UNIVERSITY OF PITTSBURGH

FINANCIAL REPORT

FISCAL YEAR 2014

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

Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of the University of Pittsburgh – Of the Commonwealth System of Higher Education (the University), which comprise the consolidated balance sheets as of June 30, 2014 and 2013, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of the University of Pittsburgh – Of the Commonwealth System of Higher Education as of June 30, 2014 and 2013, and the changes in their net assets and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Pittsburgh, Pennsylvania
September 29, 2014

UNIVERSITY OF PITTSBURGH
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2014 AND 2013
(in thousands of dollars)

	2014	2013
ASSETS:		
Cash and cash equivalents *(Notes 1 and 5)*	$ 60,831	$ 196,807
Operating investments *(Notes 4 and 5)*	539,378	407,586
Inventories and deferred charges	23,745	22,700
Accounts and notes receivable, net *(Note 2)*	160,875	160,053
Contributions receivable, net *(Note 3)*	34,336	32,857
Student loans receivable, net	47,485	48,569
Deposits of bond and note proceeds *(Notes 1 and 5)*	-	90,403
Foundation assets *(Note 1)*	26,006	22,726
Endowment investments *(Notes 4 and 5)*	3,514,183	2,994,207
Endowed funds held by third parties *(Note 5)*	22,714	19,954
Property, plant, and equipment, net *(Note 6)*	1,795,335	1,788,475
TOTAL ASSETS	$ 6,224,888	$ 5,784,337
LIABILITIES:		
Accounts payable and accrued expenses	$ 100,952	$ 103,358
Accrued payroll and related liabilities	70,344	75,008
Deferred student and other revenue	42,638	43,775
Advanced receipt of grant funds	63,768	71,582
Refundable U.S. government student loans	33,280	32,928
Other liabilities *(Notes 5 and 9)*	107,982	103,685
Pension and postretirement obligations *(Note 10)*	444,025	406,825
Conditional asset remediation obligation *(Note 7)*	40,929	40,571
Bonds and notes payable *(Note 8)*	947,631	1,103,491
TOTAL LIABILITIES	1,851,549	1,981,223
NET ASSETS:		
Unrestricted *(Notes 1 and 11)*	2,876,556	2,506,552
Temporarily restricted *(Notes 1 and 11)*	848,626	674,134
Permanently restricted *(Notes 1 and 11)*	648,157	622,428
TOTAL NET ASSETS	4,373,339	3,803,114
TOTAL LIABILITIES AND NET ASSETS	$ 6,224,888	$ 5,784,337

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

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2014
COMPARED TO SUMMARY INFORMATION FOR THE YEAR ENDED JUNE 30, 2013
(in thousands of dollars)

	2014				
OPERATING REVENUES:	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	2013
Tuition and fees	$ 724,080	$ -	$ -	$ 724,080	$ 703,914
Tuition discounts	(162,642)	-	-	(162,642)	(158,216)
Net tuition and fees	561,438	-	-	561,438	545,698
Commonwealth appropriation	147,797	-	-	147,797	144,308
Commonwealth construction grants	40,392	-	-	40,392	43,996
Grants and contracts	693,526	-	-	693,526	738,502
Grants and contracts – ARRA	4,051	-	-	4,051	20,890
Contributions for operations	35,923	11,124	-	47,047	37,359
Investment income – operating investments	5,618	-	-	5,618	8,532
Endowment distributions for operations	96,629	-	-	96,629	87,513
Sales and services, educational and other	161,785	-	-	161,785	143,042
Sales and services, auxiliary	140,189	-	-	140,189	132,565
Rental revenue	17,780	-	-	17,780	18,353
Other	89,601	-	-	89,601	65,073
Net assets released from restrictions	12,633	(12,633)	-	-	-
Total operating revenues	2,007,362	(1,509)	-	2,005,853	1,985,831
OPERATING EXPENSES:					
Salaries and wages	866,178	-	-	866,178	867,745
Fringe benefits	255,279	-	-	255,279	264,221
Total compensation	1,121,457	-	-	1,121,457	1,131,966
Supplies	101,930	-	-	101,930	107,384
Business and professional	298,161	-	-	298,161	297,487
Utilities	48,719	-	-	48,719	47,093
Maintenance and facilities	44,046	-	-	44,046	43,248
Depreciation	159,266	-	-	159,266	151,542
Interest	42,559	-	-	42,559	44,784
Other	64,954	-	-	64,954	57,216
Total operating expenses ***(Note 12)***	1,881,092	-	-	1,881,092	1,880,720
Change in net assets from operating activities	126,270	(1,509)	-	124,761	105,111
OTHER ACTIVITIES:					
Investment gains, net of endowment distributions for operations	268,595	176,001	1,974	446,570	187,018
Contributions for endowment	-	-	23,755	23,755	26,015
Change in fair value of interest rate swaps	(1,343)	-	-	(1,343)	41,166
Nonperiodic changes in benefit plans *(Note 10)*	(23,518)	-	-	(23,518)	43,398
Total other activities	243,734	176,001	25,729	445,464	297,597
CHANGE IN NET ASSETS	370,004	174,492	25,729	570,225	402,708
NET ASSETS, BEGINNING OF YEAR	2,506,552	674,134	622,428	3,803,114	3,400,406
NET ASSETS, END OF YEAR	$ 2,876,556	$ 848,626	$ 648,157	$ 4,373,339	$ 3,803,114

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

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2013
(in thousands of dollars)

	2013			
OPERATING REVENUES:	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Tuition and fees	$ 703,914	$ -	$ -	$ 703,914
Tuition discounts	(158,216)	-	-	(158,216)
Net tuition and fees	545,698	-	-	545,698
Commonwealth appropriation	144,308	-	-	144,308
Commonwealth construction grants	43,996	-	-	43,996
Grants and contracts	738,502	-	-	738,502
Grants and contracts – ARRA	20,890	-	-	20,890
Contributions for operations	31,967	5,392	-	37,359
Investment income – operating investments	8,532	-	-	8,532
Endowment distributions for operations	87,513	-	-	87,513
Sales and services, educational and other	143,042	-	-	143,042
Sales and services, auxiliary	132,565	-	-	132,565
Rental revenue	18,353	-	-	18,353
Other	65,073	-	-	65,073
Net assets released from restrictions	19,687	(19,687)	-	-
Total operating revenues	2,000,126	(14,295)	-	1,985,831
OPERATING EXPENSES:				
Salaries and wages	867,745	-	-	867,745
Fringe benefits	264,221	-	-	264,221
Total compensation	1,131,966	-	-	1,131,966
Supplies	107,384	-	-	107,384
Business and professional	297,487	-	-	297,487
Utilities	47,093	-	-	47,093
Maintenance and facilities	43,248	-	-	43,248
Depreciation	151,542	-	-	151,542
Interest	44,784	-	-	44,784
Other	57,216	-	-	57,216
Total operating expenses ***(Note 12)***	1,880,720	-	-	1,880,720
Change in net assets from operating activities	119,406	(14,295)	-	105,111
OTHER ACTIVITIES:				
Investment gains, net of endowment distributions for operations	118,481	65,800	2,737	187,018
Contributions for endowment	-	-	26,015	26,015
Change in fair value of interest rate swaps	41,166	-	-	41,166
Nonperiodic changes in benefit plans *(Note 10)*	43,398	-	-	43,398
Total other activities	203,045	65,800	28,752	297,597
CHANGE IN NET ASSETS	322,451	51,505	28,752	402,708
NET ASSETS, BEGINNING OF YEAR	2,184,101	622,629	593,676	3,400,406
NET ASSETS, END OF YEAR	$ 2,506,552	$ 674,134	$ 622,428	$ 3,803,114

