annuity program in the Long Term Portfolio. The longer investment horizon of the Long Term Portfolio allows for an equity-oriented strategy to achieve higher expected returns over time, and permits the use of less liquid alternative investments, providing for equity diversification beyond the stock markets. The Long Term Portfolio includes investments in domestic and non-U.S. stocks and bonds, commingled funds and limited partnerships consisting of venture capital, private equity, real estate, natural resources and absolute return strategies.

The University also separately invests certain endowments and charitable remainder trusts, unexpended bond proceeds and other funds with investment restrictions outside of the Daily, Monthly and Long Term Portfolios.

Authorizations: The University's investment policies are governed and authorized by University Bylaws and the Board of Regents. The approved asset allocation policy for the Long Term Portfolio sets general targets for both equities and fixed income securities. Since diversification is a fundamental risk management strategy, the Long Term Portfolio is broadly diversified within these general categories.

The endowment spending rule provides for distributions from the University Endowment Fund to the entities that benefit from the endowment fund. The annual distribution rate is 4.5 percent of the one-quarter lagged seven year moving average fair value of fund shares. To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. Distributions are also made from the UIP based on the 90-day U.S. Treasury Bill rate. The University's costs to administer and grow the University Endowment Fund and UIP are funded by investment returns.

Note 2--Cash and Investments--Continued

Cash and Cash Equivalents and Unexpended Bond Proceeds: Cash and cash equivalents, which totaled $397,279,000 and $133,365,000 at June 30, 2019 and 2018, respectively, represent cash and short-term money market investments in mutual funds, overnight collective funds managed by the University's custodian or short-term highly liquid investments registered as securities and held by the University or its agents in the University's name. Of its cash and cash equivalents, the University had actual cash balances in its bank accounts in excess of Federal Deposit Insurance Corporation limits in the amount of $14,121,000 and $42,720,000 at June 30, 2019 and 2018, respectively. The University does not require its deposits to be collateralized or insured.

Unexpended bond proceeds, which totaled $90,813,000 and $82,797,000 at June 30, 2019 and 2018, respectively, represent short-term money market investments in mutual funds. These amounts are used solely for the reimbursement of qualifying expenditures for construction projects associated with certain outstanding general revenue bonds issued by the University.

Cash and cash equivalents and unexpended bond proceeds include certain securities that are subject to the leveling requirements defined by GASB. Level 1 securities, which primarily consist of money market funds and U.S. government securities, totaled $278,275,000 and $132,042,000 at June 30, 2019 and 2018, respectively. Level 2 securities, which primarily consist of U.S. agencies, totaled $36,000,000 and $34,100,000 at June 30, 2019 and 2018, respectively.

Investments: At June 30, 2019 and 2018, the University's investments, which are held by the University or its agents in the University's name, are summarized as follows:

	2019	**2018**
	(in thousands)	
Cash equivalents, noncurrent	$ 167,876	$ 229,067
Equity securities	1,222,061	1,238,818
Fixed income securities	1,361,575	1,826,821
Commingled funds	3,295,746	3,101,671
Nonmarketable alternative investments	8,339,202	7,608,059
Other investments	(1,046)	8,845
	$ 14,385,414	$ 14,013,281

Note 2--Cash and Investments--Continued

At June 30, 2019 and 2018, the fair value of the University's investments based on the inputs used to value them is summarized as follows:

2019	Level 1	Level 2	Level 3 (in thousands)	NAV	Total Fair Value
Cash equivalents, noncurrent	$ 167,876	-	-	-	$ 167,876
Equity securities:					
Domestic	314,972		$ 46,539		361,511
Foreign	859,552		998		860,550
	1,174,524	-	47,537	-	1,222,061
Fixed income securities:					
U.S. Treasury	735,365				735,365
U.S. government agency		$ 27,355			27,355
Corporate and other		586,024	12,831		598,855
	735,365	613,379	12,831	-	1,361,575
Commingled funds:					
Absolute return				$ 2,282,226	2,282,226
Domestic equities	162			423,668	423,830
Global equities	3			569,546	569,549
U.S. fixed income	3,164				3,164
Other	16,977				16,977
	20,306	-	-	3,275,440	3,295,746
Nonmarketable alternative investments:					
Venture capital				2,249,481	2,249,481
Absolute return				1,885,870	1,885,870
Private equity			267,327	1,354,169	1,621,496
Real estate			10,993	1,265,848	1,276,841
Natural resources			204,555	1,100,959	1,305,514
	-	-	482,875	7,856,327	8,339,202
Other investments	(3,145)	(7,184)	9,283	-	(1,046)
	$ 2,094,926	$ 606,195	$ 552,526	$ 11,131,767	$ 14,385,414

Note 2--Cash and Investments--Continued

	2018				
	Level 1	Level 2	Level 3 (in thousands)	NAV	Total Fair Value
Cash equivalents, noncurrent	$ 229,067	-	-	-	$ 229,067
Equity securities:					
Domestic	401,755		$ 34,971		436,726
Foreign	801,506		586		802,092
	1,203,261	-	35,557	-	1,238,818
Fixed income securities:					
U.S. Treasury	752,529				752,529
U.S. government agency		$ 116,085			116,085
Corporate and other		955,166	3,041		958,207
	752,529	1,071,251	3,041	-	1,826,821
Commingled funds:					
Absolute return				$ 2,006,037	2,006,037
Domestic equities	17,089			263,389	280,478
Global equities	9,495			758,608	768,103
U.S. fixed income	9,453			33,589	43,042
Other	4,011				4,011
	40,048	-	-	3,061,623	3,101,671
Nonmarketable alternative investments:					
Venture capital				1,771,258	1,771,258
Absolute return				1,636,355	1,636,355
Private equity			343,688	1,504,786	1,848,474
Real estate			9,225	1,104,080	1,113,305
Natural resources			224,151	1,014,516	1,238,667
	-	-	577,064	7,030,995	7,608,059
Other investments	(2,131)	966	10,010	-	8,845
	$ 2,222,774	$ 1,072,217	$ 625,672	$ 10,092,618	$ 14,013,281

Investments categorized as Level 1 are valued using prices quoted in active markets for those securities. Equity securities categorized as Level 3 represent investments in start-up or venture companies. Fixed income securities categorized as Level 2 represent investments valued using a matrix pricing technique, which values debt securities based on their relationship to a benchmark and the relative spread to that benchmark. Fixed income securities categorized as Level 3 represent debt investments with select venture funded University faculty start-ups as well as a note receivable associated with the sale of a portion of the University's nonmarketable alternative real estate investments at June 30, 2019. Nonmarketable alternative investments categorized as Level 3 primarily represent direct investments which are valued using models that rely on inputs which are unobservable in the market.

Note 2--Cash and Investments--Continued

The University's investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts recorded in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forwards, futures and commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counterparty to perform according to the terms of the contract. The University's risk of loss in the event of a counterparty default is typically limited to the amounts recognized in the statement of net position and is not represented by the contract or notional amounts of the instruments.

Fixed income securities have inherent financial risks, including credit risk and interest rate risk. Credit risk for fixed income securities is the risk that the issuer will not fulfill its obligations. Nationally recognized statistical rating organizations ("NSROs"), such as S&P Global and Moody's, assign credit ratings to security issues and issuers that indicate a measure of potential credit risk to investors. Fixed income securities considered investment grade are those rated at least BBB by S&P Global and Baa by Moody's. To manage credit risk, the University specifies minimum average and minimum absolute quality NSRO ratings for securities held pursuant to its management agreements.

The University minimizes concentration of credit risk, the risk of a large loss attributed to the magnitude of the investment in a single issuer of fixed income securities, by diversifying its fixed income issues and issuers and holding U.S. Treasury securities which are considered to have minimal credit risk. The University also manages this risk at the account level by limiting each fixed income manager's holding of any non-U.S. government issuer to 5 percent of the value of the investment account.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of fixed income securities. Effective duration, a commonly used measure of interest rate risk, incorporates a security's yield, coupon, final maturity, call features and other embedded options into one number expressed in years that indicates how price-sensitive a security or portfolio of securities is to changes in interest rates. The effective duration of a security or portfolio indicates the approximate percentage change in fair value expected for a one percent change in interest rates. The longer the duration, the more sensitive the security or portfolio is to changes in interest rates. The weighted average effective duration of the University's fixed income securities was 5.0 years at June 30, 2019 compared to 4.2 years at June 30, 2018. The University manages the effective duration of its fixed income securities at the account level, where fixed income managers generally may not deviate from the duration of their respective benchmarks by more than 25 percent. The Monthly Portfolio held positions in bond futures at June 30, 2019 and 2018, which are used to adjust the duration of cash equivalents and the fixed income portion of the portfolios.

Note 2--Cash and Investments--Continued

The composition of fixed income securities at June 30, 2019 and 2018, along with credit quality and effective duration measures, is summarized as follows:

2019

	U.S. Government	Investment Grade	Non-Investment Grade (in thousands)	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 724,727				$ 724,727	5.0
U.S. Treasury inflation protected	10,638				10,638	7.3
U.S. government agency	27,355				27,355	0.9
Mortgage backed		$ 13,346	$ 404	$ 6,514	20,264	0.8
Asset backed		34,271		377	34,648	0.7
Corporate and other		508,015	13,583	22,345	543,943	5.5
	$ 762,720	$ 555,632	$ 13,987	$ 29,236	$ 1,361,575	5.0

2018

	U.S. Government	Investment Grade	Non-Investment Grade (in thousands)	Not Rated	Total	Duration (in years)
U.S. Treasury	$ 527,662				$ 527,662	8.7
U.S. Treasury inflation protected	224,867				224,867	2.2
U.S. government agency	116,085				116,085	0.4
Mortgage backed		$ 82,258	$ 2,930	$ 22,634	107,822	0.6
Asset backed		68,336		2,210	70,546	0.7
Corporate and other		753,876	16,841	9,122	779,839	3.2
	$ 868,614	$ 904,470	$ 19,771	$ 33,966	$ 1,826,821	4.2

Of the University's fixed income securities, 97 percent were rated investment grade or better at both June 30, 2019 and 2018, and 63 percent and 59 percent of these securities consisted of either U.S. treasury and government agencies or non-U.S. government securities rated AAA/Aaa at June 30, 2019 and 2018, respectively.

Commingled (pooled) funds include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures which are generally unrated and unregulated. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy. These investments are structured to limit the University's risk exposure to the amount of invested capital.

Note 2--Cash and Investments--Continued

Nonmarketable alternative investments consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. There is not an active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner. The University's limited partnerships are diversified in terms of manager selection, industry and geographic focus. At June 30, 2019 and 2018, no individual partnership investment represented 5 percent or more of total investments.

Absolute return strategies in the commingled funds and nonmarketable alternative investments classifications include long/short stock programs, merger arbitrage, intra-capital structure arbitrage and distressed debt investments. The goal of absolute return strategies is to provide, in aggregate, a return that is consistently positive and uncorrelated with the overall market.

The University's investments in commingled funds and nonmarketable alternative investments are contractual agreements that may limit the ability to initiate redemptions due to notice periods, lock-ups and gates. Additional information about current redemption terms and outstanding commitments at June 30, 2019 is summarized as follows (amounts in thousands):

	Fair Value	Remaining Life	Outstanding Commitments	Redemption Terms	Redemption Notice
Commingled funds	$ 3,295,746	N/A		Daily, monthly, quarterly and annually, with varying notice periods	Lock-up provisions range from none to 3 years
Nonmarketable alternative investments	$ 8,339,202	1-12 years	$ 6,089,675	Ineligible for redemption	N/A

Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Of the University's commingled funds at June 30, 2019 and 2018, approximately 75 percent and 79 percent are redeemable within one year, with 58 percent and 63 percent redeemable within 90 days under normal market conditions. The remaining amounts are redeemable beyond one year, with redemption of certain funds dependent on disposition of the underlying assets. The University's committed but unpaid obligation to nonmarketable alternative investments is further discussed in Note 14.

Note 2--Cash and Investments--Continued

The University participates in non-U.S. developed and emerging markets through commingled funds invested in non-U.S./global equities and absolute return strategies. Although all of these funds are reported in U.S. dollars, price changes of the underlying securities in local markets as well as changes to the value of local currencies relative to the U.S. dollar are embedded in investment returns. In addition, a portion of the University's equity securities and nonmarketable alternative investments are denominated in foreign currencies, which must be settled in local (non-U.S.) currencies.

Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. Forward foreign currency contracts are typically used to manage the risks related to fluctuations in currency exchange rates between the time of purchase or sale and the actual settlement of foreign securities. Various investment managers acting for the University use forward foreign exchange contracts in risk-based transactions to carry out their portfolio strategies and are subject to agreements that provide minimum diversification and maximum exposure limits by country and currency.

The value of the University's non-U.S. dollar holdings, net of the value of the outstanding forward foreign exchange contracts, totaled $1,726,091,000 or 12 percent of total investments at June 30, 2019, and $1,766,714,000 or 13 percent of total investments at June 30, 2018, and are summarized as follows:

	2019	2018
	(in thousands)	
Euro	$ 805,536	$ 983,971
British pound sterling	289,940	252,537
Japanese yen	232,252	233,049
Swedish krona	111,224	78,464
Canadian dollar	83,105	79,368
Swiss franc	68,733	35,564
Norwegian krone	39,071	49,760
Other	96,230	54,001
	$ 1,726,091	$ 1,766,714

Note 2--Cash and Investments--Continued

The Long Term Portfolio and the Monthly Portfolio participate in a short-term, fully collateralized, securities lending program administered by the University's master custodian. Together, the Portfolios had $64,548,000 and $79,224,000 in securities loans outstanding at June 30, 2019 and 2018, respectively. At loan inception, an approved borrower must deliver collateral of cash, securities or letters of credit to the University's lending agent equal to 102 percent of fair value for domestic securities and 105 percent for foreign securities. Collateral positions are monitored daily to ensure that borrowed securities are never less than 100 percent collateralized. At June 30, 2019, collateral of $67,327,000 (104 percent of securities on loan) includes invested cash of $29,485,000 and U.S. government securities of $37,842,000, while at June 30, 2018, collateral of $82,085,000 (104 percent of securities on loan) includes invested cash of $29,727,000 and U.S. government securities of $52,358,000.

Cash collateral held by the University's lending agent, along with the offsetting liability to return the collateral at loan termination, are recorded in the statement of net position. Neither the University nor its securities lending agent has the ability to pledge or sell securities received as collateral unless a borrower defaults. Securities loans may be terminated upon notice by either the University or the borrower.

Note 3--Accounts Receivable

The composition of accounts receivable at June 30, 2019 and 2018 is summarized as follows:

	2019	**2018**
	(in thousands)	
Patient care	$ 539,653	$ 507,827
Sponsored programs	172,681	164,264
State appropriations, educational and capital	67,353	67,230
Student accounts	32,715	27,457
Other	36,975	32,219
	849,377	798,997
Less allowance for uncollectible accounts receivable:		
Patient care	125,731	123,370
All other	9,025	8,816
	$ 714,621	$ 666,811

Note 4--Notes and Pledges Receivable

The composition of notes and pledges receivable at June 30, 2019 and 2018 is summarized as follows:

	2019	2018
	(in thousands)	
Notes:		
Federal student loan programs	$ 74,153	$ 85,918
University student loan funds	15,691	16,664
Other	1,396	1,390
	91,240	103,972
Less allowance for uncollectible notes	3,134	3,134
Total notes receivable, net	88,106	100,838
Gift pledges:		
Capital	138,983	165,342
Operations	167,350	164,920
	306,333	330,262
Less:		
Allowance for uncollectible pledges	8,137	9,523
Unamortized discount to present value	4,840	4,942
Total pledges receivable, net	293,356	315,797
Total notes and pledges receivable, net	381,462	416,635
Less current portion	80,035	79,765
	$ 301,427	$ 336,870

The principal repayment and interest rate terms of federal and University loans vary considerably. The allowance for uncollectible notes only applies to University funded notes and the University portion of federal student loans, as the University is not obligated to fund the federal portion of uncollected student loans. Federal loan programs are funded principally with federal advances to the University under the Perkins and various health professions loan programs.

Note 4--Notes and Pledges Receivable--Continued

Payments on pledges receivable at June 30, 2019 are expected to be received in the following years ended June 30 (in thousands):

2020	$ 63,261
2021	57,970
2022	43,855
2023	35,386
2024	46,680
2025 and after	59,181
	$ 306,333

Permanent endowment pledges do not meet eligibility requirements, as defined by GASB, until the related gift is received. Accordingly, permanent endowment pledges totaling $156,957,000 and $168,926,000 at June 30, 2019 and 2018, respectively, are not recognized as assets in the accompanying financial statements. In addition, bequest intentions and other conditional promises are not recognized as assets until the specified conditions are met due to uncertainties with regard to their realizability and valuation.

Note 5--Capital Assets

Capital assets activity for the years ended June 30, 2019 and 2018 is summarized as follows:

2019 (in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 129,376	$ 24,533	$ 599	$ 153,310
Land improvements	143,738	18,026	1,463	160,301
Infrastructure	262,207	2,550		264,757
Buildings	9,178,875	265,783	31,782	9,412,876
Construction in progress	301,434	111,773		413,207
Equipment	2,098,370	228,688	84,565	2,242,493
Library materials	646,376	28,115		674,491
	12,760,376	679,468	118,409	13,321,435
Less accumulated depreciation	6,639,379	567,857	112,770	7,094,466
	$ 6,120,997	$ 111,611	$ 5,639	$ 6,226,969

2018 (in thousands)	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 126,617	$ 2,952	$ 193	$ 129,376
Land improvements	137,981	7,275	1,518	143,738
Infrastructure	258,449	4,149	391	262,207
Buildings	8,618,377	620,725	60,227	9,178,875
Construction in progress	476,124	(174,690)		301,434
Equipment	2,050,848	163,428	115,906	2,098,370
Library materials	620,200	26,176		646,376
	12,288,596	650,015	178,235	12,760,376
Less accumulated depreciation	6,243,154	568,707	172,482	6,639,379
	$ 6,045,442	$ 81,308	$ 5,753	$ 6,120,997

The increase in construction in progress of $111,773,000 in 2019 represents the amount of capital expenditures for new projects of $559,735,000 net of assets placed in service of $447,962,000. The decrease in construction in progress of $174,690,000 in 2018 represents the amount of capital expenditures for new projects of $527,908,000 net of assets placed in service of $702,598,000.

During 2018, the University recognized $24,698,000 of additional depreciation expense in connection with the impairment of certain components of Metro Health's hospital facilities.

Note 6--Long-term Debt

Long-term debt at June 30, 2019 and 2018 is summarized as follows:

	2019	2018
	(in thousands)	
Commercial paper:		
Tax-exempt, variable rate (1.57%)*	$ 142,990	$ 155,595
Taxable, variable rate (2.30%)*	2,250	2,865
General revenue bonds:		
Series 2019A, 5.00% through 2036	148,330	
unamortized premium	26,936	
Series 2019B, taxable, 2.535% to 3.416% through 2029	16,755	
Series 2019C, 4.00% through 2049	61,725	
unamortized premium	5,949	
Series 2018A, 4.00% to 5.00% through 2048	135,130	137,510
unamortized premium	17,988	19,055
Series 2017A, 4.00% to 5.00% through 2047	447,410	456,265
unamortized premium	72,310	78,186
Series 2015, 4.00% to 5.00% through 2046	294,850	302,415
unamortized premium	44,612	47,640
Series 2014A, 4.25% to 5.00% through 2044	74,250	76,060
Series 2014B, 2.071% to 3.516% through 2024	4,820	5,730
unamortized premium	6,056	6,503
Series 2013A, 2.50% to 5.00% through 2029	43,575	44,975
unamortized premium	1,424	1,649
Series 2012A, variable rate (1.78%)* through 2036	50,000	50,000
Series 2012B, variable rate (1.86%)* through 2042	65,000	65,000
Series 2012D-1, variable rate (1.80%)* through 2025 with partial swap to fixed through 2025	56,635	60,220
Series 2012D-2, variable rate (1.80%)* through 2030 with partial swap to fixed through 2026	58,315	62,725
Series 2012E**, variable rate (2.17%)* through 2033	94,525	95,020
Series 2010A, taxable Build America Bonds, 4.926% to 5.593% through 2040	163,110	163,110
Series 2010C, 3.75% to 5.00% through 2027	38,330	50,485
unamortized premium	2,937	3,647
Series 2010D, taxable Build America Bonds, 3.356% to 5.333% through 2041	157,860	165,790
Series 2009A, 3.00% to 5.00% through 2019		4,165
unamortized premium		2,769
Series 2009B, variable rate (1.52%)* through 2039	118,710	118,710
Series 2009D, taxable Build America Bonds, 5.155% to 6.172% through 2019		89,815
Series 2008A, variable rate (1.93%)* through 2038	57,085	57,085
Series 2008B, variable rate (1.82%)* through 2028 with swap to fixed through 2026	65,070	70,845
Other	91	174
	2,475,028	2,394,008
Less:		
Commercial paper and current portion of bonds payable	232,095	237,371
Long-term bonds payable subject to remarketing, net	133,616	195,552
	$ 2,109,317	$ 1,961,085

* Denotes variable rate at June 30, 2019
** Denotes variable rate bonds not subject to remarketing

Note 6--Long-term Debt--Continued

Certain variable rate bonds have remarketing features which allow bondholders to put debt back to the University. Accordingly, variable rate bonds payable is classified as current unless supported by liquidity agreements, such as lines of credit or standby bond purchase agreements, which can refinance the debt on a long-term basis. The classification of the University's variable rate bonds payable at June 30, 2019 and 2018 is summarized as follows:

	2019	**2018**
	(in thousands)	
Variable rate bonds payable subject to remarketing	$ 470,815	$ 484,585
Less:		
Current principal maturities	14,365	13,770
Long-term liquidity agreements:		
Unsecured lines of credit	275,263	275,263
Standby bond purchase agreements	47,571	
Long-term bonds payable subject to remarketing, net	$ 133,616	$ 195,552

The University's available lines of credit were entirely unused at both June 30, 2019 and 2018.

In connection with certain issues of variable rate debt, the University has entered into floating-to-fixed interest rate swaps to convert all or a portion of the associated variable rate debt to synthetic fixed rates to protect against the potential of rising interest rates. The fair value, significant terms and other information about the University's interest rate swaps is discussed in Note 7.

Note 6--Long-term Debt--Continued

Long-term debt activity for the years ended June 30, 2019 and 2018 is summarized as follows:

	2019			
	Beginning Balance	Additions (in thousands)	Reductions	Ending Balance
Commercial paper	$ 158,460		$ 13,220	$ 145,240
Bonds	2,235,374	$ 260,034	165,711	2,329,697
Other	174		83	91
	$ 2,394,008	$ 260,034	$ 179,014	$ 2,475,028

	2018			
	Beginning Balance	Additions (in thousands)	Reductions	Ending Balance
Commercial paper	$ 161,045	$ 6,600	$ 9,185	$ 158,460
Bonds	2,154,723	156,728	76,077	2,235,374
Other	1,747		1,573	174
	$ 2,317,515	$ 163,328	$ 86,835	$ 2,394,008

The University maintains a combination of variable and fixed rate debt supported by general revenues, with effective interest rates that averaged 3.0 percent and 2.9 percent in 2019 and 2018, respectively, including federal subsidies for interest on taxable Build America Bonds.