UNIVERSITY OF PITTSBURGH
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013
(in thousands of dollars)

	2014	2013
CASH AND EQUIVALENTS:		
End of year	$ 60,831	$ 196,807
Beginning of year	196,807	47,751
CHANGE IN CASH AND CASH EQUIVALENTS	$ (135,976)	$ 149,056
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ 570,225	$ 402,708
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	159,266	151,542
Net bond premium amortization	(5,460)	(5,961)
Loss on disposal of plant assets	2,316	3,814
Investment gains	(506,852)	(245,311)
Change in fair value of interest rate swaps	1,343	(41,166)
Contributions restricted for long-term investment	(69,647)	(87,130)
Changes in operating assets and liabilities:		
Accounts, notes, contributions, and loans receivable, net	(1,217)	24,006
Other assets	(1,045)	(714)
Accounts payable and accrued expenses	(1,421)	442
Pension and postretirement obligations	37,200	(25,132)
Conditional asset remediation obligation	358	(375)
Other liabilities	(1,710)	2,191
Government student loans and deferred revenue	(8,599)	(4,942)
Net cash provided by operating activities	174,757	173,972
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expended for property, plant, and equipment - University	(128,050)	(184,104)
Expended for property, plant, and equipment - commonwealth	(40,392)	(43,996)
Change in accounts payable for property, plant, and equipment	(985)	2,606
Purchases/sales of operating investments, net	(131,355)	218,145
Purchases of endowment investments	(1,061,112)	(1,352,853)
Proceeds from sales/maturities of endowment investments	1,045,331	1,239,205
Change in endowed funds held by third parties, excluding gains	(540)	14
Change in foundation assets	(3,280)	(1,492)
Net cash used for investing activities	(320,383)	(122,475)
CASH FLOW FROM FINANCING ACTIVITIES:		
Principal repayment of debt	(150,400)	(30,000)
Proceeds from issuance of debt	-	122,318
Change in deposits of bond and note proceeds	90,403	(81,889)
Contributions restricted for long-term investment	69,647	87,130
Net cash provided by financing activities	9,650	97,559
CHANGE IN CASH AND CASH EQUIVALENTS	$ (135,976)	$ 149,056
Supplemental disclosure of cash flow information:		
Cash paid for interest (excluding fees)	$ 50,279	$ 51,117
Noncash investing activity for property, plant, and equipment-accounts payable	$ 33,801	$ 34,786

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING PRACTICES

Organization

Founded in 1787, the University of Pittsburgh of the Commonwealth System of Higher Education (the University) is an institution of higher education with a three-pronged mission to provide the highest-quality instruction for its students, engage in innovative research activities, and support the state and local community through public service programs. In its 227 year history, the University has evolved into an internationally recognized center of learning and research. The University's main campus in the City of Pittsburgh is comprised of 16 schools and several academic centers educating nearly 29,000 students in various undergraduate, graduate, and doctorate-professional programs. Four regional campuses with a total enrollment approximating 6,400 students are located throughout western Pennsylvania.

Relationship with the Commonwealth of Pennsylvania

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

The entire management, control, and conduct of the instructional, administrative, and financial affairs of the University are vested in the Board of Trustees. The Board of Trustees is composed of fifty-two members (thirty-six voting members), including twelve commonwealth trustees and sixteen special trustees elected by the board. Special trustees may attend all meetings of the board and are entitled to and exercise all rights, responsibilities, and privileges of trusteeship, except the right to vote at board meetings.

As a state-related institution, the University receives an annual operating appropriation from the commonwealth. The appropriation is subject to the commonwealth's annual budget process. There is no assurance that such appropriation will continue to be made, or will be made, at current levels or at levels requested by the University. The appropriation from the commonwealth was $147.8 million in 2014 and $144.3 million in 2013. In addition to the annual appropriation, the commonwealth also funds certain capital projects in support of the University's mission. Amounts funded by the commonwealth for capital projects were $40.4 million in 2014 and $44.0 million in 2013.

Basis of Presentation

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

The other activities section of the Consolidated Statements of Activities includes investment gains, net of endowment distributions for operations; contributions for endowment; changes in fair value of interest rate swaps; and nonperiodic changes in pension and postretirement benefit plans. Endowment distributions for operations represent endowment income distributions not reinvested in the endowment (see Note 11).

Basis of Accounting

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

In accordance with GAAP, the University's net assets have been classified as unrestricted, temporarily restricted, or permanently restricted based upon the existence or absence of donor-imposed restrictions. Unrestricted net assets are not subject to donor-imposed restrictions and are used for general operating purposes of the University. This class of net assets also includes certain contributions and endowment earnings whose donor-imposed restrictions have been met within the fiscal year. Temporarily restricted net assets are subject to certain time or purpose restrictions by the donor. Upon satisfaction of these restrictions, the net assets are transferred to unrestricted. Amounts released from restrictions in 2014 and 2013 relate primarily to cash collections on pledges where purpose restrictions had already been met. Temporarily restricted net assets at June 30, 2014 and 2013 consist of endowment balances ($824.7 million and $648.9 million, respectively); the net present value of temporarily restricted contributions and unconditional pledges ($19.0 million and $20.6 million, respectively); and split-interest agreements ($4.9 million and $4.6 million, respectively). Permanently restricted net assets are those subject to permanent donor-imposed restrictions and at June 30, 2014 and 2013 consist of endowment balances ($620.5 million and $597.5 million, respectively); the net present value of permanently restricted contributions and unconditional pledges ($15.3 million and $12.8 million, respectively); and private student loan funds ($12.4 million and $12.1 million, respectively).

Donor-restricted endowed contributions require that the original corpus of the contributions be maintained in perpetuity. The distributions from earnings generated by these contributions may be either expended or reinvested in the endowment, in accordance with donor restrictions and contribution and spending policies (see Note 11).

Estimates

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

Revenue Recognition

Revenue for programs or activities to be conducted in future periods such as student tuition and room and board are classified as deferred revenue. Revenue for these activities is recognized as services are provided. Advanced receipt of exchange transactions such as grants and contracts are also classified as deferred revenue, with revenue being recognized as funds are expended and sponsored programs are executed.

Tuition discounts are recorded to the extent that either institutional financial aid or aid funded by contributions, endowment distributions, and grant activities are awarded. Tuition discounts attributable to institutional funds in 2014 and 2013 were $138.8 million and $136.9 million, respectively. Tuition discounts attributable to contributions, endowment distributions, and grant activities in 2014 and 2013 were $23.8 million and $21.3 million, respectively.