The University utilizes commercial paper to provide interim financing for its capital improvement program. The Board of Regents has authorized the issuance of up to $300,000,000 in commercial paper backed by a general revenue pledge. Outstanding commercial paper debt is converted to long-term debt financing, as appropriate, within the normal course of business.

During 2019, the University issued $226,810,000 of General Revenue Bonds with a net original issue premium of $33,224,000, which included $148,330,000 of fixed rate, tax-exempt bonds Series 2019A, $16,755,000 of fixed rate, taxable bonds Series 2019B and $61,725,000 of fixed rate, tax-exempt bonds Series 2019C. Total bond proceeds of $260,034,000 were utilized to refund existing bonds of $83,985,000 and to provide $175,245,000 for capital projects and $804,000 for debt issuance costs.

Note 6--Long-term Debt--Continued

The refunded bonds represent the remaining portion of General Revenue Bonds Series 2009D, which had an average interest rate of 5.98 percent and a final maturity date of April 1, 2030. As a result of the refunding, the University reduced its aggregate debt service payments over the next 11 years by $10,769,000, resulting in an economic gain with present value savings of $9,493,000.

During 2018, the University issued $137,510,000 of fixed rate General Revenue Bonds Series 2018A with a net original issue premium of $19,218,000. Total bond proceeds of $156,728,000 were utilized to provide $156,200,000 for capital projects and $528,000 for debt issuance costs.

Deferred outflows associated with the University's refunding activity totaled $10,481,000 and $14,095,000 at June 30, 2019 and 2018, respectively, which will be amortized into interest expense over the remaining life of the refunded bonds.

Debt obligations are generally callable by the University and mature at various dates through fiscal 2049. Principal maturities, including interest on debt obligations, based on scheduled bond maturities for the next five years and in subsequent five-year periods are as follows:

	Principal	Interest* (in thousands)	Total
2020	$ 217,551	$ 86,047	$ 303,598
2021	76,250	83,700	159,950
2022	79,725	81,303	161,028
2023	81,010	78,325	159,335
2024	87,225	75,214	162,439
2025-2029	468,850	321,451	790,301
2030-2034	465,690	223,482	689,172
2035-2039	490,670	130,926	621,596
2040-2044	233,755	49,834	283,589
2045-2049	96,090	10,367	106,457
Total payments	2,296,816	$ 1,140,649	$ 3,437,465
Plus unamortized premiums	178,212		
	$ 2,475,028		

* Interest on variable rate debt is estimated based on rates in effect at June 30, 2019; amounts do not reflect federal subsidies to be received for Build America Bonds interest

Note 6--Long-term Debt--Continued

If all variable rate bonds were put back to the University and existing unsecured lines of credit were not extended upon their current expiration dates, the total principal payments due in 2020 would increase to $351,167,000, total principal payments due in 2021 would increase to $259,752,000, total principal payments due in 2022 would increase to $112,582,000, total principal payments due in 2023 would increase to $93,848,000 and total principal payments due in 2024 would increase to $89,379,000. Accordingly, principal payments due in subsequent years would be reduced to $396,813,000 in 2025 through 2029, $364,240,000 in 2030 through 2034, $331,065,000 in 2035 through 2039 and $201,880,000 in 2040 through 2044. Principal payments due in 2045 through 2049 would not change. There would not be a material impact on annual interest payments due to the low variable rate of interest on these bonds.

Note 7--Derivative Instruments

Derivatives held by the University are recorded at fair value in the statement of net position. For hedging derivative instruments that are effective in significantly reducing an identified financial risk, the corresponding change in fair value is deferred and included in the statement of net position. For all other derivative instruments, changes in fair value are reported as net investment income (loss).

Note 7--Derivative Instruments--Continued

Derivative instruments held by the University at June 30, 2019 and 2018 are summarized as follows:

	2019	
	Notional Amount	Fair Value
	(in thousands)	
Investment derivative instruments:		
Futures	$ 79,838	$ (3,145)
Foreign currency forwards:		
Chinese yuan	340,704	7,792
New Zealand dollar	181,678	4,568
Norwegian krone	168,849	(2,938)
Russian ruble	36,354	2,784
Euro	210,332	1,987
Japanese yen	14,948	(1,929)
All other currencies	1,079,010	(1,474)
	2,031,875	10,790
Other	1,834,929	(14,445)
	$ 3,946,642	$ (6,800)
Effective cash flow hedges:		
Floating-to-fixed interest rate swaps on debt	$ 138,900	$ (13,695)

	2018	
	Notional Amount	Fair Value
	(in thousands)	
Investment derivative instruments:		
Futures	$ 183,096	$ (2,131)
Foreign currency forwards:		
Chinese yuan	332,924	10,829
Swedish krona	209,549	8,221
South African rand	58,800	(7,463)
Australian dollar	207,419	(7,647)
Turkish lire	59,214	(8,269)
Brazil real	123,133	(11,745)
All other currencies	1,573,663	20,467
	2,564,702	4,393
Other	2,939,567	(790)
	$ 5,687,365	$ 1,472
Effective cash flow hedges:		
Floating-to-fixed interest rate swaps on debt	$ 152,655	$ (12,212)

Note 7--Derivative Instruments--Continued

The University utilizes bond futures in its investment portfolios to adjust the duration of cash equivalents and fixed income securities, while foreign currency forward contracts are utilized to settle securities and transactions denominated in foreign currencies and manage foreign exchange risk. Other derivative instruments in the University's investment portfolios consist primarily of interest rate swaps, credit default swaps and total return swaps used to carry out investment and portfolio strategies.

In connection with certain issues of variable rate debt, the University has entered into floating-to-fixed interest rate swaps to convert all or a portion of the associated variable rate debt to synthetic fixed rates to protect against the potential of rising interest rates. The fair value of these swaps generally represent the estimated amount that the University would pay to terminate the swap agreements at the statement of net position date, taking into account current interest rates and creditworthiness of the underlying counterparty. The valuation inputs used to determine the fair value of these instruments are considered Level 2, as they rely on observable inputs other than quoted market prices. The notional amount represents the underlying reference of the instrument and does not represent the amount of the University's settlement obligations.

At June 30, 2019 and 2018, the fair value of floating-to-fixed interest rate swaps associated with the University's variable rate debt is ($13,695,000) and ($12,212,000), respectively, and is included in the statement of net position as a component of deposits of affiliates and other. The deferred outflows for these effective cash flow hedges totaled $4,694,000 and $731,000 at June 30, 2019 and 2018, respectively.

The change in fair value of derivative instruments, which includes realized gains and losses on positions closed, for the years ended June 30, 2019 and 2018 is summarized as follows:

	2019	**2018**
	(in thousands)	
Investment derivative instruments:		
Investment portfolios:		
Futures	$ 22,332	$ 8,592
Foreign currency forwards	41,907	(58,308)
Other	(117,840)	1,098
	$ (53,601)	$ (48,618)
Floating-to-fixed interest rate swap on debt	$ -	$ 186
Effective cash flow hedges:		
Floating-to-fixed interest rate swaps on debt	$ (1,483)	$ 7,100

Note 7--Derivative Instruments--Continued

The University's interest rate swaps, along with their associated variable rate debt and significant terms, are summarized below.

The floating-to-fixed interest rate swap associated with the Series 2008B General Revenue Bonds has a notional amount of $48,355,000 and $54,130,000 at June 30, 2019 and 2018, respectively, and the notional amount decreases as principal on the underlying bonds is repaid. The University makes payments based on a fixed rate of 3.105 percent and receives variable rate payments from the swap counterparty based on 68 percent of One-Month USD LIBOR, until the swap terminates in April 2026. The University has the option to terminate the swap upon five business days written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2019 and 2018 and has a fair value of ($3,884,000) and ($3,076,000), respectively.

The floating-to-fixed interest rate swap associated with the Series 2012D-2 General Revenue Bonds has a notional amount of $34,030,000 and $38,430,000 at June 30, 2019 and 2018, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. The University makes payments based on a fixed rate of 3.229 percent and receives variable rate payments from the swap counterparty based on 68 percent of the One-Month USD LIBOR, until the swap terminates in December 2025. The University has the option to terminate the swap upon five business days written notice and payment of the fair market compensation for the value of the swap. This swap is considered an effective hedge at June 30, 2019 and 2018 and has a fair value of ($2,376,000) and ($2,010,000), respectively.

The first floating-to-fixed interest rate swap associated with the Series 2012D-1 General Revenue Bonds has a notional amount of $44,670,000 at both June 30, 2019 and 2018, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. The University makes payments based on a fixed rate of 4.705 percent and receives variable rate payments from the swap counterparty based on the floating Securities Industry and Financial Markets Association ("SIFMA") Municipal Index through the final maturity dates of the underlying bonds in December 2024. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2019 and 2018 and has a fair value of ($6,816,000) and ($6,234,000), respectively.

The second floating-to-fixed interest rate swap associated with the Series 2012D-1 General Revenue Bonds has a notional amount of $11,845,000 and $15,425,000 at June 30, 2019 and 2018, respectively, covering a portion of the principal outstanding and the notional amount decreases as principal on the underlying bonds is repaid. The University makes payments based

Note 7--Derivative Instruments--Continued

on a fixed rate of 4.685 percent and receives variable rate payments based on the floating SIFMA Municipal Index through the final maturity dates of a portion of the underlying bonds in December 2021. The counterparty has the option of terminating the swaps if for any 180-day period the average variable rate is more than 7.0 percent. This swap is considered an effective hedge at June 30, 2019 and 2018 and has a fair value of ($619,000) and ($892,000), respectively.

Using rates in effect at June 30, 2019, the projected cash flows for the floating-to-fixed interest rate swaps deemed effective cash flow hedges, along with the debt service requirements of the associated variable rate debt, are summarized as follows:

	Variable Rate Bonds		Swap	Total
	Principal	Interest	Payments, Net	Payments
	(in thousands)			
2020	$ 14,365	$ 3,144	$ 2,717	$ 20,226
2021	15,000	2,871	2,438	20,309
2022	15,645	2,599	2,157	20,401
2023	26,150	2,208	1,660	30,018
2024	27,320	1,728	1,022	30,070
2025-2029	79,405	3,209	426	83,040
2030	2,135	16		2,151
	$ 180,020	$ 15,775	$ 10,420	$ 206,215

By using derivative financial instruments to hedge exposures to changes in interest rates, the University is exposed to termination risk and basis risk. There is termination risk with floating-to-fixed interest rate swaps as the University or swap counterparty may terminate a swap if the other party fails to perform under the terms of the contract or its credit rating falls below investment grade. Termination risk is the risk that the associated variable rate debt no longer carries a synthetic fixed rate and if at the time of termination a swap has a negative fair value, the University is liable to the counterparty for payment equal to the swap’s fair value. The University is also exposed to basis risk as a portion of the variable payments paid to the University by the counterparties are based on a percentage of LIBOR. Basis risk is the risk that changes in the relationship between SIFMA and LIBOR may impact the synthetic fixed rate of the variable rate debt. At June 30, 2019 and 2018, the University is not exposed to credit risk as the swaps have negative fair values.

The University is subject to collateral requirements with its counterparties on certain derivative instrument positions. To meet trading margin requirements for bond futures, the University had cash and U.S. government securities with a fair value of $10,227,000 and $15,306,000 at June 30, 2019 and 2018, respectively, on deposit with its futures broker as collateral.

Note 8--Self-Insurance

The University is self-insured for medical malpractice, workers' compensation, directors' and officers' liability, property damage, auto liability and general liability through Veritas Insurance Corporation. The University is also self-insured for various employee benefits through internally maintained funds.

Claims and expenses are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported and the future costs of handling claims. These liabilities are generally based on actuarial valuations and are reported at present value, discounted at a rate of 5 percent.

Changes in the total reported liability for insurance and benefits obligations for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019	**2018**
	(in thousands)	
Balance, beginning of year	$ 235,162	$ 214,035
Claims incurred and changes in estimates	745,730	694,199
Claim payments	(748,980)	(673,072)
Balance, end of year	231,912	235,162
Less current portion	104,235	98,159
	$ 127,677	$ 137,003

Note 9--Pension Plan

Metro Health has a noncontributory, single employer defined benefit pension plan, which covered substantially all employees prior to being frozen as of December 31, 2007. The plan generally provides benefits based on each employee's years of service and final average earnings, as defined, and does not provide any automatic or ad-hoc cost of living adjustments. The Metro Health Board of Directors has the authority to establish and amend benefit provisions of the plan.

The annual pension expense and net pension liability is actuarially determined using the entry age normal level percentage of pay method. Metro Health has elected to measure the net pension liability one year prior to the fiscal year end reporting date and amounts measured at June 30, 2018 and 2017 were determined based on an actuarial valuation at October 1, 2017 and 2016, respectively. There are no significant changes known which would impact the total net pension liability between the measurement date and the reporting date, other than typical plan experience.

For purposes of the June 30, 2018 and 2017 measurement dates, the number of plan participants consisted of the following:

	2018	**2017**
Active participants	574	612
Vested terminated participants	905	947
Retirees, beneficiaries and disabled participants	372	366
	1,851	1,925

Note 9--Pension Plan--Continued

Changes in the reported net pension liability for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019		
	Total Pension Liability	Plan Fiduciary Net Position (in thousands)	Net Pension Liability
Balance, beginning of year	$ 72,680	$ 76,503	$ (3,823)
Interest cost	4,930		4,930
Changes in assumptions	(273)		(273)
Differences between expected and actual plan experience	1,361		1,361
Benefit payments	(4,489)	(4,489)	-
Contributions from the employer		1,047	(1,047)
Net investment income:			
Expected investment earnings		5,234	(5,234)
Differences between expected and actual investment earnings		(1,168)	1,168
Balance, end of year	$ 74,209	$ 77,127	$ (2,918)

	2018		
	Total Pension Liability	Plan Fiduciary Net Position (in thousands)	Net Pension Liability
Balance, beginning of year	$ 73,968	$ 70,532	$ 3,436
Interest cost	5,013		5,013
Changes in assumptions	(822)		(822)
Differences between expected and actual plan experience	(767)		(767)
Benefit payments	(4,712)	(4,712)	-
Contributions from the employer		2,171	(2,171)
Net investment income:			
Expected investment earnings		4,848	(4,848)
Differences between expected and actual investment earnings		3,664	(3,664)
Balance, end of year	$ 72,680	$ 76,503	$ (3,823)

The plan fiduciary net position as a percentage of the total pension liability was 104 percent and 105 percent at June 30, 2019 and 2018, respectively.

Note 9--Pension Plan--Continued

Significant actuarial assumptions used at the June 30, 2018 and 2017 measurement dates are as follows:

	2018	2017
Discount rate	7.00%	7.00%
Inflation	2.00%	2.00%
Investment rate of return	7.00%	7.00%
Mortality table	RP-2014 Employee and Healthy Annuitant, Scale MP-2017	RP-2014 Employee and Healthy Annuitant, Scale MP-2016

Discount rates are based on the expected rate of return on pension plan investments. The projection of cash flows used to determine the single discount rate for each fiscal year end assumed that employer contributions will be made based on the minimum contribution projection under provisions of ERISA and the Pension Protection Act of 2006, including MAP-21, for future years. Based on the stated assumptions, the pension plan's fiduciary net position and future contributions were sufficient to finance the future benefit payments of the current plan members for all projection years. As a result, the long-term expected rate of return on pension plan investments was applied to all periods of the projected benefit payments to determine the total pension liability.

The long-term expected rate of return on pension plan investments of 7.00 percent at both June 30, 2018 and 2017 was determined using the expected future rates of return for the target asset allocation of the portfolio. The target allocation and best estimate geometric rates of return by asset class are summarized as follows:

	2018		2017	
	Portfolio Allocation	Long-Term Expected Return	Portfolio Allocation	Long-Term Expected Return
U.S. large cap	25.0%	6.3%	25.0%	6.8%
U.S. mid cap	10.5%	7.1%	10.5%	7.6%
U.S. small cap	6.5%	7.8%	6.5%	8.3%
International developed	14.0%	5.2%	14.0%	5.6%
Emerging market	9.0%	5.1%	9.0%	5.6%
STRIPs	7.0%	4.3%	7.0%	4.5%
Corporate 10+ year	28.0%	5.0 %	28.0%	4.8%

Note 9--Pension Plan--Continued

A one-percentage point change in the discount rate would impact the reported net pension liability at June 30, 2019 and 2018 as follows:

	2019		2018	
	1% Decrease	1% Increase	1% Decrease	1% Increase
	(in thousands)			
Net pension liability	$ 8,313	$ (6,931)	$ 8,751	$ (7,252)

The components of pension income for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019	2018
	(in thousands)	
Interest cost	$ 4,930	$ 5,013
Expected investment earnings	(5,234)	(4,848)
Amortization of deferred outflows and deferred inflows	(7,857)	(9,582)
	$ (8,161)	$ (9,417)

Deferred outflows and deferred inflows related to the reported net pension liability at June 30, 2019 and 2018 are summarized as follows:

	2019		2018	
	Deferred Outflows	Deferred Inflows	Deferred Outflows	Deferred Inflows
	(in thousands)			
Changes in assumptions		$ 330		$ 8,047
Differences between expected and actual plan experience	$ 789	161	$ 626	464
Differences between expected and actual investment earnings	934	2,724		3,720
	1,723	3,215	626	12,231
Contributions made after measurement date	1,244		1,047	
	$ 2,967	$ 3,215	$ 1,673	$ 12,231

Note 9--Pension Plan--Continued

Deferred outflows and deferred inflows related to changes in assumptions and differences between expected and actual experience will be recognized into expense in the following years ended June 30 based upon the average future work life expectancy of plan participants (in thousands):

2020	$ (638)
2021	(589)
2022	(499)
2023	234
	$ (1,492)

The inputs used to determine the fair value of the plan's investments reported at June 30, 2019 and 2018 are summarized as follows:

	2019			
	Level 1	Level 2 (in thousands)	NAV	Total Fair Value
Equity securities	$ 53,515			$ 53,515
Fixed income securities		$ 22,616		22,616
Nonmarketable alternative investments			$ 996	996
	$ 53,515	$ 22,616	$ 996	$ 77,127

	2018			
	Level 1	Level 2 (in thousands)	NAV	Total Fair Value
Equity securities	$ 54,057			$ 54,057
Fixed income securities		$ 21,297		21,297
Nonmarketable alternative investments			$ 1,149	1,149
	$ 54,057	$ 21,297	$ 1,149	$ 76,503

Note 10--Postemployment Benefits

The University provides retiree health and welfare benefits, primarily medical, prescription drug, dental and life insurance coverage, to eligible retirees and their eligible dependents. Substantially all full-time regular University employees may become eligible for these benefits if they reach retirement age while working for the University. For employees retiring on or after January 1, 1987, contributions toward health and welfare benefits are shared between the University and the retiree and can vary based on date of hire, date of retirement, age and coverage elections.

The University also provides income replacement benefits, retirement savings contributions and health and life insurance benefits to substantially all regular University employees that are enrolled in a University sponsored long-term disability plan and qualify, based on disability status while working for the University, to receive basic or expanded long-term disability benefits. Contributions toward the expanded long-term disability plan are shared between the University and employees and vary based on years of service, annual base salary and coverage elections. Contributions toward the basic long-term disability plan are paid entirely by the University.

These postemployment benefits are provided through single-employer plans administered by the University. The Executive Vice Presidents of the University have the authority to establish and amend benefit provisions of the plans.

Actuarial projections of benefits expense are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided and announced future changes at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point.

The University's reported liability for postemployment benefits obligations is calculated using the entry age normal level percent of pay method. The University has elected to measure the total postemployment liability one year prior to the fiscal year end reporting date and amounts measured at June 30, 2018 and 2017 were determined based on an actuarial valuation at January 1, 2018 and 2017, respectively. There are no significant changes known which would impact the total postemployment liability between the measurement date and the reporting date, other than typical plan experience.

Note 10--Postemployment Benefits--Continued

For purposes of the June 30, 2018 and 2017 measurement dates, the number of plan participants consisted of the following:

	2018		2017	
	Retiree Health and Welfare	Long-term Disability	Retiree Health and Welfare	Long-term Disability
Active employees	42,559	36,331	40,757	35,020
Retirees receiving benefits	10,092		9,694	
Surviving spouses	871		862	
Participants receiving disability benefits		578		619
	53,522	36,909	51,313	35,639

Note 10--Postemployment Benefits--Continued

Changes in the reported total liability for postemployment benefits obligations for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019		
	Retiree Health and Welfare	Long-term Disability (in thousands)	Total
Balance, beginning of year	$ 3,002,304	$ 301,436	$ 3,303,740
Service cost	112,698	29,235	141,933
Interest cost	110,559	11,241	121,800
Changes in assumptions	(379,778)	(3,537)	(383,315)
Differences between expected and actual plan experience	23,232	(5,697)	17,535
Benefit payments	(53,974)	(33,664)	(87,638)
Balance, end of year	2,815,041	299,014	3,114,055
Less current portion	56,815	30,897	87,712
	$ 2,758,226	$ 268,117	$ 3,026,343

	2018		
	Retiree Health and Welfare	Long-term Disability (in thousands)	Total
Balance, beginning of year	$ 2,930,656	$ 267,671	$ 3,198,327
Service cost	115,686	28,101	143,787
Interest cost	86,129	8,024	94,153
Changes in assumptions	(124,729)	16,855	(107,874)
Differences between expected and actual plan experience	43,472	9,249	52,721
Benefit payments	(48,910)	(28,464)	(77,374)
Balance, end of year	3,002,304	301,436	3,303,740
Less current portion	53,974	33,664	87,638
	$ 2,948,330	$ 267,772	$ 3,216,102

Since a portion of retiree medical services will be provided by the University's health system, the reported liability for postemployment benefits obligations is net of the related margin and fixed costs associated with providing those services which totaled $579,735,000 and $611,361,000 at June 30, 2019 and 2018, respectively.

Note 10--Postemployment Benefits--Continued

The University's liability for postemployment benefits obligations at June 30, 2019 is not reduced by the anticipated Medicare Retiree Drug Subsidy for future periods. This subsidy would reduce the total postemployment benefits liability by approximately $295,000,000.

Assets used to fund postemployment benefits are not maintained in a separate legal trust. The University has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently pays for postemployment benefits on a pay-as-you-go basis. The University's reported postemployment benefits obligations at June 30, 2019 and 2018 as a percentage of covered payroll of $4,013,983,000 and $3,792,553,000 was 78 percent and 87 percent, respectively.

Significant actuarial assumptions used at the June 30, 2018 and 2017 measurement dates are as follows:

	2018	2017
Discount rate*	3.87%	3.58%
Inflation rate	2.00%	2.00%
Immediate/ultimate administrative trend rate	0.0%/3.0%	0.0%/3.0%
Immediate/ultimate medical trend rate	6.5%/4.5%	6.5%/4.5%
Immediate/ultimate Rx trend rate	9.0%/4.5%	9.5%/4.5%
Increase in compensation rate	4.00%	4.00%
Mortality table**	RP-2014 White Collar Head Count Table, Scale MP-2017	RP-2014 White Collar Head Count Table, Scale MP-2016
Average future work life expectancy (years):		
Retiree health and welfare	9.14	9.17
Long-term disability	11.47	11.43

* Bond Buyer 20-year General Obligation Municipal Bond Index as of the last publication of the measurement period

** Based on the University's study of mortality experience from 2010-2014

Note 10--Postemployment Benefits--Continued

A one-percentage point change in the discount rate and assumed health care cost trend rates would impact the reported total liability for postemployment benefits obligations at June 30, 2019 and 2018 as follows:

	2019		**2018**	
	1% Decrease	1% Increase	1% Decrease	1% Increase
	(in thousands)			
Discount rate:				
Retiree health and welfare	$ 604,507	$ (467,375)	$ 677,895	$ (520,431)
Long-term disability	$ 11,362	$ (11,012)	$ 11,211	$ (11,260)
Health care trend rates:				
Retiree health and welfare	$ (511,949)	$ 688,288	$ (563,305)	$ 768,219
Long-term disability	$ (12,311)	$ 12,540	$ (11,907)	$ 12,196

The components of postemployment benefits expense for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019		
	Retiree Health and Welfare	Long-term Disability (in thousands)	Total
Service cost	$ 112,698	$ 29,235	$ 141,933
Interest cost	110,559	11,241	121,800
Amortization of deferred outflows and deferred inflows	(21,731)	3,135	(18,596)
	$ 201,526	$ 43,611	$ 245,137

	2018		
	Retiree Health and Welfare	Long-term Disability (in thousands)	Total
Service cost	$ 115,686	$ 28,101	$ 143,787
Interest cost	86,129	8,024	94,153
Amortization of deferred outflows and deferred inflows	17,278	3,940	21,218
	$ 219,093	$ 40,065	$ 259,158

Note 10--Postemployment Benefits--Continued

Deferred outflows and deferred inflows related to the reported total liability for postemployment benefits obligations at June 30, 2019 and 2018 are summarized as follows:

	2019		2018	
	Deferred Outflows	Deferred Inflows	Deferred Outflows	Deferred Inflows
	(in thousands)			
Changes in assumptions	$ 189,425	$ 438,981	$ 217,407	$ 111,127
Differences between expected and actual plan experience	72,475	5,200	58,623	
	261,900	444,181	276,030	111,127
Benefit payments made after measurement date	87,712		87,638	
	$ 349,612	$ 444,181	$ 363,668	$ 111,127

Deferred outflows and deferred inflows related to changes in assumptions and the differences between expected and actual plan experience will be recognized into expense in the following years ended June 30 based upon the average future work life expectancy of plan participants (in thousands):

2020	$ (18,596)
2021	(18,596)
2022	(18,596)
2023	(18,596)
2024	(18,596)
2025 and beyond	(89,301)
	$ (182,281)

Note 11--Retirement Plan

The University has a defined contribution retirement plan for all qualified employees through TIAA and Fidelity Management Trust Company ("FMTC") mutual funds. All regular and supplemental instructional and primary staff are eligible to participate in the plan based upon age and service requirements. Participants maintain individual contracts with TIAA, or accounts with FMTC, and are fully vested.

For payroll covered under the plan, eligible employees generally contribute 5 percent of their pay and the University generally contributes 10 percent of employees' pay to the plan, while certain employees generally contribute 4.5 percent of their pay, with the University contributing 9 percent of those employees' pay to the plan. The University contribution commences after an employee has completed one year of employment. Participants may elect to contribute additional amounts to the plans within specified limits that are not matched by University contributions. Contributions and covered payroll under the plan (excluding participants' additional contributions) for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019	**2018**
	(in thousands)	
University contributions	$ 304,344	$ 286,376
Employee contributions	$ 158,856	$ 150,488
Payroll covered under plan	$ 4,013,983	$ 3,792,553
Total payroll	$ 4,182,021	$ 3,947,501

Note 12--Net Position

The composition of net position at June 30, 2019 and 2018 is summarized as follows:

	2019	2018
	(in thousands)	
Net investment in capital assets	$ 3,742,630	$ 3,722,086
Restricted:		
Nonexpendable:		
Permanent endowment corpus	2,328,667	2,146,358
Expendable:		
Net appreciation of permanent endowments	2,144,532	2,067,392
Funds functioning as endowment	2,382,037	2,308,185
Restricted for operations and other	685,988	631,747
Unrestricted	3,520,054	3,405,277
	$ 14,803,908	$ 14,281,045

Unrestricted net position is not subject to externally imposed stipulations; however, it is subject to internal restrictions. For example, unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. At June 30, 2019 and 2018, substantially all of the unrestricted net position has been designated for various academic programs, research initiatives and capital projects.

Note 13--Federal Direct Lending Program

The University distributed $279,638,000 and $301,194,000 during the years ended June 30, 2019 and 2018, respectively, for student loans through the U.S. Department of Education ("DoED") federal direct lending program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements. The statement of net position includes a receivable of $2,514,000 and $3,183,000 at June 30, 2019 and 2018, respectively, for DoED funding received subsequent to distribution.

Note 14--Commitments and Contingencies

Authorized expenditures for construction and other projects unexpended at June 30, 2019 were $905,719,000. Of these expenditures, the University expects that $725,656,000 will be funded by internal sources, gifts, grants and future borrowings; $89,250,000 by the State Building Authority and the remaining $90,813,000 will be funded using unexpended bond proceeds.

Under the terms of various limited partnership agreements approved by the Board of Regents or University officers, the University is obligated to make periodic payments for advance commitments to venture capital, private equity, real estate, natural resources and absolute return strategies. At June 30, 2019, the University had committed, but not paid, a total of $6,089,675,000 in funding for these alternative investments. Based on historical capital calls and discussions with those managing the limited partnerships, outstanding commitments for such investments are anticipated to be paid in the following years ended June 30 (in thousands):

2020	$ 2,028,944
2021	1,413,306
2022	1,017,833
2023	631,414
2024	393,723
2025 and beyond	604,455
	$ 6,089,675

These commitments are generally able to be called prior to an agreed commitment expiration date and therefore may occur earlier or later than estimated.

The University has entered into capital and operating leases for certain space and equipment, which expire at various dates through 2039. Outstanding commitments for these leases are expected to be paid in the following years ended June 30:

	Capital (in thousands)	Operating
2020	$ 10,589	$ 47,369
2021	10,053	42,360
2022	10,211	38,335
2023	10,327	33,058
2024	8,815	29,771
2025-2029	45,738	78,248
2030-2034	48,351	16,526
2035-2039	18,821	2,135
	162,905	$ 287,802
Less amount representing interest	72,894	
Present value of minimum lease payments	$ 90,011	

Note 14--Commitments and Contingencies--Continued

Operating lease expenses totaled $47,572,000 and $49,058,000 in 2019 and 2018, respectively.

Substantial amounts are received and expended by the University under federal and state programs and are subject to audit by cognizant governmental agencies. This funding relates to research, student aid, patient care and other programs. The University believes that any liabilities arising from such audits will not have a material effect on its financial position.

The University is a party to various pending legal actions and other claims in the normal course of business, and is of the opinion that the outcome of these proceedings will not have a material adverse effect on its financial position.

Note 15--Operating Expenses by Function

Operating expenses by functional classification for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019				
	Compensation and Benefits	Supplies and Services	Depreciation (in thousands)	Scholarships and Fellowships	Total
Instruction	$ 1,031,768	$ 163,400			$ 1,195,168
Research	583,018	274,560			857,578
Public service	132,685	76,032			208,717
Academic support	278,109	87,967			366,076
Student services	100,220	28,743			128,963
Institutional support	196,839	75,132			271,971
Operations and maintenance of plant	92,387	259,190			351,577
Auxiliary enterprises	3,353,925	1,558,780			4,912,705
Depreciation			$ 567,857		567,857
Scholarships and fellowships				$ 164,428	164,428
	$ 5,768,951	$ 2,523,804	$ 567,857	$ 164,428	$ 9,025,040

	2018				
	Compensation and Benefits	Supplies and Services	Depreciation (in thousands)	Scholarships and Fellowships	Total
Instruction	$ 1,000,388	$ 152,833			$ 1,153,221
Research	555,853	267,734			823,587
Public service	129,675	81,769			211,444
Academic support	255,641	61,604			317,245
Student services	89,762	27,516			117,278
Institutional support	185,801	60,702			246,503
Operations and maintenance of plant	53,337	297,558			350,895
Auxiliary enterprises	3,160,935	1,452,876			4,613,811
Depreciation			$ 568,707		568,707
Scholarships and fellowships				$ 156,738	156,738
	$ 5,431,392	$ 2,402,592	$ 568,707	$ 156,738	$ 8,559,429

Note 16--UM Health

Condensed financial information for UM Health, a blended component unit, before the elimination of certain intra-University transactions, at and for the years ended June 30, 2019 and 2018 is as follows:

	2019	2018
	(in thousands)	
Condensed Statement of Net Position		
Assets:		
Current assets	$ 78,296	$ 121,110
Noncurrent assets	258,841	242,561
Total assets	337,137	363,671
Deferred outflows	5,479	5,094
Total assets and deferred outflows	$ 342,616	$ 368,765
Liabilities:		
Current liabilities	$ 49,389	$ 60,717
Noncurrent liabilities	208,875	214,465
Total liabilities	258,264	275,182
Deferred inflows	5,860	15,042
Net position:		
Net investment in capital assets	19,765	(2,536)
Restricted:		
Nonexpendable	3,881	3,247
Expendable	13,567	13,310
Unrestricted	41,279	64,520
Total net position	78,492	78,541
Total liabilities, deferred inflows and net position	$ 342,616	$ 368,765
Condensed Statement of Revenues, Expenses and Changes in Net Position		
Operating revenues	$ 472,905	$ 434,611
Operating expenses other than depreciation expense	438,974	401,607
Depreciation expense	22,028	46,268
Operating gain (loss)	11,903	(13,264)
Nonoperating expenses, net	(6,966)	(7,408)
Other expenses, net	(4,986)	(3,268)
Decrease in net position	(49)	(23,940)
Net position, beginning of year	78,541	102,481
Net position, end of year	$ 78,492	$ 78,541
Condensed Statement of Cash Flows		
Net cash provided by operating activities	$ 15,865	$ 10,509
Net cash used in noncapital financing activities	(1,033)	(1,187)
Net cash used in capital and related financing activities	(53,924)	(32,866)
Net cash provided by investing activities	23,942	148
Net decrease in cash and cash equivalents	(15,150)	(23,396)
Cash and cash equivalents, beginning of year	21,327	44,723
Cash and cash equivalents, end of year	$ 6,177	$ 21,327

Required Supplementary Information (Unaudited)

Pension Plan

Changes in the reported net pension liability for the years ended June 30are summarized as follows:

	2019		
	Total Pension Liability	Plan Fiduciary Net Position (in thousands)	Net Pension Liability
Balance, beginning of year	$ 72,680	$ 76,503	$ (3,823)
Interest cost	4,930		4,930
Changes in assumptions	(273)		(273)
Differences between expected and actual plan experience	1,361		1,361
Benefit payments	(4,489)	(4,489)	-
Contributions from the employer		1,047	(1,047)
Net investment income:			
Expected investment earnings		5,234	(5,234)
Differences between expected and actual investment earnings		(1,168)	1,168
Balance, end of year	$ 74,209	$ 77,127	$ (2,918)

	2018		
	Total Pension Liability	Plan Fiduciary Net Position (in thousands)	Net Pension Liability
Balance, beginning of year	$ 73,968	$ 70,532	$ 3,436
Interest cost	5,013		5,013
Changes in assumptions	(822)		(822)
Differences between expected and actual plan experience	(767)		(767)
Benefit payments	(4,712)	(4,712)	-
Contributions from the employer		2,171	(2,171)
Net investment income:			
Expected investment earnings		4,848	(4,848)
Differences between expected and actual investment earnings		3,664	(3,664)
Balance, end of year	$ 72,680	$ 76,503	$ (3,823)

Required Supplementary Information (Unaudited)--Continued

Pension Plan--Continued

	2017		
	Total Pension Liability	Plan Fiduciary Net Position (in thousands)	Net Pension Liability
Balance, beginning of year	$ 96,414	$ 67,236	$ 29,178
Interest cost	4,482		4,482
Changes in assumptions	(24,906)		(24,906)
Differences between expected and actual plan experience	2,067		2,067
Benefit payments	(4,089)	(4,089)	-
Contributions from the employer		2,903	(2,903)
Net investment income:			
Expected investment earnings		3,166	(3,166)
Differences between expected and actual investment earnings		1,316	(1,316)
Balance, end of year	$ 73,968	$ 70,532	$ 3,436

The plan fiduciary net position as a percentage of the total pension liability reported at June 30 was as follows:

2019	104%
2018	105%
2017	95%

Employer contributions in relation to actuarially determined contributions for the years ended June 30 are as follows:

	Employer Contributions*	Actuarially Determined Contributions (in thousands)	Excess (Deficient) Contributions
2019	$ 1,244	$ 393	$ 851
2018	$ 1,047	$ 1,622	$ (575)
2017	$ 2,171	$ 1,754	$ 417

* Reflects no employer contributions after April 30 of the respective fiscal year

Pension Plan--Continued

Significant methods and assumptions used to calculate the actuarially determined contributions for the years ended June 30 are as follows:

Actuarially determined contributions	The plan is subject to funding requirements under the provisions of ERISA and the Pension Protection Act of 2006 (including MAP-21, HATFA and BBA). The actuarially determined contributions represent the IRC Section 430 minimum required contributions.
Contributions in relation to actuarially determined contributions	Under IRC Section 430, the due date to pay minimum required contributions for the plan year is generally 8½ months after the end of the plan year. For the plan years ended September 30, contributions are due by June 15 of the following year.
Actuarial cost method	Unit Credit method
Asset valuation method	24-month smoothed value of assets
Interest rate	

	First Segment Rate	Second Segment Rate	Third Segment Rate	Effective Rate
2019	4.16%	5.72%	6.48%	5.94%
2018	4.16%	5.72%	6.48%	5.93%
2017	4.43%	5.91%	6.65%	6.13%

Mortality	Prescribed by the Secretary of Treasury and described in Treasury regulation 1.430(h)(3)-1. Based on the RP-2000 gender distinct table that reflects projected mortality improvements 15 years into the future from the valuation date for nonannuitants and seven years into the future for annuitants.

Postemployment Benefits

The historical reconciliation of the total reported liability for postemployment benefits obligations for the years ended June 30 is summarized as follows (amounts in thousands):

	2019	2018	2017
Service cost	$ 141,933	$ 143,787	$ 122,073
Interest cost	121,800	94,153	108,561
Changes in assumptions	(383,315)	(107,874)	255,041
Differences between expected and actual plan experience	17,535	52,721	14,028
Benefit payments	(87,638)	(77,374)	(72,302)
Net change	$ (189,685)	$ 105,413	$ 427,401
Total liability, beginning of year	$ 3,303,740	$ 3,198,327	$ 2,770,926
Total liability, end of year	$ 3,114,055	$ 3,303,740	$ 3,198,327
Covered employee payroll	$ 4,013,983	$ 3,792,553	$ 3,568,918
Total liability, end of year, as a percentage of covered employee payroll	78%	87%	90%

Discount rates used in determining the total reported liability for postemployment benefits obligations at June 30 are as follows:

2019	3.87%
2018	3.58%
2017	2.85%
2016	3.80%

UNIVERSITY OF MICHIGAN HEALTH SYSTEM

FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2019
with
REPORT OF INDEPENDENT AUDITORS

UNIVERSITY OF MICHIGAN HEALTH SYSTEM

June 30, 2019

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Report of Independent Auditors

To the Regents of the University of Michigan

We have audited the accompanying financial statements of the University of Michigan Health System ("UMHS"), which consists of certain departments of the University of Michigan, which comprise the statement of net position as of June 30, 2019, and the related statements of revenues, expenses, and changes in net position and of cash flows for the year then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit 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 our 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, we consider internal control relevant to UMHS'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 UMHS'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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Michigan Health System which consists of certain departments of the University of Michigan, as of June 30, 2019, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1 to the financial statements, the University of Michigan Hospitals and the University of Michigan Medical Group, which consist of certain departments of the University of Michigan, were combined to present UMHS in 2019. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the financial statements of UMHS present only the net position, revenues, expenses and changes in net position, and cash flows of that portion of the financial reporting entity of the University of Michigan that is attributable to the transactions of UMHS. They do not purport to, and do not, present fairly the financial position of the University of Michigan as of June 30, 2019, and the changes in its financial position or its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

The accompanying management's discussion and analysis on pages 3 through 15 is required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 17, 2019

Management's Discussion and Analysis (Unaudited)

Introduction

The following discussion and analysis provides an overview of the financial position of the University of Michigan Health System ("UMHS") at June 30, 2019 and 2018 and its activities for the two fiscal years ended June 30, 2019. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

UMHS is a part of the University of Michigan (the "University"), and is one of four University units that together comprise Michigan Medicine. Along with UMHS, Michigan Medicine includes the University of Michigan Medical School ("Medical School"), Michigan Health Corporation (a wholly owned corporation created for joint venture and managed care initiatives) and UM Health(a wholly owned corporation created to hold and develop Michigan Medicine's statewide network of hospitals, hospital joint ventures and other hospital affiliations). Michigan Medicine maintains a tradition of excellence in teaching, advancement of medical science and patient care, consistently ranking among the best health care systems in the nation. The leadership and management of Michigan Medicine are provided by the University's Executive Vice President for Medical Affairs.

Michigan Medicine entities have a tripartite mission focusing on clinical, research and medical and biomedical educational activities. As part of the clinical mission, UMHS operates a 1,043 licensed bed acute care and psychiatric facility, several ambulatory care centers and various other health care programs across Michigan. UMHS serves as the principal teaching facility of the Medical School. Substantially all physician services to UMHS patients are provided by the University of Michigan Medical Group ("UMMG"). The UMMG is comprised of the Medical School faculty and activities provided by the UMMG are included within UMHS in order to comprehensively present all activity related to the clinical mission of Michigan Medicine. UMHS also provides educational and clinical opportunities to students of the University's Schools of Nursing, Dentistry, Pharmacy, Social Work and Public Health.

In 2019, the activities of the previously reported University of Michigan Hospitals ("UMH") and the UMMG were combined to form UMHS, resulting in a change in reporting entity. In accordance with Governmental Accounting Standards Board ("GASB") Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, this combination is included in the financial statements as if it occurred at the beginning of the earliest period presented.

Michigan Medicine and UMHS have been recognized by several external organizations. During 2019, this recognition included the following:

- Named to the U.S. News & World Report Honor Roll as the 11th best adult hospital in the nation, as well as Best Hospital in Michigan and Detroit Metro area and receiving top tier national rank in 14 adult specialties. This is the 27th consecutive year UMHS has been nationally recognized by U.S. News & World Report for strong across-the-board performance.
- C.S. Mott Children's Hospital was again named one of the best children's hospitals in the country in pediatric specialty care, and the only children's hospital in Michigan to be nationally ranked in all ten pediatric specialties, according to U.S. News & World Report.
- Named in the top 100 of Newsweek's list of "World's Best Hospitals".
- Named to Becker's Hospital Review's annual list of the "100 Great Hospitals in America".
- Michigan Medicine was named the top employer in the state of Michigan by Forbes.
- For the 13th consecutive year, Michigan Medicine earned an "A" from the nonprofit Leapfrog Group patient safety organization based on performance on a wide array of patient safety measures.
- Named as one of the 68 greenest hospitals in America by Becker's Hospital Review based on the commitment to provide sustainable, environmentally-friendly patient care.
- The Medical School ranked as one of the top medical schools in the country for training in research, primary care, geriatrics, internal medicine, women's health and family medicine by U.S. News & World Report.
- Michigan Medicine featured in Becker's Hospital Review's "150 Top Places to Work in Healthcare" for the seventh consecutive year.
- Named one of the "Best and Brightest" companies to work for in Metropolitan Detroit by the National Association of Business Resources for commitment to excellence in human resources and employee enrichment. Michigan Medicine was further recognized for its employee achievement and recognition programs.

Financial Highlights

	2019 (in millions)
Operating Results	
Operating revenues	$ 4,279.5
Operating income	$ 127.9
Decrease in net position	$ (9.6)

Operating revenues remained strong in 2019 due to continued growth in patient activity as well as strong revenue per patient case. Operating expenses also increased in 2019, primarily due to costs associated with the growth in patient activity and capacity expansion, including increased expenses associated with compensation and supplies. Net position, which represents the residual interest in UMHS's assets and deferred outflows after liabilities and deferred inflows are deducted, decreased $9.6 million in 2019, driven by positive operating and investment performance, offset by transfers to the Medical School.

Net position has been restated at July 1, 2018 for the change in reporting entity, and is summarized as follows (in millions):

UMH net position at June 30, 2018	$ 1,926.7
UMMG	(52.0)
UMHS net position at July 1, 2018, as restated	$ 1,874.7

For purposes of management's discussion and analysis, comparative data for the statement of net position has been provided by combining UMMG with UMH at June 30, 2018.

Using the Financial Statements

UMHS's financial report includes three financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. These financial statements are prepared in accordance with GASB principles.

Statement of Net Position

The statement of net position presents the financial position of UMHS at the end of the fiscal year and includes all assets, deferred outflows, liabilities, and deferred inflows of UMHS. The difference between total assets and deferred outflows as compared to total liabilities and deferred inflows - net position - is one indicator of the current financial condition of UMHS, while the change in net position is an indication of whether the overall financial condition improved or worsened during the year. UMHS's assets, deferred outflows, liabilities, deferred inflows and net position at June 30, 2019 and 2018 are summarized as follows:

	2019	**2018**
	(in millions)	
Current assets	$ 715.2	$ 673.0
Noncurrent assets:		
Unexpended debt proceeds	0.8	21.3
Investments	1,523.6	1,494.1
Capital assets, net	1,451.0	1,497.5
Other	25.9	14.4
Total assets	3,716.5	3,700.3
Deferred outflows	82.0	96.3
Total assets and deferred outflows	3,798.5	3,796.6
Current liabilities	261.5	258.5
Noncurrent liabilities:		
Long-term debt	963.2	997.8
Obligations for postemployment benefits	559.6	623.1
Other	56.8	42.5
Total liabilities	1,841.1	1,921.9
Deferred inflows	92.3	
Net position	$ 1,865.1	$ 1,874.7

Current assets consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents on deposit with the University totaled $274.5 million at June 30, 2019. Absent the negative cash impact of including UMMG, in 2019, cash and cash equivalents increased as compared to 2018, primarily attributable to strong operating performance, as well as decreased capital spending.

Accounts receivable from patient care services is recorded at the estimated net realizable amount due from patients, third party payers and others for services rendered. Accounts receivable from net patient care services increased to $350.5 million at June 30, 2019, primarily due to increased patient activity.

Unexpended debt proceeds totaled $817,000 at June 30, 2019. During 2019, no new debt was borrowed from the University.

Investments, consisting principally of long-term assets held in the University Endowment Fund, totaled $1.5 billion at June 30, 2019. Investments increased in 2019, primarily due to strong market performance.

Total cash, cash equivalents and investments, excluding restricted cash and unexpended debt proceeds, amounted to $1.8 billion at June 30, 2019, which represents 165 days of operating expenses (excluding depreciation and non-cash postemployment benefits expense). In 2019, days of operating expenses decreased, primarily due to an increase in average daily operating expenses combined with increased transfers to the Medical School.

Net capital assets, defined as gross capital assets less accumulated depreciation, totaled $1.5 billion in 2019. Capital additions totaled $162.2 million in 2019, which included investments in clinical expansion as well as facility and infrastructure improvements.