Cash and Cash Equivalents and Operating Investments

Cash equivalents consist of operating investments with original maturities of 90 days or less. Operating investments include Treasury instruments and other high quality, liquid securities that at the time of purchase are rated A3/P-1 or better by Moody’s Investors Service or A-/A-1 or better by Standard & Poor’s Ratings Services. Operating investments, together with cash, are utilized to fund the University’s short-term operating needs and are invested with the expectation that such securities can be liquidated at their current value within a 7-day period. Cash and cash equivalents that are part of endowment investments are shown therewith, as such funds are utilized for endowment purposes rather than University operating needs.

Allowance for Doubtful Accounts

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

Contributions

The University records at fair value unconditional pledges (which are agreements with donors involving non-reciprocal transfers of cash or other assets) as either temporarily restricted or permanently restricted contributions dependent upon the nature of the donor-imposed restrictions. Contributions whose restrictions are met in the same fiscal year as receipt are combined and reported with unrestricted contributions. Contributions receivable (classified as Level 3 in the fair value hierarchy) are discounted at a risk-adjusted rate commensurate with the donor’s payment plan.

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

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

Deposits of Bond and Note Proceeds
Deposits of bond and note proceeds consist of unspent funds which will be used for certain capital projects and for repayment of certain debt obligations. These funds are invested in cash, cash equivalents, and U.S. Treasury securities and are reported on the Consolidated Balance Sheets at fair value.

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

Endowment Investments
The University's endowment investments are reported at fair value. The fair value of direct University holdings in publicly traded securities is based upon quoted market prices. The fair value of all other investments, which consist of indirect holdings in both privately and publicly traded assets, is determined using net asset value (NAV) per share or unit of interest. Used as a practical expedient for the estimated fair value, NAV per share or its equivalent is provided by the fund manager and reviewed by the University. Indirect holdings of private assets primarily consist of University interests in funds investing in nonmarketable alternatives, real assets, and/or distressed securities, whereas indirect holdings of publicly traded assets primarily consist of University interests in marketable alternatives or other commingled funds.

Nonmarketable alternatives are private equity or equity-like holdings, such as mezzanine and subordinated debt interests, in venture, buyout, or recapitalized companies or properties. Real assets are physical assets, or financial assets associated with such physical assets, whose income streams and/or fair values tend to rise with inflation; they include real estate, natural resources, commodities, and other hard assets. Marketable alternatives consist of distressed debt and hedging strategies, including event-driven hedging strategies, such as merger or credit arbitrage, and value-driven hedging strategies, such as long/short, market neutral, and other hedging strategies.

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

Fair Value Measurements
As of June 30, 2014 and 2013, the carrying values of the University's inventories and deferred charges, accounts and notes receivable, contributions receivable, accounts payable, accrued expenses, and deferred student and other revenue approximate their fair values because of the terms and relatively short maturity. An estimate of the fair value of student loan receivables administered by the University under federal government loan programs is not practical because the receivables can only be assigned to the United States government or its designees.

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

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.

- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 – Unobservable inputs for the asset or liability that are used to measure fair value when observable inputs are not available. These inputs are developed based upon the best information available in such circumstances.

University investments for which NAV is used as a practical expedient to estimate fair value are classified as either Level 2 or 3 assets in the fair value hierarchy, depending on the University's ability to redeem its interest in the fund. If the University's interest can be redeemed without penalty within the near term (generally within 90 days of June 30), the University's interest in the fund is classified as a Level 2 investment, otherwise, the University's interest is classified as a Level 3 investment.

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

Derivative Financial Instruments
The University records derivatives at fair value on the Consolidated Balance Sheets with changes in fair value reflected in the Consolidated Statements of Activities (see Note 9).

Split-Interest Agreements
These agreements with donors consist primarily of charitable gift annuities, pooled income funds, and irrevocable charitable remainder trusts for which the University serves as trustee. Assets are invested and payments are made to donors and/or other beneficiaries in accordance with the respective agreements. Other liabilities include $9.5 million and $9.0 million at June 30, 2014 and 2013, respectively, for split-interest agreements.

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

Insurance Liabilities
The University is self-insured through an agreement with UPMC to provide medical coverage for its employees. A liability for estimated incurred but unreported claims of $6.2 million and $7.4 million has been recorded at June 30, 2014 and 2013, respectively, based upon management's analysis of claims history. This liability is reflected in accrued payroll and related liabilities on the Consolidated Balance Sheets.

The University is also self-insured for certain other activities, including workers' compensation, unemployment compensation, and litigation claims. Liabilities have been established for these programs generally based on third-party administrators' estimates using the University's historical loss experience. The self-insurance accrual is subject to periodic adjustment by the University based on actual loss experience factors. Liabilities for these other self-insured obligations aggregated $9.3 million and $9.5 million at June 30, 2014 and 2013, respectively, and are included in accrued payroll and related liabilities on the Consolidated Balance Sheets.

Grants and Contracts
The University conducts sponsored program activity with various sponsors, including agencies and departments of the federal government, the commonwealth, local government entities, companies, and foundations. Sponsored activity in 2014 and 2013 was $697.6 million and $759.4 million, respectively, with approximately 61% of the funding awarded through the National Institutes of Health. Grants and contracts – ARRA represents funding received through the American Recovery and Reinvestment Act of 2009. Most University sponsored activity is conducted on a cost reimbursable basis with the University receiving funding after the related expenses have been incurred. Certain sponsors, however, provide funding in advance of related expenses, and such funding is recorded as advanced receipt of grant funds on the Consolidated Balance Sheets. Revenue from sponsored awards is recognized as the related expenses are incurred. There is no assurance that sponsored awards will continue to be made at current levels.

The University incurs both direct and indirect costs in the conduct of its sponsored activity. Recovery of indirect costs through federal awards is based upon predetermined rates negotiated with the Department of Health and Human Services. Indirect cost recovery rates from nonfederal sources may vary. Funds received through federal sources are subject to audit each year in accordance with the Office of Management and Budget Circular A-133.

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

Tax-Exempt Status
The University is exempt from federal income tax under Section 501(c)(3) of the United States Internal Revenue Code. Accordingly, it is not subject to income taxes except to the extent it has taxable income from activities that are not related to its exempt purpose.

The University annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the consolidated financial statements. No provision for income taxes was required for 2014 or 2013.

Footnote Disclosures
Certain 2013 footnote disclosures have been aligned to conform with the 2014 presentation.

NOTE 2: ACCOUNTS AND NOTES RECEIVABLE, NET

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

	2014	2013
	(in thousands of dollars)	
Sponsored grant receivables, net	$ 86,106	$ 91,491
Plant construction receivables due from commonwealth	25,012	22,615
Hospitals and affiliated organizations receivables, net	21,296	19,834
Student receivables, net	10,302	9,837
Interest income receivables	1,447	1,809
Other receivables, net	16,712	14,467
Total accounts and notes receivable, net	$ 160,875	$ 160,053

NOTE 3: CONTRIBUTIONS RECEIVABLE, NET

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

	2014	2013
	(in thousands of dollars)	
Amounts due in:		
Less than one year	$ 15,700	$ 14,350
One to five years	19,130	19,602
Greater than five years	1,871	841
Gross contributions receivable	36,701	34,793
Less:		
Allowance for uncollectible pledges	(1,378)	(1,299)
Unamortized discounts	(987)	(637)
Total contributions receivable, net	$ 34,336	$ 32,857

The five largest outstanding pledge balances represented 37% of the University's net contributions receivable at both June 30, 2014 and 2013.