In 2019, the University became a member of Metropolitan Detroit Area Hospital Services, Inc. ("MDAHS"), a Michigan nonprofit membership corporation. The primary purpose of this organization is to construct and operate a centralized laundry facility for nonprofit hospitals. In exchange for its membership in MDAHS, the University assumed a contractual obligation representing a portion of MDAHS's debt service attributable to the construction of the new facility. Within the UMHS financial statements at June 30, 2019, the University's equity interest is reflected as an increase in other noncurrent assets of $14.5 million, while the contractual obligation is reflected as a corresponding increase in other noncurrent liabilities of $14.5 million at June 30, 2019.

Deferred outflows represent the consumption of net assets attributable to a future period and are primarily driven by activity associated with the portion of the University's obligations for postemployment benefits allocated to UMHS. Deferred outflows totaled $82.0 million at June 30, 2019.

Current liabilities include accounts payable, accrued employee compensation, amounts due to other University units, third party settlements and reserves, and the current portion of both obligations for postemployment benefits and outstanding debt. Third party settlements and reserves totaled $30.2 million at June 30, 2019. The increase in this balance in 2019 is primarily due to activity related to prior year estimates as well as the establishment of current year positions.

Total outstanding debt amounted to $997.8 million at June 30, 2019 with effective interest rates that averaged 3.7 percent.

Obligations for postemployment benefits totaled $582.7 million at June 30, 2019, of which $23.1 million is current. The liability represents the actuarially determined present value of certain medical and dental insurance, prescription drug coverage, group life insurance and long-term disability benefits to eligible retirees and their eligible dependents. The decrease in the reported liability at June 30, 2019 was driven primarily by an increase in the discount rate and a reduction in the expected health care claims cost due to favorable experience.

Deferred inflows represent the acquisition of net assets attributable to a future period and are primarily driven by activity associated with the portion of the University's obligations for postemployment benefits allocated to UMHS. Deferred inflows totaled $92.3 million at June 30, 2019.

Net position represents the residual interest in UMHS's assets and deferred outflows after liabilities and deferred inflows are deducted. The composition of UMHS's net position at June 30, 2019 and 2018 is summarized as follows:

	2019	**2018**
	(in millions)	
Net investment in capital assets	$ 422.9	$ 454.9
Restricted:		
Nonexpendable	10.2	8.3
Expendable	56.8	59.8
Unrestricted	1,375.2	1,351.7
	$ 1,865.1	$ 1,874.7

Net investment in capital assets represents UMHS's capital assets net of accumulated depreciation, unexpended debt proceeds, and outstanding principal balances of debt and capital lease liabilities attributable to the acquisition, construction or improvement of those assets.

Restricted nonexpendable net position includes the historical value (corpus) of gifts to UMHS's permanent endowment funds, as well as certain investment earnings stipulated by the donor to be reinvested permanently. Restricted expendable net position is subject to externally imposed stipulations governing their use and includes net appreciation of permanent endowments not stipulated by the donor to be reinvested permanently.

Unrestricted net position is not subject to externally imposed donor or government stipulations and may be designated for specific purposes by action of management or the Board of Regents. Substantially all unrestricted net position is designated for patient care and capital programs.

Statement of Revenues, Expenses and Changes in Net Position

The statement of revenues, expenses and changes in net position presents UMHS's results of operations. UMHS's revenues, expenses and other changes in net position for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019	**2018**
	(in millions)	
Operating revenues	$ 4,279.5	$ 3,433.6
Operating expenses	4,151.6	3,290.7
Operating income	127.9	142.9
Total nonoperating and other revenues, net	58.9	109.5
Net revenues before transfers	186.8	252.4
Transfers to other University units, net	(196.4)	(231.8)
(Decrease) increase in net position	$ (9.6)	$ 20.6

The impact of the change in reporting entity to combine UMMG with UMH in order to form UMHS has been reflected as of the beginning of the earliest period presented in the financial statements, or July 1, 2018. Therefore, the statement of revenues, expenses and changes in net position presented above for the year ended June 30, 2018 reflects only the activities of UMH. During 2018, UMMG reported total operating revenues of $481.9 million and total operating expenses of $560.8 million.

Operating Revenues

Approximately 98.4 percent of operating revenues are from patient care. The majority of net patient care revenue is received under contractual arrangements with governmental payers (Medicare and Medicaid) and private insurers. Net patient care revenue increased in 2019, driven primarily by growth in patient volume. A summary of patient activity statistics for the year ended June 30, 2019 is as follows:

Inpatient discharges	49,471
Patient days	318,446
Observation cases	18,557
Surgeries	59,735
Outpatient visits	2,756,441
Adjusted cases	159,018

Adjusted cases, which is an aggregate acuity adjusted activity measurement combining inpatient discharges and outpatient case activity, increased 6.6 percent in 2019.

Operating Expenses

UMHS's operating expenses for the year ended June 30, 2019 are summarized as follows (in millions):

Compensation	$ 1,290.1
Benefits	449.8
Expenses reimbursed by other Michigan Medicine units	(3.2)
Supplies	915.2
Depreciation	207.6
Medical School faculty and other services	659.7
Michigan Medicine Administrative Services	278.7
Other operating expenses	353.7
	$ 4,151.6

While total operating expenses increased in 2019, expense management continues to be a focus of UMHS leadership, specifically in the areas of compensation and supplies expense.

Compensation and benefits increased in 2019 and represents 41.9 percent of total operating expenses. This growth is primarily related to hiring due to increases in patient activity volumes and capacity expansion.

Supplies expense increased in 2019 and reflects growth in patient volumes and new therapies, as well as increased costs of prescription drugs and infusion treatments.

Medical School faculty and other services expense increased in 2019, primarily due to increased service payments, driven by growth in professional revenue. Michigan Medicine Administrative Services expense also increased in 2019, primarily due to funding new information technology initiatives and programs within Michigan Medicine.

Other operating expenses increased in 2019 primarily due to maintenance and facility costs associated with capacity expansion, as well as increased routine maintenance expense.

Nonoperating and Other Revenues (Expenses)

UMHS's nonoperating and other revenues (expenses) for the year ended June 30, 2019 are summarized as follows (in millions):

Interest expense, net	$ (40.3)
Net investment income	92.5
Private gifts for other than capital and permanent endowment purposes	5.2
Capital and permanent endowment gifts	1.5
	$ 58.9

Substantially all UMHS investments are held in University investment pools, which generate both income distributions and unrealized gains. Income distributions consist primarily of payments from the University Endowment Fund based on the University's endowment spending rule. Additionally, investments held in the University Endowment Fund are recorded at fair value based on the net asset value of the investment pool. Any unrealized change in the value of these investments is included as a component of net investment income.

While lower than 2018, positive investment performance in 2019 provided an increase to UMHS's net position. Net investment income for the year ended June 30, 2019 is summarized as follows (in millions):

Income distributions and other investment income	$ 65.7
Net increase in the fair value of investments	26.8
Net investment income including net realized and unrealized gains	$ 92.5

Transfers with Other University of Michigan Units

UMHS makes equity transfers to the Medical School and other University units. These transfers are generally in support of the Medical School's academic and research missions. UMHS reports these transfers as changes in net position, separately from the excess of revenues over expenses. UMHS's practice is to record the equity transfer upon payment to the Medical School in accordance with the related agreement. Transfers with other University units for the year ended June 30, 2019 are summarized as follows (in millions):

Transfers to:	
Medical School academic and non-patient care purposes	$ (195.3)
Other University units	(6.6)
	(201.9)
Transfers from:	
Medical School	1.6
Other University units	3.9
	5.5
Transfers to other University units, net	$ (196.4)

Transfers to other University units decreased in 2019, primarily driven by payments made in 2018 to provide financial support for the establishment of a joint venture between the University and St. Joseph Mercy Chelsea Hospital.

Statement of Cash Flows

The statement of cash flows provides additional information about UMHS's financial results by reporting the major sources and uses of cash. UMHS's cash flows for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019	**2018**
	(in millions)	
Cash received from operations	$ 4,309.9	$ 3,400.6
Cash expended for operations	(3,923.7)	(3,087.8)
Net cash provided by operating activities	386.2	312.8
Net cash used in noncapital financing activities	(189.8)	(229.5)
Net cash used in capital and related financing activities	(255.1)	(278.0)
Net cash provided by investing activities	83.4	127.2
Net increase (decrease) in cash and cash equivalents	24.7	(67.5)
Cash and cash equivalents, beginning of year	364.9	432.4
University of Michigan Medical Group	(115.1)	
Cash and cash equivalents, beginning of year, as restated	249.8	432.4
Cash and cash equivalents, end of year	$ 274.5	$ 364.9

The impact of the change in reporting entity to combine UMMG with UMH in order to form UMHS has been reflected as of the beginning of the earliest period presented in the financial statements, or July 1, 2018. Therefore, the statement of cash flows presented above for the year ended June 30, 2018 reflects only the activities of UMH.

Cash received from operations primarily consists of net patient care revenues. Net cash used in noncapital financing activities primarily consists of transfers from UMHS to the Medical School in support of the Medical School's academic and research missions. Net cash used in capital and related financing activities primarily consists of purchases of capital assets and proceeds from issuance of capital debt. Net cash provided by investing activities primarily consists of realized investment income.

Economic Factors That May Affect the Future

In September 2018, the 297,000 square foot Brighton Center for Specialty Care was completed. This facility provides specialty services in both pediatric and adult health care, musculoskeletal health, ophthalmology, diagnostic imaging and pathology and comprehensive cancer service.

In September 2019, the Board of Regents approved plans for the construction of a 690,000 square foot clinical inpatient tower with an estimated cost of $920 million and an expected completion date of fall 2024. Work also continued on a new parking structure which will add approximately 1,000 new spaces, with an expected completion date in 2020. While not funded by UMHS, this parking structure will benefit the patients, families, staff and faculty of Michigan Medicine.

In addition to improving capacity through facility, technology, quality, safety and efficiency, UMHS also prioritized development and progress on clinical affiliations and population management programs. In July 2018, the University entered into a joint venture with St. Joseph Mercy Chelsea hospital to jointly operate the 133-bed facility in Chelsea, Michigan. In September 2018, the University formed a collaboration with St. Joseph Mercy Ann Arbor ("SJMAA") on the 10 East Medicine Unit, which is located within SJMAA hospital and staffed by Michigan Medicine physicians that provide care for adult, non-surgical, general medicine patients requiring admission.

In March 2019, the University approved a master affiliation agreement with Sparrow Health System, paving the way for ongoing collaboration. In April 2019, the University, along with Trinity Health and Henry Ford Health System, became a member of MDAHS, a Michigan nonprofit membership corporation. MDAHS will build a new 105,000 square foot state-of-the-art centralized laundry processing facility that is scheduled to be operational in July 2020 and will provide Michigan Medicine with linen services at a lower cost and higher quality than its current internal operations.

In 2019, Michigan Medicine also continued to foster other existing affiliations with area hospitals and networks to enhance patient care, clinical research, physician recruitment and support services. Michigan Medicine collaborated with affiliated partners Mid-Michigan Health, Metro Health, and others, to continue to provide accessible, quality patient care. Michigan Medicine also continued involvement with the Together Health Network as a referral provider for complex quaternary health care. These clinical affiliation agreements and population management programs are designed to expand community access and improve patient, family and provider experiences across the continuum of care.

Federal and state lawmakers continue to discuss further Medicare and Medicaid changes which may target graduate medical education-related payments, causing a potentially significant impact on teaching hospitals like UMHS. Private insurance and managed care contracts historically provide for annual increases in reimbursement rates that meet or exceed the rate of inflation; however, there can be no assurance that such trends will continue.

The state of Michigan currently operates a no-fault auto insurance system that requires all auto insurance policies to include unlimited lifetime medical benefits in the event of catastrophic injuries. In May 2019, the governor of Michigan signed a bill to reform this no-fault auto insurance system. The legislation allows drivers to choose the level of personal injury protection coverage they wish to purchase and creates a new fee schedule for medical providers that caps the reimbursement rates charged to auto insurers for medical care to a percentage of Medicare rates. This expected change in reimbursement is anticipated to impact UMHS's financial results beginning in July 2021. Given these challenges, management continues to explore and implement strategies to contain or reduce expense growth.

As a labor intensive organization, UMHS's most significant operating expense is compensation and benefits, and management has resource strategies in place to attract and retain high quality staff. In 2019, UMHS signed a new three-year labor agreement with a large portion of the hospital's unionized staff.

Management believes that UMHS is poised to succeed in an environment where quality, appropriateness and innovation are rewarded. As part of Michigan Medicine, UMHS has a multi-year track record of a high degree of integration and alignment with the Medical School. This alignment and integration allows UMHS to partner with highly talented physicians and in particular, physicians practicing in specialty areas, thereby providing a greater opportunity for future growth. This competitive advantage, coupled with a solid financial position and record of investment in clinical capacity and information technology, favorably positions UMHS to execute the emerging strategic initiatives listed above.

UMHS participates in debt issuances originated by the University, which maintains the highest credit ratings of S&P Global (AAA) and Moody's (Aaa). These ratings allow UMHS to secure capital funds as needed on extremely competitive terms to further enhance the patient experience. The continued stability of these credit ratings is important to the long-term strategic direction of UMHS.

Although there are many risks and uncertainties, management believes UMHS is well positioned to maintain its strong financial condition in the era of health care reform.

UNIVERSITY OF MICHIGAN HEALTH SYSTEM

Statement of Net Position

	June 30, 2019 (in thousands)
Assets and Deferred Outflows	
Current Assets:	
Cash and cash equivalents on deposit with the University	$ 274,532
Accounts receivable, net	350,450
Receivable from other University units	171
Current portion of pledges receivable, net	3,267
Inventory and other current assets	86,825
Total Current Assets	715,245
Noncurrent Assets:	
Unexpended debt proceeds on deposit with the University	817
Investments on deposit with the University	1,523,640
Pledges receivable, net	11,416
Other assets	14,453
Capital assets, net	1,450,955
Total Noncurrent Assets	3,001,281
Total Assets	3,716,526
Deferred Outflows	81,956
Total Assets and Deferred Outflows	$ 3,798,482
Liabilities, Deferred Inflows and Net Position	
Current Liabilities:	
Accrued compensation	$ 95,759
Accounts payable and accrued expenses	77,889
Current portion of obligations for postemployment benefits	23,081
Current portion of long-term debt	34,544
Third party settlements and reserves	30,201
Total Current Liabilities	261,474
Noncurrent Liabilities:	
Long-term debt	963,216
Payable to other University units	11,291
Obligations for postemployment benefits	559,574
Other	45,519
Total Noncurrent Liabilities	1,579,600
Total Liabilities	1,841,074
Deferred Inflows	92,341
Net Position:	
Net investment in capital assets	422,947
Restricted:	
Nonexpendable	10,158
Expendable	56,777
Unrestricted	1,375,185
Total Net Position	1,865,067
Total Liabilities, Deferred Inflows and Net Position	$ 3,798,482

The accompanying notes are an integral part of the financial statements.

UNIVERSITY OF MICHIGAN HEALTH SYSTEM

Statement of Revenues, Expenses and Changes in Net Position

	Year Ended June 30, 2019 (in thousands)
Operating Revenues	
Net patient service revenue (net of provision for bad debts of $115,715 in 2019)	$ 4,212,431
Other revenue	67,070
Total Operating Revenues	4,279,501
Operating Expenses	
Compensation and benefits	1,736,743
Supplies, services and other	1,268,937
Depreciation	207,616
Michigan Medicine Administrative Services	278,661
Medical School faculty and other services	659,683
Total Operating Expenses	4,151,640
Operating Income	127,861
Nonoperating Revenues (Expenses)	
Interest expense, net	(40,298)
Net investment income	92,504
Private gifts for other than capital and permanent endowment purposes	5,179
Total Nonoperating Revenues, Net	57,385
Income Before Other Revenues and Transfers	185,246
Other Revenues	
Capital and permanent endowment gifts	1,446
Gain on disposal of capital assets	8
Total Other Revenues	1,454
Net Revenues Before Transfers	186,700
Transfers to other University units, net	(196,371)
Decrease in Net Position	(9,671)
Net Position, Beginning of Year	1,926,708
University of Michigan Medical Group	(51,970)
Net Position, Beginning of Year, As Restated	1,874,738
Net Position, End of Year	$ 1,865,067

The accompanying notes are an integral part of the financial statements.

UNIVERSITY OF MICHIGAN HEALTH SYSTEM

Statement of Cash Flows

	Year Ended June 30, 2019 (in thousands)
Cash Flows from Operating Activities	
Received from patient care services	$ 4,213,068
Received from non-patient sources	65,249
Expenses reimbursed by other University units	31,566
Payments to employees	(1,677,867)
Payments to suppliers	(1,168,756)
Payments to other University units	(1,077,086)
Net Cash Provided by Operating Activities	386,174
Cash Flows from Noncapital Financing Activities	
Private gifts and other receipts	6,591
Transfers to other University units, net	(196,432)
Net Cash Used in Noncapital Financing Activities	(189,841)
Cash Flows from Capital and Related Financing Activities	
Purchases of capital assets, net	(182,835)
Interest payments	(43,196)
Principal payments on capital debt and capital lease obligations	(32,582)
Private gifts and other receipts	3,427
Transfers from Medical School for capital projects	61
Net Cash Used in Capital and Related Financing Activities	(255,125)
Cash Flows from Investing Activities	
Investment income	65,772
Net increase in noncurrent investments and other assets	(2,759)
Decrease in unexpended capital debt proceeds	20,472
Net Cash Provided by Investing Activities	83,485
Net Increase in Cash and Cash Equivalents	24,693
Cash and Cash Equivalents on Deposit with the University, Beginning of Year	364,936
University of Michigan Medical Group	(115,097)
Cash and Cash Equivalents on Deposit with the University, Beginning of Year, as Restated	249,839
Cash and Cash Equivalents on Deposit with the University, End of Year	$ 274,532

The accompanying notes are an integral part of the financial statements.

UNIVERSITY OF MICHIGAN HEALTH SYSTEM

Statement of Cash Flows--Continued

	Year Ended June 30, 2019 (in thousands)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating income	$ 127,861
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	207,616
Changes in assets and liabilities:	
Accounts receivable, net	(28,696)
Receivable from other University units	20,991
Inventory and other current assets	(11,123)
Accrued compensation	7,125
Accounts payable and accrued expenses	11,960
Payable to other University units	(19,773)
Third-party settlements and reserves	20,261
Obligations for postemployment benefits	(57,185)
Changes in deferred outflows	(3,734)
Changes in deferred inflows	110,871
Net Cash Provided by Operating Activities	$ 386,174

The accompanying notes are an integral part of the financial statements.

Note 1--Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation: The Regents of the University of Michigan (the "University") have the ultimate responsibility for the University of Michigan Health System ("UMHS") and, as part of the University, the assets, deferred outflows, liabilities, deferred inflows, revenues, expenses and changes in net position of UMHS are included in the consolidated financial statements of the University. UMHS serves as the principal teaching facility for the University of Michigan Medical School ("Medical School"), and the majority of physician services to UMHS patients are provided by Medical School faculty. As part of the University, UMHS is exempt from income taxes under Internal Revenue Code Sections 501(c)(3) and 115.

UMHS is an operating unit of Michigan Medicine. Along with UMHS, Michigan Medicine includes the Medical School, Michigan Health Corporation (a wholly owned corporation created for joint venture and managed care initiatives) and UM Health (a wholly owned corporation created to hold and develop Michigan Medicine's statewide network of hospitals, hospital joint ventures and other hospital affiliations).

UMHS and the Medical School maintain various agreements to address the financial design and integration of their patient care activities. Revenue from hospital services and professional revenue from physicians is recorded by UMHS. Patient care expenses other than physician compensation are recorded by UMHS, while physician compensation is recorded by the Medical School. UMHS makes payments to the Medical School for faculty services provided to UMHS related to faculty participation in the direction and supervision of clinical and graduate medical education programs.

In 2019, the activities of the previously reported University of Michigan Hospitals ("UMH") and the University of Michigan Medical Group were combined to form UMHS, resulting in a change in reporting entity. In accordance with Governmental Accounting Standards Board ("GASB") Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, this combination is included in the financial statements as if it occurred at the beginning of the earliest period presented.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. UMHS reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB, on the accrual basis. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Net position is categorized as:

- Net investment in capital assets: Capital assets, net of accumulated depreciation, unexpended debt proceeds, and outstanding principal balances of debt and capital lease liabilities attributable to the acquisition, construction or improvement of those assets.
- Restricted:

  Nonexpendable - Net position subject to externally imposed stipulations that it be maintained permanently. Such net position includes the corpus portion (historical value) of gifts to UMHS's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

  Expendable - Net position subject to externally imposed stipulations that can be fulfilled by actions of UMHS pursuant to those stipulations or that expire by the passage of time. Such net position includes net appreciation of UMHS's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- Unrestricted: Net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Regents. Substantially all unrestricted net position is designated for patient care and capital programs.

Summary of Significant Accounting Policies: For purposes of the statement of cash flows, UMHS considers all highly liquid investments purchased with a maturity of three months or less, to be cash equivalents. Cash equivalents generally represent investments in the University Investment Pool ("UIP"), a short-term commingled pool managed by the University that can be readily liquidated to pay contractual liabilities.

Accounts receivable consists primarily of patient activity and is recorded net of allowances for uncollectible accounts receivable, which totaled $115,539,000 at June 30, 2019. The allowance is based on management's judgment of potential uncollectible amounts, which includes such factors as historical experience and type of receivable.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

UMHS receives pledges and bequests of financial support from corporations, foundations and individuals. Revenue is recognized when a pledge representing an unconditional promise to give is received and all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Permanent endowment pledges do not meet eligibility requirements, as defined by GASB, and are not recorded as assets until the related gift is received.

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are made, commensurate with expected future payments. An allowance for uncollectible pledges receivable is provided based on management's judgment of potential uncollectible amounts and includes such factors as prior collection history, type of gift and nature of fundraising.

Inventories consist primarily of medical and surgical, pharmaceutical and other supplies. Inventories are stated at the lower of cost or market, with the cost determined on the first-in, first-out basis.

Investments on deposit with the University represent investments in the University Endowment Fund ("UEF"), a commingled pool which is invested entirely in the Long Term Portfolio, a diversified, equity-oriented investment pool managed by the University. The fair market value of UEF shares is determined at the end of each calendar quarter based on the fair value of the pool. Participants may purchase or redeem UEF shares at fair market value at each valuation date, subject to minimum holding and notice requirements.

Capital assets are recorded at cost or, if donated, at acquisition value at the date of donation. All capital assets other than land are depreciated using the straight-line method of depreciation using the following asset lives:

Buildings and leasehold improvements	3 to 50 years
Infrastructure and land improvements	3 to 25 years
Equipment and software	3 to 16 years

UMHS accrues paid time off ("PTO") leave for employees based upon length of service and employee classification. Accrued PTO leave benefits are paid at the employee's regular hourly rate when used, paid as part of the annual PTO sellback program, or paid upon termination of employment, reduction in force, or start of a leave of absence.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

UMHS's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net position are those that generally result from exchange transactions such as payments or expenditures related to patient care services provided. Nearly all of UMHS's revenues and expenses are the result of exchange transactions. Certain significant revenue streams are classified as nonoperating revenues, most notably investment income.

UMHS has agreements with third-party payers that provide for payments to UMHS at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for service rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in the future periods as final settlements are determined.