The University has been named a beneficiary in the wills of numerous donors or has received conditional pledges totaling $185.2 million and $147.4 million at June 30, 2014 and 2013, respectively. These bequests and conditional pledges are not included in the consolidated financial statements.

The University is one of the beneficiaries of the Dietrich Foundation (the Foundation), a public charity created by William S. Dietrich II pursuant to an Amended and Restated Declaration of Trust dated August 23, 2011 (the Trust). The Foundation is a 509(a)(3) Type I supporting organization, organized and operated exclusively for charitable, scientific, and educational purposes. Its primary mission is to provide ongoing support to a number of educational institutions, largely in the greater Pittsburgh area, including the University. The Trust provides that five of the Foundation's nine trustees shall be educational institution trustees, two of whom shall be appointed by the University. The Foundation expects to continue making annual distributions to its named charitable beneficiaries, pursuant to which the University would receive 25% of the total income distributed.

The market value of the Foundation's net assets at June 30, 2014 was reported to be approximately $653.2 million, of which approximately $163.3 million is attributable to the University based upon current beneficiary allocations. The University has not recognized an interest in the Foundation because the Foundation's trustees, by a super-majority vote, have the authority to adjust the allocation of annual distributions among the educational institution beneficiaries. Distributions from the Foundation are recorded as contributions for endowment in the Consolidated Statements of Activities and are held by the University in separate, permanently restricted funds within the University's endowment; each is designated appropriately as a Dietrich Foundation endowment fund. Distributions received from the Foundation totaled $4.8 million and $3.6 million in 2014 and 2013, respectively.

NOTE 4: ENDOWMENT AND OPERATING INVESTMENTS

Investments at June 30 consist of the following:

	2014	2013
	(in thousands of dollars)	
Endowment investments:		
Pooled	$ 3,481,731	$ 2,965,077
Nonpooled	32,452	29,130
Subtotal endowment investments	3,514,183	2,994,207
Operating investments *(Note 1)*	539,378	407,586
Total endowment and operating investments	$ 4,053,561	$ 3,401,793
Composition of endowment investments:		
Cash and cash equivalents	$ 89,687	$ 58,095
Domestic equities	509,214	417,065
International equities	704,212	567,732
U.S. government and government agencies' securities, bank acceptances and certificates, and commercial paper	173,910	162,552
Corporate bonds and other obligations	172,138	150,745
Alternative investment funds and partnerships:		
Marketable alternatives	679,077	598,232
Nonmarketable alternatives	644,737	561,120
Real assets	541,208	478,666
Total endowment investments	$ 3,514,183	$ 2,994,207
Composition of operating investments:		
U.S. government and government agencies' securities, repurchase agreements, and commercial paper	$ 337,224	$ 230,993
Corporate bonds and other obligations	183,600	159,072
Other	18,554	17,521
Total operating investments	$ 539,378	$ 407,586

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

The philosophies and policies employed in the management of the endowment are long-term by definition, as they are based on the expectation that the endowment will continue to provide financial support to the University in perpetuity. Accordingly, the University's investment policy is intended to optimize long-term total return — income plus capital appreciation — relative to the level of risk taken.

The University's investment policy contemplates the effects of its spending policy. The endowment spending policy balances the need for reliable and predictable earnings distributions to support current University activities with the desire to maintain the purchasing power of endowment assets so that they can continue providing financial support for future generations (see Note 11).

The following table summarizes the University's investments at June 30, 2014 and 2013 for which net asset value (NAV) was used as a practical expedient to estimate fair value:

Asset Class	Fair Value Determined Using NAV 2014	Fair Value Determined Using NAV 2013	Unfunded Commitments at June 30, 2014	Redemption Frequency	Redemption Notice Period
			(in thousands of dollars)		
International equities	$ 138,623	$ 118,428	$ -	Quarterly	60-120 days
Marketable alternatives:					
Redeemable within one year	531,269	484,178	-	90-365 days	30-180 days
Redeemable beyond one year	83,662	44,673	-	1-3 years	30-60 days
Nonredeemable	64,146	69,381	2,087	NA	NA
Total marketable alternatives	679,077	598,232	2,087		
Nonmarketable alternatives	644,737	561,120	313,799	NA	NA
Real assets:					
Redeemable	92,559	58,428	-	Monthly	10 days
Nonredeemable	448,649	420,238	208,141	NA	NA
Total real assets	541,208	478,666	208,141		
Total	$ 2,003,645	$ 1,756,446	$ 524,027		

Descriptions follow for each of the investments set forth in the table above:

International Equities
A portion of the University's investments in emerging markets equities are interests in one or more comingled funds that hold publicly traded emerging market equities.

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

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

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

NOTE 5: FAIR VALUE MEASUREMENTS

The following tables summarize the inputs used in valuing the University's assets and liabilities carried at fair value at June 30, 2014 and 2013:

	2014			
	Level 1	Level 2	Level 3	Total
Assets	*(in thousands of dollars)*			
Cash and cash equivalents	$ 51,594	$ 9,237	$ -	$ 60,831
Endowment investments:				
Cash and cash equivalents	51,778	37,909	-	89,687
Domestic equities	496,835	12,379	-	509,214
International equities	546,940	145,010	12,262	704,212
U.S. government, corporate bonds, and other obligations	269,045	73,076	3,927	346,048
Marketable alternatives	-	270,036	409,041	679,077
Nonmarketable alternatives	-	-	644,737	644,737
Real assets	-	92,408	448,800	541,208
Operating investments:				
U.S. government, corporate bonds, and other obligations	412,022	108,802	-	520,824
Other	982	-	17,572	18,554
Endowed funds held by third parties	-	-	22,714	22,714
Total assets	$ 1,829,196	$ 748,857	$ 1,559,053	$ 4,137,106
Liabilities				
Interest rate swaps	$ -	$ 69,304	$ -	$ 69,304

	2013			
	Level 1	Level 2	Level 3	Total
Assets	*(in thousands of dollars)*			
Cash and cash equivalents	$ 91,964	$ 104,843	$ -	$ 196,807
Endowment investments:				
Cash and cash equivalents	56,607	1,488	-	58,095
Domestic equities	416,635	430	-	417,065
International equities	441,914	118,428	7,390	567,732
U.S. government, corporate bonds, and other obligations	219,414	89,661	4,222	313,297
Marketable alternatives	-	251,831	346,401	598,232
Nonmarketable alternatives	-	-	561,120	561,120
Real assets	-	58,003	420,663	478,666
Operating investments:				
U.S. government, corporate bonds, and other obligations	320,355	69,710	-	390,065
Other	737	-	16,784	17,521
Deposits of bond and note proceeds	42,399	48,004	-	90,403
Endowed funds held by third parties	-	-	19,954	19,954
Total assets	$ 1,590,025	$ 742,398	$ 1,376,534	$ 3,708,957
Liabilities				
Interest rate swaps	$ -	$ 67,961	$ -	$ 67,961

The following table summarizes the change in the Level 3 activity for the years ended June 30, 2014 and 2013:

	International Equities	U.S. Government Corporate and Other	Marketable Alternatives	Nonmarketable Alternatives	Real Assets	Other	Total
	(in thousands of dollars)						
Balance - June 30, 2012	$ 7,364	$ 2,803	$ 273,995	$ 574,187	$ 402,090	$ 30,074	$ 1,290,513
Capital calls/purchases	4,650	-	111,625	74,782	48,665	560	240,282
Distributions/sales	(5,225)	(296)	(43,388)	(139,483)	(60,583)	(784)	(249,759)
Transfers out	-	-	(24,352)	-	-	-	(24,352)
Realized losses	(22)	-	-	-	-	-	(22)
Unrealized gains	623	1,715	28,521	51,634	30,491	6,888	119,872
Balance - June 30, 2013	7,390	4,222	346,401	561,120	420,663	36,738	1,376,534
Capital calls/purchases	7,049	-	75,904	74,008	69,508	1,171	227,640
Distributions/sales	(3,710)	(295)	(32,040)	(139,800)	(90,303)	(1,196)	(267,344)
Transfers out	-	-	(28,612)	-	-	-	(28,612)
Realized gains	239	-	-	-	-	-	239
Unrealized gains	1,294	-	47,388	149,409	48,932	3,573	250,596
Balance - June 30, 2014	$ 12,262	$ 3,927	$ 409,041	$ 644,737	$ 448,800	$ 40,286	$ 1,559,053

Gains and losses (realized and unrealized) for Level 3 activity are reported in other activities in the Consolidated Statements of Activities. The unrealized gains related to investments held at June 30, 2014 and 2013 were $248.0 million and $118.3 million, respectively.

For the year ended June 30, 2014, $28.6 million of Level 3 assets were transferred to Level 2 as a result of the expiration of lock-up periods for four marketable alternatives funds; now these investments may be redeemed within 90 days of June 30. There were $24.4 million of Level 3 assets transferred to Level 2 in 2013 as a result of the expiration of lock-up periods for three marketable alternatives funds.

There were no transfers of investments between Level 1 and Level 2 in 2014 or 2013.

NOTE 6: PROPERTY, PLANT, AND EQUIPMENT, NET

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

	2014	2013
	(in thousands of dollars)	
Land	$ 51,321	$ 51,352
Buildings and improvements	2,807,784	2,586,824
Equipment	691,532	663,045
Library books	256,908	246,905
Works of art, historical treasures, and similar assets	17,448	17,174
Construction in progress	147,518	260,070
Subtotal	3,972,511	3,825,370
Less: Accumulated depreciation	(2,177,176)	(2,036,895)
Total property, plant, and equipment, net	$ 1,795,335	$ 1,788,475

The amount capitalized in property, plant, and equipment related to expenditures funded by the commonwealth on behalf of the University totaled $603.1 million and $530.5 million at June 30, 2014 and 2013, respectively. The net book value of these items was $279.3 million and $226.3 million at June 30, 2014 and 2013, respectively.

NOTE 7: CONDITIONAL ASSET REMEDIATION OBLIGATION

The University has recognized liabilities for conditional asset retirement obligations. The University performed an analysis of such obligations and determined that asbestos remediation costs represented the primary source of such liabilities. The University reviewed facilities on all campuses and estimated the timing, method, and cost of remediation. The analysis included an estimated inflation factor and discount rate, which were used to determine the present value of the obligation.

The following table details the change in the liabilities for the year ended June 30:

	2014	2013
	(in thousands of dollars)	
Balance - beginning of year	$ 40,571	$ 40,946
Accretion and other adjustments	1,122	107
Liabilities settled	(764)	(482)
Balance - end of year	$ 40,929	$ 40,571

NOTE 8: BONDS AND NOTES PAYABLE

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

	Range of Years Remaining to Maturity	2014 Effective Interest Rates	Outstanding Principal *(in thousands of dollars)* 2014	2013
Variable-rate bonds:				
Series 2007-B Bonds	26-27	0.07%-0.16%	$ 44,621	$ 44,621
Series 2005-A Bonds	23-25	0.08%-0.12%	40,000	-
Series 2005-B Bonds	17-24	0.08%-0.15%	45,000	45,000
Series 2005-C Bonds	18-21	0.08%-0.16%	30,000	30,000
Series 2002-B Bonds	17-22	0.08%-0.10%	15,000	-
Total variable-rate bonds			174,621	119,621
Term-rate bonds:				
Series 2005-A Bonds		5.00%	-	40,000
Series 2002-B Bonds		5.00%	-	15,000
Total term-rate bonds			-	55,000
Fixed-rate bonds and notes:				
Series 2009-A/B Bonds	3 mos.-17	3.18%-5.10%	373,140	373,140
Series 2007-B Bonds	9-14	4.28%-4.69%	60,000	60,000
Series 2005-A Bonds	14-16	4.69%-4.83%	35,000	35,000
Series 2002-A Bonds	1-9	2.68%-4.31%	30,000	30,000
Series 2002-B Bonds	12-13	4.53%-4.74%	14,500	14,500
Series 2000-A/B/C Bonds	10-21	4.37%-5.07%	124,400	154,800
Series 2012 PANTHER Notes, due July 2, 2013		0.21%	-	120,000
Series 2013 PANTHER Notes, due July 11, 2014		0.18%	120,000	120,000
Noninterest-bearing promissory note			171	171
Total fixed-rate bonds and notes			757,211	907,611
Unamortized net premium			15,799	21,259
Total bonds and notes payable			$ 947,631	$ 1,103,491

Fair value estimates of the bonds and notes payable are based upon observable interest rates and maturity schedules, signifying Level 2 liabilities in the fair value hierarchy ($1,044.4 million in 2014 and $1,181.0 million in 2013).

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

2015	$ 155.0
2016	$ 30.5
2017	$ 27.4
2018	$ 26.4
2019	$ 35.0

The foregoing principal payments do not include $174.6 million of variable-rate demand bonds (VRDBs) in commercial paper (CP) mode, all of which have final maturity dates between 2031 and 2041. These bonds bear short-term rates that are fixed over staggered periods of approximately 90 days each and are remarketed at the expiry of each rate period.

On the mandatory tender date of September 16, 2013, the University converted its $55.0 million of term-rate mode bonds to CP mode.

Liquidity support for the $174.6 million of outstanding VRDBs in CP mode is provided by the University. In the event the University receives notice of an optional tender on its VRDBs in CP mode, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University will have a current obligation to purchase the tendered bonds. To provide a secondary source of liquidity for this type of event, the University entered into a $100.0 million unsecured standby liquidity agreement with a financial institution that matures in June 2016. Since the October 2009 effective date of the liquidity agreement, no draws have occurred.

The PANTHERS of 2013 were issued in June 2013 in the amount of $120.0 million and were repaid on July 11, 2014.

In July 2014, the University issued its Pitt Asset Notes - Tax Exempt Higher Education Series 2014 (PANTHERS of 2014) in the amount of $100.0 million. Of this amount, $90.0 million was used to partially refund the $120.0 million of PANTHERS of 2013 that matured on July 11, 2014, and $10.0 million was used for equipment expenditures. The PANTHERS of 2014 mature on July 22, 2015.