UMHS provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. As UMHS does not pursue collection of amounts once determined to qualify as charity care, they are not reported as revenues in the accompanying statement of revenues, expenses and changes in net position.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The most significant areas that require management estimates relate to valuation of accounts receivable, contractual arrangements with third-party payers and reimbursement, as well as valuation of investments.

Note 2--Cash and Investments

Cash and investments at June 30, 2019 are summarized as follows (in thousands):

Cash and cash equivalents - University Investment Pool	$ 274,532
Investments:	
University Endowment Fund	1,523,607
Other investments	33
Total investments	1,523,640
Total cash, cash equivalents and investments	$ 1,798,172

The University maintains centralized management for substantially all cash and investments of UMHS. Cash reserves and relatively short duration assets are invested in the UIP, while longer term assets held in the UEF are invested in the University's Long Term Portfolio. The UIP is principally invested in investment-grade money market securities, U.S. government and other fixed income securities and absolute return strategies. The longer investment horizon of the Long Term Portfolio allows for an equity-oriented strategy to achieve higher expected returns over time, and permits the use of less liquid alternative investments, providing for equity diversification beyond the stock markets.

The UEF consists of both permanent endowments and funds functioning as endowment. Permanent endowments are those funds received from donors with the stipulation that the principal remain intact and be invested in perpetuity to produce income that is to be expended for the purposes specified by the donors. Funds functioning as endowment consist of amounts (restricted gifts or unrestricted funds) that have been allocated by UMHS for long-term investment purposes, but are not limited by donor stipulations requiring UMHS to preserve principal in perpetuity. Substantially all of the amounts invested by UMHS in this pool are funds functioning as endowment.

The University's investment policies are governed and authorized by University Bylaws and the Board of Regents. The approved asset allocation policy for the Long Term Portfolio, in which the UEF invests, sets general targets for both equities and fixed income securities. Since diversification is a fundamental risk management strategy, the Long Term Portfolio is broadly diversified within these general categories. At June 30, 2019, the Long Term Portfolio consisted of cash and equivalents (1 percent), fixed income securities (4 percent), U.S. and non-U.S. equities (9 percent), commingled funds (25 percent) and nonmarketable alternative investments (61 percent).

Note 2--Cash and Investments--Continued

Commingled (pooled) funds held in the Long Term Portfolio include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures which are generally unrated and unregulated. Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Commingled funds are primarily invested in non-U.S./global equities and absolute return strategies, but also include exposure to domestic fixed income and equity securities. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy; however, these investments are structured to limit the University's risk exposure to the amount of invested capital.

Nonmarketable alternative investments held in the Long Term Portfolio consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. These limited partnerships include venture capital, private equity, real estate, natural resources and absolute return strategies. There is not an active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner.

The Long Term Portfolio holds investments denominated in foreign currencies and forward foreign exchange contracts used to manage the risk related to fluctuations in currency exchange rates between the time of purchase or sale and the actual settlement of foreign securities. Various investment managers acting for the University also use forward foreign exchange contracts in risk-based transactions to carry out their portfolio strategies. Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. The Long Term Portfolio's non-U.S. dollar exposure amounted to 11 percent of the portfolio at June 30, 2019.

The University's investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts recorded in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forwards, futures and commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counterparty to perform according to the terms of the contract. The University's risk of loss in the event of a counterparty default is typically limited to the amounts recognized in the statement of net position and is not represented by the contract or notional amounts of the instruments.

Note 2--Cash and Investments--Continued

UMHS receives quarterly distributions from the UEF based on the University's endowment spending rule. The annual distribution rate is 4.5 percent of the one-quarter lagged seven year moving average fair value of fund shares. To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. Monthly distributions are also made from the UIP to UMHS based on the 90-day U.S. Treasury Bill rate. The University's costs to administer and grow the UEF and UIP are funded by investment returns.

Withdrawals may be made quarterly from the UEF, with notice given to the University one month prior to the end of the preceding quarter, based upon University policy, generally after a five-year investment period. Withdrawals may be made from the UIP on a daily basis.

GASB defines fair value and establishes a framework for measuring fair value that includes a three tiered hierarchy of valuation inputs, placing a priority on those which are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The three levels of inputs, of which the first two are considered observable and the last unobservable, are as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date
- Level 2 - Other significant observable inputs, either direct or indirect, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; or market corroborated inputs
- Level 3 - Unobservable inputs

A significant portion of the underlying investments of the University's commingled pools include nonmarketable alternative investments and certain commingled funds described earlier in this note that are priced by managers using net asset value. The proprietary valuation techniques and unobservable pricing assumptions used by these managers to estimate fair value may have a significant impact on the resulting fair value determination of these investments. However, UMHS uses Level 2 inputs to measure the fair value of its investments in the University's commingled pools described in Note 1 and within this note, since shares may be purchased or sold subject to holding and notice requirements at the fair market values determined by the University.

Note 3--Pledges Receivable

The composition of pledges receivable at June 30, 2019 is summarized as follows (in thousands):

Gift pledges outstanding:	
Capital	$ 5,427
Operations	10,231
	15,658
Less:	
Allowance for uncollectible pledges	842
Unamortized discount to present value	133
Total pledges receivable, net	14,683
Less current portion	3,267
	$ 11,416

Pledges receivable are recognized net of estimated uncollectable amounts when all applicable eligibility requirements are met.

Payments on pledges receivable at June 30, 2019 are expected to be received in the following years ended June 30 (in thousands):

2020	$ 3,879
2021	3,587
2022	3,138
2023	1,302
2024	1,252
2025 and after	2,500
	$ 15,658

Note 4--Capital Assets

Capital assets activity for the year ended June 30, 2019 is summarized as follows (in thousands):

	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 30,423		$ 599	$ 29,824
Land improvements	22,080	$ 9,435	1,463	30,052
Buildings	2,091,417	131,490	30,344	2,192,563
Equipment	648,004	100,613	46,264	702,353
IT Infrastructure	332,405	12,479	16,284	328,600
Construction in progress	122,368	(91,848)		30,520
	3,246,697	162,169	94,954	3,313,912
Less accumulated depreciation	1,749,156	207,616	93,815	1,862,957
	$ 1,497,541	$ (45,447)	$ 1,139	$ 1,450,955

The decrease in construction in progress of $91,848,000 in 2019 represents the amount of capital expenditures for new projects of $162,169,000 net of capital assets placed in service of $254,017,000. Retirements of $94,954,000 in 2019, are primarily related to fully depleted clinical equipment and information technology assets no longer in service. Interest of $877,000 was capitalized in 2019.

UMHS's capital assets, net includes assets under capital leases of $26,600,000 at June 30, 2019. These assets are principally comprised of the Northville Health Center building and equipment under capital lease.

Note 5--Long-term Debt

Long-term debt at June 30, 2019 is summarized as follows (in thousands):

Payable to the University:	
2018, 4.05% to 5.05% through 2048	$ 47,670
unamortized premium	6,312
2017, 4.05% to 5.05% through 2047	101,330
unamortized premium	15,576
2012, 4.71% through 2025	44,760
2012, 3.23% to 3.25% through 2030	58,315
2012, 2.60% to 3.25% through 2033	83,335
2012, 3.65% through 2038	64,940
2012, 2.00% to 5.00% through 2042	56,710
2012, 2.00% to 5.00% through 2032	31,755
unamortized premium	1,258
2010, 0.68% to 5.00% through 2041	113,685
unamortized discount	(352)
2010, 3.20% to 3.64% through 2040	141,470
unamortized discount	(496)
2010, 2.00% to 5.00% through 2027	95,130
unamortized premium	3,866
2009, 2.00% to 5.00% through 2039	131,935
unamortized premium	561
	997,760
Less current portion	34,544
	$ 963,216

Note 5--Long-term Debt--Continued

Long-term debt activity for the year ended June 30, 2019 is summarized as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
Payable to the University	$ 1,031,386	$ -	$ 33,626	$ 997,760

Principal maturities, including interest on debt obligations, based on scheduled bond maturities for the next five years and in subsequent five-year periods are as follows (in thousands):

	Principal	Interest	Total
2020	$ 32,005	$ 38,687	$ 70,692
2021	36,140	37,599	73,739
2022	38,720	36,194	74,914
2023	40,825	34,450	75,275
2024	43,775	32,652	76,427
2025-2029	230,365	136,427	366,792
2030-2034	218,760	95,275	314,035
2035-2039	222,725	50,586	273,311
2040-2044	78,620	15,401	94,021
2045-2048	29,100	3,270	32,370
	971,035	$ 480,541	$ 1,451,576
Plus unamortized premiums, net	26,725		
	$ 997,760		

UMHS participates in the University's debt stabilization program and is charged interest at a composite fixed rate based on available fixed rate debt instruments at the time the internal loan from the University is created. Periodically, the University reviews payments made under the fixed rate schedules as compared to actual interest payments made by the University to outside debt holders and may utilize excess interest paid by units to support future strategic projects. UMHS maintains fixed rate debt with an effective interest rate that averaged 3.7 percent in 2019.

Note 6--Third Party Payment and Reimbursement

A substantial portion of UMHS's revenue is received under contractual arrangements with Medicare, Medicaid and Blue Cross and Blue Shield of Michigan. Payments from these third party payers are based on a combination of prospectively determined rates and retrospectively settled amounts. Many of the payment calculations require the use of estimates. Final settlement of the amount due to UMHS or payable to the payers is subject to the laws and regulations governing the federal and state programs and post-payment audits, which may result in further adjustments by the payers. Management believes that reasonable provisions for anticipated adjustments have been made in the financial statements.

Certain adjustments made by third parties in previously settled cost reports are being appealed. Recoveries are recognized in the financial statements as adjustments to prior year settlements at the time the appeals are resolved. Settlement balances are reported net, along with any reserve balances, as third party settlements and reserves in the statement of net position. The significant settlements from prior periods that resolved in 2019 were related to non-government payers from 2017 and 2018, and resulted in amounts payable by UMHS of $12,074,000.

UMHS also provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Since UMHS does not pursue collection of amounts once determined to qualify as charity care, they are not reported as revenues in the accompanying statement of revenues, expenses and changes in net position. Charges foregone for services provided under UMHS's charity care policy for the year ended June 30, 2019 were $76,839,000. Bad debt provisions for the year ended June 30, 2019 were $115,715,000. Both items, when considered in total, reflect the impact of patients being insured under health insurance exchange products and the Medicaid expansion in Michigan.

The distribution of net patient care service revenue by primary payer source for the year ended June 30, 2019 is as follows:

Medicare	25.5%
Medicaid	11.8%
Blue Cross	40.0%
Other	22.7%

Note 7--Transactions with Other University of Michigan Units

UMHS has amounts receivable from and payable to other University units at June 30, 2019 as follows (in thousands):

Amounts receivable from other University units:	
Michigan Health Corporation	$ 171
Amounts payable to other University units:	
Michigan Medicine Administrative Services	$ 11,291

Amounts payable consists principally of UMHS's portion of expenses incurred by the Michigan Medicine Administrative Services organization to accrue compensated absences.

UMHS had various other transactions with University units for the year ended June 30, 2019 which are summarized as follows (in thousands):

Operating (expenses) revenues:	
Clinical services provided by the Medical School	$ (659,683)
Amounts received from the Medical School to reimburse UMHS for expenses related to Medical School revenue and operating support, net	3,231
Services provided by other University units	(73,176)
Services provided to other University units	7,344
Premium insurance payments	(45,776)
Services provided by Michigan Medicine Administrative Services	(278,661)
Rent and other	(16)
Equity transfers to:	
Medical School academic and other non-patient care purposes, net	(193,717)
Other University units, net	(2,654)

Note 7--Transactions with Other University of Michigan Units--Continued

UMHS's operations are dependent on services received from the Medical School and the Executive Vice President for Medical Affairs ("EVPMA") office, including the majority of the physician services that are provided to UMHS patients. Accordingly, UMHS recognizes expense for these services in operating expenses. UMHS incurred $659,683,000 of expense for services provided by the Medical School in 2019. UMHS is also reimbursed for the salary cost of UMHS employees that perform professional services related to the Medical School. These reimbursements are recorded as a reduction to compensation and benefits expense on the statement of revenues, expenses and changes in net position, and totaled $3,231,000 in 2019.

In the course of normal operations, UMHS both provides and receives services from other University units. Services received include benefits administration, grounds maintenance, parking services, information technology, security services, payroll and human resources. UMHS included $73,176,000 in operating expenses for these services during 2019. Services provided by UMHS include those of University Occupational Health Services and risk management administration. To compensate UMHS for these services, various University units reimbursed UMHS $7,344,000 during 2019, which is included as a reduction to total operating expenses.

Operating expenses include UMHS's share of the initial premiums charged by Veritas for liability, property and casualty insurance, including worker's compensation. The premiums are based on the present value, using a discount rate of 5 percent, of the ultimate losses as estimated by an independent actuary. Medical Professional Liability premiums and premium credits are held solely by UMHS.

Certain UMHS administrative functions are performed by a shared Michigan Medicine Administrative Services environment that combines similar functions from the Medical School and EVPMA office. Functions that are centralized include finance, legal, development, information technology and other services that can be provided from a single office to each part of the Michigan Medicine organization in a cost-effective manner. Costs incurred by the Michigan Medicine Administrative Services environment are allocated to each participating organization based upon effort expended for each function. In 2019, $278,661,000 of operating expense was allocated to UMHS for the performance of these functions.

UMHS conducts equity transfers to and receives equity transfers from other University units. These equity transfers are generally made in support of the research and academic missions and are made at the discretion of UMHS leadership.

Note 7--Transactions with Other University of Michigan Units--Continued

In 2016, a ten-year internal arrangement between UMH and the Medical School was established to provide financial support for strategic investments and to increase faculty engagement and integration within the clinical mission. In 2017, the Medical School transferred funds of $129,733,000 to UMHS, which were invested in the University's Long Term Portfolio. In exchange for this investment, UMHS distributes transfers back to the Medical School equal to the University's endowment distribution rate applied to the investment on an annual basis, with additional distributions occurring based on various metrics related to the financial performance of the clinical mission. Under this arrangement, UMHS transferred $35,053,000 to the Medical School during 2019.

Note 8--Postemployment Benefits

UMHS participates in the University's postemployment benefits plan which provides retiree health and welfare benefits; primarily medical, prescription drug, dental and life insurance coverage, to eligible retirees and their eligible dependents. Substantially all of UMHS's regular employees may become eligible for these benefits if they reach retirement age while working for UMHS. For employees retiring on or after January 1, 1987, contributions toward health and welfare benefits are shared between UMHS and the retiree, and can vary based on date of hire, date of retirement, age and coverage elections.

The University also provides income replacement benefits, retirement savings contributions, and health and life insurance benefits to substantially all regular UMHS employees who are enrolled in a University sponsored long-term disability plan and qualify, based on disability status while working for UMHS, to receive basic or expanded long-term disability benefits. Contributions toward the expanded long-term disability plan are shared between UMHS and employees and vary based on years of service, annual base salary and coverage elections. Contributions toward the basic long-term disability plan are paid entirely by UMHS.

These postemployment benefits are provided through single-employer plans administered by the University. The Executive Vice Presidents of the University have the authority to establish and amend benefit provisions of these plans.

Actuarial projections of postemployment benefits are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided and announced future changes at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

Note 8--Postemployment Benefits--Continued

The University's reported liability for postemployment benefits obligations was calculated using the entry age normal level percent of pay method. UMHS's annual postemployment benefits expense and liability represents an allocation of UMHS's relative share of the University's expense and liability, based on the method in which the retiree benefits are funded. The funding method is based upon a percentage of salary dollars of active employees who qualify for retiree benefits.

Changes in the reported total liability for UMHS's postemployment benefits obligations for the year ended June 30, 2019 are summarized as follows (in thousands):

	Retiree Health and Welfare	Long-term Disability	Total
Balance, beginning of year	$ 602,134	$ 37,706	$ 639,840
Net benefits expense	51,265	4,422	55,687
Decrease in deferred outflows	(1,138)	(863)	(2,001)
Increase in deferred inflows	(109,489)	(1,382)	(110,871)
Balance, end of year	542,772	39,883	582,655
Less current portion	18,009	5,072	23,081
	$ 524,763	$ 34,811	$ 559,574

At June 30, 2019, deferred outflows reported in the statement of net position include benefit payments made after the measurement date of $18,009,000. UMHS has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently pays for postemployment benefits on a pay-as-you-go basis. UMHS's reported postemployment benefits obligations at June 30, 2019 as a percentage of covered payroll of $1,247,191,000 was 47 percent.

Note 8--Postemployment Benefits--Continued

Significant actuarial assumptions used at the June 30, 2018 and 2017 measurement dates are as follows:

	2018	2017
Discount rate*	3.87%	3.58%
Inflation rate	2.00%	2.00%
Immediate/ultimate administrative trend rate	0.0%/3.0%	0.0%/3.0%
Immediate/ultimate medical trend rate	6.5%/4.5%	6.5%/4.5%
Immediate/ultimate Rx trend rate	9.0%/4.5%	9.5%/4.5%
Increase in compensation rate	4.00%	4.00%
Mortality table**	RP-2014 White Collar Head Count Table, Scale MP-2017	RP-2014 White Collar Head Count Table, Scale MP-2016
Average future work life expectancy (years):		
Retiree health and welfare	9.14	9.17
Long-term disability	11.47	11.43

* Bond Buyer 20-year General Obligation Municipal Bond Index as of the last publication of the measurement period

** Based on the University's study of mortality experience from 2010-2014

Note 9--Retirement Plan

UMHS participates in the University's retirement plan, a defined contribution retirement plan through TIAA and Fidelity Management Trust Company ("FMTC") mutual funds. All staff are eligible to participate in the plan based upon age and service requirements. Participants maintain individual contracts with TIAA, or accounts with FMTC, and are fully vested.

Eligible employees may contribute either 4.5 or 5 percent of their pay, depending on their position. After an employee has completed one year of employment, UMHS will contribute an amount equal to 9 or 10 percent of each employee's pay to the plan. Participants may elect to contribute additional amounts to the plan within specified limits that are not matched by UMHS contributions. Contributions and covered payroll under the plan (excluding additional participant contributions) for the year ended June 30, 2019 is summarized as follows (in thousands):

UMHS contributions	$ 93,135
Employee contributions	$ 48,613
Payroll covered under plan	$ 1,247,191
Total payroll	$ 1,277,030

Note 10--Commitments and Contingencies

UMHS has entered into capital and operating leases for certain buildings and equipment, which expire at various dates through 2039. Outstanding commitments for these leases are expected to be paid in the following years ended June 30 (in thousands):

	Capital	Operating
2020	$ 3,736	$ 23,397
2021	3,045	23,714
2022	3,045	23,060
2023	2,999	20,018
2024	2,861	19,501
2025-2029	15,020	48,978
2030-2034	15,775	16,526
2035-2039	16,560	2,135
	63,041	$ 177,329
Less amount representing interest	30,621	
Present value of minimum lease payments	$ 32,420	

Operating lease expenses, which include leases with other University units, totaled $31,279,000 in 2019.

Capital lease obligations consist primarily of a 25-year lease involving the 100,000 square foot building, 10 acres of land and site improvements that house the Northville Health Center facility.

UMHS is a party to various pending legal actions and other claims in the normal course of business, and is of the opinion that the outcome of these proceedings will not have a material adverse effect on its financial position.

FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2019 and 2018
with
REPORT OF INDEPENDENT AUDITORS

INTERCOLLEGIATE ATHLETICS
OF THE UNIVERSITY OF MICHIGAN

June 30, 2019 and 2018

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Report of Independent Auditors

To the Regents of the University of Michigan

We have audited the accompanying financial statements of the Intercollegiate Athletics of the University of Michigan ("ICA"), which consists of certain departments of the University of Michigan, which comprise the statement of net position as of June 30, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

Auditors' Responsibility

Our responsibility is to express an opinion on the 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 our 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, we consider internal control relevant to ICA'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 ICA'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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Intercollegiate Athletics of the University of Michigan, which consists of certain departments of the University of Michigan as of June 30, 2019 and 2018, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements of ICA are intended to present the net position, revenues, expenses and changes in net position, and cash flows of only that portion of the business type activities of the University of Michigan that are attributable to the transactions of ICA. They do not purport to, and do not, present fairly the financial position of the University of Michigan as of June 30, 2019 and 2018, and the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

The accompanying management's discussion and analysis on pages 3 through 9 is required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 17, 2019

Management's Discussion and Analysis (Unaudited)

Introduction

The following discussion and analysis provides an overview of the financial position of Intercollegiate Athletics of the University of Michigan ("ICA") at June 30, 2019 and 2018 and its activities for the three fiscal years ended June 30, 2019. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

ICA operates under the control of the Regents of the University of Michigan (the "University") to administer the intercollegiate athletic programs of the University. As part of the University, the assets, deferred outflows, liabilities, deferred inflows, revenues, expenses and changes in net position of ICA are included in the consolidated financial statements of the University. All organizations controlled by ICA, consisting of its various departments, are included in the financial statements. Organizations not controlled by ICA, such as certain booster and alumni organizations, are not included in the financial statements.

Financial Highlights

ICA's financial position remains strong, with total assets and deferred outflows of $919.8 million and total liabilities and deferred inflows of $422.7 million at June 30, 2019, as compared to total assets and deferred outflows of $914.0 million and total liabilities and deferred inflows of $408.6 million at June 30, 2018. Net position, which represents the residual interest in ICA's total assets and deferred outflows after total liabilities and deferred inflows are deducted, totaled $497.1 million and $505.4 million at June 30, 2019 and 2018, respectively. ICA's change in net position for the years ended June 30 is summarized as follows:

	2019	**2018** (in millions)	**2017**
Operating revenues	$ 181.5	$ 163.7	$ 136.5
Operating expenses	$ 200.7	$ 195.4	$ 176.0
Net nonoperating and other activities	$ 10.9	$ 35.2	$ 56.4
(Decrease) increase in net position	$ (8.3)	$ 3.5	$ 16.9

In 2018, Congress passed the Tax Cuts and Jobs Act of 2017, which eliminated the tax deductibility for seating donations. As a result, effective January 1, 2018, ICA has presented preferred seat contributions as exchange type transactions and will therefore reflect this activity in operating revenues within the statement of revenues, expenses and changes in net position.

ICA's operating revenues increased $17.8 million in 2019 due primarily to the change in presentation of preferred seat contributions from nonoperating to operating activity and increases in spectator admissions due to an additional home football game. ICA's operating revenues increased $27.2 million in 2018 due primarily to increases in conference distributions, the change in the presentation of preferred seat contributions from nonoperating to operating activity and an increase in other revenues related to a football game guarantee.

Significant recurring sources of revenue for ICA, including gifts and investment income, are included in nonoperating revenues, as required by the Governmental Accounting Standards Board ("GASB"). Net nonoperating and other activities decreased in both 2019 and 2018 due primarily to the change in presentation of preferred seating donations from nonoperating to operating activity.

ICA's operating expenses increased $5.3 million in 2019 due primarily to increases in compensation, team and game, and depreciation expense. ICA's operating expenses increased $19.4 million in 2018 due primarily to increases in compensation, operation and maintenance of plant, and depreciation expense.

Using the Financial Statements

ICA's financial report includes three financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. These financial statements are prepared in accordance with GASB principles.