The University had three general unsecured credit facilities, aggregating $75.0 million, at June 30, 2014. No draws were made under the facilities during 2014 or 2013. Although each of the three credit facilities carry an expiry date of October 28, 2014, it is management's intention to extend each facility for another 364-day term.

Interest costs incurred in 2014 and 2013 were $42.6 million and $44.8 million, respectively. Included in these amounts is capitalized interest associated with various construction projects. Capitalized interest for both 2014 and 2013 was $2.6 million.

NOTE 9: DERIVATIVE AND OTHER FINANCIAL INSTRUMENTS

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

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

Not including University derivative instruments held by various alternative investment funds, University financial assets invested in derivative instruments had a fair value, based upon Level 1 of the fair value hierarchy, of $45.2 million and $24.4 million at June 30, 2014 and 2013, respectively, which are included in endowment investments on the Consolidated Balance Sheets.

The University liabilities arising from variable-to-fixed interest rate swap agreements associated with certain University debt obligations had an aggregated fair value of $69.3 million and $68.0 million at June 30, 2014 and 2013, respectively, and are included in other liabilities on the Consolidated Balance Sheets (see Note 5). The fair value represents the estimated amount the University would be required to pay to terminate these agreements as of the respective fiscal year-end. The University recorded in the Consolidated Statements of Activities an unrealized loss of $1.3 million in 2014 and an unrealized gain of $41.2 million in 2013 due to changes in fair value of the swaps.

The aggregate notional amount of the swap agreements associated with University debt was $395.3 million and $425.7 million at June 30, 2014 and 2013, respectively. These swaps were entered into for the sole purpose of hedging interest payable on certain University VRDBs. The variable interest rates received by the University under the swap agreements are either 67% or 70% of one- or three-month LIBOR, while the fixed rates paid by the University range from 3.25% to 5.14%. Net swap payments made or received by the University are reported in interest expense in the Consolidated Statements of Activities. No collateral was called or posted during 2014 or 2013 with respect to these swap agreements. Furthermore, the University does not anticipate posting collateral pursuant to these swap agreements since there are no collateral thresholds applicable to the University given the University's current credit ratings.

Pension

The University provides retirement benefits under contributory or noncontributory plans to substantially all employees. The University's contributory plan provides for participation in the Teachers Insurance and Annuity Association (TIAA) and College Retirement Equities Fund (CREF) and in investment funds of the Vanguard Group. The plan is fully funded and requires three years of service for vesting of the University contribution. Employees hired before January 1, 1995 were immediately vested. University contributions to this plan in 2014 and 2013 were $73.1 million and $71.9 million, respectively.

The noncontributory plan is a defined benefit pension plan that covers employees who do not participate in the contributory plan. The plan provides for vesting after five years with pension benefits accruing at 2.1% of base salary or the Social Security wage base, whichever is lower. Pension benefits are payable upon normal retirement at age 65 or early retirement at age 55, in accordance with the conditions and pension eligibility criteria described in the plan. University contributions to this plan in 2014 and 2013 were $4.4 million and $7.2 million, respectively.

Postretirement

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

Though funding is not required, the University has elected to fund its postretirement liability via a quasi-endowment fund, which is managed together with the University's pooled endowment investments (see Notes 4 and 11). The fair value of these investments at June 30, 2014 and 2013 was $341.3 million and $279.4 million, respectively, and is included in endowment investments on the Consolidated Balance Sheets. Although the University has established this quasi-endowment for the postretirement plan, payments to beneficiaries of this plan are currently made through nonendowed operating funds.

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

In 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively, the Health Care Acts) were signed into law. The Health Care Acts include several provisions that are included in the measurement of the postretirement benefit obligation.

The University uses a measurement date of June 30 for plan assets and the benefit obligations. Information related to the benefit obligation, assets, and funded status of the defined benefit pension plan and the postretirement benefit plan as of and for the years ended June 30, 2014 and 2013 is summarized in the table below:

	Defined Benefit Plan		Postretirement Plan	
	2014	2013	2014	2013
	(in thousands of dollars)			
Net periodic benefit cost:				
Service cost	$ 4,775	$ 5,856	$ 13,871	$ 14,687
Interest cost	4,289	3,908	18,969	17,559
Expected return on plan assets	(5,058)	(4,303)	-	-
Actuarial loss	477	1,809	1,594	3,025
Amortization of transition obligation	-	-	-	3,031
Amortization of prior service credit	(52)	(53)	(3,964)	(3,965)
Net periodic benefit cost	$ 4,431	$ 7,217	$ 30,470	$ 34,337
Funded status:				
Benefit obligation at beginning of year	$ 86,569	$ 87,482	$ 388,476	$ 398,916
Service cost	4,775	5,856	13,871	14,687
Interest cost	4,289	3,908	18,969	17,559
Actuarial loss (gain)	11,347	(9,959)	17,314	(26,615)
Benefits paid	(776)	(718)	(16,788)	(16,071)
Benefit obligation at end of year	$ 106,204	$ 86,569	$ 421,842	$ 388,476
Fair value of plan assets at beginning of year	$ 68,220	$ 54,441		
Actual return on plan assets	12,146	7,280		
Actual plan contributions	4,431	7,217		
Benefits paid	(776)	(718)		
Fair value of plan assets at end of year	$ 84,021	$ 68,220		
Funded status – liability recognized on Consolidated Balance Sheets:				
Pension and postretirement obligations	$ (22,183)	$ (18,349)	$ (421,842)	$ (388,476)
Accumulated benefit obligation	$ 101,661	$ 82,977		

Estimated 2015 employer contribution to the defined benefit plan: *(in thousands of dollars)*	$ 4,756

	Defined Benefit Plan		Postretirement Plan	
	2014	2013	2014	2013
Weighted-average assumptions used to determine the benefit obligation (liability) at June 30:				
Discount rate	4.5%	5.0%	4.5%	5.0%
Rate of compensation increase	3.0%	3.0%	-	-
Assumed health care trend cost:				
Initial trend – pre-age 65 retirees	-	-	7.0%	8.0%
Initial trend – post-age 65 retirees	-	-	5.0%	6.0%
Ultimate trend	-	-	4.5%	4.5%
Year to reach ultimate	-	-	2020	2021
Weighted-average assumptions used to determine the net periodic cost (expense) for the years ended June 30:				
Discount rate	5.0%	4.5%	5.0%	4.5%
Rate of compensation increase	3.0%	3.0%	-	-
Expected long-term return on plan assets	7.5%	8.0%	-	-
Assumed health care trend cost:				
Initial trend – pre-age 65 retirees	-	-	8.0%	8.0%
Initial trend – post-age 65 retirees	-	-	6.0%	7.0%
Ultimate trend	-	-	4.5%	4.5%
Year to reach ultimate	-	-	2021	2020

Estimated future benefit payments:	Defined Benefit Plan	Postretirement Plan
	(in thousands of dollars)	
2015	$ 1,853	$ 16,855
2016	$ 2,060	$ 19,741
2017	$ 2,323	$ 21,001
2018	$ 2,624	$ 22,421
2019	$ 2,893	$ 23,955
2020 - 2024	$ 20,085	$ 168,127

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

	Increase		Decrease	
	(in millions of dollars)			
	Revised Amount	Percent Change	Revised Amount	Percent Change
Service and interest cost (medical component only)	$ 32.5	8.4%	$ 25.7	14.4%
Total periodic benefit cost	$ 34.6	13.6%	$ 23.7	22.3%
Benefit obligation for health care benefits	$ 411.1	7.8%	$ 336.7	11.7%
Total benefit obligation	$ 451.4	7.0%	$ 377.1	10.6%

Pension Assets

Assets related to the University's defined benefit pension plan are segregated in a trust managed by a third-party investment manager. The fair value of these assets at June 30, 2014 and 2013 was $84.0 million and $68.2 million, respectively. The fund is invested through common collective trust funds in domestic and international equities and fixed income securities using the S&P 500 Index as a benchmark for domestic equities, the MSCI EAFE Index for international equities, and the Barclays Intermediate Government/Credit Bond Index for the fixed income securities. The specific investment objective is to meet or exceed the investment policy benchmark over the long term. Plan investments are determined using NAV per share as a practical expedient for estimated fair value and are classified in the fair value hierarchy as Level 2, as the University can redeem its interest without penalty, generally within 90 days of June 30.