Management's Discussion and Analysis (Unaudited)--Continued

Statement of Net Position

The statement of net position presents the financial position of ICA at the end of the fiscal year and includes all assets, deferred outflows, liabilities and deferred inflows of ICA. The difference between total assets and deferred outflows as compared to total liabilities and deferred inflows - net position - is one indicator of the current financial condition of ICA, while the change in net position is an indication of whether the overall financial condition has improved or worsened during the year. ICA's assets, deferred outflows, liabilities, deferred inflows and net position at June 30 are summarized as follows:

	2019	**2018**	**2017**
		(in thousands)	
Net current assets (liabilities):			
Cash equivalents	$ 141,562	$ 130,138	$ 144,532
Receivables and other assets, net	17,496	19,022	19,878
Advance sale of game tickets	(45,072)	(44,364)	(39,384)
Current portion of notes payable	(10,544)	(9,913)	(6,903)
Other current liabilities	(21,433)	(22,921)	(28,661)
Total net current assets	82,009	71,962	89,462
Net noncurrent assets, deferred outflows, (liabilities) and (deferred inflows):			
Unexpended debt proceeds			12,783
Investments	136,122	124,709	108,408
Pledges receivable, net	62,391	72,036	83,496
Other noncurrent assets	11,786	10,953	9,177
Capital assets, net	546,196	552,493	527,950
Deferred outflows	4,282	4,606	4,146
Other liabilities	(2,128)		
Unearned revenues	(8,779)	(10,169)	(11,585)
Obligations for postemployment benefits	(31,993)	(34,314)	(34,023)
Notes payable	(289,856)	(277,255)	(282,063)
Deferred inflows	(12,908)	(9,580)	(5,819)
Total net noncurrent assets and (net deferred inflows)	415,113	433,479	412,470
Net position	$ 497,122	$ 505,441	$ 501,932

ICA continues to make investments in its physical plant financed by debt, capital gifts and reserves. In 2019, ICA completed construction of the Football Performance Center. In 2018, ICA completed construction of the Stephen M. Ross Athletics South Competition and Performance project and continued construction of the Football Performance Center.

Outstanding debt at June 30, 2019 and 2018 totaled $300.4 million and $287.2 million, respectively.

ICA's net position decreased $8.3 million in 2019. Net position at June 30, 2019 and 2018 totaled $497.1 million and $505.4 million, respectively, and is summarized as follows:

	2019	**2018** (in thousands)	**2017**
Net investment in capital assets	$ 245,796	$ 265,325	$ 251,767
Restricted:			
Nonexpendable	83,503	75,194	65,649
Expendable	166,723	161,114	177,836
Unrestricted	1,100	3,808	6,680
	$ 497,122	$ 505,441	$ 501,932

Results of Operations

ICA measures its results of operations based on certain activities, which are summarized as follows for the years ended June 30:

	2019	2018 (in thousands)	2017
Revenues:			
Spectator admissions	$ 53,930	$ 46,399	$ 55,339
Conference distributions	53,922	53,136	36,458
Preferred seat contributions	30,205	33,035	30,513
Private gifts for other than capital and endowment purposes, current funds	4,771	5,423	7,591
Corporate sponsorships and other media rights	18,478	18,079	18,361
Licensing royalties	9,732	10,543	12,014
Facilities revenues	7,075	4,822	6,743
Concessions, publications and parking	4,323	3,662	4,511
Other revenues	3,830	10,594	3,081
Investment income, current funds	6,531	5,387	4,271
Total Revenues	192,797	191,080	178,882
Expenses and other uses:			
Salaries, wages and benefits, current funds	72,474	68,646	62,076
Financial aid	27,340	26,385	24,954
Team and game	37,866	37,213	34,656
Other operating and administrative	15,529	14,696	13,839
Equity transfers to the University, current funds	6,020	9,328	4,315
Operations and maintenance of plant, current funds	9,874	9,512	9,390
Deferred maintenance transfer	5,350	5,000	7,000
Debt service transfer	17,464	17,263	15,218
Total expenses and other uses	191,917	188,043	171,448
Excess of revenues over expenses and other uses	$ 880	$ 3,037	$ 7,434

Excess of revenues over expenses and other uses decreased $2.2 million and 4.4 million in 2019 and 2018, respectively.

Management's Discussion and Analysis (Unaudited)--Continued

ICA's revenues increased $1.7 million in 2019 due primarily to increases in spectator admissions and facilities revenues. ICA's expenses and other uses increased $3.9 million in 2019 primarily due to increases in compensation and financial aid.

Statement of Cash Flows

The statement of cash flows provides additional information about ICA's financial results by reporting the major sources and uses of cash. ICA's cash flows for the years ended June 30 are as follows:

	2019	2018 (in thousands)	2017
Net cash provided by (used in) operating activities	$ 14,831	$ 4,749	$ (19,149)
Net cash (used in) provided by noncapital financing activities	(716)	13,940	36,030
Net cash used in capital and related financing activities	(9,103)	(49,958)	(17,644)
Net cash provided by investing activities	6,412	16,875	8,252
Net increase (decrease) in cash equivalents	$ 11,424	$ (14,394)	$ 7,489

Cash received from operations primarily consists of spectator admissions, conference distributions and preferred seat contributions. Cash received from noncapital financing primarily consists of private gifts. Cash used in capital and related financing activities primarily related to ICA's continued investment in its physical plant.

Economic Factors That May Affect the Future

ICA continues to make significant investments in its facilities that have required additional debt and the use of ICA cash reserves. ICA believes that it is well positioned to generate sufficient cash flows to finance planned facility projects and sustain continued success in its operations and support of the student-athlete and athletic department.

To ensure facilities funding requirements are met, ICA management continues to emphasize positive operating results, expanded private giving and continued use of long-term debt to support the future infrastructure and facility renewal needs of the department. In 2013, ICA initiated the South Campus Athletics project fundraising campaign with the goal of obtaining sufficient private giving to support its plan to construct new and replacement facilities for its teams and student-athletes. Based on the success of the campaign, ICA completed construction of the Athletics South Competition and Performance project, which added competition and practice venues, and team centers for lacrosse, track and rowing, as well as medical, performance science, nutritional, and strength and conditioning facilities. In addition, ICA has completed the construction of the Football Performance Center project. Planning efforts for the Ferry Field area projects continue, with a primary focus on the construction of the Student-Athlete Development and Dining Facility.

A major portion of ICA's revenue, such as conference media contracts and corporate sponsorship arrangements, is contractually defined for future years. However, a significant portion of ICA's revenue base, such as gifts, football admissions and premium seat sales, is directly tied to the success of its football program. While ICA has historically sold out the premium seats at Michigan Stadium and enjoyed football season ticket renewals of greater than 95 percent, ICA would be negatively impacted if the football program were to experience declined success, which would likely result in decreased spectator admissions, preferred seat contributions and gift revenue.

Additional external risks which may significantly impact ICA include lawsuits involving the National Collegiate Athletic Association, grant-in-aid limits and the overall student-athlete support structure. Health care, injury prevention, full cost of attendance provisions, student-athlete trust funds and professional agent representation will continue to be discussed. Furthermore, potential future landscape changes could arise in the form of additional benefits for student-athletes beyond their participation.

INTERCOLLEGIATE ATHLETICS
OF THE UNIVERSITY OF MICHIGAN

Statement of Net Position

	June 30, 2019	June 30, 2018
	(in thousands)	
Assets and Deferred Outflows		
Current Assets:		
Cash equivalents on deposit with the University	**$ 141,562**	$ 130,138
Accounts receivable, net	**3,866**	3,861
Current portion of pledges receivable, net	**10,454**	11,483
Current portion of prepaid expenses and other assets	**3,176**	3,678
Total Current Assets	**159,058**	149,160
Noncurrent Assets:		
Endowment investments on deposit with the University	**136,122**	124,709
Pledges receivable, net	**62,391**	72,036
Prepaid expenses and other assets	**11,786**	10,953
Capital assets, net	**546,196**	552,493
Total Noncurrent Assets	**756,495**	760,191
Total Assets	**915,553**	909,351
Deferred Outflows	**4,282**	4,606
Total Assets and Deferred Outflows	**$ 919,835**	$ 913,957
Liabilities, Deferred Inflows and Net Position		
Current Liabilities:		
Accounts payable and accrued expenses	**$ 10,207**	$ 12,595
Accrued compensation	**6,239**	4,981
Advance sale of game tickets	**45,072**	44,364
Current portion of unearned revenues	**4,987**	5,345
Current portion of notes payable to the University	**10,544**	9,913
Total Current Liabilities	**77,049**	77,198
Noncurrent Liabilities:		
Other liabilities	**2,128**	
Unearned revenues	**8,779**	10,169
Obligations for postemployment benefits	**31,993**	34,314
Notes payable to the University	**289,856**	277,255
Total Noncurrent Liabilities	**332,756**	321,738
Total Liabilities	**409,805**	398,936
Deferred Inflows	**12,908**	9,580
Net Position:		
Net investment in capital assets	**245,796**	265,325
Restricted:		
Nonexpendable	**83,503**	75,194
Expendable	**166,723**	161,114
Unrestricted	**1,100**	3,808
Total Net Position	**497,122**	505,441
Total Liabilities, Deferred Inflows and Net Position	**$ 919,835**	$ 913,957

The accompanying notes are an integral part of the financial statements.

INTERCOLLEGIATE ATHLETICS
OF THE UNIVERSITY OF MICHIGAN

Statement of Revenues, Expenses and Changes in Net Position

	Year Ended June 30, 2019 (in thousands)	2018
Operating Revenues		
Spectator admissions	**$ 53,930**	$ 46,399
Conference distributions	**53,922**	53,136
Preferred seat contributions	**30,205**	16,457
Corporate sponsorships and other media rights	**18,478**	18,079
Licensing royalties	**9,732**	10,543
Facilities revenues	**7,075**	4,822
Concessions, publications and parking	**4,323**	3,662
Other revenues	**3,830**	10,594
Total Operating Revenues	**181,495**	163,692
Operating Expenses		
Salaries, wages and benefits	**74,496**	71,259
Financial aid	**27,340**	26,385
Team and game	**39,366**	37,213
Other operating and administrative	**15,529**	14,696
Operations and maintenance of plant	**13,175**	17,188
Depreciation	**30,761**	28,621
Total Operating Expenses	**200,667**	195,362
Operating Loss	**(19,172)**	(31,670)
Nonoperating Revenues (Expenses)		
Private gifts for other than capital and endowment purposes	**4,775**	5,430
Preferred seating donations		16,578
Net investment income	**9,994**	11,817
Interest expense and other, net	**(10,028)**	(10,126)
Total Nonoperating Revenues, Net	**4,741**	23,699
Loss Before Other Revenues and Transfers	**(14,431)**	(7,971)
Other Revenues		
Capital gifts	**3,714**	10,836
Private gifts for permanent endowment purposes	**7,815**	8,905
Total Other Revenues	**11,529**	19,741
Net (Expenses) Revenues Before Transfers	**(2,902)**	11,770
Transfers to other University departments, net	**(5,417)**	(8,261)
(Decrease) Increase in Net Position	**(8,319)**	3,509
Net Position, Beginning of Year	**505,441**	501,932
Net Position, End of Year	**$ 497,122**	$ 505,441

The accompanying notes are an integral part of the financial statements.

INTERCOLLEGIATE ATHLETICS
OF THE UNIVERSITY OF MICHIGAN

Statement of Cash Flows

	Year Ended June 30, 2019	2018
	(in thousands)	
Cash Flows from Operating Activities		
Spectator admissions	**$ 54,851**	$ 51,053
Conference distributions	**53,859**	52,792
Preferred seat contributions	**30,205**	16,457
Corporate sponsorships and other media rights	**13,231**	14,571
Licensing royalties	**9,821**	10,633
Facilities revenues	**7,209**	6,066
Concessions, publications and parking	**4,847**	3,443
Other revenues	**3,857**	10,553
Payments for salaries, wages and benefits	**(71,960)**	(69,501)
Payments for financial aid	**(27,340)**	(26,385)
Payments for team and game expenses	**(34,786)**	(34,238)
Payments for other operating and administrative expenses	**(14,940)**	(14,996)
Payments for operations and maintenance of plant	**(14,023)**	(15,699)
Net Cash Provided by Operating Activities	**14,831**	4,749
Cash Flows from Noncapital Financing Activities		
Private gifts for other than capital and endowment purposes	**4,701**	5,623
Preferred seating donations		16,578
Transfers to other University departments, net	**(5,417)**	(8,261)
Net Cash (Used in) Provided by Noncapital Financing Activities	**(716)**	13,940
Cash Flows from Capital and Related Financing Activities		
Capital gifts	**14,458**	24,488
Proceeds from issuance of capital debt	**26,540**	6,630
Principal payments on capital debt	**(12,735)**	(7,845)
Interest payments on capital debt	**(10,807)**	(10,053)
Purchases of capital assets	**(26,559)**	(63,178)
Net Cash Used in Capital and Related Financing Activities	**(9,103)**	(49,958)
Cash Flows from Investing Activities		
Investment income	**7,614**	6,173
Increase in investments on deposit with the University, net	**(1,202)**	(2,081)
Decrease in unexpended capital debt proceeds on deposit with the University		12,783
Net Cash Provided by Investing Activities	**6,412**	16,875
Net Increase (Decrease) in Cash Equivalents	**11,424**	(14,394)
Cash Equivalents on Deposit with the University, Beginning of Year	**130,138**	144,532
Cash Equivalents on Deposit with the University, End of Year	**$ 141,562**	$ 130,138

The accompanying notes are an integral part of the financial statements.

INTERCOLLEGIATE ATHLETICS
OF THE UNIVERSITY OF MICHIGAN

Statement of Cash Flows--Continued

	Year Ended June 30, 2019	2018
	(in thousands)	
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:		
Operating loss	**$ (19,172)**	$ (31,670)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation expense	**30,761**	28,621
Changes in assets and liabilities:		
Accounts receivable, net	**(5)**	(410)
Prepaid expenses and other assets	**(1,091)**	(1,947)
Accounts payable and accrued expenses	**2,029**	1,963
Accrued compensation	**(1,063)**	309
Advance sale of game tickets	**708**	4,980
Unearned revenues	**(1,748)**	589
Changes in deferred outflows	**324**	(460)
Changes in deferred inflows	**4,088**	2,774
Net Cash Provided by Operating Activities	**$ 14,831**	$ 4,749

The accompanying notes are an integral part of the financial statements.

Note 1--Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation: Intercollegiate Athletics of the University of Michigan ("ICA") operates under the control of the Regents of the University of Michigan (the "University") to administer the intercollegiate athletic programs of the University. As part of the University, the assets, deferred outflows, liabilities, deferred inflows, revenues, expenses and changes in net position of ICA are included in the consolidated financial statements of the University. All organizations controlled by ICA, consisting of its various departments, are included in the financial statements; organizations not controlled by ICA, such as certain booster and alumni organizations, are not included in the financial statements. As part of the University, ICA is exempt from income taxes under Internal Revenue Code Sections 501(c)(3) and 115.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board ("GASB"). ICA reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB, on the accrual basis. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

Net position is categorized as:

- Net investment in capital assets: Capital assets, net of accumulated depreciation, unexpended debt proceeds and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:

  Nonexpendable - Net position subject to externally imposed stipulations that it be maintained permanently. Such net position includes the corpus portion (historical value) of gifts to ICA's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

  Expendable - Net position subject to externally imposed stipulations that can be fulfilled by actions of ICA pursuant to those stipulations or that expire by the passage of time. Such net position includes net appreciation of ICA's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- Unrestricted: Net position not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Regents.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Summary of Significant Accounting Policies: For purposes of the statement of cash flows, ICA considers all highly liquid investments purchased with a maturity of three months or less, to be cash equivalents. Cash equivalents generally represent investments in the University Investment Pool ("UIP"), a short-term commingled pool managed by the University that can be readily liquidated to pay contractual liabilities.

ICA receives pledges and bequests of financial support from corporations, foundations and individuals. Revenue is recognized when a pledge representing an unconditional promise to give is received and all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Permanent endowment pledges do not meet eligibility requirements, as defined by GASB, and are not recorded as assets until the related gift is received.

Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are made, commensurate with expected future payments. An allowance for uncollectible pledges receivable is provided based on management's judgment of potential uncollectible amounts and includes such factors as prior collection history, type of gift and nature of fundraising.

Endowment investments primarily represent investments in the University Endowment Fund ("UEF"), a commingled pool which is invested entirely in the Long Term Portfolio, a diversified, equity-oriented investment pool managed by the University. The fair market value of UEF shares is determined at the end of each calendar quarter based on the fair value of the pool. Participants may purchase or redeem UEF shares at fair market value at each valuation date, subject to minimum holding and notice requirements.

Capital assets are recorded at cost or, if donated, at acquisition value at the date of donation. Depreciation of capital assets is provided on a straight-line method over the estimated useful lives of the respective assets, which generally range from four to forty years.

Advance sale of game tickets consists of spectator admissions collected for athletic contests scheduled for the subsequent fiscal year and therefore not earned as of the end of the current fiscal year.

Unearned revenues consist primarily of cash received from unearned sponsorships and other contracts which have not yet been earned under the terms of the agreements.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

For donor restricted endowments, the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan, permits the Board of Regents to appropriate an amount of realized and unrealized endowment appreciation as determined to be prudent. The University's policy is to retain net realized and unrealized appreciation with the endowment after spending rule distributions. Cumulative net appreciation of permanent endowment funds, which totaled $39,859,000 and $37,699,000 at June 30, 2019 and 2018, respectively, is available to meet spending policy rate distributions and is recorded in restricted expendable net position. The University's endowment spending rule is further discussed in Note 2.

Conference distributions consist of television revenue, bowl distributions, National Collegiate Athletic Association ("NCAA") distributions and conference championship payouts distributed to ICA by the Big Ten Conference, net of spectator admissions revenue sharing.

Preferred seat contributions represent an annual seating program for men's football, basketball and ice hockey, with seat location linked to contribution levels. In 2018, Congress passed the Tax Cuts and Jobs Act of 2017, which eliminated the tax deductibility for seating donations. As a result, effective January 1, 2018, preferred seat contributions have been presented as exchange type transactions and reflected in operating revenues.

ICA records non-cash, value-in-kind trade transactions in both corporate sponsorships and other media rights revenue and team and game expense. These transactions consist primarily of athletic apparel and footwear, and amounted to $3,390,000 and $3,293,000 in 2019 and 2018, respectively.

Team and game expenses include post-season play expenditures, net of reimbursement from the Big Ten Conference, the NCAA and sponsoring bowl organizations.

Interest expense and other is recorded net of capitalized interest and gain (loss) on disposal of plant assets.

Operating activities as reported in the statement of revenues, expenses and changes in net position are those that generally result from exchange transactions, such as sales of tickets for games and payments made for services or goods received. Nonexchange transactions are reported as nonoperating activities.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Note 2--Cash and Investments

The University maintains centralized management for substantially all cash and investments of ICA. Cash reserves and relatively short duration assets are invested in the UIP, while longer term assets held in the UEF are invested in the University's Long Term Portfolio. The UIP is principally invested in investment-grade money market securities, U.S. government and other fixed income securities and absolute return strategies. The longer investment horizon of the University's Long Term Portfolio allows for an equity-oriented strategy to achieve higher expected returns over time, and permits the use of less liquid alternative investments, providing for equity diversification beyond the stock markets.

The UEF consists of both permanent endowments and funds functioning as endowment. Permanent endowments are those funds received from donors with the stipulation that the principal remain intact and be invested in perpetuity to produce income that is to be expended for the purposes specified by the donors. Funds functioning as endowment consist of amounts (restricted gifts or unrestricted funds) that have been allocated by ICA for long-term investment purposes, but are not limited by donor stipulations requiring ICA to preserve principal in perpetuity.

The University's investment policies are governed and authorized by University Bylaws and the Board of Regents. The approved asset allocation policy for the Long Term Portfolio, in which the UEF invests, sets general targets for both equities and fixed income securities. Since diversification is a fundamental risk management strategy, the Long Term Portfolio is broadly diversified within these general categories. At June 30, 2019 and 2018, the Long Term Portfolio consisted of cash and equivalents (1 percent and 2 percent), fixed income securities (4 percent and 6 percent), U.S. and non-U.S. equities (9 percent and 10 percent), commingled funds (25 percent and 21 percent) and nonmarketable alternative investments (61 percent and 61 percent).

Commingled (pooled) funds held in the Long Term Portfolio include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures which are generally unrated and unregulated. Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Commingled funds are primarily invested in non-U.S./global equities and absolute return strategies, but also include exposure to domestic fixed income and equity securities. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy; however, these investments are structured to limit the University's risk exposure to the amount of invested capital.

Note 2--Cash and Investments--Continued

Nonmarketable alternative investments held in the Long Term Portfolio consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. These limited partnerships include venture capital, private equity, real estate, natural resources and absolute return strategies. There is not an active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner.

The Long Term Portfolio holds investments denominated in foreign currencies and forward foreign exchange contracts used to manage the risk related to fluctuations in currency exchange rates between the time of purchase or sale and the actual settlement of foreign securities. Various investment managers acting for the University also use forward foreign exchange contracts in risk-based transactions to carry out their portfolio strategies. Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. The Long Term Portfolio's non-U.S. dollar exposure amounted to 11 and 10 percent of the portfolio at June 30, 2019 and 2018, respectively.

The University's investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts recorded in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forwards, futures and commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counterparty to perform according to the terms of the contract. The University's risk of loss in the event of a counterparty default is typically limited to the amounts recognized in the statement of net position and is not represented by the contract or notional amounts of the instruments.

ICA receives quarterly distributions from the UEF based on the University's endowment spending rule. The annual distribution rate is 4.5 percent of the one-quarter lagged seven year moving average fair value of fund shares. To protect endowment principal in the event of a prolonged market downturn, distributions are limited to 5.3 percent of the current fair value of fund shares. Monthly distributions are also made from the UIP to ICA based on the 90-day U.S. Treasury Bill rate. The University's costs to administer and grow the UEF and UIP are funded by investment returns.

Note 2--Cash and Investments--Continued

Withdrawals may be made quarterly from the UEF, with notice given to the University one month prior to the end of the preceding quarter, based upon University policy, generally after a five year investment period. Withdrawals may be made from the UIP on a daily basis.

GASB defines fair value and establishes a framework for measuring fair value that includes a three tiered hierarchy of valuation inputs, placing a priority on those which are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The three levels of inputs, of which the first two are considered observable and the last unobservable, are as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date
- Level 2 - Other significant observable inputs, either direct or indirect, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; or market corroborated inputs
- Level 3 - Unobservable inputs

A significant portion of the underlying investments of the University's commingled pools include nonmarketable alternative investments and certain commingled funds described earlier in this note that are priced by managers using net asset value. The proprietary valuation techniques and unobservable pricing assumptions used by these managers to estimate fair value may have a significant impact on the resulting fair value determination of these investments. However, ICA uses Level 2 inputs to measure the fair value of its investments in the University's commingled pools described in Note 1 and within this note, since shares may be purchased or sold subject to holding and notice requirements at the fair market values determined by the University.

Note 3--Pledges Receivable

The composition of pledges receivable at June 30, 2019 and 2018 is summarized as follows:

	2019	2018
	(in thousands)	
Gift pledges outstanding:		
Capital	$ 70,452	$ 81,679
Operations	5,193	5,045
	75,645	86,724
Less:		
Allowance for uncollectible pledges	1,727	1,899
Unamortized discount to present value	1,073	1,306
Total pledges receivable, net	72,845	83,519
Less current portion	10,454	11,483
	$ 62,391	$ 72,036

Payments on pledges receivable at June 30, 2019 are expected to be received in the following years ended June 30 (in thousands):

2020	$ 10,797
2021	11,504
2022	9,114
2023	8,074
2024	12,389
2025 and after	23,767
	$ 75,645

As discussed in Note 1, permanent endowment pledges do not meet eligibility requirements, as defined by GASB, until the related gift is received. Accordingly, permanent endowment pledges totaling $13,987,000 and $16,204,000 at June 30, 2019 and 2018, respectively, are not recognized as assets in the accompanying financial statements. In addition, bequest intentions and other conditional promises are not recognized as assets until the specified conditions are met because of uncertainties with regard to their realizability and valuation.

Note 4--Capital Assets

Capital assets activity for the years ended June 30, 2019 and 2018 is summarized as follows:

2019	Beginning Balance	Additions	Retirements	Ending Balance
		(in thousands)		
Land	$ 1,818			$ 1,818
Land improvements	22,464	$ 1,459		23,923
Infrastructure	2,840			2,840
Buildings	752,416	24,944	$ 858	776,502
Construction in progress	11,836	(3,276)		8,560
Equipment	11,364	1,726	256	12,834
	802,738	24,853	1,114	826,477
Less accumulated depreciation	250,245	30,761	725	280,281
	$ 552,493	$ (5,908)	$ 389	$ 546,196

2018	Beginning Balance	Additions	Retirements	Ending Balance
		(in thousands)		
Land	$ 1,818			$ 1,818
Land improvements	21,773	$ 691		22,464
Infrastructure	2,840			2,840
Buildings	615,272	137,212	$ 68	752,416
Construction in progress	98,106	(86,270)		11,836
Equipment	10,594	1,666	896	11,364
	750,403	53,299	964	802,738
Less accumulated depreciation	222,453	28,647	855	250,245
	$ 527,950	$ 24,652	$ 109	$ 552,493

In 2019, the decrease in construction in progress of $3,276,000 represents the amount of capital assets placed in service of $26,403,000 net of capital expenditures for new projects of $23,127,000. In 2018, the decrease in construction in progress of $86,270,000 represents the amount of capital assets placed in service of $138,268,000 net of capital expenditures for new projects of $51,998,000.

Note 5--Notes Payable to the University of Michigan

Long-term debt activity for the years ended June 30, 2019 and 2018 is summarized as follows:

2019 (in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Payable to the University	$ 287,168	$ 26,540	$ 13,308	$ 300,400
Less current portion	9,913			10,544
	$ 277,255			$ 289,856

2018 (in thousands)	Beginning Balance	Additions	Reductions	Ending Balance
Payable to the University	$ 288,966	$ 6,630	$ 8,428	$ 287,168
Less current portion	6,903			9,913
	$ 282,063			$ 277,255

During 2019 and 2018, ICA received debt proceeds of $26,540,000 and $6,630,000, respectively, from the University to finance the construction of the Stephen M. Ross Athletics South Competition and Performance project.

ICA participates in the University's debt stabilization program and is charged interest at a composite rate based on available variable and fixed rate debt instruments. Periodically, the University reviews payments made under the fixed rate schedules as compared to actual interest payments made by the University to outside debt holders and may utilize excess interest paid by units to support future strategic projects. Fixed interest rates on debt obligations outstanding at June 30, 2019 and 2018 range from 2.25 to 5.40 percent.

Note 5--Notes Payable to the University of Michigan--Continued

In 2019 and 2018, ICA incurred interest costs totaling $11,740,000 and $11,446,000, respectively.

Principal maturities and interest on long-term debt for the next five years and in subsequent five-year periods are as follows:

	Principal (in thousands)	Interest
2020	$ 9,980	$ 11,337
2021	12,140	10,904
2022	12,460	10,458
2023	13,065	9,994
2024	8,310	9,587
2025-2029	47,390	42,405
2030-2034	58,530	31,274
2035-2039	76,230	15,124
2040-2044	20,335	4,612
2045-2047	34,900	857
	293,340	$ 146,552
Plus unamortized premiums	7,060	
	$ 300,400	

Note 6--Transactions with Other University of Michigan Units

ICA reimbursed the University for certain goods and services received in addition to making intra-University equity transfers during the years ended June 30, 2019 and 2018 as follows:

	2019	2018
	(in thousands)	
Financial Aid (Tuition and Housing)	$ 23,127	$ 22,249
Goods and Services:		
Utilities	3,654	3,789
Plant services	1,276	1,451
Technology/Telecommunications	1,279	1,089
Insurance coverage	1,101	913
Security	871	676
Medical services	829	736
Business and finance allocation	697	678
Budget administration allocation	566	540
Marching Band support	463	798
Other	968	984
Total Goods and Services	11,704	11,654
Equity Transfers:		
Television revenue sharing	5,795	5,503
Recreational Sports and Unions infrastructure renewal		3,600
Exercise & Sport Science Initiative	150	150
Recreational Sports transfer	75	75
Total Equity Transfers	6,020	9,328
	$ 40,851	$ 43,231

Note 6--Transactions with Other University of Michigan Units--Continued

The recurring allocation associated with the television distributions received from the Big Ten Conference, is based on an agreed upon amount and presented within transfers to other University departments, net.

In order to support the Recreational Sports and Unions infrastructure renewal financing plan, ICA has agreed to a commitment for annual payments of $1,800,000 for a period of 30 years.

During 2019 and 2018, ICA received $603,000 and $1,067,000, respectively, from the Michigan Matching Initiative for Student Support and the Bicentennial Matching Program, which offered an additional incentive for donors to establish or support endowed scholarship funds for undergraduate and graduate fellowships. Qualifying scholarship endowment gifts were matched at 25 percent for the Matching Initiative and 50 percent for the Bicentennial Matching Program.

Certain facilities used by ICA are located on land owned by the University which is not included in these financial statements. The University does not charge ICA rent for the use of this land.

Note 7--Postemployment Benefits

ICA participates in the University's postemployment benefits plan which provides retiree health and welfare benefits; primarily medical, prescription drug, dental and life insurance coverage, to eligible retirees and their eligible dependents. Substantially all of ICA's regular employees may become eligible for these benefits if they reach retirement age while working for ICA. For employees retiring on or after January 1, 1987, contributions toward health and welfare benefits are shared between ICA and the retiree and can vary based on date of hire, date of retirement, age and coverage elections.

The University also provides income replacement benefits, retirement savings contributions and health and life insurance benefits to substantially all regular ICA employees who are enrolled in a University sponsored long-term disability plan and qualify, based on disability status while working for ICA, to receive basic or expanded long-term disability benefits. Contributions toward the expanded long-term disability plan are shared between ICA and employees and vary based on years of service, annual base salary and coverage elections. Contributions toward the basic long-term disability plan are paid entirely by ICA.

These postemployment benefits are provided through single-employer plans administered by the University. The Executive Vice Presidents of the University have the authority to establish and amend benefit provisions of the plans.

Actuarial projections of postemployment benefits are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided and announced future changes at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

The University's recorded liability for postemployment benefits obligations was calculated using the entry age normal level percent of pay method. ICA's annual postemployment benefits expense and liability represents an allocation of ICA's relative share of the University's expense and liability, based on the method in which the retiree benefits are funded. The funding method is based upon a percentage of salary dollars of active employees that qualify for retiree benefits.

Note 7--Postemployment Benefits--Continued

Changes in the reported total liability for ICA's postemployment benefits obligations for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019		
	Retiree Health and Welfare	Long-term Disability (in thousands)	Total
Balance, beginning of year	$ 34,158	$ 1,073	$ 35,231
Net benefits expense	1,870	92	1,962
Decrease in deferred outflows	(247)	(17)	(264)
Increase in deferred inflows	(4,058)	(30)	(4,088)
Balance, end of year	31,723	1,118	32,841
Less current portion	739	109	848
	$ 30,984	$ 1,009	$ 31,993

	2018		
	Retiree Health and Welfare	Long-term Disability (in thousands)	Total
Balance, beginning of year	$ 34,002	$ 930	$ 34,932
Net benefits expense	2,559	40	2,599
Increase in deferred outflows	371	103	474
Increase in deferred inflows	(2,774)		(2,774)
Balance, end of year	34,158	1,073	35,231
Less current portion	799	118	917
	$ 33,359	$ 955	$ 34,314

At June 30, 2019, deferred outflows reported in the statement of net position include benefit payments made after the measurement date of $739,000. ICA has no obligation to make contributions in advance of when insurance premiums or claims are due for payment and currently pays for postemployment benefits on a pay-as-you-go basis. ICA's reported postemployment benefits obligations at June 30, 2019 and 2018, as a percentage of covered payroll of $53,681,000 and $51,913,000 were 61 and 68 percent, respectively.

Note 7--Postemployment Benefits--Continued

Significant actuarial assumptions used at the June 30, 2018 and 2017 measurement dates are as follows:

	2018	2017
Discount rate*	3.87%	3.58%
Inflation rate	2.00%	2.00%
Immediate/ultimate administrative trend rate	0.0%/3.0%	0.0%/3.0%
Immediate/ultimate medical trend rate	6.5%/4.5%	6.5%/4.5%
Immediate/ultimate Rx trend rate	9.0%/4.5%	9.5%/4.5%
Increase in compensation rate	4.00%	4.00%
Mortality table**	RP-2014 White Collar Head Count Table, Scale MP-2017	RP-2014 White Collar Head Count Table, Scale MP-2016
Average future work life expectancy (years):		
Retiree health and welfare	9.14	9.17
Long-term disability	11.47	11.43

* Bond Buyer 20-year General Obligation Municipal Bond Index as of the last publication of the measurement period
** Based on the University’s study of mortality experience from 2010-2014

Note 8--Retirement Plan

ICA participates in the University's retirement plan, a defined contribution retirement plan through TIAA and Fidelity Management Trust Company ("FMTC") mutual funds. All staff are eligible to participate in the plan based upon age and service requirements. Participants maintain individual contracts with TIAA, or accounts with FMTC, and are fully vested.

For payroll covered under the plan, eligible employees generally contribute 5 percent of their pay and ICA generally contributes an amount equal to 10 percent of employees' pay to the plan. ICA's contribution commences after an employee has completed one year of employment. Participants may elect to contribute additional amounts to the plan within specified limits that are not matched by ICA contributions. Contributions and covered payroll under the plan (excluding participant's additional contributions) for the years ended June 30, 2019 and 2018 are summarized as follows:

	2019	2018
	(in thousands)	
ICA contributions	$ 3,093	$ 2,772
Employee contributions	$ 1,614	$ 1,456
Payroll covered under plan	$ 53,681	$ 51,913
Total payroll	$ 58,468	$ 56,149

Note 9--Commitments and Contingencies

ICA's commitments to complete construction in progress and other authorized acquisitions of property, plant and equipment amounted to $40,541,000 at June 30, 2019, which will be funded with cash on hand, gifts and future borrowings.

THE VERITAS INSURANCE CORPORATION

FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2019 and 2018
with
REPORT OF INDEPENDENT AUDITORS

THE VERITAS INSURANCE CORPORATION

June 30, 2019 and 2018

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Report of Independent Auditors

To the Board of Directors of
The Veritas Insurance Corporation

We have audited the accompanying financial statements of The Veritas Insurance Corporation (the "Corporation"), a component unit of the University of Michigan, which comprise the statement of net position as of June 30, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

Auditors' Responsibility

Our responsibility is to express opinion on the 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 our 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, we consider internal control relevant to the Corporation'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 Corporation'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.

PricewaterhouseCoopers LLP, 185 Asylum Street, Suite 2400, Hartford, CT 06103-3404
T: (860) 241 7000, F: (860) 241 7590, www.pwc.com/us

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Veritas Insurance Corporation, a component unit of the University of Michigan, as of June 30, 2019 and 2018, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The accompanying management's discussion and analysis on pages 3 through 11 is required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 17, 2019

THE VERITAS INSURANCE CORPORATION

Management's Discussion and Analysis (Unaudited)

Introduction

The following discussion and analysis provides an overview of the financial position of The Veritas Insurance Corporation (the "Corporation") at June 30, 2019 and 2018 and its activities for the three fiscal years ended June 30, 2019. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Corporation, a wholly-owned subsidiary of the University of Michigan (the "University"), provides insurance coverage to the University. The University is the sole shareholder of the Corporation. As part of the University, the assets, liabilities, revenues, expenses and changes in net position of the Corporation are included in the consolidated financial statements of the University.

The Corporation provides direct insurance for medical professional liability, property damage, general liability (including hospital general liability) and educators' legal liability (including directors' and officers' liability). Indemnification is also provided for the University's workers' compensation and auto liability coverages.

The Corporation's insurance policies generally feature aggregate loss limits. For policies incepted in 2019 and 2018, the annual aggregate loss limits were $70 million and $50 million, respectively, for medical professional liability and $5 million for property damage. General liability, educators' legal liability and auto liability coverages were limited by a combined annual aggregate loss limit of $12 million in 2019 and $10 million in 2018.

In addition, the Corporation writes, on a direct basis, basket aggregate umbrella liability coverage. A portion of the basket aggregate umbrella liability program is reinsured by Munich Reinsurance America, Inc. The Corporation also wrote, on a direct basis, additional excess liability coverage for general liability and auto liability. This program was fully reinsured by Swiss Reinsurance Company until October 2018 when it was discontinued. Starting in 2019, the Corporation writes, on a direct basis, additional excess liability coverage for medical professional liability on a claims made basis. This policy is fully reinsured by Chubb/CNA and AXA XL.

Financial Highlights

For the year ended June 30, 2019, the Corporation's net position increased by $3.2 million to $52.5 million. Net investment gains increased net position by $12.2 million, while operating activities decreased net position by $9.0 million.

As a result of unfavorable loss experience, capital and surplus were not sufficient to provide premium credits in 2019.

Premium credits to be distributed at June 30 are as follows:

	2019	**2018** (in millions)	**2017**
Medical professional liability			$ 10.3
Educators' legal liability			2.4
Property damage			
General liability			
Hospital premises liability			0.1
Workers' compensation liability			2.2
Total premium credits	$ -	$ -	$ 15.0

Overview of the Financial Statements

The financial statements report information about the Corporation as a whole using accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board, which have also been used in the preparation of the Annual Statement filed with the Vermont Department of Financial Regulation. Financial statements include the Statement of Net Position, which provides information about the Corporation's financial condition at the end of the fiscal year; the Statement of Revenues, Expenses and Changes in Net Position, which presents information regarding the results of operations and changes in net position for the year; the Statement of Cash Flows, which displays information pertaining to cash receipts and disbursements during the year; and the notes to the financial statements. These statements collectively, and the discussion included herein, present the financial condition of the Corporation at June 30, 2019 and 2018, and its revenues, expenses and changes in net position and cash flows for the years then ended.

Statement of Net Position

The statement of net position presents the financial position of the Corporation at the end of the fiscal year and includes all assets and liabilities of the Corporation. The difference between total assets and total liabilities - net position - is one indicator of the current financial condition of the Corporation, while the change in net position is an indication of whether the overall financial condition has improved or worsened during the year. The Corporation's assets, liabilities and net position at June 30 are summarized as follows:

	2019	**2018** (in millions)	**2017**
Cash equivalents and investments	$ 226.4	$ 218.3	$ 217.3
Other assets	2.2	1.5	2.8
Total assets	228.6	219.8	220.1
Reserves for losses and loss adjustment expenses	169.7	164.8	143.4
Return premiums payable to affiliated units			15.0
Other liabilities	6.4	5.7	5.2
Total liabilities	176.1	170.5	163.6
Unrestricted net position	$ 52.5	$ 49.3	$ 56.5

The assets of the Corporation totaled $228.6 million at June 30, 2019, an increase of $8.8 million as compared to the prior year. The increase is primarily due to positive investment performance during the year and lower operating expenses compared to the prior year.

The major components of invested assets at June 30, 2019 were $250,000 in cash equivalents, $107.7 million in the University's Daily and Monthly Portfolios and $118.4 million in the University's Long Term Portfolio. The major components of invested assets at June 30, 2018 were $250,000 in cash equivalents, $102.7 million in the University's Daily and Monthly Portfolios and $115.3 million in the University's Long Term Portfolio. The asset allocations for both 2019 and 2018 are consistent with the asset allocation target ranges adopted by the Corporation's Board of Directors.

The major components of liabilities are reserves for losses and loss adjustment expenses ("LAE"). At June 30, 2019, reserves for losses and LAE totaled $169.7 million, an increase of $4.9 million, or 3.0 percent from the prior year. Of this amount, $53.1 million related to reserves on known claims and $116.6 million related to incurred but not reported reserves. The Corporation's reserves for losses and LAE are based upon management's best estimates, claim adjusters' determinations and actuarial valuations, discounted at a rate of 5 percent for both 2019 and 2018. The increase in reserves for losses and LAE is primarily due to higher losses incurred compared to payout of claims in 2019.

Management's Discussion and Analysis (Unaudited)--Continued

The activity in the reserves for losses and LAE for the years ended June 30 is summarized as follows:

	2019	2018 (in millions)	2017
Reserves for losses and LAE, beginning of year	$ 164.8	$ 143.4	$ 136.2
Less reinsurance recoverable on unpaid losses	1.1	1.0	1.1
Net reserves for losses and LAE, beginning of year	163.7	142.4	135.1
Incurred losses and LAE related to:			
Current year	53.0	48.4	44.0
Prior years	5.5	19.6	(7.5)
Total incurred losses and LAE	58.5	68.0	36.5
Total paid losses and LAE	(53.8)	(46.7)	(29.2)
Net reserves for losses and LAE, end of year	168.4	163.7	142.4
Reinsurance recoverable on unpaid losses	1.3	1.1	1.0
Reserves for losses and LAE, end of year	$ 169.7	$ 164.8	$ 143.4

Reserves for losses and LAE by line of business at June 30 are summarized as follows:

	2019	2018	2017
Medical professional liability	80.9%	78.4%	78.2%
Workers' compensation	8.6	9.4	10.0
Educators' legal liability	5.1	5.8	5.6
Property damage	2.6	3.6	3.8
Basket aggregate liability and excess insurance	1.4	1.3	1.3
Auto liability	0.5	0.5	0.5
General liability	0.8	0.9	0.4
Hospital premises liability	0.1	0.1	0.2
	100.0%	100.0%	100.0%

The Corporation may return funds to the University, its policyholder, for favorable loss experience and investment returns in the form of premium credits. The Corporation's Board of Directors declares premium credits based on unrestricted net position in excess of adopted goals. One-third of the excess net position is distributed as premium credits subject to an annual review. The premium credits are accrued on financial statements for the year in which they are declared, and paid to the University in the subsequent year's premium renewals as credits. No premium credits were declared during the years ended June 30, 2019 and 2018.

Net position is unrestricted and totaled $52.5 million and $49.3 million at June 30, 2019 and 2018, respectively. This is in excess of the $250,000 minimum unimpaired paid-in capital and surplus required by the state of Vermont. The increase in 2019 is due primarily to positive investment performance of $12.2 million offsetting an operating loss of $9.0 million.

The Corporation's net position distribution policy includes the potential for premium credits and allows for a one-time dividend when audited balances of net position are such that the reserve to net position ratio is lower than 2:1. All dividends are subject to approval by the Vermont Department of Financial Regulation.

Statement of Revenues, Expenses and Changes in Net Position

The Corporation's revenues, expenses and changes in net position for the years ended June 30 are summarized as follows:

	2019	**2018**	**2017**
		(in millions)	
Direct written premiums	$ 51.5	$ 44.1	$ 43.1
Change in unearned premiums	(0.7)		0.3
Returned premiums			(15.0)
Ceded written premiums expired	(1.0)	(1.0)	(1.0)
Total operating revenues	49.8	43.1	27.4
Losses and loss adjustment expenses	58.5	68.0	36.5
Other operating expenses	0.3	0.3	0.2
Total operating expenses	58.8	68.3	36.7
Operating loss	(9.0)	(25.2)	(9.3)
Nonoperating revenues	12.2	18.0	17.8
Increase (decrease) in net position	$ 3.2	$ (7.2)	$ 8.5

The Corporation's operating revenues totaled $49.8 million in 2019, compared to $43.1 million in 2018, an increase of $6.7 million, or 15.5 percent. The increase is primarily due to an increase in premiums written. The direct written premium contributions from the University are based on actuarially projected needs using loss data valued six to ten months prior to the inception of the policy. This loss data is adjusted for loss trend and exposure changes which include a factor for inflation. Based on these projections, the direct written premiums needed for 2019 were $7.4 million higher than 2018.

Returned premiums are the Corporation's declared premium credits, a distribution of unrestricted net position in excess of adopted goals. No premiums were returned in 2019 or 2018 due to unfavorable loss development in several programs.

Gross written premiums net of premium credits by line of business for the years ended June 30 are summarized as follows:

	2019	**2018**	**2017**
Medical professional liability	66.4%	64.4%	63.3%
Workers' compensation	10.7	12.0	13.1
Educators' legal liability	8.0	7.8	4.2
Property damage	9.2	9.9	13.5
Basket aggregate liability and excess insurance	3.5	2.7	4.3
Auto liability	1.5	2.3	1.2
General liability	0.5	0.6	0.4
Hospital premises liability	0.2	0.3	
	100.0%	100.0%	100.0%

Incurred losses and LAE for the years ended June 30 are summarized as follows:

	2019	**2018** (in millions)	**2017**
Incurred losses and LAE related to:			
Current year	$ 53.0	$ 48.4	$ 44.0
Prior years	5.5	19.6	(7.5)
Total incurred losses and LAE	$ 58.5	$ 68.0	$ 36.5

In 2019, total incurred losses and LAE decreased $9.5 million, or 14.0 percent, to $58.5 million. The decrease is primarily due to more favorable development than actuarially expected for prior year claims resulting in a decrease of $14.1 million in prior year incurred losses partially offset by an increase in current year losses of $4.6 million.

In 2019, unfavorable prior year loss development totaling $5.5 million is mainly attributable to Medical professional liability ("MPL"). For MPL, prior year ultimate losses increased by $7.1 million mainly due to an earlier than expected settlement of a large claim from policy year 2016/17. General liability losses increased by $1.4 million due to unfavorable development greater than actuarially expected for policy year 2015/16. Workers' compensation ("WC") losses increased by $0.5 million mainly due to earlier than expected settlements of claims from policy years 2015/16, 2016/17 and 2017/18. Property losses decreased by $3.6 million due to more favorable development than actuarially expected for policy year 2017/18. Other lines of business in aggregate saw unfavorable development of $0.1 million.

In 2018, unfavorable prior year loss development totaling $19.6 million is mainly attributable to unfavorable development in MPL. For MPL, prior year ultimate losses increased by $13.0 million mainly due to unfavorable development more than actuarially expected for policy years 2011/12, 2015/16 and 2016/17. Educators' legal liability losses increased by $5.2 million due to unfavorable development greater than actuarially expected for policy year 2016/17. General liability losses increased by $0.9 million due to unfavorable actuarial development greater than actuarially expected for policy year 2015/16. WC losses increased by $1.9 million due to unfavorable actuarial development. Property losses decreased by $1.5 million due to more favorable development than actuarially expected for policy year 2016/17. Other lines of business in aggregate saw unfavorable development of $0.1 million.

Nonoperating revenues, representing net investment income, decreased $5.8 million to $12.2 million in 2019, as compared to $18.0 million in 2018. This decrease was primarily a result of lower investment performance in the Daily and Monthly Portfolios and Long Term Portfolio compared to the prior year.