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

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

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

	Target Allocation	2014 *(in thousands of dollars)* Level 2	2013 Level 2
Asset class			
Equity securities:			
Stock index and small cap	35%	$ 29,307	$ 22,237
International	35%	28,234	21,065
Debt securities	30%	25,242	17,591
Cash and cash equivalents	-	1,238	7,327
Total pension plan assets		$ 84,021	$ 68,220

NOTE 11: ENDOWMENT NET ASSETS

The commonwealth has not adopted The Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and, instead, enacted in December 1998 Pennsylvania Act 141 (codified as Title 15 of the Pennsylvania Consolidated Statutes §5548(c) and referred to herein as "Title 15") to govern the investment of restricted funds held in trust by Pennsylvania nonprofit corporations. Title 15 permits Pennsylvania nonprofit corporations to elect a total return approach for determining income distributions from restricted funds held in trust, whereby income is defined as a stipulated percentage of the value of the assets held; the stipulated percentage must be determined at least annually and may be no less than 2% nor more than 7%, and the value of the assets held must be averaged over a period of three or more preceding years. A resolution to elect a total return approach for determining endowment income distributions for the University's consolidated investment pool was passed by the University's Board of Trustees on October 21, 1999. The University's endowment income distribution is determined annually using a stipulated percentage of 4.25% of the endowment's three-year average fair value, provided that such distribution is not less than the amount distributed in the previous year. The endowment income distribution amounts for 2014 and 2013 were approximately 4.25% and 4.45%, respectively, of the endowment's three-year average fair value.

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

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

	2014			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	(in thousands of dollars)			
Donor-restricted endowment funds	$ -	$ 824,655	$ 620,510	$ 1,445,165
Quasi-endowment funds	2,056,794	-	-	2,056,794
Total endowment net assets	$ 2,056,794	$ 824,655	$ 620,510	$ 3,501,959

	2013			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	(in thousands of dollars)			
Donor-restricted endowment funds	$ -	$ 648,930	$ 597,494	$ 1,246,424
Quasi-endowment funds	1,735,312	-	-	1,735,312
Total endowment net assets	$ 1,735,312	$ 648,930	$ 597,494	$ 2,981,736

The change in endowment net assets for the years ended June 30, 2014 and 2013 was as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	(in thousands of dollars)			
Endowment net assets – June 30, 2012	$ 1,480,978	$ 583,459	$ 556,271	$ 2,620,708
Endowment return:				
Endowment earnings	25,756	-	2,441	28,197
Gains	178,998	65,471	76	244,545
Total endowment return	204,754	65,471	2,517	272,742
Contributions	103	-	38,706	38,809
Distributions for operations	(87,513)	-	-	(87,513)
Net transfers	136,990	-	-	136,990
Endowment net assets – June 30, 2013	1,735,312	648,930	597,494	2,981,736
Endowment return:				
Endowment earnings	32,937	-	1,748	34,685
Gains	334,259	175,725	29	510,013
Total endowment return	367,196	175,725	1,777	544,698
Contributions	1,027	-	21,239	22,266
Distributions for operations	(96,629)	-	-	(96,629)
Net transfers	49,888	-	-	49,888
Endowment net assets – June 30, 2014	$ 2,056,794	$ 824,655	$ 620,510	$ 3,501,959

Approximately 99% of the University's endowment funds are collectively managed in a broadly diversified pool of assets called the consolidated investment pool. The Investment Committee of the Board of Trustees provides general oversight, policy guidance and performance review of the consolidated investment pool and approves asset allocation and spending policies.

NOTE 12: FUNCTIONAL EXPENSES

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

	2014	2013
	(in thousands of dollars)	
Instruction	$ 524,781	$ 526,347
Research	638,949	671,241
Public service	81,674	86,827
Academic support	183,817	174,345
Libraries	48,582	48,537
Student services	133,426	124,437
Institutional support	137,341	125,691
Auxiliary enterprises	132,522	123,295
Total functional expenses	$ 1,881,092	$ 1,880,720

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

NOTE 13: RELATED PARTIES

The University has relationships and affiliation agreements with separately incorporated entities including UPMC and affiliated hospitals and UPP. These relationships include a common paymaster arrangement for certain University School of Medicine (SOM) faculty with academic and clinical responsibilities; contractual obligations for UPMC and UPP to support certain educational and research functions at the University; and property rental agreements. Transactions with all related entities are conducted in the ordinary course of business and are discussed below.

Certain University SOM faculty and staff provide clinical services through their University appointments to UPMC, UPP, and affiliated hospitals. The University invoices these entities monthly for reimbursement of the clinical portion of the associated compensation costs. SOM faculty members having both a University academic appointment and a separate, external appointment for clinical responsibilities participate in the common paymaster arrangement for purposes of determining appropriate FICA taxation. In addition to the reimbursable compensation costs, the University also engages in other transactions with these entities, which include providing certain facilities-related services, telephone, mailing, printing, and various other services, which are reimbursed at cost. Reimbursements from UPMC, UPP, and affiliated hospitals for clinical compensation and other costs totaled $141.0 million and $137.2 million in 2014 and 2013, respectively.

In 1998, the University signed a 10-year agreement with UPMC that included financial commitments designed to further the two entities’ commitment to their interrelated teaching, research, clinical care, and community service missions. As part of the agreement, UPMC provides $12.5 million annually in funding for the SOM. UPMC also provides additional funding up to $2.5 million annually on a matching basis. The match is on a one-to-two basis with UPMC matching $1 for every $2 provided by the University to support health sciences programs. The University has received this match each year since the inception of the agreement. This agreement was amended in 2007 under essentially the same terms, except for a provision to provide an additional $10.0 million per year in 2007, increased annually by $0.5 million from

2008 through 2016. The University received $28.5 million and $28.0 million (including the annual match) in 2014 and 2013, respectively. Effective July 1, 2014, the term of the agreement was extended through June 30, 2018. These amounts are reported as other revenue in the Consolidated Statements of Activities.