Statement of Cash Flows

The statement of cash flows provides additional information about the Corporation's financial results by reporting the major sources and uses of cash. The Corporation's cash flows for the years ended June 30 are summarized as follows:

	2019	**2018** (in millions)	**2017**
Cash received from operations	$ 51.5	$ 30.5	$ 30.8
Cash expended for operations	(55.6)	(47.5)	(30.6)
Net cash (used in) provided by operating activities	(4.1)	(17.0)	0.2
Net cash provided by (used in) investing activities	4.1	17.0	(0.2)
Net change in cash equivalents	$ -	$ -	$ -

The primary source of cash from operations is the collection of premiums. Premiums collected totaled $51.5 million, $29.1 million and $30.8 million in 2019, 2018 and 2017, respectively. The $21.0 million increase in cash received from operations in 2019 is primarily due to a $22.5 million increase in premiums collected. This increase was primarily due to no premium credits being declared in 2018.

Cash expended for operating activities, which primarily represents payment of losses and LAE, ceded reinsurance premiums and other underwriting expenses, totaled $55.6 million in 2019, as compared to $47.5 million in 2018. The increase in 2019 is due to increased payments for losses and LAE in the current year.

Cash provided by investing activities decreased $12.9 million in 2019, due primarily to a lower volume of investment sales over investment purchases compared to the prior year.

Economic Factors That May Affect the Future

The Corporation faces several factors which directly or indirectly affect its financial position and operations. State and Federal regulations relating to insurance liabilities could change. In addition, the insurance marketplace is competitive and the Corporation's ability to place coverage in the insurance market and purchase reinsurance may change.

The Corporation employs an investment strategy that balances asset allocation between current and noncurrent investments. Current assets are invested in the University's Daily and Monthly Portfolios, while noncurrent assets are invested in the University's Long Term Portfolio. The strategy seeks to maximize total return at the appropriate level of risk over a time horizon commensurate with payment patterns of the Corporation's loss retentions. However, investment results looking forward are subject to future market conditions and volatility.

The Corporation discounts reserves for losses based on expected investment returns and actuarially determined payment patterns. A discount rate of 5 percent was used for 2019, 2018 and 2017. This estimate may change based on periodic assessments of investment strategies, actual returns and future market conditions. Each year, the discount rate is reviewed with the Corporation's Board of Directors and the University's Treasurer's Office.

The Corporation acquires certain reinsurance and excess insurance coverage in the commercial market. In recent years, the Corporation has been able to access adequate levels of commercial reinsurance and excess insurance at moderate premium costs. However, insurance industry results due to underwriting performance, investment returns, and major accidents and disasters could impact the cost of, and the Corporation's value assessment of, commercial risk transfer options in the future.

THE VERITAS INSURANCE CORPORATION

Statement of Net Position

	June 30, 2019	June 30, 2018
Assets		
Current Assets:		
Cash equivalents	$ 250,000	$ 250,000
Investments on deposit with the University	107,724,603	102,723,605
Losses receivable from the University	134,331	14,330
Prepaid premium tax	11,596	10,539
Prepaid reinsurance premiums	763,765	319,417
Reinsurance recoverable on paid losses	185	12,961
Total Current Assets	108,884,480	103,330,852
Noncurrent Assets:		
Investments on deposit with the University	118,398,637	115,368,894
Reinsurance recoverable on unpaid losses	1,350,151	1,101,865
Total Noncurrent Assets	119,748,788	116,470,759
Total Assets	$ 228,633,268	$ 219,801,611
Liabilities and Net Position		
Current Liabilities:		
Reserves for losses and loss adjustment expenses	$ 48,102,244	$ 48,419,513
Unearned premium reserves	4,461,300	3,787,407
Premium tax payable	2,161	
Losses payable and accrued liabilities	1,921,578	1,815,471
Total Current Liabilities	54,487,283	54,022,391
Noncurrent Liabilities:		
Reserves for losses and loss adjustment expenses	121,645,147	116,412,754
Total Liabilities	176,132,430	170,435,145
Net Position:		
Unrestricted	52,500,838	49,366,466
Total Net Position	52,500,838	49,366,466
Total Liabilities and Net Position	$ 228,633,268	$ 219,801,611

The accompanying notes are an integral part of the financial statements.

THE VERITAS INSURANCE CORPORATION

Statement of Revenues, Expenses and Changes in Net Position

	Year Ended June 30, 2019	2018
Operating Revenues		
Gross direct written premiums	$ 51,565,500	$ 44,121,255
Change in unearned premiums	(673,893)	(41,675)
Total direct written premiums earned	50,891,607	44,079,580
Ceded written premiums	(1,009,250)	(958,255)
Change in prepaid reinsurance	(68,152)	2,675
Total ceded written premiums expired	(1,077,402)	(955,580)
Net earned premiums	49,814,205	43,124,000
Total Operating Revenues	49,814,205	43,124,000
Operating Expenses		
Losses and loss adjustment expenses	58,527,390	68,044,137
Management fees	58,671	59,202
Premium tax	155,242	142,240
Other expenses	127,391	121,926
Total Operating Expenses	58,868,694	68,367,505
Operating Loss	(9,054,489)	(25,243,505)
Nonoperating Revenues		
Net investment income	12,188,861	18,047,531
Total Nonoperating Revenues	12,188,861	18,047,531
Increase (Decrease) in Net Position	3,134,372	(7,195,974)
Net Position, Beginning of Year	49,366,466	56,562,440
Net Position, End of Year	$ 52,500,838	$ 49,366,466

The accompanying notes are an integral part of the financial statements.

THE VERITAS INSURANCE CORPORATION

Statement of Cash Flows

	Year Ended June 30, 2019	2018
Cash Flows from Operating Activities		
Insurance premiums collected, net	$ 51,565,500	$ 29,071,255
Payments for losses and loss adjustment expenses	(53,775,045)	(46,320,898)
(Payments) collections for losses recoverable	(107,225)	1,433,908
Payments for net ceded reinsurance premiums	(1,521,750)	(958,255)
Payments for other expenses	(162,470)	(165,128)
Payments for premium tax	(157,130)	(99,698)
Net Cash Used in Operating Activities	(4,158,120)	(17,038,816)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	127,999,286	89,391,094
Purchases of investments	(123,845,709)	(72,754,520)
Investment income	4,543	402,242
Net Cash Provided by Investing Activities	4,158,120	17,038,816
Net Change in Cash Equivalents	-	-
Cash Equivalents, Beginning of Year	250,000	250,000
Cash Equivalents, End of Year	$ 250,000	$ 250,000
Reconciliation of Operating Loss to Net Cash Used in Operating Activities:		
Operating loss	$ (9,054,489)	$ (25,243,505)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Changes in assets and liabilities:		
Losses receivable from the University	(120,001)	837,905
Premium tax recoverable		42,893
Prepaid premium tax	(1,057)	(351)
Prepaid reinsurance premiums	(444,348)	(2,675)
Reinsurance recoverable on paid losses	12,776	596,003
Reinsurance recoverable on unpaid losses	(248,286)	(133,465)
Reserves for losses and loss adjustment expenses	4,915,124	21,461,378
Return premiums payable to affiliated units		(15,050,000)
Unearned premium reserves	673,893	41,675
Premium tax payable	2,161	
Losses payable and accrued liabilities	106,107	411,326
Net Cash Used in Operating Activities	$ (4,158,120)	$ (17,038,816)

The accompanying notes are an integral part of the financial statements.

Note 1--Organization and Summary of Significant Accounting Policies

Organization and Basis of Presentation: The Veritas Insurance Corporation (the "Corporation"), domiciled in Vermont, is a wholly-owned captive insurance subsidiary of the University of Michigan (the "University"). The University is the sole shareholder of the Corporation. The Corporation is considered to be an integral part of the University. As a part of the University, the assets, liabilities, revenues, expenses and changes in net position of the Corporation are included in the consolidated financial statements of the University. As a wholly-owned subsidiary of the University, the Corporation is exempt from federal income taxes under the provisions of Sections 501(c)(3) and 115(a) of the Internal Revenue Code.

The Corporation provides direct insurance for medical professional liability, property damage, general liability (including hospital general liability) and educators' legal liability (including directors' and officers' liability). Indemnification is also provided for the University's workers' compensation and auto liability coverages.

The Corporation's insurance policies generally feature aggregate loss limits. For policies incepted in 2019 and 2018, the annual aggregate loss limits were $70,000,000 and $50,000,000, respectively, for medical professional liability and $5,000,000 for property damage. General liability, educators' legal liability and auto liability coverages were limited by a combined annual aggregate loss limit of $12,000,000 in 2019 and $10,000,000 in 2018. Starting in 2019, the Corporation writes, on a direct basis, additional excess liability coverage for medical professional liability on a claims made basis. This policy is fully reinsured by Chubb/CNA and AXA XL.

In addition, the Corporation writes, on a direct basis, basket aggregate umbrella liability coverage. A portion of the basket aggregate umbrella liability program is reinsured by Munich Reinsurance America, Inc. The Corporation also wrote, on a direct basis, additional excess liability coverage for general liability and auto liability. This program was fully reinsured by Swiss Reinsurance Company until October 2018 when it was discontinued. For insurance written and reinsurance ceded with a policy term different from the financial reporting period, unearned premium and prepaid reinsurance is recognized for the unexpired terms of the policies in force.

All coverages are provided on an occurrence basis with the exception of educators' legal liability and excess medical professional liability which are provided on a claims made basis.

The Corporation maintains $250,000 in cash equivalents to meet the state of Vermont's minimum unimpaired paid-in capital and surplus requirement for a single parent captive insurance company.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board ("GASB"), which have also been used in the preparation of the Annual Statement filed with the Vermont Department of Financial Regulation. The Corporation reports as a special purpose government entity engaged primarily in business type activities, as defined by GASB, on the accrual basis. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

Summary of Significant Accounting Policies: For purposes of the statement of cash flows, the Corporation considers all highly liquid investments purchased with a maturity of three months or less, to be cash equivalents.

Investments are reported in both the current and noncurrent sections of the statement of net position. Current investments are those funds invested in the University's Daily and Monthly Portfolios, and can be readily liquidated to pay contractual liabilities. Noncurrent investments are those funds invested in the University's Long Term Portfolio and are considered by management to be of a long duration.

Investments in marketable securities held indirectly through participation in the Daily and Monthly Portfolios and Long Term Portfolio are carried at fair value as established by the major securities markets. Purchases and sales of investments are accounted for on the trade date basis. Investment income is recorded on the accrual basis. Realized and unrealized gains and losses are reported in investment income.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

Investments in nonmarketable limited partnerships, held indirectly through participation in the Long Term Portfolio, are generally carried at fair value provided by the management of the investment partnerships at June 30, 2019 and 2018. As these investments are not readily marketable, the estimated value is subject to uncertainty, and therefore, may differ from the value that would have been used had a ready market for these investments existed.

Derivative instruments, such as financial futures, forward foreign exchange contracts and interest rate swaps held indirectly through participation in the Daily and Monthly Portfolios and Long Term Portfolio, are recorded on the contract date and are carried at fair value using listed price quotations or amounts that approximate fair value. Investments in the Long Term Portfolio denominated in foreign currencies are translated into U.S. dollar equivalents using year-end spot foreign currency exchange rates. Purchases and sales of investments denominated in foreign currencies and related income are translated at the spot exchange rate on the transaction dates.

The reserves for losses and loss adjustment expenses (“LAE”) are reported gross of reinsurance and include case basis estimates of reported losses, plus supplemental amounts related to incurred but not reported losses. The reserves are based upon management’s best estimate, which includes claim adjusters’ valuations and actuarial determinations, and are discounted to present value. The interest rate used to discount reserves at both June 30, 2019 and 2018 was 5 percent, which reflects management’s best estimate of the total portfolio rate of return. Future adjustments to these amounts resulting from the continuous review process, as well as differences between estimates and ultimate losses, will be reflected in the statement of revenues, expenses and changes in net position when such adjustments become known.

In the normal course of business, the Corporation seeks to reduce the losses that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Ceded written premiums are recognized pro-rata over the term of the underlying reinsurance policy. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Amounts recoverable from reinsurers for losses paid by the Corporation as of the statement of net position date are recorded as a current asset. Estimated amounts recoverable from reinsurers related to noncurrent reserves for losses are recorded as a noncurrent asset. The Corporation is contingently liable should the reinsurers become unable to meet their contractual obligations.

Note 1--Organization and Summary of Significant Accounting Policies--Continued

The Corporation's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net position are those that generally result from the exchange of premiums and payment of claims.

Premiums are earned and reinsurance premiums are expensed on a monthly pro-rata basis over the terms of the underlying insurance policies. Unearned premium reserves and prepaid reinsurance premiums represent that portion of premiums written or ceded applicable to the unexpired terms of the policies in force.

Premium taxes are expensed over the terms of the policies to which they relate. Accordingly, prepaid premium tax is established for the portion of those premium taxes applicable to the unexpired period of the policies in force.

The Corporation distributes, in the form of returned premium credits, unrestricted net position in excess of adopted goals. One-third of the excess net position is distributed as premium credits subject to an annual review. The distribution policy includes guidelines for declaring dividends, which allows for a one-time dividend when audited balances of net position are such that the reserve to net position ratio is lower than 2:1. All premium credits and dividend declarations are at the discretion of the Board of Directors (the "Board") and dividends are subject to prior approval from the Vermont Department of Financial Regulation. There were no premium credits declared in 2019 or 2018.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates. The most significant areas that require management estimates relate to the reserves for losses and LAE.

Note 2--Cash Equivalents and Investments

The Board has adopted an asset allocation target range of 45-55 percent to cash equivalents and fixed income securities and 45-55 percent to equity-oriented strategies, with $250,000 to be maintained in cash equivalents to meet the state of Vermont's minimum unimpaired paid-in capital and surplus requirement.

Cash equivalents and investments of the Corporation are invested in the University's centrally managed investment pools. Cash reserves and relatively short duration assets are invested in the University's Daily and Monthly Portfolios, while longer term assets are invested in the University's Long Term Portfolio. The Daily and Monthly Portfolios are principally invested in investment-grade money market securities, U.S. government and other fixed income securities and absolute return strategies. The longer investment horizon of the Long Term Portfolio allows for an equity-oriented strategy to achieve higher expected returns over time, and permits the use of less liquid alternative investments, providing for equity diversification beyond the stock markets.

The Corporation's cash equivalents and investments on deposit with the University at June 30, 2019 and 2018 are summarized as follows:

	Amortized Cost	Unrealized Gains	Fair Value
2019			
Cash equivalents	$ 250,000		$ 250,000
Daily and Monthly Portfolios	98,915,573	$ 8,809,030	107,724,603
Long Term Portfolio	102,159,178	16,239,459	118,398,637
	$ 201,324,751	$ 25,048,489	$ 226,373,240
2018			
Cash equivalents	$ 250,000		$ 250,000
Daily and Monthly Portfolios	94,402,631	$ 8,320,974	102,723,605
Long Term Portfolio	96,864,360	18,504,534	115,368,894
	$ 191,516,991	$ 26,825,508	$ 218,342,499

Note 2--Cash Equivalents and Investments--Continued

At June 30, 2019 and 2018, the Daily and Monthly Portfolios were comprised of 20 percent and 5 percent money market securities, 42 percent and 60 percent fixed income securities and the remaining 38 percent and 35 percent in fixed income oriented externally managed commingled funds, limited partnerships and other investments providing additional diversification benefits to the pools. Money market securities include mutual funds, overnight pooled vehicles managed by the University's custodian and short term highly liquid securities generally maturing in 90 days or less. Of the fixed income securities, 95 percent were rated investment grade, and 59 percent consisted of U.S. Treasury and government agencies and non-U.S. government securities rated AAA/Aaa at June 30, 2019, compared to 96 percent and 55 percent, respectively, at June 30, 2018. Fixed income securities considered investment grade are those rated at least BBB and Baa by two nationally recognized statistical rating organizations, S&P Global and Moody's.

Effective duration is a commonly used measure of interest rate risk, incorporating a security's yield, coupon, final maturity, call features and other embedded options into one number expressed in years that indicates how price-sensitive a security or portfolio of securities is to changes in interest rates. This measure indicates the approximate percentage change in fair value expected for a one percent change in interest rates. The weighted average effective duration of the fixed income securities in the Daily and Monthly Portfolios was 0.7 years and 1.1 years at June 30, 2019 and 2018, respectively.

The University's investment policies are governed and authorized by University Bylaws and the Board of Regents. The approved asset allocation policy for the Long Term Portfolio sets general targets for both equities and fixed income securities. Since diversification is a fundamental risk management strategy, the Long Term Portfolio is more broadly diversified within these general categories. At June 30, 2019 and 2018, the Long Term Portfolio consisted of cash and equivalents (1 percent and 2 percent), fixed income securities (4 percent and 6 percent), U.S. and non-U.S. equities (9 percent and 10 percent), commingled funds (25 percent and 21 percent) and nonmarketable alternative investments (61 percent and 61 percent).

Commingled (pooled) funds held in the Long Term Portfolio and Monthly Portfolio include Securities and Exchange Commission regulated mutual funds and externally managed funds, limited partnerships and corporate structures which are generally unrated and unregulated. Commingled funds have liquidity (redemption) provisions, which enable the University to make full or partial withdrawals with notice, subject to restrictions on the timing and amount. Commingled funds are primarily invested in non-U.S./global equities and absolute return strategies, but also include exposure to domestic fixed income and equity securities. Certain commingled funds may use derivatives, short positions and leverage as part of their investment strategy; however, these investments are structured to limit the University's risk exposure to the amount of invested capital.

Note 2--Cash Equivalents and Investments--Continued

Nonmarketable alternative investments held in the Long Term Portfolio and Monthly Portfolio consist of limited partnerships and similar vehicles involving an advance commitment of capital called by the general partner as needed and distributions of capital and return on invested capital as underlying strategies are concluded during the life of the partnership. These limited partnerships include venture capital, private equity, real estate, natural resources and absolute return strategies. There is not an active secondary market for these alternative investments, which are generally unrated and unregulated, and the liquidity of these investments is dependent on actions taken by the general partner.

The Long Term Portfolio holds investments denominated in foreign currencies and forward foreign exchange contracts used to manage the risk related to fluctuations in currency exchange rates between the time of purchase or sale and the actual settlement of foreign securities. Various investment managers acting for the University also use forward foreign exchange contracts in risk-based transactions to carry out their portfolio strategies. Foreign exchange risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. The Long Term Portfolio’s non-U.S. dollar exposure amounted to 11 percent and 10 percent of the portfolio at June 30, 2019 and 2018, respectively.

The University’s investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts recorded in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forwards, futures and commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counterparty to perform according to the terms of the contract. The University’s risk of loss in the event of a counterparty default is typically limited to the amounts recognized in the statement of net position and is not represented by the contract or notional amounts of the instruments.

Note 2--Cash Equivalents and Investments--Continued

GASB defines fair value and establishes a framework for measuring fair value that includes a three tiered hierarchy of valuation inputs, placing a priority on those which are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The three levels of inputs, of which the first two are considered observable and the last unobservable, are as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date
- Level 2 - Other significant observable inputs, either direct or indirect, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable; or market corroborated inputs
- Level 3 - Unobservable inputs

A significant portion of the underlying investments of the University's commingled pools include nonmarketable alternative investments and certain commingled funds described earlier in this note that are priced by managers using net asset value. The proprietary valuation techniques and unobservable pricing assumptions used by these managers to estimate fair value may have a significant impact on the resulting fair value determination of these investments. However, the Corporation uses Level 2 inputs to measure the fair value of its investments in the University's commingled pools, since shares may be purchased or sold subject to holding and notice requirements at the fair market values determined by the University.

Note 3--Reserves for Losses and Loss Adjustment Expenses

Activity in the reserves for losses and LAE for the years ended June 30, 2019 and 2018 is summarized as follows:

	2019	2018
Reserves for losses and LAE, beginning of year	$ 164,832,267	$ 143,370,889
Less reinsurance recoverable on unpaid losses	1,101,865	968,400
Net reserves for losses and LAE, beginning of year	163,730,402	142,402,489
Add incurred losses and LAE related to:		
Current year	53,035,364	48,443,147
Prior years	5,492,026	19,600,990
Total incurred losses and LAE	58,527,390	68,044,137
Less paid losses and LAE related to:		
Current year	4,507,178	3,594,766
Prior years	49,353,374	43,121,458
Total paid losses and LAE	53,860,552	46,716,224
Net reserves for losses and LAE, end of year	168,397,240	163,730,402
Reinsurance recoverable on unpaid losses	1,350,151	1,101,865
Reserves for losses and LAE, end of year	169,747,391	164,832,267
Less current portion	48,102,244	48,419,513
	$ 121,645,147	$ 116,412,754

The liabilities for losses and LAE reserves are determined by actuarial estimates of ultimate reported losses based upon the Corporation’s historical and industry loss experience.

Note 3--Reserves for Losses and Loss Adjustment Expenses--Continued

The payment pattern utilized for loss reserve discounting purposes has been actuarially determined. The effects of the practice of discounting reserves have been to reduce liabilities and increase unrestricted net position by $23,795,004 and $22,299,620 at June 30, 2019 and 2018, respectively.

In 2019, incurred losses and LAE related to policies incepted during the year increased $4,592,217. Incurred losses and LAE related to prior years totaled $5,492,026 due to net unfavorable loss development. Medical professional liability increased $7,098,538, general liability increased $1,412,327 and workers' compensation increased $543,661, which was offset by a property damage decrease of $3,626,278. The remaining lines of coverage provided combined unfavorable development of $63,778. The net unfavorable development is primarily due to claims experience reporting higher than previously projected for recent prior policy years.

In 2018, incurred losses and LAE related to policies incepted during the year increased $4,452,142. Incurred losses and LAE related to prior years totaled $19,600,990 due to net unfavorable loss development. Medical professional liability increased $13,044,373, educators' legal liability increased $5,248,296 general liability increased $880,455 and workers' compensation increased $1,904,545, which was offset by a property damage decrease of $1,520,420. The remaining lines of coverage provided combined unfavorable development of $43,741. The net unfavorable development is primarily due to claims experience reporting higher than previously projected for recent prior policy years.

Note 4--Transactions with the University of Michigan

All premiums written and losses and loss adjustment expenses incurred result from insurance coverage written with the University.

For the years ended June 30, 2019 and 2018, the University provided claims administration and risk management services, with an estimated value of $8,514,000 and $7,790,000, respectively, at no cost to the Corporation.

The University contracts with a qualified risk consultant for actuarial services to assist in the projection and valuation of the Corporation's losses. The University also contracts for insurance brokerage services which assist the Corporation in placing ceded reinsurance in the commercial market. Fees paid for actuarial and brokerage services are included in the risk management services provided by the University, at no cost to the Corporation.

Note 5--Unrestricted Net Position

The Corporation is required to file an Annual Statement with the Vermont Department of Financial Regulation. There were no differences in net position and changes in net position between the audited financial statements and the Annual Statement for the years ended June 30, 2019 and 2018.

Unrestricted net position at June 30, 2019 and 2018 is summarized as follows:

	2019	**2018**
Common stock, par value $1,000 per share - authorized, issued and outstanding 1,000 shares	$ 1,000,000	$ 1,000,000
Additional paid-in capital	4,454,333	4,454,333
Retained earnings	47,046,505	43,912,133
	$ 52,500,838	$ 49,366,466