The UPMC agreement was further amended in 2009 to include additional financial support through the Children's Hospital of Pittsburgh of UPMC (CHP) to the University of at least $7.5 million annually related to an agreement detailing the transfer of certain pediatric research programs from CHP to the University. This transfer standardized procedures, eliminated duplication of services, improved efficiency, reduced costs, and enhanced recruitment efforts for pediatric programs. The University received $10.0 million and $9.6 million in 2014 and 2013, respectively, related to this additional support. These amounts are reported as sales and services, educational and other in the Consolidated Statements of Activities.

UPMC also provided $13.8 million and $13.4 million in 2014 and 2013, respectively, of contractual dean's tax, which represents support for the academic and research activities of the SOM. This activity is reported as sales and services, educational and other in the Consolidated Statements of Activities.

UPMC also provides additional academic support to the School of Medicine. These funds are used to support new programs, recruit faculty, and for general support of the School's academic mission. The University recorded $43.7 million and $37.7 million in 2014 and 2013, respectively. These amounts are reported as sales and services, educational and other in the Consolidated Statements of Activities.

Additionally, UPMC provided support to various departments within the SOM to augment their operating budgets. These payments were made to those departments which do not generate sufficient revenues to meet their research and academic costs. Payments made by UPMC for this purpose totaled $9.0 million and $8.6 million in 2014 and 2013, respectively, and are reported as sales and services, educational and other in the Consolidated Statements of Activities.

The University is involved in certain rental arrangements where the University acts as both lessor or lessee with UPMC and its affiliates. Rental revenue from UPMC and affiliates totaled $9.6 million and $10.2 million in 2014 and 2013, respectively. Rent expense paid to UPMC and affiliates totaled $23.2 million and $24.7 million in 2014 and 2013, respectively.

In July 2013, UPMC provided support of $2.6 million for building renovations in the Department of Neurosurgery at the SOM. This amount is reported as unrestricted contributions for operations in the Consolidated Statement of Activities.

In April 2013, the University entered into a five-year agreement with UPMC to provide full-time, armed police aid, support, and assistance for six UPMC facilities. Payments made by UPMC for these services totaled $2.0 million in 2014, and are reported as other revenue in the Consolidated Statement of Activities.

UPMC serves as the provider of health insurance coverage to all eligible University employees who enroll in the plan. The University is self-insured for these costs and reimburses UPMC for actual claims cost. Health insurance expense including administrative fees totaled $103.9 million and $105.7 million in 2014 and 2013, respectively, and is reported as fringe benefits in the Consolidated Statements of Activities.

UPMC receives federal matching funds for costs incurred by academic medical centers for medical assistance services. The funds are remitted to the University to support the activities of the SOM, the Western Psychiatric Institute and Clinic (WPIC), the Center for Public Health Practice, and the clinic within the School of Dental Medicine. These remittances were $11.5 million and $8.2 million in 2014 and 2013, respectively, and are reported as commonwealth appropriation revenue in the Consolidated Statements of Activities.

In 2003, the University and UPMC created the Medical and Health Sciences Foundation (MHSF), a separate 501(c)(3) organization. The mission of MHSF is to create a unified fundraising organization for the University's schools of the health sciences and UPMC. The arrangement calls for the cost of MHSF to be split evenly between the University and UPMC. In 2014 and 2013, UPMC's share of total operating costs for MHSF totaled $4.4 million and $4.2 million, respectively, and is reported as other revenue in the Consolidated Statements of Activities. All contributions generated by MHSF are credited to the University or UPMC based upon donor intent.

In November 2004, the University entered into an agreement with UPMC to jointly construct and own the Carrillo Street steam plant, a gas-fired steam-generating facility. The University funded 78.1% of construction costs with UPMC funding the remaining 21.9%. The plant provides steam to each entity's respective buildings and is managed by the University.

A lease arrangement exists between the University and the commonwealth for WPIC. Since 1949, the University has managed WPIC under an agreement between the University and the commonwealth whereby the University rents for a consideration of $1 per year the land, building, equipment, and other items that are used by WPIC. The agreement provides for continuing terms of 10 years each; however, this agreement is cancelable by either party on one year's written notice. In 1992, the University subleased to UPMC the land, building, equipment, and other items subject to the current lease arrangement between the commonwealth and the University. This sublease arrangement continued to be in effect during 2014 and 2013. Included in property, plant, and equipment is $196.4 million and $194.9 million at June 30, 2014 and 2013, respectively, related to the land, buildings, and equipment used by WPIC. Accumulated depreciation related to these assets totaled $160.8 million and $156.7 million at June 30, 2014 and 2013, respectively.

The University also has an arrangement with UPMC whereby certain research-related costs incurred by UPMC (primarily staff compensation) in relation to WPIC and the University of Pittsburgh Cancer Institute (UPCI) research awards are charged to such awards via an electronic billing and reimbursed to UPMC each month. Payments totaled $27.3 million in 2014 and $30.4 million in 2013 and are recorded as expenses in the Consolidated Statements of Activities. All billings are recorded at cost.

UPMC provided support payments to UPCI for various subsidies, research initiatives, and general support. These payments totaled $11.9 million and $10.6 million in 2014 and 2013, respectively, and are primarily reported in other revenue in the Consolidated Statements of Activities.

NOTE 14: COMMITMENTS AND CONTINGENCIES

At June 30, 2014 and 2013, the University had outstanding contractual commitments of $82.1 million and $57.0 million, respectively, for property, plant, and equipment expenditures.

The University engages in various leasing activities as both a lessor and lessee. Rental revenue from operating leases was $17.8 million and $18.4 million in 2014 and 2013, respectively. Rental expense for operating leases was $45.4 million in 2014 and $47.5 million in 2013. Minimum future rental revenue and expense under operating leases that have initial or remaining noncancelable lease terms for the years ended June 30 are as follows:

	Rental Revenue	Rental Expense
	(in thousands of dollars)	
2015	$ 16,651	$ 42,401
2016	$ 15,729	$ 29,205
2017	$ 6,648	$ 23,012
2018	$ 5,357	$ 21,392
2019	$ 3,023	$ 20,995
Thereafter	$ 12,518	$ 111,128

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

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

In 2014, the University received $35.6 million in a legal settlement regarding a patent infringement case. This amount is reported, net of $17.0 million in legal and other expenses, as other revenue in the Consolidated Statement of Activities.

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

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

NOTE 15: SUBSEQUENT EVENTS

On September 18, 2014, the University issued $95.0 million of Series 2014 Capital Project Bonds (the Bonds), $49.0 million of which are fixed-rate Series A Bonds and $46.0 million of which are variable-rate Series B Bonds that were issued in commercial paper mode. The Bonds have a final maturity date of 2044 with a weighted average life of 21.3 years.

The University has evaluated subsequent events through September 29, 2014, the date on which the consolidated financial statements were issued, and determined that there were no other subsequent events requiring disclosure or adjustment to the consolidated financial statements.

MEMBERSHIP OF THE BOARD OF TRUSTEES FISCAL YEAR 2014

The consolidated financial statements have been reviewed and approved by the University's Audit Committee. The Audit Committee is comprised of outside directors having requisite financial expertise and meets regularly with University management and both internal and external auditors to review internal accounting controls, audit issues, and financial reporting matters. The committee meets with the external auditors in private sessions and is also responsible for approving the independent auditing firm retained each year. Nonvoting representatives on the committee include members of the University's administration as well as student, faculty, and staff representatives.